

Chapter 1

Introduction

1.1 Background of the study

VAT is an indirect tax system and no doubts in its possibilities to collect revenue compare to other indirect tax system. It has been twelfth year since the VAT has been implemented in Nepal. Despite various allegation, obstacles, hurdles, and objections, the twelve years since implementation has passed swiftly. The difficult times spent in the implementation of Value Added Tax still cannot be forgotten.

It will not be wrong to say that it is an achievement in itself that the Value Added Tax has reached the position it has today despite various challenges. Considering today's conducive environment and condition it is more relevant to develop a new thinking regarding work direction and strategic planning so as to make the implementation more effective and productive in future than to criticize the implementation of the past. The need or urgent and greater efforts has been realized to make the system more effective and productive. An attempt has been in this study to present a brief account of various types of challenges and difficulties faced at different times and the circumstances.

The central economic problems of all societies include traditional questions such as what, where, how much and for whom goods and services should be produced. The use of natural bounty in an optimal and a rational manner is the sole objective of a society indulged in the twenty first century. The virtually patchy distribution of resources has excreted the difficulties of the rural poor

and improvised city dwellers. Today's concern of the underdeveloped countries is for the achievement of the economic development which suggests maximum welfare of the maximum people and the efficient allocation of resources. Economic development demands reduction in inequality and poverty, decrease in unemployment, improvement of living standards and foreign trade account, reasonable degree of price level stability, acceptance rate of economic growth and modification in social and institutional environment over time. Economic development generally includes improvements in material welfare, especially for person with the lowest incomes. The eradication of the mass poverty with its correlate of illiteracy, diseases and early death; changes in the composition of inputs and outputs that generally includes shifts in activities the organization of the economy in such a way that employment in general among the working age population rather than the situation of a privileged minority; and the correspondingly greater participation of broadly based groups in making decision about the directions economics and otherwise in which they should move to improve their welfare(Charles and Bruce 1997:1)

Europe, America and Japan are the three giant economic blocks of the world creating the huge amount of surplus that ultimately enhances the per capita income of the people. Rest of the economics strives for the access of these economic blocks. Most of the third world countries are lagging behind in the path of economic development. Such countries are characterized by rampant corruption, widespread poverty, increasing budget deficit, low rate of capital saving, ever dependency on donors and so on.

All the aforementioned features impede in the process of economic development. Specially, the budget deficit creates the resource gap.

Nepal's membership to the World Trade Organization (WTO) has brought new challenges in Nepalese economy. It has ensured the free flow of foreign goods and services into the territorial boundary of Nepal. The provisions regarding the most favored Nation, National treatment, Non discrimination and

predictability are the mandatory to its members. The compliance with the agreement in the most otherwise there is a tribunal body for dispute settlement under such circumstances Nepal no longer can rely on custom duty, which used to be the significant component of revenue generation. It is also the signatory of the other bilateral trade agreements. In the first half of 1980's Nepal had to face the problem of deficit balance of payment due to high public expenditure. The budget deficit has balanced by printing paper notes. It increased inflation and imported and aggregated the problem of balance payment. The size of import could not be met with size of export.

To overcome this problem Nepal introduced the "Economic stabilization program" in 1985 by taking economic adjustment load from International Monetary Fund(IMF). Under this program the government did the work reducing aggregate demand by absorbing excessive liquidity of the economy, controlling the bank loans that goes to the private sectors and government, encouraging and discouraging import. Therefore the problem of balance of payment of 1980's may be regarded as the beginning of the liberalization in Nepal. After that Structural Adjustment Program was launched in 1987 to give the continuity to the economic stabilization program of 1985 again taking stabilization facility from IMF (Joshi, 2008:216). Nepal had been generating bulk of its tax revenue from import duties. The restrictive economic policies of India benefited Nepal until the beginning of 1990s. Indian tourists were engrossed to buy goods by Nepal from third countries. These also used to be deflected to India by both the Nepali and Indian traders. This type of lure in trade however is diminishing by the advent of the liberal economic policy of India in early 1990s.

In fact, a scientific and a feasible Tax is a must to any government of any country at any time in order to establish good governance and lead a nation to progress and prosperity. For the first time the world, France introduced VAT System in 1954 AD.; couldn't cross its boundary till 1959. But the introduction

and the application of the VAT was taken the greater pace in the nineteen sixties.

Value Added Tax is popularly known as “VAT” in short. VAT is propounded by Dr. Wilhelm Von Siemens of Germany for the first time in 1919 A.D. He advised that the German authorities to implement the system in order to solve the problem of short Government revenue were found in those days, in order to replace the multistage sales tax. In 1921 professor Thomas S. Adams recommended VAT in the U.K (www.VAT.com:13)

Ivory Coast and several continent of Africa are second and third countries who introduced the system in 1960 and 1967 AD. Further the process of expansion of the European Union, together with the alignment of the land of potential candidates for membership, has ensured increasing consistency in the form of VAT operating in Europe (Williams, 165). All members’ states of the organization of Economic cooperation and Development (OCED) apart from the United States of America have introduced VAT in their tax regimes. Asian nations excluding Brunei and Malaysia have adopted VAT. India had introduced VAT as modified Valued Added Tax (MoDVAT). China also adopted partial VAT in 1984 and id full-fledged in 1994(Dhungana, 2003:49).

As the part of the tax reforms in Nepal, sales tax in Nepal was introduced in 2022 B.S by Finance Act. At that time, it was imposed on retail level. In 2022 B.S sales tax Act and Rules were introduced. The sales tax collection point was shifted to wholesale level in Ashwin 2025 B.S and import production stage on Ashadh in 2031 B.S. In 2049/50 B.S policy of imposing sales tax in two stages in import level/Production level and wholesale level was introduced but this system was again changed in fiscal-year 2051/52 B.S. Before the reform program was implemented in fiscal year 1986/86, Nepal’s Tax system was almost administratively unmanageable in terms of rates, incentives, deduction, tax holidays, etc. without much revenue being collected in the national exchequer.

Due to unsuitability of sales tax, Nepal has implemented Value Added Tax(VAT) as the joint form of sales tax, hotel tax and contract tax (Pushpa Raj Kandel, 2004:13) from 16 November 1997, However the concept of this tax in Nepal was introduced in early years 1990s. His Majesty Government of Nepal included the concept of introducing VAT in Nepal in its 8th plan.

The sales tax now been reformed to VAT. Value Added Tax has replaced sales tax hotel tax, contract tax and entertainment tax. There is a single rate of 13%. In the process of reform Department of tax, department of customs and department of excise have been merged into single department, which have been named as Inland Revenue Department. VAT is relatively a new tax.

1.2 Focuses of the Study

The study focuses on theory, practices and directly toward the challenges for Value Added Tax (VAT) implementation in the Nepalese perspectives. Implementation of VAT is in its preliminary stage. It deeply focuses on finding the path for effective implementation and their root cause of avoidance, evasion and leakage points along with the role of different stakeholders for its effective implementation of VAT. The theory and practice of VAT is not the free from misunderstanding and misinterpretation amongst its stakeholders. The business community levels as well as the consumers don't seem to be supportive in its implementation; there seems some information gap between the policies maker and stakeholders are main challenges for implementation. The study focuses on challenges for implementation of VAT, its development, trends of VAT collection, and its contribution in the national economy.

1.3 Statement of the problem.

Nepal is an underdeveloped country. Her economy is vulnerable to minor changes due to its rugged topography, low productivity and lack of industrialization, dependence on India, landlocked etc. Increase in population ad regular expenses in comparison to the revenue is the main reason that

government is failed to achieve its target result for the economic development. So she is in need of effective collection system for her treasure that will be mobilized for the welfare of her citizens ultimately results in the development of the country; Internal source of revenue is inadequate and too much dependence on external source (foreign grants of loan) are not fruitful and effective way to collect the capital as required by the nations development program.

For the purpose like other developed nation to reduce the economic dependency on foreign assistance for development expenditure government needs to continue its efforts to mobilize domestic resources. Nepal has brought different reforms in the tax collection system that would enable a natural growth of economic activities along with increasing the income of its government. Among them introduction and implementation of VAT in place of sales tax. Its implementation has not been successful till the date due to widespread poverty illiteracy, lack of information, creation of confusion and ignorance and also the absence of clarity regarding VAT which was opposed by businessman's professional and other sector.

Most of the people are uneducated as a result we can't expect greater they are aware towards VAT and VAT collection. Moreover VAT has been new term for educated group too. VAT Act 2052 and VAT Regulation 053 have not been able to bring more business organization into tax net. The evasion of VAT has been increasing in rate from since the beginning of its implementation.

VAT was implemented after several preparation programs such as publicity, campaign, workshop, training, advertisement ,publication of articles, discussion on radio and television, commenced various booklets and other material were published. In this process only the positive aspect of VAT were discussed and published. The negative aspect was not taking into consideration. Inefficient administration and tax cheater businessman, against them how government

could levy VAT tightly. It is told that smuggling would automatically be uprooted, revenue leakage would be controlled then export increases and revenue collection would increase so foreign aid would to be required after implementation of VAT. Moreover several tax payers have been maintaining two sets of accounts, issuing two types of invoices, collecting VAT from buyers but not depositing them to treasury and collection. Unregistered business firm to VAT and open boarder with our neighbor and undervalued invoice are the major problem in VAT due to which goods are coming through illegal means and government lose the revenue. Since it has some technical aspects in challenges in implementation of VAT as a result smuggler are benefitted while the nation has been adversely affected. So the main problem of the study is to find out the existing provision why is government always fail to collect its targeted and exerting effort for challenges of better implementation of VAT. The study is directed to resolve the following issues

- a) What is the existing situation of challenges on the implementation of VAT?
- b) What is the contribution of VAT to total tax, GNI and GDP?
- c) What are the strength and weakness of VAT implementation in Nepal?
- d) How can government improve the VAT implementation in Nepal?

1.4 Objectives of the study

The main objective of the study is to analyze the challenges for VAT implementation in Nepal. The specific objectives of the study are outlined follows:

- a) To review the theoretical aspect of VAT.
- b) To evaluate the contribution of VAT to total tax, G.N.I. and G.D.P
- c) To analyze the challenges for better and effective VAT implementation in Nepal.
- d) To analyze the strength and weakness of VAT implementation in Nepal.
- e) To provide appropriate suggestion for improvements and further research of VAT system in Nepal.

1.5 Limitation of study

The study is not free from limitation. The study assumes the following limitation

1. The survey is concentrated within Kathmandu valley
2. The sample size is only 150 respondents.
3. Information regarding the contribution of VAT on the GDP and GNI is collected from secondary source.
4. The study period is 2000/01 to 2006/07.

1.6 Organization of the study

Chapter 1: Introduction

This chapter includes the brief background. This study is concerned with historical development of VAT, contribution of VAT in GDP and implementation of VAT in Nepal. Thesis chapter includes the sub chapter like, Focus of the study, statement of the problem, significance of the study and organization of the study.

Chapter 2: Review of literature.

This chapter includes the conceptual framework and literature review related to the findings of a few past researchers, historical background of VAT in the world as well as in Nepal, its implementation of success.

Chapter 3: Research methodology

In this study, the survey research is being adopted, the research design the population and sample the sampling procedure the data gathering procedure the statistical procedure and data analysis procedure. Most of the study is collected from math books tax journals tax newspapers, budget and websites to tax and VAT.

Chapter 4: Presentation and Analysis of Data.

The collected data are thoroughly checked compiled and presented in appropriate table to facilitate analysis and interpretation. Tabularization is done to get answers from the specific objectives. Analysis is done descriptively as well as statistically for the statistical tools such as Karl Pearson's coefficient correlation, regression analysis, times series, hypothesis test, percentage, bar graphs, pie chart, and line graph and trend analysis will be used.

Chapter 5: Summary, Conclusion and Recommendation

This chapter includes the summary, conclusions and recommendation made in this study.

Chapter 2

Review of Literature

2.1 Conceptual Framework

Value Added Tax is a tax levied on value-added on goods and services by the enterprises at the successive stage of production and distribution. Value Added Tax is the gross receipt from sales after subtraction all expenditure on goods and purchase from other firms. Looking from one angle value added by a firm is total of incomes paid put by the firm to factors employed and value is a processing or handling these purchased item with its own labor force and machinery, building, or other capital goods.

Clear concept can be attained through an example. Consider the case of sugar production. A farmer produces sugarcane and sells it to the miller. Miller adds value in the process changing sugarcane into sugar. All the expenditure including profit made by the constitutes the value added of that miller. Miller sells his product that is sugar wholesaler who, in turn, sells to the retailer with an increased value. Ultimately, sugar sold to the consumer with some additional value. Thus, at each stage of production distribution, value is added and sum total of all value added exactly equal to final sales value of the sugar.

VAT, like other sales taxes is classified as an indirect tax because it is paid by business firm to the government and shifted to the purchasers of the product, rather than be collected directly by the government from the purchases, goods and services constitute base of VAT and it is shifted forward to the consumers. A basic characteristic of VAT that deduction is permitted of tax paid on purchase of goods purchased for direct reseller and materials and parts physically incorporated into goods to be sold.

Value Added Tax (VAT) is the most recent innovation in the field of taxation. It is considered as the reformed form of sales tax. Sales tax is levied on the sales of goods and services, is commonly divided into three groups namely: Turnover tax, single-stage tax, and VAT. Turnover tax is levied at all the stages of production and the distribution process. The single tax may be levied at manufacturing level or at Wholesale Level Sales Tax (WLST) or at Retail Level Sales Tax (RLST) so the single tax is known as manufacture's tax, wholesaler's tax and retailer's tax. On the other hand VAT is imposed on the value added at each stage of production and distribution. VAT is the multiple stage tax, which grown as the hybrid form of the turnover tax in the sense that VAT is also charged on all stages of production and distribution process. VAT however differs from the sales turnover tax as the later is imposed on the total value at each stage while the former is imposed only on the value added at each stage. VAT is similar to the retail stage sales tax. Theoretically, VAT is broad-based as it covers the value added to each commodity by a firm during all stages of production and distribution process. There is presumption that VAT is shifted completely to the consumer.

2.1.1 Origin and Development

Value-added tax, a recent innovation in the field of taxation, is being a major step in process of tax reform in many countries in the world. Such widespread popularity of VAT in last some years has become one of the most astonishing phenomenons of public finance. The evolution of VAT is the most significant event in the history of commodity taxes and the speed with which the Value Added Tax has spread around the world is unmatched by that of any other tax in modern time (Shoup, 1988:139)

While going to the origin point of the VAT, it was proposed for the first time by Wilhelm Von Siemens for Germany in 1919 as an improved turnover tax. The improvement consisted in the subtraction of previous outlays from taxable sales with the result that the tax base of each firm would be reduced to the

value, which is added to the product (Sullivan, 1965:12). Thereafter in 1921, Prof. Thomas S. Adams suggested the tax for the United States of America to replace the existing corporate income tax. Further, same tax was recommended in 1949 by the Shoup Mission for the purpose of reconstructing the Japanese economy by avoiding the existing defects of the turnover taxes. Although, these proposal and recommendation were not come into practice. Argentina and Brazil instead, introduced a partial value added form to the existing manufactures' sales tax respectively in 1935 and 1948 by allowing manufactures to pay tax on the excess of sales over their purchase. However, VAT was not actually introduced by any country till 1953. Thus, the development of VAT remained limited only in theory up to the early years of 1950s.

Real practice of VAT started since 1954 in France; however it covered only the industrial sector and was designed only up to the wholesale level. After a gap of six years, Ivory Coast becomes first follower of France when it adopted VAT in 1960. Next African country, Senegal also implemented VAT since 1961. VAT in these both African countries limited to import and manufacturing stage only. Since the 1960s VAT become a popular subject matter of taxation in many countries. In the year of 1968, France redesigned the existing VAT system and extended to the retail level. Germany also adopted VAT in the same year. Since 1969, VAT was in operation in Netherlands and Sweden and also other three Equador, Lusembourg and Norway included VAT in their tax system. VAT was also effective in Belgium and Ireland since 1971 and 1972 respectively. Thus, the trends showed that VAT become most popular in the Europe, where VAT was suggested and implemented for the first time.

Vietnam was the first Country in Asia to introduce VAT, which introduced it in 1943. Pakistan introduced VAT in 1990 as the first among the SAARC countries. In this process Nepal adopted VAT since 1997. However, India, the biggest in the SAARC, has following only MODVAT since 1996. The basic purpose of this kind of system is to relive inputs from taxation so that

production distortional due to taxation is avoided. In the system of MODVAT, the excise duty and countervailing duty of custom in respect of inputs used in manufacturing process are allowed to subtract from taxes on outputs. Further, American tax system has not included VAT until now.

As the experience shows, VAT still, has not become a perfect substitute for the taxes like excise duties, special consumption tax etc. This further implies that VAT has not caught the fancy of the extent as it is claimed in theory. So far as developing countries are concern, the system of VAT adopted is less neutral and less comprehensive. Therefore, most of the developing countries are facing problems of Tax administration, tax evasion and high cost of collection. Besides, VAT has gaining a growing attraction in both the developed and developing countries. The countries adopting VAT are listed following:

Table 2.1

Momentum of VAT

Year	Name of the Country
1954	France
1960	Ivory Coast
1961	Senegal
1967	Brazil, Denmark
1968	Germany, Uruguay
1969	Netherland, Sweden
1970	Ecuador, Luxemburg, Norway
1971	Belgium
1972	Ireland
1973	Austria, Bolivia, Italy, USA, Vietnam
1975	Argentina, Chili, Colombia, Kostunica, Nicaragua

1976	Honduras, Israel, Peru
1977	Korea, Panama
1980	Mexico
1982	Haiti
1983	Dominical Republic, Guatemala
1984	China
1985	Indonesia, Turkey
1986	Morocco, New Zealand, Nyzar, Portugal, Spain, Twain
1987	Granada, Greece
1988	Hungary, Philippines, Tunisia
1989	Japan, Malabi
1990	Iceland, Kenya, Pakistan, Trinidad, Tobago
1991	Bangladesh, Benin, Canada, Jamaica, Mali, South Africa, Egypt,
1992	Algeria, Armenia, Azerbaijan, Belarus, Cyprus, Alsalvador, Estonia, Fiji, Kazakhstan, Kirgiz Republic, Russia, Tajikistan, Thailand, Turkmenistan, Ukraine, Uzbekistan, Moldova
1993	Burkina Faso, Check Republic, Magnolia, Paraguay, Poland, Romania, Jarjiya, Slovakia, Venezuela
1994	Bulgaria, Finland, Lithuania, Singapore, Western Samoa, Madagascar, Nigeria
1995	Gawain, Ghana, Switzerland, Zambia, Malta, Mauritania, Togo, Latvia
1996	Albania, Guyana, Uganda
1997	Warwedos, Congo Republic, Nepal
1998	Croatia, Mongolia, Srilanka, Tanzania, Vanuatu
1999	Cambodia, Cameroon, Mozambique, Netherlands Anthills, Papua,

	Newgenia, Slovenia
2000	Australia, Chad, Myasidoniya, Namibia, Sudan
2001	Rwanda
2002	Lebanon
2003	Ethiopia, Lesotho, Serbia, Montenegro

Source: VAT project

2.1.1.1 Origin and Destination Principle

While considering the international trade, the origin and the destination principle have greater significances. Choice among these two principles largely depends on the goals and the policies of the nation, accession to international trade, computing method and the type of VAT. In case of the international trade, two serious alternatives appear while implementing VAT in any country. They are taxing all domestically produced goods including exported ones and exempting all imports or taxing all the imports and making exempting for all exported goods and services to the foreign countries.

Origin Principle

Under this principle, goods and services produced in a country are subjected to tax at the place where they are produced or rendered, wherever they are consumed, and the goods and services imported from the abroad are beyond the tax base. Hence this principle is in the favor of imports and against exports where there is open broader and cross-country trade. Thus, this principle affects BOP of the country negatively specially for those who have a poor performance in the world economy. The principle could be followed, with appropriate changes in the exchange rate, but countries are reluctant to attempt this approach (Shoup, 1988; 143).

As the country can enforce jurisdiction over firms located within its jurisdiction, the principle is much simpler and there would be no export rebates

on sale delivery within the Common Market countries, rather each country would give credit for tax imposed in the country of origin. Under such circumstances, the origin principle has gaining more importance in EEC countries to achieve the ultimate objectives. The three methods-subtraction, addition, and tax credit; are all equally well adopted to use of a single rate origin-principle value-added tax with respect to exports. Imports, in contrast, are bound to present a difficult problem for the origin principle if the tax credit method is used (Shoup, 1969:263). Administrative complexity widens when the tax credit method is adopted along with an origin-principle VAT having different rates at different stages.

Initial adoption of origin principle requires that the VAT rate should be more or less uniform among the countries; otherwise until such time as exchange rate or relative price levels are adjusted, manufacturers in the low-tax countries will have an advantage over those in the high-tax countries, which are unable to protect their firms by tariff barriers within a Common Market Area (Due, 1976:119). Also, the principle origin does not need any adjustment among subtraction and addition to reach the goal of taxing only domestic value that is added to the foreign imports at the tax rates identical to those applying to similar values added to the domestically produced goods. This principle will have negative impact for most of the developing countries where the tourism has a significant importance and the government is intended to encourage tourism and domestic purchases by tourists. Further, the origin principle converts into the destination country, in the sense that the rate of tax of country of importation determines the combined tax of both countries.

Destination Principle

Destination principle includes all the imports in the tax net while exports are free from tax. As the principle taxes imports and exempts exports, it will have favorable effect on the country's BOP. Under these principles, tax would be collected at importation and the firm would receive credit for this tax and a

refund when the products are exported. This means tax levied on the import of the basic raw materials, semi-manufactured goods etc., which are imported for the production in the domestic market will be refunded when the product is exported. Indeed, by principle, no tax is collected upon importation at all, other than by the ultimate user. The broad result is that the relative ability of one country to another will be unaffected by a destination arrangements which treats imported and home prepared goods. Thus, neutrality, one of the essential features of the goods taxation, is provided by the destination principle by means of no discrimination between imported and domestic product.

VAT is universally established on a destination basis, imports being subject to tax at the time of importation (but not necessarily at the same rate) and on subsequent sales and exports being free of tax with full refund of all taxes paid on previous transaction in the goods in questions. At given exchange rates, the destination principle is the most satisfactory whereby to protect the country's position in the world market and ensure that within the country imports are not favored over domestic goods (Due, 1976; 119). Destination principle can be implemented easily and precisely for both rebate of cumulated tax on exports and compensating tax on imports. Under the destination principle, tax-credit method is superior than other two, since it provides the precise information on cumulated tax paid without breaking the credit chain. Administrative simplicity and the non-discrimination are the main reason for the popularity of the destination principle. However, this principle does not function smoothly in a Common Market Area when the fiscal frontiers are abandoned. Difficulty arises to enforce payment of a tax when the sale is made to an individual.

In conclusion, destination principle is more appropriate, for a country having consumption type of value-added tax with the tax-credit method of consumption. Special benefit by this destination principle can attain by those countries who have open border and cross-country trade, and less competent in the open market.

2.1.2 VAT Records and Accounts

VAT is based on a self-assessment system under the self assessment system; a tax payer is required to keep a proper account of all his/her business transaction. Accounting here refers to a record of his/her business transactions in order to collect taxes from the consumers while selling taxable goods or services. The following VAT records and account should be maintained properly.

2.1.2.1 Introduction

Value Added Tax (VAT) is tax based on the transaction of goods and services. Te taxpayer has to maintain accounts of his/her transactions. This type of accounting is simple. For this purpose, the taxpayer has to maintain a purchase book, a Sales book and VAT accounts. Besides that has to issue tax invoice or abbreviated tax invoice while selling/supplying goods or services. A brief introduction to the accounting system related to these is described below.

2.1.2.2 Purchase Book

A registered taxpayer has to maintain a complete record of all the purchases and imports made of goods and services throughout the month. In the purchase book, the date when a commodity or service was purchased, and the invoice number, and the name and registration number of the supplier has to be stated.

Similarly, the total purchase value, the purchase value of taxable goods or services, the import value of taxable goods or services and the tax amount paid should be stated. A sample of purchase book is as follows:

) “Purchase of non taxable” implies purchase of import of the items listed in the Schedule 1 of the VAT Act. This list includes primarily goods and services related to basic needs, social welfare service, goods made for the use of disabled persons, educational and cultural goods and services, etc.

-) “Purchase of taxable: implies the purchase of those goods and services within the county. Taxable import implies the import of goods and services that is in the “tax exempted” list of goods and services.
-) The purchase book does not have to be submitted at the VAT office, but has to be shown at the time of inspection or if when the tax officer wishes to see it.
-) The person has to get the purchase book certified by the tax officer either by taking it to the Inland Revenue Office or at the time when the tax officer comes on business inspection.
-) The purchase book has to be maintained safely up to a period of six years after the transaction period is over.

2.1.2.3 Sales Book

The sales book is similar to the purchase book. The sales of goods and services throughout the tax period should be recorded in this. An example is given below.

-) In the sales book, the date when the sale was made, the invoice number, and the name and registration number of the buyer has to stated. Similarly, the total sales value, the sales value of non-taxable goods, the zero-rated sales value, the sales value of taxable goods and the amount tax should be stated.
-) “Sales of non-taxable” implies the sales of the items listed in Schedule 1 of the VAT Act.
-) Zero-rated sales imply the sale of those taxable items, listed in Schedule 2 of the VAT Act within the country of their export outside the country.
-) The person has to get the sales book certified either by taking it to the Inland Revenue Office or by the concerned tax officer at the time when he/she comes on an inspection of the transaction of the taxpayer.
-) The purchase book does not have to be submitted at the IRD office, but has to be shown when the tax officer wishes to see it.

-) The purchase book has to be maintained safely up to a period of six years after the transaction period is over.

2.1.2.4 VAT Accounts

VAT accounts are an integrated, abbreviated version of the purchase book and sales book as described above. The VAT account shows the tax paid on purchases, the tax collected through sales and the self-assessed tax amount that has to be paid to the government by the taxpayer. An example of VAT accounts is given below.

The taxpayer has to maintain this account each month and keep it with oneself. This does not have to be submitted at the Inland Revenue Office along with the VAT statement but has to be shown to the Tax Officer when he/she wishes to see it.

2.1.2.5 Tax Invoice

There are two types of tax invoice:

-) Tax Invoice

A registered taxpayer has to issue a tax invoice while selling goods or services.

But “Tax Invoice has to be stated as “title” only in the first copy of the bill and not in the other two, out of a total of three copies, the first original copy has to be given to the recipient, the second copy has to be maintained in a separate record to be submitted at the tax office if and when asked for and the third copy should be maintained as record for the purpose of one’s transaction.

An Example of Tax Invoice

Invoice number: Transaction date:

Seller’s taxpayer identification number: Date of issue of invoice:

Seller’s name:

Address:

Buyer's name:

It is not necessary that all sellers have to issue the invoice in the pattern given above. Based on one's transaction, the invoice pattern can be changed with the permission of the tax officer, but all information contained in the sample pattern above has to be entered.

-) "Tax Invoice" should be stated as title only in the first original copy of the invoice.
-) Issuing and receiving invoice is one of the prime duties of a VAT registrant.
-) If a tax invoice is not issued, the VAT registrant has to face penalty and will also fore go the facility of tax deduction.

) Abbreviated Tax Invoice

In the sale of up to NRS. 5000, including tax, an abbreviated tax invoice can be issued. An example of an abbreviated tax invoice is given below. To issue an abbreviated tax invoice he taxpayer has to take the permission of the tax officer.

An example of an Abbreviated Tax Invoice

Date:

Invoice Number:

Seller's Name: Address:

Taxpayer identification Number:

Tax Rate (%):

-) IN cases where most sales comprise of small items and low costs, the invoice can be issued by combining the items as "some goods" under particulars.

-) If the buyer demands a tax invoice instead of an abbreviated one then a tax invoice has to be issued

2.1.2.6 Credit or Debit Note

-) If there is a difference in value after the commodity or service has been supplied based on the tax invoice, then a debit or credit note has to be issued.
-) When issuing such a note it has to be stated whether it is a credit note or a debit note.
-) The date and the names of the buyer and seller along with their taxpayer identification number and address have to be stated in the credit or debit note.
-) The relevant tax invoice number also has to be stated.
-) If the goods have been returned the reason for doing so has to be stated.
-) The item returned along with its cost has to be stated.
-) The difference arising in the tax amount after the debit or credit note has been issued also has to be clearly stated.

2.1.2.7 When an Item Purchased is to be returned

The quantity, quality and the nature of the item is the same:

-) If an item purchased is damaged, torn or stained and is exchanged with the same or similar item, the same tax amount stated in the tax invoice has to be maintained. Or, since the tax invoice has already been issued, preparing a credit note and issuing a new invoice can exchange the item.
-) If an item purchased is damaged, torn, or stained and is exchanged with the same or similar item, the same tax amount stated in the tax invoice has to be maintained. Or, since the tax invoice has already been issued, preparing a credit note and issuing a new invoice can exchange the item. If the item is similar but the cost is different:

-) Let us assume that the cost of the item purchased was NRS. 100. But at the time of exchange, if for some reason the cost has come down to NRS. 75, then a credit note has to be issued.
-) If for some reasons the cost of the above item purchased at NRS. 100 have reached NRS. 150 at the time of exchange, then the tax amount on the additional NRS. 50 have to be charged and a reference to the tax invoice number has to be made.

2.1.2.8 Others

Once the purchase book, sales book and the VAT accounts have been prepared, it will be easy for the taxpayer to calculate the tax amount that he/she has to pay while preparing the VAT return. To estimate how much tax has to be submitted to the government within a stipulated time period, the tax incurred has to be deducted from the tax collected within that period. If the tax collected is more than the tax paid, then the person has to submit the extra tax amount received from sale to the government. But if the tax paid in purchase is more than the tax collected from sales, then the person can adjust the extra amount in the tax due in the following month. If this process continues for six consecutive months and the amount is still not adjusted then the taxpayer can write an application to the concerned Inland Revenue Office to get a refund of the amount that has not been adjusted. Once such an application is received, the tax officer has to refund this amount within 60 days from the date that the application has been received. If the amount due is not refunded within 60 days, it has to be paid back along with interest.

Most states are obliged by international agreement not to discriminate against supplies by ways of import. The primary source of this obligation is Article III of GATT. A growing number of states are also under other obligations include the terms of customs unions and free trade area agreements, double tax agreements, and bilateral trading and investment agreements.

2.1.3 Types of VAT

There are several bases to classify the different types of VAT. However, the classification of VAT on the basis of the treatment of capital goods is much important. Considering the treatment of capital goods, the following classification has been made in broad sense.

2.1.3.1 The Gross National Product Type

The base for this type of VAT includes capital goods along with the value added on the other raw materials, semi-manufactured goods etc, purchased from other firms. Hence, under these variants, capital goods purchased from other are not allowed to deduct from sales while calculating the tax base. Even the depreciation in subsequent years is not deductible from the tax base. Thus, the base of VAT consists of consumption and gross investment, which is equivalent to gross national product (GNP). The tax is therefore equivalent in its coverage, to a retail sales tax, which includes in its base durable capital goods.

Base of VAT = GNP = C + I_g

Where, C = Consumption; I_g = Gross investment

2.1.3.2 The Income Type

Under the income type of VAT capital goods purchased from other firm are not deducted from the tax base, however, the depreciation in the subsequent years are allowed to deduct from the base. Similarly, it requires that an access of year-end inventory over year-beginning inventory over year-end inventory to be deducted (Shoup, 1969; 252). Thus, tax base under this variant, includes consumption and net investment, which is equivalent to the net national product (NNP). Therefore, tax base is given as,

Base of VAT = NNP = C + I_n;

Where C = Consumption; I_n = Net investment

2.1.3.3 The Consumption Type

All capital goods purchased from other firms in the sense tax year are allowed to deduct from the sales value while calculating the base under the consumption type VAT. Although description in the subsequent years can not be beyond the tax base. As the consumption is only the case of VAT, this type is known as the consumption type. Under the destination principle, this type of VAT has an identical base with the retail sale tax on consumer goods and service. No distinction is made between parts and materials physically incorporated into the product, supplies and fuel and durable capital goods. Among this three types VAT and GNP type has broader base than the remaining two and has received serious consideration in various countries. In GNP type both capital goods and depreciation goods are under the tax net while the income type exclude depreciation and consumption type excludes capital goods from the tax base, in the recent years, the consumption type of VAT has gaining popularity in several countries in Europe and elsewhere. The reason for the popularity of this type is that this variant doesn't affect decision regarding investment and growth since it relieves investment from any tax burden (Lindholm, 1970:1180). Since the tax does not discriminate against the capital intensive techniques in favor of labor incentive technique, there is no need for a firm to switch over from capital to labor incentive methods (Khadka,1989:3). But GNP type of VAT discourage firm to use capital incentive methods of production and encourage using the methods, which don't involve frequent year to year fluctuation in physical volume of inventories. Moreover, this GNP type creates substantial disincentive for saving and investment for which reason the tax is not accepted by the countries. From the economic growth respective both the income and gross product VAT has an anti investment bias (Crowford, 1993:6). The distinction between the purchase of Capital Goods and intermediate goods is not needed under consumption variant, which is essential under other two variant. The income type also needs the computation of depreciation in subsequent year, which further complicate

administration. Thus consumption variant is attractive from the point of tax administration. Even from the consideration of foreign trade, consumption variant is more attractive than the income variant since the former is compatible with destination principle and later with origin principle. Thus, the consumption variant is most desirable than the other two variants in several respect.

VAT can also be classified on the basis of the vertical coverage through production and distribution stages. Under this classification extent of vertical coverage forwarded from manufacturing has more practical importance which has three sub-divisions with different bases. Firstly, the value-added principle may be used within the manufacturing sector only, with tax applying to each manufacturer on his value-added but not by wholesalers or retailers, except to a limited degree. Secondly, the tax may be extended through the last wholesale transaction usually called a pre-retail VAT. Lastly, VAT may be extended through the retail level from the earlier stages of production. This type of VAT is known as comprehensive or full-fledged VAT. Under the same classification, next type is based on the extent of vertical coverage backward from manufacturer. Under this type, VAT may be extended to all producers of basic raw materials including farmers. However, this type creates administrative difficulties due to the large number of small establishments and scattered units.

2.1.4 Methods of Computation of VAT

Value Added Tax can be collected by using the different methods of computation however the choice of the appropriate method depends basically on the type of VAT employed and the principle under which VAT is adopted. The VAT can be computed by employing any of the three methods; i) addition method, ii) subtraction method, and iii) tax-credit method; among which "the last method has never been utilized" (Due,1976:71)

2.1.4.1 Addition Method

Under this method, value-added is the total sum of the factor payments made by the business firms, which is equivalent to the gross income received by the factors of production. The tax base is computed by adding the payments made by the firms to factors of productions employed in turning out the product, such as wages, interest, rent, royalties and profits (Sullivan,1965; 7). Thus, VAT under addition method is the function of the total factor payments as given by;

$VAT = f(W+R+I+P)$; where W= Wage, R= Rent, I= Interest, P= Profit

If the firm constructs its own capital good rather than purchasing it, this addition method captures the value added by the firm. The capital method is readily applicable to the income type but clumsy for the consumption type of Value Added Tax (Musgrave and Musgrave, 1976:401). Virtually, no country uses the addition method, although, Argentina and Israel have applied it to selected economic activities, such as banking and finance, where value of inputs and outputs is difficult to measure (Cnossen, 1992; 217,218). From the practical point of view, this method is more complex to compute. It would be awkward to use the addition method to compute the base of the consumption type of Value Added Tax, since to the net profit figure there would have to be added depreciation and the excess of opening inventory over closing inventory (deducted, as a part of cost of goods sold, in computing net profits), with subtraction of capital goods purchased or produced within the firm and subtraction of an excess of closing inventory over opening inventory (Shoup, 1969:258).

2.1.4.2 Subtraction Method

Under this method, value added is determined as net turnover which is obtained by subtracting the cost of materials from sales proceeds (Khadka, 1989:5) and the procedure was used in the Michigan VAT (Due, 1976;71). Value added is obtained by subtracting purchases of produced goods from the figure of sales during the period, as given in functional form by,

$$\text{VAT} = f(\text{Sv} - \text{Pv})$$

Where, Sv = Sales value; Pv = Purchase value

This method of calculating VAT is suitable for the consumption variants of VAT. This method is not well suited for discrimination among types of consumer goods but it need not only any adjustment to operate correctly for imports under the origin principle. Same thing also happens to the addition method. However, under the destination principle, these both methods of direct calculation can not supply the information need to compute precisely the export rebate or the import compensating tax, when there is not uniform rate to all stages of value added of all goods and services.

2.1.4.3 Tax Credit Method

Tax credit method is also known as the invoice method and uses as indirect subtraction technique to compute the tax liability. Value added, as such, is never calculated at all, in this method, but the effect is exactly the same as if the figure was calculated and the tax rate applied. Since, the firm deducts the amount of the tax paid on its purchases during the period from the figure calculated by applying the tax rate to its figure of taxable sales for the period. Under this method, tax payers are allowed to subtract the taxes already paid by their suppliers and passed on to them from the gross tax liability which is levied on the total value of their sales. Thus, in contrast to the subtraction method, which deducts purchases from sales and levies taxes on the differences, tax on purchases is subtracted from the tax on sales under the tax credit method (Khadka 1989;5). Hence, net tax liability is given by

$$\begin{aligned}\text{VAT} &= f(\text{outputs-inputs}) \\ &= \text{Tax paid on sales} - \text{Tax paid on purchases}\end{aligned}$$

Among the three methods of computing VAT the tax credit method is widely favored in the countries of the European Economic Community and elsewhere. The invoice method is used generally in European countries and constitutes an

advantage of the value added approach, especially in countries where tax compliance is otherwise poor (Musgrave and Musgrave, 1976: 402). The tax credit method is so superior to the other methods in terms of the application and enforcement, as well as adaptability to various rate modifications. that is now universally employed. The tax credit methods can be especially useful if it is desired to reduce the rate of the Value Added Tax at some stage in the production and distribution process, say the raw materials or farm products stage, for administration reason, without reducing the total tax paid on total value added (Shoup, 1969:259). However, this tax credit method fails to give credit for tax prior to the exempt that is given to either of pre-import domestic stages except the first stage, because the tax credit chain is broken. The tax credit method encounters still more difficulties under an origin principle value adder tax that imposes different stage simply for administrative reasons. Beyond this positive and negative aspect of tax credit method, it has a power to make the overall rate depend on the imposed at the stage of production or distribution. Whatever may be the rate at various earlier stages? The methods of calculation VAT liability under different methods are shown in the table.

Table 2.2**Calculation of VAT Liability by Different Methods (13% VAT)**

		Stage of production and Distribution			
		Manufacturer	Wholesaler	Retailer	total
A	Addition Method				
	a. Wages	2000	1100	400	3500
	b. Rent	600	300	1000	1900
	c. Interest	300	200	200	700
	d. Profit	700	400	800	1900
	e. value-added(a+b+c+d)	3600	2000	2400	8000
	f. VAT liability(13% of e)	468	260	312	1040
B	Subtraction methods				
	a. sales	8600	10600	13000	32200
	b. Purchase	5000	8600	10600	24200
	c. Value-added(a-b)	3600	2000	2400	8000
	d. VAT liability(13% of c)	468	260	312	1040
C	Tax credit methods				
	a. Sales	8600	10600	13000	32200
	b. Tax on sales	1118	1378	1690	4186
	c. Purchase	5000	8600	10600	24200
	d. Tax on purchases	650	1118	1378	3140
	e. Net VAT liabilities(b-d)	468	260	312	1040

Note: All sales and purchase are exclusive of Tax and figure are arbitrary assumed.

Thus, all tax credit method has the following major benefits over the other two types of VAT computation.

- i). In the tax credit method, tax liability is attached to transaction that makes it legally and technically superior.
- ii). Tax collection is easy.
- iii). Cross-checking is possible.
- iv). It provides the benefit of catch up effect that makes under evaluation and evasion impossible,
- v). There will be no loss of revenue due to the exemptions granted to the small traders.
- vi). It never demands for the calculation of value-added total tax.
- vii). Liability entirely depends on the rate on the last stage, so rate differentiation is possible for the same revenue yield.

This mechanism is further desirable since it puts an equal burden of taxation on both imports and domestic products, irrespective of channels of distribution and proportion of value added at various stages. Thus, the tax credit method is desirable for several reasons and has been adopted by many countries of the world.

From the above table, it is clear that VAT liability calculated by any of the three methods is same that Rs. 1040. In the table, VAT rate is same that is 13% for all methods. However, if there is rate differentiation in different stage VAT liability will differ for different method. Although, the change in the VAT liability will be same under both the addition and subtraction method, as there is same amount of value added at each stage of production and distribution. Assuming that the transactions(Figure) presented in the table are for economy as a whole in a specific period of time, a VAT of 13% rate gives Rs. 1040 as tax under the first two methods having the amount of value added Rs. 8000. In tax credit method, value added, as such is never calculated, however VAT

liability exactly equals to that by other methods. Thus, VAT is levied on the basis of value added but not directly.

2.1.5 Taxable Persons

It is desirable to include all kinds of goods and services or business activities into the scope of VAT so that all consumption expenditure comes under the taxable base of VAT as him/her Taxable person. However, in practice the base of VAT is not as broad as to cover all exemption goods and services.

2.1.5.1 Taxable persons within the scope of Law

A person within the scope of VAT is usually described as a taxable person. A VAT law should include all legal persons created under the law of the state that engage in economic activities of any kind, as well as all physical persons. A VAT law may regard an association or partnership, although the association does not for general legal purposes, have separate personality. Governmental bodies at the national, regional and local levels are to be included as taxable persons.

2.1.5.2 Excluding persons with low levels of Business Activity

Most states require only some of the many persons active in business within the state to be taxable persons. Setting a minimum level or threshold of business activity and requiring only those persons with levels of activity above the minimum to be taxable person normally achieves this. Those with levels of activity below that level are not required to be taxable persons, although they are often given the right to voluntarily choose to be taxable persons. The usual measure of business activity is the total turnover of taxable goods and services supplied by the person over a set period.

2.1.5.3 VAT Register

To administer the VAT, it is standard practice to establish a formal state register of those who are registered persons. There must be a requirement that

any person who is, or should be a taxable person take the necessary action to seek to be registered for the VAT.

2.1.5.4 VAT Number

States sometimes decide to adopt and adapt an existing register such as the register for companies or a general register of tax payers to act as the VAT register. That is for a state to decide, but the register must be capable of generating a unique VAT number for each taxable person as well as providing the tax authorities with up-to-date list of those, and only those, who are taxable persons.

2.1.5.5 Voluntary Registration

States often allow those who are not required to be registered to register voluntarily. This may be appropriate for many organizations that intend to have a large turnover, but have not yet reached it; incur large expenditure in one year, expecting the income in the next year; or are carrying out business with this information to be known by the customers. Voluntary registration also allows those operating just below the threshold level to avoid any competitive disadvantages compared with other operators who are required to register.

2.1.5.6 Exporters and Persons engaged in international activities

In most of the states VAT is not levied to the exporters. To avoid the exporters from paying VAT provision is made for them to claim back any input tax they have paid in making the exports.

Therefore, exporters and those in a similar position must be registered. If they have not registered then they are not entitled to claim back the input tax.

2.1.5.7 Effect of not registered

A person who is to register for the VAT is taxable person who is subject to collect VAT on all supplies whether or not the person is registered.

2.1.5.8 Cancellation of registration

There are main three conditions for the cancellation of VAT registration. The first case is where a person has been registered for VAT properly or not, the person registered for VAT but if his current level of business is below the threshold then his registration for VAT is cancelled. The second case is when the person is not allowed to carry any business activity by the law. The third case is when the person has registered for VAT by mistakenly or by misrepresentation on the part of the person

2.1.5.9 Continuing registration despite a change in the taxable person

Situations will arise where a person ceases carrying on a business unavoidably. For example, the death, insolvency, winding up a company may mean that the person registered as running a business is no longer running it. The business will usually continue at least for a time to be run by some other person.

2.1.6 Value Added Tax and Other Sales Taxes

Sales Tax has been taken as most established tax and regarded as consumption related tax. Sales tax has greater revenue potentiality power due to its broad based coverage and most of the under developed countries are survived by the sales tax and other kinds of its developed forms. Sales taxes are directly imposed upon production and distribution process and collected by the seller. With the flow of time, classical types of sales taxes could not face its challenges and many reforms held to avoid the demerits of its multistage turnover or cascade type mainly alternative are areas choose between VAT and a single stage sales tax such as manufactures sales tax, wholesale level or retails sales tax.

2.1.6.1 VAT versus Turnover Tax

The turnover tax, the earliest form of the sales tax, offers the advantage of simplicity-all transaction are taxed, typically at a uniform rate, and the yields the maximum revenue for given tax rate. As the tax is imposed on the gross

monetary value of a product at multiple stages of business activity, it is multistage and broad based in nature. The turnover tax or cascade tax is levied as a percentage of sales, regardless of value added, at each stage of sale right from the initial production of materials to the final sales to the consumers. Thus, the burden of tax as a percentage of consumer expenditures vary widely on different goods because of the varying number of transactions involved in different commodities between initial production and final sale to the consumer. Since, turnover is proportional to a firm's turnover, gives an incentive to vertical integration, as the tax may-make it cheaper to produce an intermediate product within a firm than to buy a similar input produced more efficiently by an outside supplier. In contrast, Value Added Tax do not provide this artificial adjustment to vertical integration so have been very widely adopted in preference to turnover tax. Under the system of turnover tax, taxable value of any commodity depends on the number of stages it passes through the production and distribution process. This makes the larger base for the cascade tax so the revenue productivity is high. Instead, value-added tax is less productive since the base is only value-added. Thus, "a serious advantage of the turnover tax is the cumulative taxation that occurs as goods move through successive stages of production and distribution" (Goode, 1984; 153).

Since the turnover tax applies to the total volume of transaction of the product at each stage of production and distribution, it creates a strong incentive for reducing the economic activities at earlier stages like performing many activities of production and distribution under a single roof. Thus, turnover tax encourages integration and discourages specialization. Such artificially encouraged integration results in loss of efficiency and lowers output and growth rate and many in any case lead to undesirable concentrations of economic power and monopolistic tendencies. There will not be any incentive for integration in a VAT system, since the total amount of tax on the product will be the production and distribution system, and the taxable price is always

equal to the final price of the product. Thus, from the view point of neutrality VAT is so far superior to the turnover tax.

The turnover tax is comparatively easy to administer as it applies on gross sales so that there is no need of tax credit. The double-checking and several provisions associated with VAT create complicity however makes the tax system transparent, efficient and equitable. Comparative easiness and simplicity also can be found in turnover tax in the viewpoint of tax compliance. But due to the self-enforcing feature of VAT, it is more attractive to check the tax evasion. An uneven burden is also created on various commodities by turnover tax and further the burden varies with the typical number of transaction through which a commodity passes on its way to the final consumer. The cascade form of tax also tends to discriminate against domestically produced goods and compared with imports, since the former pass through a large number of taxable sales transactions within the country than the latter. VAT avoids this problem, since the imported goods will either bear tax on their full value at the time of importation or (under the tax credit method) have this value taxed at the first subsequent sale, and then subsequent value added will be taxed same fashion as with domestic goods (Due 1975; 85). Once the tariff protection is eliminated, the harmonization of sales taxes becomes essential in a Common Market Area, which is served by VAT in a satisfactory limit rather than the turnover tax.

In Europe, the turnover tax was used after World War I, from Germany, France, Italy, Belgium, the Netherlands and Austria but has been superseded by the VAT. Similarly, in many developing countries, the turnover taxes have been replaced by other forms of sales tax. However, the turnover tax will do less harm where there is little manufacturing and exports consist of primary products or the output of integrated enterprises than in countries with more diversified economies (Goode, 1984; 154).

2.1.6.2 VAT versus Manufacturers' Sales Tax

Manufacturers' sales tax is levied on the sales value of manufacturers in case of the domestic product and on the import value in case of the imported product. Basically, the tax is not levied on the sale to other sales tax registered vendors, in such cases the sellers had to note on the invoices the buyers sales tax registration number and particular of the goods. Thus, sales tax registered manufacturers could purchase their raw materials, auxiliary raw materials and chemical becoming physical ingredients of taxable products free of tax. So, the tax base of a manufacturers' sales tax narrows too much as compared to VAT which covers value added in each stages. The broader base of VAT is not only due to the inclusion of value added of each stage but also due to the coverage of services as well. If the make-up system is introduced in the tax, it will cover the various costs including transportation and profit margin of the importers in the sales tax base. MST, however, being a single stage sales tax, will avoid the worst evils of the cascade tax, if it is properly designed. Under the MST, the exclusion of unprocessed foods and many artisans' products-either legally or because of noncompliance-mitigates the burden on the lowest income classes. Unlike the cascade tax, MST creates as incentive to the firms to push various functions beyond the point of impact of the tax in order to reduce the amount of the tax due. Thus, forward integration of the manufacturer is discouraged and helps for specialization. However, when the manufacturers transfer their own activities to dealers and wholesalers, establish artificial sales depots, undervalue sales etc, it brings inefficiency in the production and distribution channel.

The distribution of the tax burden under the MST is not uniform to various consumer goods, and to the domestically produced and imported goods because of variation in magnitude of wholesale and retail level margin. The variation is haphazard, if anything, the burden will be greater on the basic necessities, which tend to have low margins than on the most luxurious goods on which the margins tend to be high. There is a particular danger of favouring imports,

since advertising and other distributive activities with respect to these goods may be performed after the point of importation, whereas the costs of these activities will be reflected in the manufacturers' prices of domestically produced goods, if they are performed by manufacturers. VAT would put an equal burden on both imports and domestic products since the burden of this tax depends upon the final price irrespective of the proportion of the value added at different stages in the process of imports, production and distributions. It would improve the efficiency and competitiveness of domestic products in the international market by relieving exports from taxation.

Under MST, one serious defect, cascading becomes inevitable when goods and services are purchased from registered firms by non-registered firms and supplied again to registered firms. In practice, it is possible in many developing countries, where importers directly sell their imports to non-registered firms or persons, which may be raw materials for manufacturing industries. Even the purchase of raw materials from registered firms or primary producers are also taxed, which further extended the cascading effect and hence strikes a growing economic sector. Further, the refund system is not perfect in MST. In contrast, VAT does not suffer from cascading or pyramiding effects and it does not affect economic growth negatively.

Under a VAT, the taxable price always equals to the final sales price of the goods so that the net tax liability cannot be reduced by altering the methods of doing business. So, there will not be incentive neither for vertical integration nor for disintegration. This makes the tax system neutral, which helps VAT to stand superior to the MST. However, VAT is difficult to administer than the MST. Basically, the difficulties arise due to the provisions like tax credit, refund, exemption, zero-rating, cross-checking etc and further, the taxpayers are in large number than the MST. However, the VAT can be made simple and effective by some measures, which are carried by the tax itself. They are; i) actual invoice based self-assessment mechanism, ii) VAT serves catch-up effects, which make tax evasion likely impossible; iii) VAT has a self policing

features; iv) cross-checking of tax liability and credit is possible; v) net tax liability is distributed to all production and distribution stages rather than concentrating only in a single stage. Lastly, to conclude, more advantages of VAT over the MST can be attained when the tax is extended to the retail level.

2.1.6.3 VAT versus Wholesalers' Sales Tax

Wholesalers' sales tax, as such, is a tax on the sales value of the wholesalers, and hence it has a broader base than the MST since it covers the margins of the wholesalers into the tax base as well. Although, the significant difference between WST and MST depends on the extent to which wholesaler's sales tax is applied to the sales to retailers. Since the wholesaling is not carried on exclusively by separated enterprises and is done also by importers and manufactures, it is necessary to register all three kinds of enterprises (manufacturers, importers and wholesalers) and collect tax on their sales to unregistered buyers including retailers and consumers. It has been recommended for developing countries by some well-known experts but in practice has been only in Portugal and a few developed countries, including the United Kingdom, Australia, and New Zealand. An administrative advantage of the wholesalers' sales tax that is relevant for equal treatment is that manufacturers who sell direct to retailers do not need to be taxed on a hypothetical price that is less than the actual price, to be able to compete with manufacturers selling it independent wholesalers (Shoup, 1969; 242).

WST encourages manufacturers or importers to sell directly to the retailers or consumers so that product remains beyond the tax net. This results a loss in the revenue on the one hand, and on the other it discriminates against those products by means of competitive advantages, which bear the tax burden, favouring those firms and products which do not pay or bear the tax burden. In contrast, VAT does not create such discrimination since it is levied at every stage of production and distribution, and tax evasion is also more difficult.

Thus, VAT is neutral among the process of production and distribution, and the consumer choices.

The problem of cascading remains coherent under WST because of imperfect poorly utilized tax credit method whereas VAT easily avoids the problem. Such cascading effect of WST creates less incentive for or competitive loss while it fails to provide proper amount of tax refunds on exports. Discrimination effects associated with WST hamper the output and economic growth. Instead of this, VAT being a neutral tax does not distort the economic growth.

2.1.6.4 VAT versus Retailers' Sales Tax

Retailers' sales tax is applied to the sales value of the retailers so retailers are required to register for sales tax purpose and tax is levied on their sales to consumers or non-registered firms or other persons. Among the all types of single stages taxes, RST is that one which has the broadest base. A retail sales tax in its pure form is the equivalent of a comprehensive consumption type of tax on value added except that it does not offer an option between the destination principle and the origin principle. Like the IT and the MST, RST includes all the services into the tax base, which is not true in case of the MST and WST. Both the taxes RST and VAT with the similar rate and coverage would raise the same amount of revenue. However, the tax is levied only on single stage under RST and on multiple stages under VAT.

There is no incentive to alter distribution system, most import and domestic goods can be treated equally, pyramiding is avoided, and the desired pattern of the distribution can be attained. Thus, RST avoids virtually all the problems associated with the MST because of the imposition at the final sale to the consumer.

The actual amount of tax under RST is not affected by the number of stages through which a commodity passes but depends on the tax rate and the final price of the commodity. In the similar manner, under a VAT system the net tax liability remains unchanged regardless the choice of production and

distribution system, since tax is levied only on the value added at each stage. In addition, some aspects like relieving producers' goods from taxation, free export from tax and broader tax adjustment are possible feasible in both the taxes VAT and RST, however, is a lesser degree in the latter. Thus, both taxes are neutral but RST is less than VAT. The problem of cascading does not appear in both VAT and RST because there is no possibility for tax being levied on tax, since inputs are relieved from taxation through the suspension technique under the RST while the same objective is achieved through the tax credit method. Both are similar while considering the treatment of imported and domestically produced goods. Further, similarity appears on the avoidance of the pyramiding problems since vendors need not be apply a mark up on the tax amount levied on earlier stages, under both the taxes. In this regard, RST may be considered a serious competitor of the VAT.

Beyond the various similarities between VAT and RST, there are also some basic differences between them. The collection of a retail sales tax places the entire impact of the sales tax upon retailers while much of VAT is collected at pre-retail levels. Under the RST, if the manufacturers or wholesalers or importers directly sell to the consumers, the whole tax amount from that community is lost, while under a VAT, it will reduce only a part of total tax liability that is amount of VAT liable at that stage. In developing countries, most of the retail traders are small entrepreneurs with relatively inadequate records and a high prosperity to evade tax. Thus, particularly in a developing country, the danger of complete evasion is far less with VAT, since any sales can be collected more effectively from typical manufacturers and wholesalers than from retailers.

The only one advantage of RST over VAT is that the number of taxpayers is small, however, a significant problem is created because of the large number of small retailers having only limited records. If such very small retailers are kept beyond the tax net from the administrative difficulty, resulting decrease in the tax base is much larger under an RST than VAT. It is because RST looses

entire amount of tax on the sale of exempted seller while such exemption causes a loss of tax only in a small amount. Taxation on services is difficult under RST than the VAT. In general, the services like telecommunication, transportation charges, construction etc are not taxed under the RST. Taxation on such services demands the separation of the services into i) sales to consumers and ii) sales to business firms, which complicates the tax system. If services are not taxed, discrimination will appear which make sales incentive to use of goods than services. This distorts the economic choices of both consumers and producers, and unnecessarily accentuates the regressive impact of the tax, because the demand for services is generally more income elastic than the demand for goods (Cnossen, 1981; 220). Further, RST cannot provide precise amount of tax refund because of the difficulty to identify producer's goods or consumer's goods.

2.1.7 Treatment of Imports

The destination principle requires a charge to VAT to be placed on all imports. This is usually done.

2.1.7.1 Taxable supplies

A taxable supply is the supply or transaction on which VAT is imposed. When taxable supply is made and then a taxable person must be imposed and collect VAT and account for it to the tax authorities. Even if the person does not do this, the tax authorities are still entitled to collect VAT from the taxable person on the assumption that the VAT has been imposed. VAT is a tax on supplies made in the course or furtherance of economic activity or put another way as part of a business. So it is confined to activities of this nature and is not imposed on other activities such as the personal hobbies of individual gifts made for personal reasons or charitable activities with any business or commercial content.

2.1.7.2 Payment for a Supply

A supply is made for payment, considerations or compensations if the taxable person making the supply receives or is entitled to receive, payment for the supply. For this purpose, it does not matter in what form the payment is made. An exchange of goods is a supply for payment or consideration by both parties to the bargain as is a supply of goods in exchange for the provisions of services by the person receiving the goods. In addition, it does not matter, who makes the payment.

It will usually come from the person receiving the supply. But the source is irrelevant. Therefore, some laws make it clear that all forms of payment are to be included as payment of consideration for the supplies even if this includes grants made by public authorities or other third parties.

The concept that a supply is within the scope of VAT only if there is payment or consideration for it allows from the fundamental nature of the tax as one imposed on the value added by a transaction. If a supply does not result in gain for the supplier, directly or indirectly, then no value is added in making the supply. By contrast, the same reasoning argues that the consideration should include all forms of payment received by the supplier, in cash or in kind, whenever and however paid and regardless of who pays them.

2.1.7.3 Transaction where no payment is payable

In principle, if there is nothing paid or payable for a supply, then it is not a taxable supply. Safeguards are needed to prevent the operation of this principle from allowing transaction to escape a charge to VAT in appropriate situations.

2.1.7.4 Supplies where payment is not full

Together with transactions for which no payment is made, but where it is deemed to be made, mention must be made of supplies where the payment made is less than the full payment or consideration that should or might be paid in

the open market. If some payment is made, then supply is within the scope of VAT.

2.1.7.5 Exempt supplies

Exempt supplies are not taxable supplies. The standard way of dealing with this is to exempt certain forms of supply that are otherwise within the scope of VAT from liability of VAT. By contrast, some states have adopted the practice of listing those supplies that subject to VAT.

It is often assumed that exemption results in the reduction of the VAT burden on the supply. This is true if the person supplied is a consumer and is not receiving the supply. It is not true if the person supplied is a taxable person. Exemption of a supply to a business results in an increase in the burden of VAT on the supply.

The reason for this is that the person running the business can offset the VAT against the VAT charged by the business, so claiming a full rebate for any VAT. The person making the exempt supply will probably have had to pay VAT on some part of the supplies made to it and will therefore have to pass some VAT on to the business as a part of its price.

This VAT that can be recovered if the supply is subject to tax, but that cannot be recovered if it is exempt. To avoid the distortions caused by this failure to recover, it is good policy not to exempt the types of supply that are typically made to business.

New Zealand has maintained special exemptions on land and buildings supplies by nonprofit organizations and individuals and financial services. The tax exempt supplies can be put into alternative taxes.

States generally have accepted treaty obligations to exempt certain supplies or imports as a part of the recognition of diplomatic and consular immunities and of similar immunities for international organizations. There involve immunity

from taxation for the embassies and consulates and for the recognized diplomats.

International practice recognizes agreed categories of goods that are exempted from customs duty on import. Practice on this is well established and ranges from the import of a limited quantity of goods bought duty free in other states to exemption of gifts to charities or similar organizations.

2.1.8 Taxable Value Supplies

2.1.8.1 Charge to VAT

VAT is designed as a tax levied as a proportion of the value added on any taxable supply. It is therefore necessary to attribute a value to all taxable supplies to ensure that the objective is achieved. To be consistent with the fundamental principles of the tax the value to be taxed must reflect the value added by the supply.

2.1.8.2 Value of international supplies.

The general rule for valuing a supply for VAT purpose is to value it at the total of all payments, or consideration, that the supplier receives or is entitled to receive as a result of the supply. In other words, the value is taken as the actual realized value.

2.1.8.3 Tax inclusive Vs. Exclusive Base

The value of a supply should be taken as including all other taxes paid on that supply. VAT is not an alternative form of excise tax or custom duty, but is a separate tax. Both custom duties and excise taxes reflect the states separate decisions to increase the price of the dutiable and excisable products by the amount of the duty of tax. That represents the value of final consumption of the goods for the VAT purpose therefore the basis of the value for VAT.

If it is felt that the combined effect of excise duty and VAT on a product is too high, the answer lies in adjusting the level of excise duty not of the VAT.

2.1.8.4 Fair market Value of Supply

The value added is always the discounted price. This is both consistent with the principles of the tax and the most practical answer. Complication arises where the effect of a discount or an arrangement on purchase results in later adjustment. In this case no account should be taken of the change in connection with the first transaction.

2.1.8.5 Value of imports.

In the special case of imports of goods it is standard practice to use the customs value of goods as the amount for VAT calculation, subject to specific adjustments. The customs value generally represents an international agreed upon approach to the valuation of goods subject to customs duty and therefore minimizes the scope for difficulty or dispute in levying VAT on import.

2.1.9 Payment of VAT

There are two elements to establish how much VAT the taxable person must pay to the tax authorities. The first is the rate of VAT to be paid on the value of the supply. The second effect is the offset of input tax against output tax to identify the net VAT payable.

2.1.9.1 Rates of VAT

It is generally accepted that the VAT should not be used as a vehicle for imposing luxury rates of indirect tax. VAT will have a main or basic rate and one or more lower rates. Arguments for lower rates therefore concentrate on socially important goods such as food and socially important services that are not exempted or outside the scope of VAT.

2.1.9.2 Zero Rates

A zero rate means that, while no VAT is due on the supply, the supplier remains entitled to claim any tax incurred in making that supply and is therefore entitled to a refund of that input tax if there is no output tax against which to offset the input tax. From one point of view a tax rate of 0% is

nonsense. It is not a rate of tax, and no tax is collected. A zero rate is therefore an exemption of the supply from output tax.

2.1.9.3 Zero Rating exports and international supplies

The main use of zero rating is to deal with exports of goods and exported supplies of international services. The destination principle calls not only for removing a direct charge to VAT from exports and international services but also for removing any VAT indirectly imposed on those supplies in the form of the input tax paid by a supplier. Few states zero rate some internal supplies. This is widely viewed as inappropriate because it amounts to subsidy of the activity or transaction treated in this way. It would be better to identify the policy reason for the subsidy and address it through a direct subsidy.

2.1.9.4 Paying VAT to tax authorities

A taxable person is liable to pay VAT to the state authorities at regular intervals after deduction of any allowable input tax.

2.1.9.5 Entitlement to Credit for Input Tax

Any VAT incurred by a taxable person as input tax should be repaid to that person in some way. The usual method of repayment is to allow the input tax to be set off as a deduction of credit against output tax collection during the same period. A duty is imposed on the taxable person to pay only the net amount to the tax authorities.

2.1.9.6 Partial Exemption

The principles are that input tax incurred only for the purpose of making taxable supplies is allowed, but input tax incurred only some other purpose or purposes should not be allowed. Input tax incurred partially for the purpose of making taxable supplies and partly for other purposes should be apportioned so that only the part devoted for making taxable supplies is available for credit.

2.1.9.7 Disallowed Input Tax

It is increasingly common practice for states to deny input tax credits for certain kinds of supply. The main group may be described as supplies of or for luxuries, amusement or entertainment.

2.1.9.8 Capital Goods

For revenue protection reasons, some states have rules that input tax on capital goods or certain kinds of capital goods to be set off over a period of years in much the same way as the deduction of capital expenditure is controlled by capital allowances or depreciation for income tax purposes.

2.1.10 VAT Registration

Under the VAT Act 2052 Sec 9, small retailer/dealers/manufactures those annual (in last 12 months) sale volume is less than the threshold limit or regarded as a non taxable exempt taxable person are not required to register under the VAT. This act has fixed this threshold as Rs. 20 Lakhss. Before starting any business making or intending to make taxable supplies exceeding or expected to exceed two million rupees in turn over (not profit) for the previous twelve months or the next three months, the person must register for VAT. Small vendors, who have previously been non taxable, shall apply for registration within 30days of the date on which their annual turnover reaches the threshold at 2 million rupees. Also a person who imports into the kingdom of Nepal goods valued at one hundred thousand rupees or more per annum for commercial purpose shall have to register.

However, any people carrying out small transaction have the possibility to be registered voluntarily. And only a registered person can deduct input VAT or have input VAT credit.

a) In case of non taxable and exempt taxable persons

The VAT Act sec5(3) and schedule-1, contains a number of possibilities according to which supplies of goods or services under specific provisions are considered to be non taxable or exempt from VAT. Persons making such non taxable or exempt supplies cannot be registered for VAT & cannot deduct input VAT or claim a refund.

b) In case of private persons

Private persons are not taxable persons according to VAT & they cannot be registered for VAT & cannot deduct input VAT or claim refund.

c) In case of employees

Income from employment is not subject to VAT

2.1.10.1 Procedures of VAT registration

Submit application before starting any business transaction if a new business is going to be established. With the application the copies of business & income tax registration certificate should be attached. Upon the inspection of application & further information registration will be made & VAT certificates with TPIN number (Tax Payers Identification Number) will be given within 30 days from the date of application. Some rules for VAT registration are as follows:

- No need to register under VAT if the transaction (purchase the goods or services other than as included in Annexure 1 of the Act) in the last 12 months are less than Rs. 20 Lakhs.
- If within the next 3 months the transaction of 12 months is likely to reach over Rs. 20 Lakhs, the business firm should apply for registration within 90 days.
- If the total year-to-date transaction reach to RS. 20 Lakhs as on any date, the business house should apply within 30 days for VAT registration. Transaction refers to the sales or purchases of goods & services.

- Business houses are required to inform the VAT office before 15 days about any changes in the reformation mentioned in the VAT application form.
- Business houses are required to inform the VAT office within 7 days of the transfer of business.

2.1.10.2 Deregistration

A VAT registered firm can apply for deregistration under the following condition:

- In case of an incorporated firm, if the incorporated firm is closed down, sold or transferred, or if incorporated firm ceases to exist by means.
- In case of personal ownership, if the owners die.
- In case of partnership firm, if it is dissolved.
- If a registered person ceases to be engaged in taxable transaction.
- If a registration is done in error.

2.1.11 Tax Plate

In order to inform public the status of the registered taxpayer automatically, each registered taxpayer is required to display the tax plate which is visible from outside in the premises of the taxpayer. The size and the color of the tax plate should be as follows:

A. The size of the tax plate should be 30 cm long and 10 cm width.

B. Information to be shown on the tax plate:

(i) Taxpayer's Identification Number (TPIN)

(ii) Taxpayer's Name.

C. The tax status of the taxpayer will be identified on the basis of the following background and the color of the tax plate:-

(i) Bush green background and letters in white color : VAT registered tax payers.

(ii) Lemon yellow background and letters in black color: Tax payers dealing in

VAT able goods and services but whose transaction is the below threshold i.e. Rs. 2 million per year.

(iii) Signal red background and letters in red color: Tax payers dealing in non – VAT able goods and services.

2.1.12 Return

In Nepal, compulsory registrants are required to submit their returns within twenty five days of the expiry of tax period of every month. Therefore compulsory registrants have to submit their return every month. Such return shall have to be submitted whether or not a taxable transaction was carried out in that months. In the case of voluntary registrants, they have to submit their return for period of four months. But the hotel & restaurant can submit their return within two months.

2.1.12.1 Debit Return

Debit returns are those returns where tax payers have to pay tax to the government. Such situation is arises when vendor's output tax is higher than input tax. Since generally sales are higher than purchases most returns then expected to show debit.

2.1.12.2 Credit Return

Credit returns are those returns where government has to pay money to taxpayers and this situation arises when tax on purchases is higher than tax on sales. This situation may arise when tax payers build up their inventory or when outputs are zero rated, such as exports.

2.1.12.3 Nil or Zero Return

Zero returns are also possible. If a tax payer's inputs taxes and output taxes are equal, then taxpayer need not pay tax and government also not liable to return the amount to taxpayer. Even if there were no transaction in a tax period tax payers are required to submit zero return.

2.1.13 Non Filing

Every compulsory Value Added Tax registrants has to submit return to government within twenty five days of expiry of four month. If vendors don't submit or file their return in given specified tax period such tax payers are termed as non filer. The Inland Revenue Department prints out the list of non filers after forty five days of the expiry of the tax period and then VAT office gives notice to each non filer. If any do not file return within the specified period even after the issue of the notice on non filer the VAT office makes a monthly or trimester assessment, depending upon the state of a particular tax payer then charge a penalty.

2.1.14 Tax Assessment

Tax assessment is a process of determining the amount of tax, any individual or company is liable to pay. Value Added Tax is self assessed tax. The amount of needed Value Added Tax payment is determined by tax payers themselves applying the tax rule to their own figures. Tax payers may file the wrong returns for the purpose of tax evasion. So the assessment again checked by the tax officers if there is any mistake or not

VAT officer can assess tax within under the noted circumstances.

-) Non submission of returns in time.
-) Furnishing of incomplete return
-) Return having misrepresentation
-) When the tax officer has sufficient reason to believe that tax burden is shown lower than actual and
-) When the tax officer has sufficient reason to believe that there is under billing.

In such cases, VAT official may have to prepare a tax assessment. Such assessment could be Computer assessment or management assessment.

2.1.14.1 Computer assessment

The computer print out the list of non filer after forty five days of expiry of tax period and then VAT office gives notice to each non filers. If any do not file return within the specified period even after the issue of the notice on non filer, the computer makes a monthly or trimester assessment, depending when the state of a particular tax payer. The process regarding computer assessment is designed in the following way.

- a) Find out the highest amount declared by the taxpayer in his tax returns during the previous twelve months from the VAT payable.
- b) If a taxpayer has not filed any return find the turnover amount stated on the registrants application. Divide this by the number of filling period in the year then multiply by the VAT rate.
- c) Pick the highest figure in (a) or (b). Add the number found in (c) to the 20% or 30% of itself to get the assessment amount.

2.1.14.2 Management assessment

The tax offices do management assessment when a tax payer receives updated information after submitting his returns and informs it to tax officers or in the case of that taxpayer, where tax officers find errors during the tax audit. The management assessment is done through the following procedure.

-) Tax officer assessed tax & determines interest and penalties.
-) Tax officer prepares management assessment on a monthly basis in case of compulsory registrants & on trimester basis in case of others.
-) Management assessment must be batched and submitted to the computer system.
-) VAT assessment will only normally extend back four years from the time the taxpayer is given a notice of assessment.

2.1.15 Collection of VAT

If tax payer does not file his return within the specified period, tax office may collect the tax by using any or all of the following methods.

-) By seizing moveable or immovable property of tax payer.
-) By offsetting the amount, if any, to be refunded the tax payer.
-) By withholding export/import other transaction of taxpayer.
-) By processing the taxpayer's by fixed & current assets.
-) By deducting from bank account
-) By suspending the transaction of tax payer.
-) By deducting the amount payable to taxpayers by government officers to government owned enterprises.
-) By collecting the pre approval of the taxpayer, the amount of 3rd party owes to the taxpayer.

Tax officers can collect tax arrears within six years of such arrears become due.

2.1.16 Tax Credit

The main feature of Value Added Tax is tax credit facility. But this facility is only for the VAT registrants. Under the Value Added Tax, taxpayer collects the VAT amount while selling goods. And taxpayers will have to pay only those VAT amount which remains after deducting his/her VAT incurred on purchases from the collection of VAT on selling goods. So tax payers can claim the amount on VAT amount paid by them. It is necessary to meet the following condition for tax credit facility.

-) Purchased goods and services should be purchased for taxable transaction
-) The VAT registrants should be issued valid invoice.
-) The claim for deduction must be made within one year of the date of invoice.

Full credit facility will be given to those businesses whose purchases are fully taxable. In case of mixed transaction i.e. both taxable and non taxable then

business man allowed to credit in only taxable purchases and sales. In case of partial use (i.e used goods for personal and business purpose) only partial input tax credit can be taken.

2.1.17 Tax Audit

VAT audit is based on the principle of self assessment by tax payers which is a totally a new concept in the Nepalese tax administration. Under sales tax system, no audit was carried out for the sales tax purpose. Tax payers were required to get their price approved and annual assessment was done by sales tax officer in a superficial way. Under income tax also tax is assessed largely the bases of best judgment of the officers.

But audit incase of Value Added Tax, a tax audit and investigation section has been created in the VAT department and VAT offices and auditors position has been created in the VAT department. Similarly, a large tax payers division has been created in the VAT department to deal particularly with the audit of large taxpayers. They have been given basic and advance account and audit training.

A special enforcement task force under strengthening revenue program was established to conduct investigation tax audit for assessing properties, making search and seizure and for procuring goods under invoiced. Administrative review in the cases related to income tax and Value Added Tax without deposit to safeguard the interest of tax payers. Arrangement has been made to decide upon the application within sixty days and notify the tax payer. In order to make tax audit simple, transplanted, quick and effective and to avoid delays and unnecessary hassles, tax payers intimated of the selection for tax audit. Arrangements was be made to complete tax audit within three months of the selection. A tax audit manual developed to make the process of tax audit transparent as well. Chartered accounts firms registered to accelerated tax audit system was introduced.

2.1.17.1 Tax Investigation

Monitoring committees were established for checking illegal imports in boarder areas and mobilized more effectively in the fiscal year 1996/97. In the fiscal year 1999/2000, joint revenue team from Inland Revenue Office, department of tax and department of VAT was formed to consistently monitor the market price indices and other information trace the revenue leakages and track down the culprits. Suggestion for reforms as pointed out in the report of the parliamentary joint committee, 1999 on the investigation of revenue leakage, were implemented. Inland Revenue Department activated to begin process for necessary actions in fiscal year 2000/2001. The Abuse of Authority Investigation commission had also been approached for their indulgence. Revenue surveillance force was fully empowered to effectively control smuggling and leakage of revenue through timely reforms in its organizational structure. Jointly conduct on the spot investigation and audit by department of VAT department of taxation in order to prevent revenue leakage by controlling acts like concealing of income or evasion of tax and activities helping to evade tax. Likewise, system of investigation and field audit of tax returns by the team of experts by visiting taxpayers' premises was expanded. Inland Revenue Department provide more authority in special vigilance in the revenue leakage of customs, VAT and income tax, collecting information on tax evasion and take necessary action in coordination with respective department, and surprise inspection of internal transportation with an arrangement of rewarding persons providing information on tax evasion. Power of audit and inspection is mentioned in VAT act sec 23.

2.1.18 Tax Refund

VAT Act has made provision regarding tax refund also. The registered businessmen are entitled to recover the tax paid on their purchases from the VAT collected from sales. If the tax on sales is less than the tax on purchases, the person claims a refund for the difference. According to Section 17 of the

Act, a registered person can offset the amount of tax he/she has collected against the tax he/she had paid or due in importing or receiving goods or services related to his own taxable transactions.

And Section 24 of the Act, said that if a registered persons offset for a month exceeds tax liability for that month, this exceed may be offset against any outstanding amount. The remainder of the exceed offset may be available as an offset for the next month.

If the taxpayer remains in credit thereafter for a continuous period of six months he can file a claim for a lump sum refund, using Schedule-10. The refund is made within 30 days from the receipt of the refund claim. If the tax payers didn't get refund after 60 days of the application submitted for refund, he can get 15% interest per annum on the claimed refund amount. The following situations are tax refund:

2.1.18.1 Refund to Exporters

Regular exporters, i.e. a registered person whose export sales for a month are 50 percent or more of his total sales for that month, can file a claim using Scehdule-10, for the refund of the amount of the remaining exceed after offsetting any outstanding amount. A regular exporter can file a claim each month. Export sales are zero rated, there is not tax due such sales, exporter may have huge credit tax amount.

2.1.18.2 Refund to Non-exporters

A registrant may have excess credits even if he is not an exporter. In this case, he can carry forward his excess tax amount till continuous six months or more. Such a situation may arise in the case of new business, an inventory building up or the purchase of large capital assets. If a registered person remains in credit for a period of six consecutive months he may submit an application for refund of VAT to the concerned VAT refund offices.

2.1.18.3 Refund to Diplomats

Accredited diplomats, as others, will be charged VAT on purchases of taxable goods and services in the local market. They are, however, entitled to claim tax credit on purchase. Diplomats may claim for refund through diplomatic mission. Claims must be made within three years from the date of transaction. They must attach the original tax invoices as well as a copy of the invoices to the refund claim. Imports by accredited diplomats are zero rated. This means that accredited diplomats do not have to pay VAT on their imports.

2.1.18.4 Refund to Tourist

Refund is also provided to the foreign tourists who visit Nepal. They have to pay VAT on their purchases but they get their money paid for VAT back. In such case, they can get their refund from the Tribhuvan International Airport after showing purchases, completed “Tourist Application for VAT refund” form certified by the Custom Officer to the VAT Refund Office. VAT refund only applies to goods taken out of Nepal within 60 days from the date of purchase. And person departing via land route also do not qualify for VAT refund.

2.1.18.5 Refund to foreign aided projects

Any person or organizations employed in carrying out a project in the kingdom of Nepal under a bilateral or multilateral agreement for which the Ministry of Finance has approved tax exemption may make a claim for refund of tax paid by them on purchases or imports made for the project as per the Bill of Quantity.

The procedure for refund will depend on the status of the person or organization. If the person or organization is registered for VAT the claim will be made on monthly or 6 monthly basis in accordance with the procedures fix for other registered tax payers. If the person or organization is not registered for

VAT, the person or organization will be required to make a claim on Schedule -18. The claims must be made within three years from the date of transaction.

2.1.19 Provisions of Penalty

1. Business unit should apply for registration before starting a business. Non-compliance with this provision will attract a penalty of Rs. 10,000.
2. If tax invoice is not issued for any taxable transaction, a penalty of Rs. 5,000 will be charged U/s 29(1)(b). If an invoice is raised without proper VAT registration, the VAT department can levy a penalty of 10,000 plus VAT on that sale.
3. A taxpayer who fails to use registration number or to clearly display the registration certificate or to inform the changes, if any, regarding business transactions within 15 days of such change, such tax payer is liable to pay Rs. 1,000 for each offence.
4. If account books are not maintained properly, penalty of Rs. 10,000 & on none allowing the books for inspection, Rs. 5,000 per occurrence U/S 29(1) (c) will be levied.
5. On violation of the VAT laws, a penalty of Rs. 1,000 per occurrence is charged.
6. If the taxpayers do not pay a tax in time then 10% of tax payment amount will be charged.
7. As per Sec.29 (2) in following cases 100% of VAT or six months' imprisonment or both will be charged.
 - (a) Tax evasion by maintaining fraudulent accounts.
 - b) Evasion of VAT by any reason.
 - c) Non registered dealer acting as a registered dealer.
 - d) Doing business during the order of suspension periods.
 - e) Non-allowing to purchase the under invoiced goods.

f) Tax payer found to have issued an invoice by under invoicing.

2.1.20 Provision of Reward

VAT law had made the provision of reward for the purpose to control the revenue leakage by making public participation. VAT office will give reward to those people who provided the information regarding the evasion of VAT. As per law a person who gives information with evidence showing that a taxpayer has evaded or attempted to evade all or some portion of tax is rewarded with the amount equal to 20% of the amount of tax collected on the basis of that information. If there is more than one information, the allotment of reward between or among them may be as determined by the Director General.

2.1.21 Appeals

A taxpayer may not always agree with the assessment made by the tax officer. In that case, tax payer may file an appeal to the revenue tribunal within thirty five days against a tax assessment or a penalty order by a tax officer or an order by the Director General relating to the suspension of his place of transaction. Before filing appeal the tax payers must deposit the disputed amount of the assessed tax due, the rest of the amount of tax due plus the whole amount of the fine shall have to be deposited or a bank guarantee of the same has to be provided.

2.1.22 VAT Administration

The success and effectiveness of a VAT in Nepal depends upon its strong enough capability for an effective operation. And VAT administration is responsible for it. It is responsible for the execution of the program work assessment, taxpayer's education, registration, assessments, collection and the rectification of taxpayer's education, registration, assessment, collection and verification of taxpayer's book and records.

The greater preparation is needed to increase implementing capability of administration. The present VAT administration may be simplified into two functional head as department and offices. So department and field officers under this department and offices under this department are responsible for administrating VAT. In absence of a technical component, honest and dedicated administration the expected smooth working of a VAT becomes really a myth and fully VAT advantage can't be achieved.

They have to conduct a survey on potential taxpayers from time to time so that potential taxpayers may not remain outside the tax net. VAT offices are also responsible for enhancing the compliance level of the taxpayers and are to be involved in tax audit and investigation. For this it required skillful personnel for successful implementation of the VAT. It is a great responsibility of tax administration to avoid undesirable effect in society.

But the government is not serious in depth attempts have been made for solving the grass root problems. There is only lecture system, preparation is confirmed only to giving lecture. Many issues regarding the design of VAT and its implemental have not been solved. No satisfactory way is launched for the treatment of small players. Threshold limit is arbitrarily fixed. The problem of compliance and prevent evasion in the VAT remain the same. The administration has not given a success attention toward the development of good information system, technical database inspection and auditing system. Thus tax investigation and audit should be effective in order to make taxpayer more careful in fulfilling their duties. VAT administration is still weak and least attractive for the personnel. Most of officer engaged in the VAT administration are not motivated. Due to lack of motivation many officials are not actively engaged in the implementation of VAT. So to motivate them special package should be introduced.

Spot checking unit & warehouse checking unit should be formed to present any kind of illegal trade and under invoicing problems. Physical stock verification

of inventories against invoices and checking carrying goods on road should be made effective to protect illegal goods being supplied.

2.1.23 Historical Background

The concept of VAT is originated from Germany in 1919. At the meantime, Dr. Wilhem Von Siemen developed the philosophy and principle of VAT by recommending it for Germany to replace turnover tax (multistage sales tax) to avoid the problems of cascading effect. Professor Thomas S. Adams recommended VAT for the U.S.A. in 1921. A detailed structure of Value Added Tax was designed for Japan in 1949 to replace enterprise and turnover taxes. Due to the new concept and fear of its complicated nature, these countries couldn't introduce immediately. France introduced VAT for the first time in 1954. Ivory Coast introduced VAT in 1960, while Senegal adopted it in 1961. Denmark and Brazil implemented it in 1967.

Among the SAARC countries, India introduced MoDVAT (Modified Value Added Tax) in 1986 for manufacturing products in order to correct excise duty. Pakistan, Bangladesh, and Sri Lanka adopted VAT in 1990, 1991, and 1998 respectively. Nowadays more than 135 countries have implemented VAT as an indirect taxation in the world.

2.1.24 Adoption of VAT in Nepal

However the concept of this tax in Nepal was introduced in early 1990s. Nepal government included the concept of introducing VAT in its eighth plan. Subsequently, the Prime Minister declared to introduce a two tier sale tax system to make the base of implementing VAT from the fiscal year 1992/93. A VAT tax force was created in 1993, under the financial assistance of USAID in order to make necessary preparation for the introduction of VAT. The VAT task force prepares the draft of VAT legislation.

The parliament of Nepal enacted VAT Act 1995 in 1995. Subsequently VAT Regulation was made in 1996. Although the Act was passed in 1995, its implementation was delayed due to political instability & strong opposition from the business community. VAT with single rate of 10 % has been fully implemented with effect from 16th November 1997 (1st Mangsir 054). It has replaced sales tax, hotel tax, contract tax & entertainment tax. VAT has been justified in the light of government fiscal imbalance and need for extra revenue mobilization through an efficient tax system. Nepal Government has increased VAT to 13% with effect from Magh 1, 061.

It is a modern type of consumption tax. It intends to collect taxes on the consumption by private consumers. But also exempted business & government pays the tax on their purchases. VAT is an indirect tax, on which tax is collected from someone other than the person who actually bears the cost of the tax (namely the seller rather than the consumer).

2.1.25 Need to introduce VAT

VAT is considered as the most important tax reform in the 20th century. VAT was introduced in Nepal for several reasons. Firstly, it was necessary to introduce VAT in order to avoid cascading effects. Under VAT tax was levied only on value added on each stage where as in sales tax was levied on total sales by which consumer has to bear a big burden of tax amount & discourage them to pay tax. So to encourage consumer VAT is introduced.

VAT broadens the tax base as it could levy up to the retail point. To a certain extent, VAT is a self policing system because any understatement would disadvantage the buyer since the credit for input tax would be affected, while any over statement would result in higher tax liability for the seller. VAT was also expected to make exports tax free through zero rating and the refund mechanism for excess credit. Furthermore, the import or manufacturer level sales tax as unequal in the sense that it put proportionately higher burden on

items that didn't have a high value added in the distribution process as compared to items that had a high value added. This meant that the tax burdened domestic products more than the imported luxury items. It was further discriminatory since it had more control on domestic products than imports, as manufacturers were required to be registered, maintain records of sales, obtain approval for their selling prices & submit monthly and annual returns where as importers did not have to fulfill of any of these formalities. This kind of system encourages import & discourages to use domestic products. So VAT need to be introduced to avoids such kind of difficulties.

In addition to the above, Nepal had to introduce VAT as its tax revenue, which was largely from customs duties, was shrinking due to the reduction in import tariffs. The import tariffs were being reduced as part of an overall tax reform and furthermore, a drastic reduction in customs tariffs by India and other trading partners put furthermore pressure for the reduction of tariffs in Nepal. Also as Nepal had been a WTO membership, it would be necessary to lower the overall level of import tariffs. In this context, it was necessary to levy a board based tax like VAT as an alternative tax system to import tariffs to generate more revenue.

At the same time, the VAT system promotes the interchange of information between the other tax systems, particularly trade taxes, as customs information is required to determine the validity of input tax credit claimed. VAT should not only been effective instrument to generate substantial revenue at customs points, but also help streamline tax policy in general VAT has a natural link with the income tax.

VAT system has refund facility also which encourage business man for investment. Under this system the consumers know the amount of tax contributed by them. So it is more transparent than other tax system.

In summary, VAT needs to be introduced for

- Develop VAT as a main source of revenue collection
- To make tax more scientific & modernize.
- To make internal tax system more transparent.
- To broaden the tax base.
- To avoid cascading effects on tax.

2.1.26 Basic Features of VAT in Nepal

VAT is a tax that is based on goods and services. It is considered to be tax that is based on consumption since this tax is based on consumption the burden of this tax has to be borne by the consumer. This tax is levied on the value addition at each stage from the time of production to consumption of all goods and services. The basic features of VAT in Nepal are tabulated below.

Table 2.3

Basic features of VAT

Type	Consumption type of VAT
Method of calculation	Tax credit method
Principle to levy VAT	Destination Principle
Level Threshold	Rs. 2 million
Rate	13%
Provisions of exemptions	As per Schedule 1
Provisions of Zero rating	As per Schedule 2
Facility of tax refund	To exporters, diplomats, non exporters and zero rated and exempt

2.1.27 Problems in implementation of VAT effectively

VAT is superior tax than other forms of sales taxes but it does not mean that it is the best one. It has also drawback, some problems or issues on its implementation if other factors are unsuitable. The actual implementation of VAT in many developed as well as developing countries show that there are many difficulties in apply the full VAT principle.

Administrative capability, stage of economic development, business structure, political issue, cooperation between private and government sector are the main problems to implement VAT system in Nepal. They arises side effects of implementation VAT & make difficulties to achieve principle merits of VAT .These problems can be reduced productive capacity of taxation. Thus there should be carefully analyzed of these problems to get expected result.

1. There has not been provision of a group registration. Thus, companies with in a group are required to register separately. Registered companies are required to levy VAT on intercompany transactions and fulfill all VAT rates, leading to increase compliance in both such system should be reviewed.
2. A tax period is one month which increase both collection & compliance cost. So a tax period should be two months in the place of one month. This provision will partly reduce the problem of credit sales.
3. Bad debts & insolvency provision should be carefully handled. It loops holes for tax avoidance. So no provision has been made for the bad debt & insolvency relief.
4. There is provision for the carry forward of excess credit for six months. Due to the non availability of immediate input tax claims, foreign company may be discourage from sheeting up their subsidies in Nepal. So, such system should be immediately reviewed.

2.1.27.1 Small Traders.

Small traders dominate the trading activities of the country. Thus, it becomes most prominent issued of implement VAT. The size of retail business in Nepal is so large. They are scattered throughout the country which make difficult to bring them into tax net.

Actually the amount of VAT is collected when the product reach on the hand of ultimate consumer & the retailers is the one who deal with consumer. So if retailer is excluded from tax net then erosion is made easier and great revenue loss may results. Therefore, it is very essential to include small traders or retailers into the VAT. But it is virtually impossible to include all small traders because of the administrative & tax compliance problems. Small traders have no systematic account recording; goods and services are sold and purchase without invoices. They are illiterate, ignorance and no practice of systematic record keeping. On the other hands inclusion of small traders increases the number of tax payers & it becomes complexity for weak Tax administration to registration; accept return verification, control evasion, inspection and auditing of taxpayer. The cost is a proportionately more than revenue.

2.1.27.2 Tax Evasion

Tax evasion is a great challenging issue to make VAT effective and successful implementation in Nepal. But weak implementation, poor administrative capability, political interfaces, corrupted mind personnel of VAT offices are the considerable reasons for widen tax evasion.

A VAT brings large number of tax payers into tax net & the tax liability would be distributed among the many less sophisticated and difficult to control group like including illiterate, unorganized retailers. It becomes a great difficult to control and deal with them. Most of them could not present required formalities that are necessary to submit VAT offices. VAT system needs expert and efficient personnel. But Nepal administration can't produce such type of staff. Most of them are not well motivated and corrupted. Inspection and special

checking stock verification are the duty of tax inspectors at related field have done not fairly. Therefore most of businesses are relaxing from these weaknesses of tax administration.

Most business man has been evading VAT by non registration at related office in name of small vendors who are liable to register. Some businesses have shown their turnover below threshold limit for purposes reduce liability. They can evade tax by under reporting of sales and purchases. Another common idea to evade tax in Nepal is unrecorded trade. Due to weak administration, a channel of unrecorded trade is developed and made a large amount of revenue loss in the system of VAT. Vendors don't show their record of some purchases and claim no credit. Such goods are purchased and sold with full trade value added but without any invoice and record. Traders are collecting VAT from the consumer by fake invoice and pocket large amount of profit. So the authorities should check inventories and warehouses stock to catch these evasions.

The effectiveness of Value Added Tax is mostly depending upon accurate invoice. Under billing, not issue invoice and lack of proper invoice are the greatest problems of Nepalese VAT system. Most of retailer don't issue invoice, because they don't themselves get proper invoices from the supplier. Such a system began at the import stage. They produce fake invoices for customs purposes showing value much lower than the price they have paid. By doing this, they pay less import duty, Value Added Tax and local development fee at the custom point. Since, this record is the basis for income tax assessment purpose. They also pay low income tax due to low valuation at the import point. Under billing and non billing would be at the manufacturing, wholesale and retail level also.

2.1.27.3 Consciousness of people

Value Added Tax is transparent in which every consumers know the amount they have paid for but such transparency will be useless until people themselves would be aware and conscious about their duties and rights. VAT

system will not be successfully implement if people do not feel that they should pay to the government and their contribution are really goes on right way through right person .For this first of all public should be aware that they should take a VAT bill for every taxable transaction. But consumers rarely have such interest. Consumers purchase goods without invoice. And it will be the great opportunity for seller to evade tax to do cross check stage.

Therefore unconsciousness of people about tax is the great problems to implement VAT effectively.

2.1.27.4 Open Boarder and barter System

Because of the open broader people freely move from India and china to Nepal. There is no legal bar and passport system between India and Nepal. People of India and Nepal can easily enter into each the nation. Often people of both countries go to border town of other country to buy their need because there is no need to pay custom duty for the good, which they have brought for personal use in limited quantities. However, many businessmen misuse such facility and they take a chance of smuggling the business in border side. They follow illegal ways to sell goods in cheap price at Nepal boarder side.

Such type of illegal unrecorded and partly recorded trade is difficult to catch by the administration. If administration finds out such kind of trade, then corruption, bribery and other malpractices further rises. In such condition the self-policing, feature of VAT and catch up effect also would not work and it becomes a great threat to success of VAT.

The trade between Nepal and Tibet is based on batter system. There is no system of invoices of goods purchased from the Tibet. Lack of invoice most of transaction are out of the tax net.

2.1.28 Government effort on VAT implementation

As we know tax is the main source of government revenue. Especially VAT has been introduced as it is the best form of indirect tax collection. So to prove it, government needs more effort on its implementation sector.

2.1.28.1 Consumer consciousness upahar program

Implementation of VAT will not be successful until consumer will aware of VAT. The main basis of Value Added Tax is the system of issuing and receiving invoices in the sale of goods and services. So consumer should be aware of taking bill compulsory. But there is still lack of this practice. Consumers think that they have to pay additional 13% if invoices are taken so they avoid taking it. And by doing this tax goes only in the taxpayers pocket and VAT can't be collected fairly. It also prevents fair competition between businessman and the professional.

So, in order to encourage billing system and thereby improve the tax system and motivate the consumers to take bills on the purchase of goods and services and motivate the sellers to issue bills on the sale of goods and services, a conscious consumer lottery program has been introduced since Magh, 2060. Government has launched this lottery program with the slogans of "Jagaruk Upabhokta Ka Lagi Subarna Abasar" i.e. "Golden Opportunity for Aware Consumers". Under this program, Nepal Government provides upahar to those consumers who take the bills while purchasing goods. The upahar includes cash prize on the basis of presented bill.

Consumer can involve in this program by submitting purchased bills and get upahar coupon from coupon counter prescribed by the government. · All types of bills except the purchase of vehicle (excluding bicycle) and star hotel will be allowed to participate in the program. However, bills issued in the name of government authority, public enterprises, local level authorities and diplomatic missions and the bills issued by the public enterprises will not be entertained in the program One coupon will be provided for total bills of Rs. 1000. And the

government collects all those bills, draw the lucky consumer's coupon number and award them by cash prize.

a) Provision of Cash Prizes to Consumers

First winner - 1 Person. Rs. 1,00,000

Second winner- 5 Persons (Rs.20,000 each) Rs. 1,00,000

Third winner- 10 Persons (Rs.10,000 each) Rs. 1,00,000

Consolation Prize - 20 Persons (Rs.5,000 each) Rs. 1,00,000

Total Rs. 4,00,000

The prize will be declared once a month on the basis of coupons distributed in that month.

b) Provision of Cash Prizes to sellers:

In order to motivate the sellers to give bills to the buyers, those sellers whose invoices have enabled the cash prizes to the consumers will also get the following cash prizes:- Total Prize Amount

- First winner - 1 Seller Rs. 25,000

- Second winner- 5 Sellers (Rs.5,000 each) Rs. 25,000

- Third winner- 10 Sellers (Rs.3,000 each) Rs. 30,000

- Consolation Prize - 20 Sellers (Rs.2,000 each) Rs. 40,000

Total Rs. 1,20,000

c) Procedures of conducting lottery program:

- IRD will print lottery coupons with serial numbers of two copies.

- A separate number will be marked in each coupon.

- One coupon will be issued to the purchaser after receiving the purchase bill of Rs. 1,000 and a copy will be retained by the contractor conducting the program. For instance, if a consumer submits 2bills containing the purchase of Rs. 600

each, he will receive one coupon and will be eligible to get another coupon in each additional amount of Rs. 1,000. However, surplus amount will not be entertained for the purpose of competition once coupons are issued after submission of the bills.

- The bills worth less than Rs. 250 will not be entertained in the program. This upahar program proved very effective. To get the cash prize consumer started to take a bill.

2.1.28.2 Information and Technology

For the effective and scientific tax administration the proper application of information & technology is very necessary. IT makes work faster, accuracy and transparency. VAT office is trying to bring different technology system to make minimize in tax evasion and tax corruption.

a) Electronic Cash Register (ECR) & fiscal printer:

VAT office found that supermarket leakage the tax using under billing system. Super market issues the bill of product from the computer to its customer. But at night they change the product amount in computer and show less tax to the VAT officer. So to reduce this kind of evasion VAT office is planning to bring ECR technology. VAT officer set/lock this software/program in the hard disk of computer. Once it locked the businessman can't change the figure of amount in the computer. And if VAT officer has any doubt in the return filed by businessman, they will take out the hard disk and tally it with the return submitted by businessman. But most of the businessmen are raising voice against of this system.

b) e- filling:

One of the main reasons of corruption in tax is frequently visiting the tax officer to the business house in the context of collecting VAT and for VAT auditing. So to minimize the meeting between VAT officers and businessman

government bring e-filing system. Businessman can file the VAT in the internet. Through this VAT officer can check the tax by sitting in the VAT office.

More over VAT office is planning to set the box (like post box) outside the business house for the purpose of minimizing tax corruption. Businessman will drop the VAT amount in the box and VAT officer will pick out that box so that VAT officers need not to meet businessman for the tax collection.

As all we know that information & technology can bring the big change so vastly. It makes the world so narrow. Advance technology is coming day by day. We should cope up with it otherwise we will be always at backside. VAT office also needs to update its information & technology section as per time requirements. Now it is a time to bring advanced technology to make its implementation section more effective.

2.2 Review of previous study

The previous research studies helps to provide the foundation to the present study. The purpose of literature review is thus to find out what research studies have been conducted in one's chosen field of study and what remains to be done.

2.2.1 Tax law designing and drafting

It is International monetary fund publication. It deals with the drafting and designing of different tax laws. VAT is also discussed here. VAT has been dealt by David Williams. The article confers standard practices on VAT in the international context. It begins with the general introduction of the VAT. The present status of VAT, its terminologies, economic implications, territorial scope, charges to VAT and its principle of non-discrimination are covered in the introduction section.

2.2.2 VAT in Nepal

It is the collection of his published papers. The first paper gives information on special political, economic, and administrative complications appeared in the course of VAT implementation in Nepal.

Nepal has adopted destination based consumption type VAT with tax credit mechanism extending through the retail level. The rate of tax was 10% a now changed to 13% combined with zero rates on exports. The exemption list is quite long and registration threshold is Rs. 2 million (200000 for imports).

Taxpayers required issuing invoices of their suppliers and maintaining purchase and sales books. The tax period is trimester for voluntarily registrants, and one month for other. The VAT Act makes provisions for the additional charges as the late payment penalties. The rate of such penalties is 10% of predicted the VAT payable in the first month, an additional 10% in the second month, and no further action. Late payment penalties are based on one calendar month from the due date. There is also a provision for the interest on non-payment. The current rate of interest is 15%. VAT is based on the principle of self assessment. Tax officials, however can assess VAT when a tax payer doesn't submit the return; or submits an incorrect or fraudulent return; tax officers are authorized to recover tax dues by various means, including retention of tax credit, deduction from the debtors, closing the business, and seizing and selling the property of the VAT debtor. (Mohamad Nurul Hasan, 2005:81)

2.2.3 Implementation of VAT in Nepal: an evaluation

The article written by Thapa, towards the weaknesses prevailing in VAT system in Nepal is critical to the timing of the introduction of VAT in Nepal. He strongly denounces the existence of an unstable Government at the time of introduction, which forced the government to accept many, compromises in this regard. He makes critique on the lack of serious consideration to the impact

of smuggling from long open border with India and Tibet. The lack of highly motivated tax administration and the proper accounting system are also impeding the functioning of VAT in Nepal.

2.2.4 VAT and it's relevancy in Nepal

This is a collection of different articles by Dr. Rup Bahadur Kahadka. The articles deal with the general introduction of VAT on the eve of the introduction of VAT in Nepal. He has compared the VAT with the sales tax, which was in use before. According to him Nepal has the experience of implementation import/manufacture level sales tax, wholesale level sales tax, and retail level sales tax. The MST had a narrow base and suffered from the cascading effect. It also discriminates against the domestic products with the imported products as the profit margin of the manufacturer is included under the base of this tax but not the profit margin of the importer. He further writes the nation missed the collecting huge revenue from the large amount of Value added on the imported luxury goods. Besides that the wholesalers used to evade sales tax by creating fake channel of distribution. However the retail level sales tax was neutral with respect to methods of production and distribution and does not suffer from cascading effect.

2.2.5 Value Added Tax: The Road Ahead

The article written by Marashini, director at the advocates for increasing publicity campaigns based on radio, television, FM programs that are popular in the cities where most of taxpayers reside. He also advises for sudden inspection of goods and services on the road to check tax evasion.

Nepal has adopted destination based consumption type VAT with tax credit mechanism extending through the retail level. The rate of tax was 10% now changed to 13% combined with zero rate on exports. The exemption list is quite long and registration threshold is Rs. 2 million (200000 for imports).

Tax payers required issuing invoices of their supplies and maintaining purchase and sales books. The tax period is trimester for voluntarily registrants, and one month for others. The VAT Act makes provisions for the additional charges as the late payment penalties. The rate of such penalties is 10% of predicted the VAT payable in the first month, and additional 10% in the second, and no further action. Late payment penalties are based on the one calendar month from the due date. There is also provision for the interest on non-payment. The current rate of interest is 15%.

VAT is based on the principle of self assessment. Tax officials, however can assess VAT when a tax payer doesn't submit the return; or submits an incorrect or fraudulent return; tax officers are authorized to recover tax dues by various means, including retention of tax credit, deduction from the debtors, closing the business, and seizing and selling the property of the VAT debtor.

2.2.6 Sales tax vs. VAT again

The argument has been improved but it still seems to be missing something, specifically it states that:

VAT, (as well as any other tax) distorts what would have happened without it. Because the price for someone rises, not all the goods that would have been traded were there no tax are traded. Correspondingly, some people are worse off than the government is made better off by tax income. In other words, a deadweight loss is created. The income lost by those being taxed is greater than the government's income; the tax is inefficient.

Okay I'm not an economist but this argument seems to be missing an important point. If someone is making less profit that means this money has to go somewhere. It doesn't just disappear. The extra money can't go to the government since the tax rate is fixed. Therefore, I would assume it probably means the final cost of the product is less therefore the consumer pays less. If the consumer pays less, they have more cash which will be invested, saved or

spent. If I am totally wrong and I don't see how, can someone please explain and improve the article since I feel it is too technical for the layperson? (Nil Einne, 2005:10-35) When thinking about it, I'm getting even more confused. When a person is making products, they need the raw material to make it. Either they buy all they need or they make fewer products, raising the price. So really, I fail to see how exactly VAT can be said to be worse than a sales tax in this regard. It's different but I don't see any way it can potentially be inherently worse than a sales tax. (Nil Einne, 2005:10)

There is an important additional function of VAT as a suppressant – cash flow. All inputs must be paid (cash outflow) inclusive of VAT. This money must come from somewhere. In many cases this is debt, with interest costs. If not debt then at the very least there is an opportunity cost (the money cannot be invested elsewhere). Sure there is VAT included in the sale price (cash inflow), but this I only received a while later. Therefore not only are intermediate companies administering and collecting VAT on behalf of governments, they are also financing it. Furthermore, if a customer is late paying, the intermediate company must still pay the VAT over to the government even if they have not themselves been paid yet, which can be a further huge drain on cash flow. This alone has put many companies out of business, and is fundamental reason why VAT is a major contributor to the far, far lower GDP per capita of the EU when compared to USA.

2.2.7 VAT: Asia and Pacific Region

In this connection, Dr Rup Bahadur Khadka (1989), an expert of Nepalese tax system, in his book, entitled "VAT in Asia and the Pacific Region" writes " VAT is the most recent innovation in the field of taxation. It is believed on the value added of goods and services. The Tax is broad as it covers the value added to each commodity by a firm during all stages of production and distribution."

This book has covered all aspects of VAT including the nature, the various types and method of computation of VAT, reason for growing popularity of

VAT etc. this apart, the report examine the structure and operation of VAT in the Asian Pacific Countries which also explores the possibility of introducing of VAT in Nepal. Probably he is the person of observer of VAT abroad and the firstly proposed VAT for Nepal with macro studied of Nepalese economy and tax system. In his proposed structure the coverage of VAT should be made as broad as possible covering all business transactions. Exemptions should not be granted unless there is a specific reason to do so, such as administration and equity, Zero rating should be limited to exports and tax rate should be single to avoid complications and inefficiencies in collection.

He lastly developed a VAT proposal for Nepal showing some successful VAT implemented Asian countries- China, Indonesia, Korea, New Zealand, Philippines, and Taiwan.

2.2.8 VAT: Administrative and Policy

An IMF (1991) occasional paper, Washington DC entitle – " Value – Added Tax: Administrative and policy issues" edited by Alan A. Tait brings out the beauty of the VAT and briefly reviews the reasons why the VAT is chosen as the main sales tax. The study concentrates on the policy concerns on the basic illustration of some theoretical as well as empirical proofs.

The study clearly depicts three main groups of reasons to adopt a VAT revenue, neutrality and efficiency.

Revenue: VAT would generate more with less cost than taxes it replaces. " Traditional income and sales taxes have meeting public resistance and the VAT provides a new, buoyant revenue base, typically yielding more than initial estimates as the case of Indonesia, Korea, New Zealand, Portugal and Tunisia how". Because of broad coverage this tax offers much greater revenue potentiality as compares to other types of taxes. According to the study the VAT contributes from 12 percents to 30 percent of revenue in most countries

Neutrality : " the VAT is nondistortionary provided there are few exemptions and little Zero- rating on investment should be fully credited and this

frequently is an improvement over the taxes replaced that often taxed capital goods."

VAT is neutral with respect to the choice of methods of production and distribution. Since the tax is levied only on the value added at each stage in the system, tax liability remains the same regardless of the system of production and distribution. Total tax paid on a given commodity depends on the rate of the tax and on the total value added (i.e. the final price) of the commodity but not on the number of stages through which it has passed. So the tax is considered vertically neutral except for the negligible element of discrimination. It also doesn't discriminate the production whether it is capital intensive or labor.

Efficiency: A significant characteristic of an ideal tax system is efficiency. An efficient tax system is one that does not cause any distortion in production and consumption in other words such a tax system does not bring any unintended and undesirable effect in the methods of production and distribution or in consumption. Rather it avoids probable distortions of the optimum allocation of resources.

In this connection Editor Alan A. Tait writes- "the VAT has often replaced inefficient, distortion and badly administered taxes"

The introduction of the VAT provides an opportunity to sweep away the cobwebs and revamp a substantial part of the tax administration.

2.2.9 VAT Tax Reform in Singapore

In a research under the title of "Tax Reform in Singapore" (Development Discussion paper No: 644) Glenn Jenkins and Dr. Rup Khadka (1998) have made an effort to assess the VAT in Singapore, which was in effect since 1993. This working paper carries the successful story of VAT's introduction and implementation in Singapore to be a good lesson for the non VAT countries and VAT Countries.

The research paper concluded that Singapore would be facing the problem of an adding population. In such a situation income taxes will put a greater burden on a smaller group of younger, working Singaporeans, this might inhibit growth and enterprise. It is, therefore, necessary to introduce a broad-based tax like GST/VAT to distribute the burden of taxation among a larger section of the population, GST is a tax on consumption and has several features. It relieves investment and saving from the tax burden and rewards enterprise and strengthens economic resilience." GST relieves exports commodity taxes through the zero rating mechanism.

2.2.10 VAT: Government Finance

Professor John F. Due and Ann f. Friedlander (1994) in their famous book "Government Finance" evaluates the VAT that in addition to avoiding the adverse consequences of turn over tax and greater revenue raise, a proper cross audit is possible. The possibility of cross checking is considered as a beauty of the VAT. In their view, tax reported as paid by one firm to its suppliers for which it takes credit against its own tax liability, should appear as tax paid to the government by the suppliers. This cross check is not automatic but it can be made by auditors or ultimately by computers. So VAT is the most meritorious one, whose uses have extended rapidly.

Prof. Due & Friedlander also show the dismal aspect of the tax principle that the Value Added Tax is somewhat more complex than the retail sales tax, particularly in concept. The number of taxpaying firms is somewhat larger, since not only retailers but all manufacturers and wholesale firms must be registered and must file return. According to them, the tax is somewhat less adaptable to exemptions than are other sales taxes, since the exemption must be handled throughout production and distribution channels. Farmers pose a serious problem to register them all as taxpaying firms would greatly add an administrative and compliance task if they are not registered they would not receive credit for the tax paid on purchase for the firm use.

Researcher accepts that "the administrative complexity" is the main visualized problem of VAT in developing countries. However, they conclude that, " it is undoubtedly the ideal form of sales tax in many countries."

2.3 Criticism of VAT

Some criticized glimpse on the literature that is available in the criticism of VAT. Though it is the backbone of the revenue collection for government's expenditure. We thought them as the loop holes of the VAT.

2.3.1 Beware of VAT

According to Dr. Daniel J. Mitchell America is one of the few nations without a value-added tax (VAT), but there is growing pressure to impose the levy. In simple terms, a VAT is a type of national sales tax. However, instead of being collected at the cash register, it is imposed on the "value added" at each stage of the production process.

Some like the VAT because it offers a new way to finance bigger government. Others like the VAT because – at least compared to the income tax – it does not impose as much damage on the economy.

Some want to use the revenues from a VAT to facilitate tax reform add/or Social Security reform. There are even some people who believe that a VAT will somehow reduce the trade deficit. However, many people dislike the VAT, often for some of the reasons listed above. Supporters of limited government opposed the tax because it makes it easier for politicians to expand the size of government. By contrast, some on the left oppose the VAT because of its one redeeming feature – it is a consumption-based levy and therefore not as easy to use for economically destructive income redistribution.

Although it is a relatively non-destructive way to collect revenue, a VAT would be a serious mistake for the United States. The only condition that would make a VAT acceptable is complete repeal of all income taxes and a constitutional amendment that prohibits Congress from were-imposing taxes on

any type of income. But this is not a realistic option, which is why the VAT should be stopped.

If history is any guide, a VAT will have several adverse effects. Specifically, a VAT will

2.3.1.1 Expand the cost of government

Countries with VAT have much heavier total tax burden than those without VAT. Before the creation of VAT, the burden of taxation in Europe was not that much larger than it was in the United States. However, since the late 1960s, when countries in Europe began to adopt Vats, Europe's aggregate tax burden has increased by about 50 percent while the U.S. tax burden has remained relatively constant.

2.3.1.2 Inadvertently increase income tax rates

One of the main arguments for the VAT is that it is a less destructive way to raise revenue. This is theoretically true, but irrelevant. In the real world, the VAT has been used as an excuse to increase income taxes as a way to maintain "distributional neutrality." Indeed, income taxes in Europe today higher than they were when VAT was implemented.

2.3.1.3 Slow economic growth and destroy jobs

A VAT undermines economic growth for two reasons. First, it reduces incentives to engage in productive behavior by driving a larger wedge between pre-tax income and post-tax consumption. Second, it facilitates larger government and the concomitant transfer of resources from the productive sector of the economy to the public sector, diminishing economic efficiency.

A VAT almost certainly I sleep apnea no-win proposition for America. Theoretically, a VAT would be acceptable if it were combined with ratification of constitutional amendment that permanently prohibits both the personal and corporate income taxes, but this is an extremely unlikely scenario. It is far

more likely that a VAT would be implemented in addition to the income tax - which is precisely why it is such a bad idea.

2.3.2 Real-World Impact of a VAT

Theoretical discussion about the advantages and disadvantages of the VAT is useful, but is also instructive to examine what happens when nations implement this tax. Do they grow faster or slower? Does the aggregate tax burden increase? Are income taxes eliminated, or at least reduced?

Many countries have already imposed VAT and the results of this real-world experiment have been dismal. Based on historical evidence and economic research, it is clear that adoption of a VAT will have several adverse consequences such as VAT triggers more government spending and higher tax burdens (Terre Aleverson, 1986: 12-16), VAT slow the economy and destroys job (Stefan Folstar and Magnus Henreksu, 2001:8), VAT means higher income taxes (OECD publication, 2004), VAT imposes heavy administrative cost on businesses and taxpayers (Graham bannock, 1986: 60)

2.3.3 Sales tax vs. VAT again

According to Nil Einne VAT, (as well as any other tax) distorts what would have happened without it. Because the price for someone rises, not all the goods that would have been traded were there no tax are traded. Correspondingly, some people are worsen off than the government is made better of by tax income. In other words, a deadweight loss is created. The income lost by those being taxed is greater than the government's income; the tax is inefficient.

There is an important additional function of VAT as suppressant – cash flow. All inputs must be paid (cash outflow) inclusive of VAT. This money must come from somewhere. In many cases this is debt, with interest costs. If not debt then at the very least there is an opportunity cost (the money cannot be invested elsewhere). Sure there is VAT included in the sale price (cash

inflow), but this I only received a while later. Therefore not only are intermediate companies administering and collecting VAT on behalf of governments, they are also financing it. Furthermore, if a customer is late paying, the intermediate company must still pay the VAT over to the government even if they have not themselves been paid yet, which can be a further huge drain on cash flow. This alone has put many companies out of business, and is fundamental reason why VAT is a major contributor to the far; far lower GDP per capita of the EU when compared to USA. Far lower GDP per capita of the EU when compared to USA.(<http://en.wikipedia.org/wiki>)

2.3.4 VAT and Inflation

According to an article by Alan S. Tait based on his survey global voice in concerned countries introducing value-added tax is that the introduction of the tax would set in motion a spiral in which tax, prices and wages would feed on each other that is, VAT would be inflationary was heard.

There are a number of variables influencing price change, and therefore, it is difficult to empirically assess the effect of VAT on prices. The impact of VAT on prices, therefore, cannot be strictly segregated from the general trend in inflation.

First, the taxes that have been replaced are also relevant. They could be a wholesale sales tax of the cascading type, a simpler VAT, a multistage ring system, a cascade production tax and so on.

Second, the design to yield equal or higher revenue also makes a difference. Third, other concurrent changes such as rise in oil or steel prices in international and internal markets, increase in utility rates, changes in wage levels, administrative change such as tighter monetary policy, price control, monitoring of prices and so on, make due impact on the price rise. It is seen that the net price effect of VAT would be nil if the VAT is an equal-yield tax. There would not be any effect on the overall price change although there may

be changes in relative prices. The tax being revenue neutral, the aggregate demand is unchanged and so there would be no impact on the aggregate price level. The economists all over the world have viewed that VAT is not inflationary.

Thus, this brings us to conclude that the potentially inflationary effect can be constrained by government policies to inform the public and traders about the expected effect of VAT on prices, the use of price controls, monitoring of prices, offsetting adjustment in other taxes and generous provisions to ensure full credit for previously paid taxes on inputs. Moreover a mechanized form of government can give it a better shape through administration. (www.economywatch.com)

2.4 Review of journals and articles

Especially it covers a comprehensive review of the published and unpublished worked by academician and schools of journals and articles. Review of journals and articles are discussed in brief.

2.4.1 Analysis of VAT in developing countries

The IMF staff papers, July, 1973 contains an article entitled “The Value Added Tax in Developing Countries” by George E. Lent, Milka Casanegra and Michele Guerard has analyzed the VAT in seven developing countries: Brazil, Ecuador, Ivory Coast, The Malagasy Republic, Morocco, Senegal, and Uruguay. As per the analysis the substantial part of the revenue in the developing countries is deprived from imports. The VAT with multiple rates and many exemptions face greater difficulties of administration and compliance than a single tax rate with the single rate and few exemptions VAT not only imposes greater discipline by reason of it’s so called self-checking features but also its self-correcting in catching up with tax that may have been

escaped at a previous stage. In this respect, it has some advantages comparatively in reducing the tax leakages.

2.4.2 VAT in Bangladesh

The IMF staff papers, July, 1973 contains an article entitled: "The equity impact of Value Added Tax in Bangladesh" by Shahabuddin M. Hussain in June 1995, which suggest that among the different VAT scheme with some exemptions and additional excises is likely to be more acceptable to the general public and the policy makers than a uniform VAT, which is in contradiction with the Brazilian experience.

2.4.3 Tax system and its reform in Nepal

An article entitled "Tax system and its reforms in Nepal" by Dr. Govinda Bhadur Thapa published in business Age has opined VAT as an important element of tax reform program in Nepal and as the other elements of the Nepalese economy that are heavily influenced by the political instability, corruption, bad governance, liquid government and Maoist revolution has caused the weak implementation of VAT.

2.4.4 Created questions after declaration of VAT inventory

An article entitled " Mulya Abhibridhhi Kar Moujdat Ghosanale Ubjeka Prashanaharu: published in Rajaswa by Mr. Ram Prasad Mainali prescribes remedial actions for the smooth operation of VAT. He has emphasized on the need of proper billing system, political commitment, motivated staffs, public awareness, technological improvement, effective auditing system, online data system and reduced threshold.

2.4.5 Reforming VAT in European Union

An internet article in entitled “VAT Reform in European Union” by Nil Ennie states that since the common VAT system was introduced in the 1970s, its declared objective has been to create the conditions necessary for the establishment of an internal market characterized by competitive atmosphere under which the taxation of imports and the non-taxation of exports in intra-Community trade would be abolished.

The VAT system was tailored to the internal market and operated within the EU area in the same way as it would a single country. i.e. to introduce a system of taxation where goods and services would tax in the Member State of origin. However, in practice, such a radical change has not secured the necessary support from Member States. Foremost amongst the reasons for this are reservations about the efficiency of the necessary clearing mechanism for the distribution of VAT receipts, and the degree of harmonization of rates that such a regime would necessitate. The elimination of custom controls within the EU area in 1993 made it necessary to reform the VAT system operating up to then according to the destination principle.

The destination principle implies that consumption taxes are levied where the products are consumed for both final consumers and producers. This system ensures production neutrality since indirect taxes does not discriminate between foreign and domestic procedures, and exports are exempt from domestic taxation. However, this principle requires the monitoring of cross-border trade flows and administrative co-operation since goods and services travel free of tax. The origin principle implies the taxation of goods and services where produced, regardless of where they are consumed.

It is better because it can be applied without border controls and exports would not travel tax-free and the potential for tax fraud would be lower. However, the origin principle introduces the possibility for the tax system to discriminate

between domestically produced goods and imports. The full move from the destination to origin principle would also induce significant changes in the distribution of VAT revenue across countries.

2.4.6 Transitional or dual system

According to James Cook in his article entitled “Dual System” opines that transitional dual system attempts to fulfill the requirements of an internal market without frontiers whilst allowing room for maneuver at the national level as regards the establishment of VAT rates and the collection and auditing of the tax. He adds the transitional regime replaced custom controls by the obligation, for all EU firms exporting to another EU country.

Under current VAT rules, public sector bodies are subject to a special VAT treatment, which potentially distorts competition. One key exemption case of public sector bodies applies to the supply of postal services, which have been traditionally operated by monopolistic public agencies and are increasingly operating in competitive markets. So the special VAT treatment granted to public bodies, in place in some countries, may operate to distort competition. It may also introduce a bias for public authorities towards self-supply of goods and services versus contracting out to the private sector since they may not claim back the VAT paid on their inputs provided by the private sector. However, Denmark, Finland, the Netherlands, Sweden, and the United Kingdom have introduced special refund schemes to allow local authorities for a refund of VAT.

2.5 Review of Dissertations

A review of preparation for VAT and its implementation also seems relevant. In this context although a number of positive steps have taken place been some short comings as well. The published and unpublished dissertation provides information about their researches which guides us and glimpse on our study. These have been presented below in brief.

2.5.1 Applicability of VAT in Nepal

Mr. Babu Ram Subedi undertook his research in 1997 with the aim of analyzing the Nepal's tax structure briefly; examining the relevancy of VAT with reference to its application in other countries; comparing VAT with other forms of sales tax and identifying possibly areas, if any for the introduction of VAT in the Nepalese tax mechanism for enhancing revenue generation. Besides that he has also emphasized on efficient, simple and transparent VAT. He further reveals that due to lack of competent, qualified, intelligent, knowledgeable, self-disciplined and well trained manpower is hindering the smooth operation of the VAT. He urged that the business community have not conceived the theoretical concept of VAT. On the basis of his findings he suggests that the exporters should handle research and investigations on various issues.

2.5.2 VAT implementation in Nepal

According to Mr. Kul Bahadur Gurung the government administration is not encouraging to the businessmen and the traders. The problem is more serious due to the lack of culture of not issuing and demanding the VAT bill and the transaction is made, non adherence to standard norms and codes of doing business, discouraging behavior of the tax officials and lack of sense of accountability in the government and the political parties. So the businessmen not take the government policies with their heart. Invoice, the fundamental document on which the edifice of the VAT is based has inherent weakness. Open boarder with China and India is also another hindrance for its effective administration and implementation.

2.5.3 VAT in Nepal: Problems and Prospects

Mr. Ghanshyam Singh carried out this research work in 2002. He has laid emphasis on the desirability of strong political commitment, an efficient and fair administration, information dissemination, environment of mutual trust,

anti corruption policy, monitoring system, anti-corruption policy, behavior on equal footing, simplification of procedures for tax compliance and abolition of single rate VAT with multi-rate VAT. He denounces the unnecessary political interferences in policy making. There needs to be an environment of mutual trust between the private sector and the government bodies. The government should strongly reinforce the implementation of VAT with the help all available tools.

2.5.4 Value Added Tax: Present Status and Future Prospects in Nepal

Mr. Ham Basnet opines with the major objective to be on familiar terms with the problems of VAT in Nepal. According to him, the government should include VAT in the school education as well as in the higher level studies. The tax administration should be vigilant to prevent the malpractices, frauds, and tax evasion. The government should encourage the business community to use expensive billing software. The government should follow carrot and stick rule for its effective implementation.

2.5.5 Value Added Tax in Nepal: Its issues and effects.

Mr. Raghubir Bista carried out this research in 1999. According to him though the future of VAT in Nepal is bright the government as well as the business community should have the strong commitment. The government should check unauthorized trade especially along the long southern boarder with India. The threshold level should be reduced from the current level.

Arjun Dhakal (2000),¹⁵ in his dissertation analyzed the Nepalese tax structure and potential revenue of VAT in Nepal. He has provided the following conclusions. Theoretically, VAT is the attractive alternative of sales tax on the ground of revenue productivity, supporting economic growth, export promoting, price stability & neutrality on production & distribution etc. Further 'cross checking' & avoiding cascading effects has made VAT 'mile stone' in the

history of reforming of the indirect tax. He has found that even VAT has high revenue potential power, it is difficult task to achieve both efficiency & equity objective under the consumption levy' practically it is going to become 'hot milk in mouth' due to inefficient tax administrators. So only introduction of VAT is not acceptable, VAT itself has great need of reforming for the Nepalese context.

Dr. Rup Khadka,(2001) ¹²"VAT is a 20th innovation in the tax system. This tax is based on goods & services. VAT is regarded to be a member of the sales tax family since it is imposed on the sales of goods & services. Since VAT is levied only on the value addition made at each stage in the process of production & distribution, this tax system is more neutral, efficient, elastic & fair & is also said to be improved version of sales tax.

So this is reformed sales tax that avoids cascading effects and provides tax credit facility as facility of refund.

Kul Prasad (2002),¹⁶ in his dissertation concludes that adaptation of VAT in Nepal is both a compulsion & a necessity. The revenue collection from other source such as income tax, custom duties & excise duty are drastically decreasing or remaining unchanged. So to get the pace of revenue generation, VAT is an appropriate path or element. The implementation of VAT will help to reduce the burden of foreign debt & will provide a great relief to our future generation. He also concludes that to achieve full merits of VAT it requires the awareness towards responsibility & accountability in every section of the economy as well as honesty & confidence between the business community & administration.

Chandra Mani Adhikari,(2003) ¹⁴" VAT is a scientific indirect tax system. It levied on value added of goods & services. Value added means the value of difference between purchasing cost & selling cost. That means VAT is collected from each & every distribution stage from production to final sales to consumers. Each distribution stage collects VAT from the value added at its

own stage. So it broadens the tax net by including all importer, exporter, wholesaler & retailer. It intends to collect tax on consumption by end users. It avoids cascading effects having tax credit facility & improved form of sales tax."

Rabin Kuninkel (2004),¹⁷ in his thesis written that the main reason behind introduction of VAT in Nepal are :

1. To increase revenue mobilization by broadening the tax base
2. To make tax system neutral & efficient
3. To establish a fair & transparent system & to promote economic growth.

He find out VAT contributes more than 40% to indirect tax. He also find out many problems regarding implementation of VAT such as lack of trained & qualified administrator, lack of awareness, lack of coordination between tax payer & collector. And he emphasized on tax education (esp. VAT). He also concluded that effective implementation of VAT is both a compulsion & necessity. If happened so VAT can able to contribute towards the economic development of country.

Dan Kumar Khadka (2005),¹⁹ in his dissertation studied that VAT is currently well received by the consumers as well as business & industrial communities of Nepal. The no. of VAT registration has been increasing gradually reaching about 25,000 in the span of last five years & expected to reach more than 30,000 in the fiscal year 2003/2004. VAT system has no weak provisions. It is one of the best models in the world. But still it is facing numerous problems in its operation. So the government needs to full cooperation from the tax administration, tax payers & business man as well as consumers in its efforts to generate more revenue.

Chapter 3

Research Methodology

3.1 Introduction

Research methodology refers to the method or procedure of research process and it is a way to solve research problems systematically. The term “Research Methodology” is combined term of “Research” and “Methodology”. Simply research refers investigation or careful study, especially in order to discover new facts or information. On the other hand, a set of methods used in particular area of activity is known as methodology.

Research generates new knowledge, which can be used from different purposes, in other word; it is a systematic effort to gain new knowledge. Furthermore the research is used to build a theory, develops policies, support decision-making and solve problems.

Methodology is the research method used to test the hypothesis. It refers to the systematic method causing the problem formatting the hypothesis, collecting the data, and analyzing the fact to reach the certain conclusion.

3.2 Research Design

Research design is the outline of a plan to test the hypothesis and framework of the study. It is also known as the conceptual structure within which research is conducted. Research designs are invented to enable the researcher to answer research question as validity, objectively, accurately, and economically as possible (Kelinger 2004:301)

After formulating the research study the logical step is to construct the research design that refers to the entire process of a planning and carrying out research study. The research design asks what approach to the problem should be taken.

What method will be used? What strategies will be most effective? Identification selection and formulation of research problems may be considered as the planning stage of research. The remaining activity refers to the designs, operation and completion of the study (Wolf and Panta, 2004:53)

So a research without a pre-drawn plan is like an ocean voyage without Mariner's compass. The use of a research design guides to a study to proceed in the right direction. The research work has followed historical as well as descriptive research design to analyze and to interpret the collected data and information. As the data and information are related to past, the historical research is used to explain those collected information during the study period. Through survey research new information and data are collected to know the effective implementation of VAT in Nepal.

3.3 Sampling Design

Sampling is the process which inference is made to whole by examining only a part.

3.3.1. Population

The population from which sample is drawn should be defined. Population represents Nepal as whole in its as demographic, geographical, and administrative and other boundaries of population. Besides this, for an opinion survey certain areas of Lalitpur district are taken in the study.

3.3.2. Sampling Size

Sample size is fixed up the sampling frame i.e. the listing of all sampling units with reference to which relevant data are collected. The targeted sample size of the study is large. Keeping this fact in mind, 50 officers, 50 businessmen, and 50 consumers are selected from the Managal Bazaar, Lagankhel, and Kumaripati of the Lalitpur district.

3.3.3 Sampling Method

The sampling method of random and systematic is stratified in this study.

3.4 Data Collection Procedure

The required data and information are collected from the secondary as well as primary data.

3.4.1 Primary Data

The questionnaire papers were prepared to collect the views of tax experts, economist tax officers, businessmen, consumers etc. Besides these, subjective opinion and information are collected from the discussion and interaction with related person, policy maker, and intellectual person.

Sample Size of Field Survey

S.N.	Group of respondent	Sample Size
1.	Officers	20
2.	Businessman	30
3.	Consumer	40
	Total	90

Source: Field survey.

3.4.2. Secondary Data

Basic data are collected from the secondary. These resources are Inland Revenue Department Central Bureau of statistics, Ministry of Finance, Custom Department, Economic Survey, Budget Speech of various years, various books, journals, websites relating to VAT and taxes and other related materials.

3.5 Data Analysis Procedure

Analysis of the data and the interpretation of the result are facts and figure with a view to reducing them to manageable proportion. The collected data is checked, compiled and presented in appropriate tables to facilitate analysis and interpretation. Tabulation will be done to get answer for specific objectives. Analysis will be done descriptively as well as statistically. For the statistical tool such as trend analysis, percentage bar graph, pie chart, line graph, and correlation coefficient, coefficient of variation are used where necessary. To test an opinion survey of the people large sample i.e. Z-test is also used to interpret the opinion survey research work.

3.5.1. Mean: Mean, also known as arithmetic's average, is the most common measure of central tendency and may be define as the value which we get by dividing the total of the values of various items in series by the total number of items

We can work it out as under

$$\text{Mean } \bar{X} = \frac{X_1 + X_2 + X_3 + \dots + X_n}{n}$$

Where, \bar{X} = the symbol we use for mean

| = summation, X_i = value of ith item $X_i, I = 1,2,\dots,n$

n= total number of items.

3.5.2 Karl Pearson's coefficient of correlation: It is most widely used tool to measure the relationship between two variables. It is denoted by 'r'. In

this research work, the coefficient of correlation we calculated in order to examine relation between targeted and actual data in various items.

The basic purpose of computing coefficient of correlation is to justify whether the planned data significant for future activities or not and whether the actual data are far from targeted data or not. So, to find out the position of both targeted and actual data we can use these tools.

It is calculated by using following formulas:

$$r = \frac{\sum xy}{\sqrt{\sum x^2} \sqrt{\sum y^2}}$$

where $x = X - \bar{X}$

$$y = Y - \bar{Y}$$

r = Co-relation coefficient.

the value of correlation coefficient lies between +1 and - 1, +1 denotes the perfect positive correlation, '0' denotes there is no correlation and '-1' denotes the negative correlation between the two variables i.e. actual and budgeted data.

3.5.3 Probable Error (PE) of the coefficient of correlation: P.E of 'r' is very useful in interpreting the value of 'r' and is worked out as under for Karl Pearson's Coefficient of correlation. It is calculated as

$$PE(r) = 0.6745 \frac{r}{\sqrt{n}}$$

Where r = correlation coefficient.

n = number of items.

3.5.4 Standard Deviation (S.D): It is the most widely used measure of dispersion of a series and is commonly denoted by the symbol 'σ' (Sigma). Standard deviation is defined as the square-root of the average of square of deviations. In the present context standard deviation is calculated for actual data as well as budgeted data's of different milk products. It is worked out as under:

$$\text{Standard deviation} = \sqrt{\frac{\sum f x_i^2}{N} - \bar{x}^2}$$

$$\text{and } \sqrt{\frac{1}{n} \sum y^2}$$

$$\text{Where } y = x_i - \bar{x}$$

3.5.5 Coefficient of Variation (C.V.): it is define as mean sum of square of the variety values from the arithmetic mean. It is obtained by using the formula:

$$C.V = \frac{\sigma}{\bar{x}} \times 100\%$$

Where C.V. = Coefficient of Variation

σ = Standard deviation

\bar{x} = Arithmetic Mean

3.5.6 Regression Analysis

Regression is the determination of statistical relationship between two or more variable. The regression used in the study determine the statistical relationship between independent variable X (i.e. Budgeted sales) and dependent variable Y (i.e. Actual sales). The basic relationship between X and Y is given by; $Y_c = a + bx$

Where, Y_c denotes the estimated value of Y for given value of X.

3.6.7 Time Series Analysis

"Time series analysis shows the relation between two variables, on being the time. It helps in understanding the pass behavior of a variable in the time series. Further, it helps in future forecasting and evaluating the present accomplishment."

$$Y = a + bx,$$

$$\text{The calculated, } a = \frac{y}{n} \qquad b = \frac{xy}{x^2}$$

Chapter 4

Data Presentation and Analysis

This chapter has been divided into two parts. Part first deals with the data presentation, the data are collected from secondary source means from Inland Revenue Department Economic Source Report and Annual Budget Report Primary source means the opinion survey and distribution questionnaires for effective implementation of VAT. The second part is concerned with the analysis the strength and weakness of challenges for the implementation of VAT.

4.1 Data Presentation

The required data and information are collected from the secondary as well as primary sources. As for practicable both primary and secondary data has been collected. The collected raw and rude data are managed and tabulated in proper table.

Every government is responsible to perform many functions and works for the growth and development of the nation. Government needs a huge volume of perform of revenue to provide social welfare, security, handle the administrative work perform the different development activities and so on; therefore, the government collects revenue from various sources. Basic source of revenue can be classified into two categories:

Tax revenue and non-tax revenue: These both sources are subjected to non-repayment and their sum constitute the government revenue. Besides this source, government has other source which is subjected to repayment such as loans, grants. However, grants are not compulsory repaid.

Total Revenue Structure

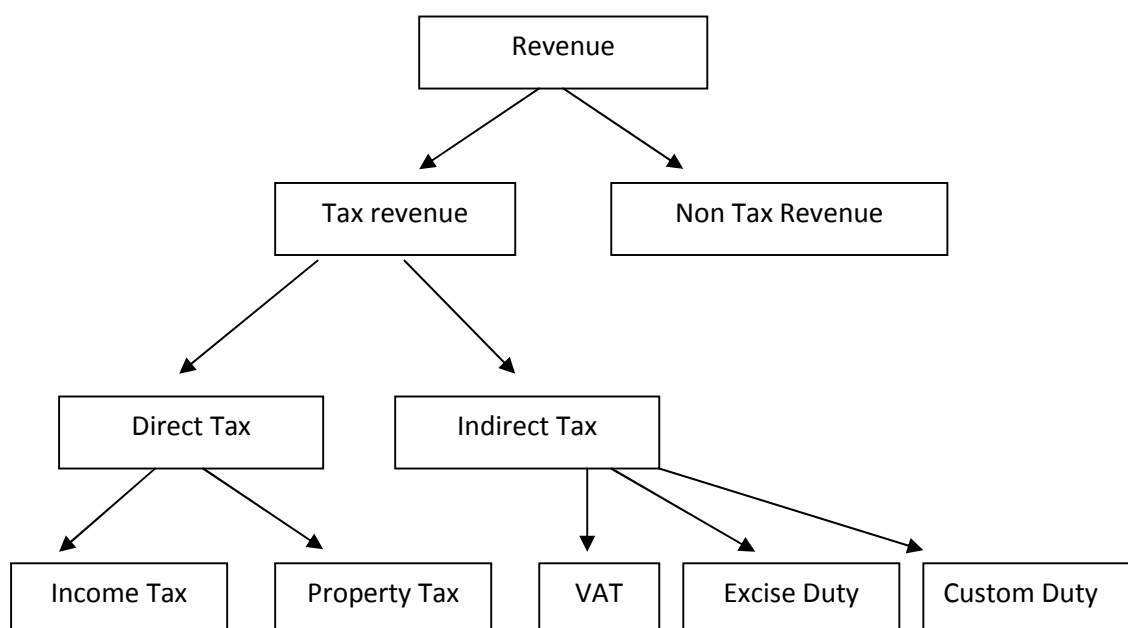


Table 4.1

Composition of Total Revenue (Rs. in million)

Fiscal Year	Total revenue	Tax Revenue		Non Tax Revenue	
		Amount	As % on TR	Amount	As % on TR
2000/01	48893.9	38865.1	79.5	10028.8	20.5
2001/02	50445.6	39330.6	79	11115.0	21
2002/03	56229.7	42587.0	75.7	13642.7	24.3
2003/04	62331.0	48173.0	77.3	14158.0	22.7
2004/05	70122.7	54104.7	77.2	16018.0	22.8
2005/06	72282.1	54730.4	79.5	14851.7	20.5
2006/07	87713.2	71126.7	81.1	16585.5	18.9
2007/08	107622.50	85155.54	79.12	22466.96	20.88

Nepalese economy is characterized by a low revenue performance in contrast to the growing public expenditure. The contribution of tax revenue is higher than non-tax revenue to the total tax revenue. In the fiscal year 2000/01, the share of tax revenue was 79.5% and the share of non-tax revenue was 20.5 of the total revenue collection. In FY 2002/03, the share of tax revenue and non-tax revenue were 57.7 and 24.3. In that year, it was seemed higher contribution of non-tax revenue.

Table 4.2

Contribution of VAT revenue to Total Revenue (Rs. In million)

Fiscal Year	Total Revenue	*VAT Revenue	VAT% as on TR
2000/01	48893.9	12382.4	25.33
2001/02	50445.6	12267.3	24.32
2002/03	56229.7	13459.7	23.94
2003/04	62331.0	14478.9	23.23
2004/05	70122.7	18885.4	26.93
2005/06	72282.1	21610.7	29.90
2006/07	87713.2	26095.6	29.75
2007/08	107622.5	29815.7	27.70

Source: Economic Survey Report of July 2009

* VAT includes sales tax, entertainment tax, hotel tax, air flight tax, and contract tax.

In the FY 2000/01, the total revenue was Rs. 48893.9 million out of which Rs. 12382.4 million was VAT revenue. That means contribute of VAT revenue

was 25.33%. The collection of VAT and total revenue was at increasing stages as per year. In FY 2007/08 the amount of both total revenue and VAT increased highly but the contribution of VAT to the total revenue is not that much increased compare to amount of total revenue and VAT. In the FY 2003/04 shows the low contribution of VAT i.e. 23.23%.

Table 4.3

Contribution of Value Added Tax on the GDP (Rs. in million)

Fiscal Year	G.D.P.	*VAT	Contribution of VAT on GDP (%)
2000/01	441519	12382.4	2.81
2001/02	442048	12267.3	2.76
2002/03	459488	13459.7	2.93
2003/04	481004	14478.9	3.01
2004/05	496026	18885.4	3.80
2005/06	514460	21610.7	4.20
2006/07	530890	26095.6	4.92
2007/08	560124	29815.70	5.32

Source: Economic Survey Report of July 2009

** VAT includes sales tax, entertainment tax, hotel tax, air flight tax, and contract tax.*

The above table reveals the contribution of Value Added Tax (VAT) on the Gross Domestic Product of the country from 2000/01 to 2007/08. The contribution of VAT was 2.81 in FY 2000/01 and almost other contributions were in increasing stage. In FY 2001/02 is slightly decreased up to 2.76. The maximum to GDP was 5.32% in FY 2007/08.

Table 4.4**Contribution of VAT on the GNI (Rs. in million)**

Fiscal Year	GNI	*VAT	Contribution of VAT on GNI
2000/01	443220	12382.4	2.79
2001/02	458838	12267.3	2.67
2002/03	491555	13459.7	2.73
2003/04	535065	14478.9	2.71
2004/05	591048	18885.4	3.20
2005/06	659010	21610.7	3.28
2006/07	734521	26095.6	3.55
2007/08	826348	29815.70	3.61

Source: Economic Survey Report of July 2009

**VAT includes sales tax, entertainment tax, hotel tax, air flight tax, and contract tax.*

The above table shows the contribution of VAT on the Gross National Income of the country from FY 2000/01 to 2007/08. In FY 2000/01 to 2003/04, there was no noticeable change. But in FY 2004/05, there was little change means increased contribution VAT to GNI was 3.20 which was in increase trend. In FY 2007/08, contribution was maximum 3.61% during the period of study.

Table 4.5**Vat Revenue Collection (Rs. in million)**

Fiscal Year	Vat Revenue Collection	% Increase
2000/01	12382.4	3.42
2001/02	12267.3	0.93
2002/03	13459.7	9.72
2003/04	14478.9	7.57
2004/05	18885.4	30.43
2005/06	21610.7	14.43
2006/07	26095.6	20.75
2007/08	29815.70	14.26

Source: Economic Survey Report of July 2009

Revenue was the source of the government for its expenditure. The trend of collection of Net VAT is increasing stage from 2000/01 to 2007/08. It was found that in the FY 2000/01, it has increment of 3.42 as per previous year recorded. But in the FY 2001/02, here was increased by 0.93% in revenue collection. In the FY 2004/05, the large percentage was increase means 30.43 where as low percentage increase in the FY 2003/04 is 7.57. The trend was in increasing stage though it was not satisfactory cause of highly fluctuation. The trend of Net VAT Revenue collection was found 12.69% is average till the study years 2000/01 to 2007/08.

Table 4.6**Composition of VAT Revenue**

Fiscal Year	Total VAT Revenue	Domestic Product	%	Import Product	%
2000/01	12382.40	4744.72	38	7303.04	59
2001/02	12267.30	4608.37	38	7339.58	60
2002/03	13459.70	4819.61	36	8629.51	64
2003/04	14478.90	5604.12	39	8874.77	61
2004/05	18885.40	6624.33	35	12270.29	65
2005/06	21610.70	8057.44	37	13888.58	64
2006/07	26095.60	9689.98	37	17014.20	65
2007/08	29815.70	9264.71	31	20438.50	69

Source: Economic Survey 2008/09

VAT is the life blood of the government expenditure. It helps in the government for its expenditure of government. VAT is collected from the two sources on from domestic product and other from import product. The composition VAT revenue from the above table was discussed. It was found that the VAT revenue collected from importer product is high than the VAT revenue collected from the domestic product. In the FY 2000/01 the ratio of domestic and import was 38:59 and in the FY 2004/05, was 35:65 and in the FY 2007/08, it was 31:69 ratio. It was clear that the import amount is always higher than the domestic amount collected.

Table 4.7**Contribution of VAT revenue to Total Tax Revenue (Rs. in million)**

Fiscal Year	Total Tax	VAT Revenue	% of VAT
2000/01	38865.10	12382.40	32
2001/02	39330.60	12267.30	31
2002/03	42587.00	13459.70	32
2003/04	48173.00	14478.90	30
2004/05	54104.70	18885.40	35
2005/06	54730.40	21610.70	39
2006/07	71126.7	26095.60	37
2007/08	85155.5	29815.70	35

Source: Economic Survey 2008/09

The contribution VAT to the total tax revenue was shown in the above table from FY 2000/01 to 2007/08. In the FY year 2000/01, 32% of predicted VAT collected to the total revenue. Then 32% in 2002/03. It was found that fraction of low percentage i.e. it was decrease in the FY year 2003/04 was 30. Then in the FY 2005/06, the highly increment was recorded of 39%.

Table 4.8**VAT collection Actual versus Estimated**

Fiscal Year	Estimated	Actual	%Achievement
2000/01	13500	12382.40	92
2001/02	14750	12267.30	83
2002/03	13730	13459.70	98
2003/04	15503	14478.90	93
2004/05	16950	18885.40	111
2005/06	23650	21610.70	91
2006/07	26463	26095.60	99
2007/08	29532	29815.70	101

Source: : Economic Survey 2008/09

VAT was collected as revenue for the expenditure of government, so the government fixed its target to collect the VAT. The estimated and actual were shown in the above table. There was found always below the estimated to the actual. Only in FY 2004/05 and 2007/08, it was found that actual is higher than the estimate were 111 and 101% respectively. Otherwise there were always less than the estimated to actual VAT collected. The very low targeted collection of VAT was in FY 2001/02 was 83%.

Table 4.9**Composition of Tax Revenue for the year 2007/08 (in 000)**

Particular	Amount	%contribution on the TTR
Direct Tax		
Income tax	17327915	31
Rent tax	706063	1
Interest tax	1060261	2
Indirect Tax		
1. Value Added Tax		
Domestic	11109740	20
Import	20044893	36
2. Excise Duty		
Domestic	840095	2
Export	2806460	5
3. Miscellaneous Tax	1513940	3
Total Tax Revenue	55409367	100

Source: Annual Report 2007/08, IRD

From the above table, the composition of Tax revenue from the year 2007/08 was also shown in the circle chart. The tax revenue composite was of direct tax and indirect tax. The direct tax was composition of income tax, rent tax, and interest taxes were 31, 1 and 2 percent respectively. In the case of indirect tax, its composition was Value Added Tax which again composition of domestic

and import supply were 20 and 36 respectively. It was found that the composition of VAT was large than other composition was 56% to total tax revenue in FY 2007/08. Then other indirect tax was Excise Duty which composed of domestic and export contributes 2 and 5 percentage to the total revenue. Excise Duty's contribution was 7 percent to the total tax revenue. The other indirect tax revenue was miscellaneous tax whose contribution to the total tax revenue was 3. The total tax revenue was Rs. 55409367 thousand in the Fiscal year 2007/08.

Table 4.10

Composition of indirect tax for the year 2006/07 (Rs. In 000)

Particulars	Amount	% Contribution on total indirect revenue
VAT	31154633	70.99
Excise Duty	11216555	25.56
Miscellaneous	1513940	3.45
Total	43885128	100

Source: Annual Report 2007/08, IRD

Indirect tax composed of VAT, Miscellaneous and Excise Duty. The total indirect tax was of Rs. 43885128 where the contribution of VAT was Rs. 31154633, Excise Duty Rs. 11216555 and Miscellaneous tax Rs. 1543940 in the fiscal year. In the above table it was found that highest contribution of VAT and lowest contribution was of miscellaneous tax were 70.99 and 3.45 percent. The contribution of the Excise Duty was 25.56 percent of the indirect tax in the FY 2007/08.

Table 4.11**Taxpayer registration and deregistration in VAT**

Fiscal Year	Registered in VAT	% Increment in taxpayer	Deregistered	Business closed
2000/01	21093	17.2	170	172
2002/02	25149	19.27	80	360
2002/03	29872	18.78	18	531
2003/04	34174	14.40	30	570
2004/05	39776	16.39	30	445
2005/06	46831	17.74	36	647
2006/07	52965	13.16	31	793
2007/08	59907	13.10	150	863

Source: Annual report 2007/08, IRD

In the table, it shows the business person and companies registered, deregistered and business closed during the study period 2000/01 to 2007/08. In the FY 2000/01 the registered in VAT was 21093 which slightly increased in 2001/02 was 25149 and 19.27 in percentage. In FY 2006/07, there was low increment in registration i.e. of 13.16 percent.

In the table the deregistered in VAT were 170, 80, 18, 30, 30, 36, 31 and 150 as 2000/01 to 2007/08 respectively. The highest deregistration was in 2000/01 and lowest in 2002/03.

In the case of business closed by the firm in 2000/01 to 2007/08 were 172, 360, 531, 570, 445, 647, 793 and 863 respectively. From study, it was found the

business closed in 2000/01 is 172 which were in low number and high number of business closed in the FY 2007/08 was 863.

Table 4.12

VAT Registration and Submission of Statement

Fiscal Year	VAT Registered	VAT statement Submitted	VAT Statement not Submitted
2000/01	21093	19710	1383
2001/02	25149	21473	3676
2002/03	29872	23099	5255
2003/04	34174	25049	7322
2004/05	39776	28525	8492
2005/06	46831	33633	13198
2006/07	52965	36457	7092
2007/08	59907	40139	9050

Source: Annual Report IRD 2007/08

VAT is the source of government expenditure. First of all business firms should register in VAT office. Then they should present the statement for the payment of VAT. In the above table it shows the registration of VAT, statement submitted and statement not submitted from the fiscal year 2000/01 to 2007/08. As country is in developing stage, the business firms are also increasing and definitely the VAT registration was increased. In Fiscal Year 2000/01, VAT registration was 21093 and it was increased rapidly up to 59907 in 2007/08. VAT registration was not quite enough but submission was necessary debit /credit or zero for revenue collection. The firm submitted

statements were 19710 in 2000/01, 21473 in 2001/02, 23099, 25049, 28525, 33633 36457 and 40139 in 2002/03 to 2007/08 respectively. There was also the firm who didn't submit the statement. Though they have to pay penalty, there were 1383, 3676, 5255, 7322, 8492, 13198, 7098 and 9050 in fiscal year 2000/01 to 2007/08 respectively. The highest VAT statement not submitted were 13198 in fiscal year 2005/06.

Table 4.13

VAT statement submitted in FY 2000/01 to 2007/08

Fiscal Year	Debit Submitted	Credit Submitted	Zero Statement	Undecided Statement	Unsubmitted Statement
2000/01	6975	8250	4471	14	1383
2001/02	6936	8844	5207	486	3676
2002/03	7178	9953	5972	396	5255
2003/04	8483	9625	6786	158	7322
2004/05	9478	10260	8271	516	8492
2005/06	10449	12882	10139	163	13198
2006/07	11457	13594	11044	362	7098
2007/08	12052	15050	12779	258	9050

Source: Annual Report 2007/08, IRD

In VAT, submission of VAT statement is most necessary work either it may be debit or credit or zero statement. VAT statement is submitted within twenty five days after completion of the month. From the above table, it shows there was debit, credit and zero statement had been submitted. There also unsolved statement and not submitted stakeholders also in the FY year 2000/01 to 2007/08. The debit statement shown in 2000/01 was 6975 person and it

gradually increased up to 12052 in 2007/08. The credit statement shown in the FY 2000/01 is 8250 and 15050 in the FY 2007/08. The zero statement shown was 4471 and 12779 in the FY 2000/01 and 2007/08 respectively. There also unsolved submitted VAT statement, it was only 14 in the FY 2000/01 but it increased up to 396 in FY 2002/03, again there was increased in 2004/05 was 516 cases. There were 258 cases in 2007/08. There was not also unsubmitted person in large numbers. It was 1383 in FY 2000/01 and it tremendously increased up to 13198 in FY 2005/06. But again it decreased up to 7098 in FY 206/07 and increased up to 9050 in FY 2007/08.

Table 4.14

Mobilization of VAT in 10th Plan (in thousand)

Fiscal Year	Value Added Tax	Increment %
2002/03	13459700	109.72
2003/04	14478900	107.57
2004/05	18885400	130.43
2005/06	21610700	114.43
2006/07	26558900	122.89
2007/08	94993600	117.34

Source: Financial Report related year and Budget Speech, Annual Report, IRD 2007/08

It is a plan to increase the sector of internal source in revenue collection from tax widening the area and flexibility. In 10th plan, the government had a target to meet 14% on GDP in the ratios of 3.5%, 8.7%, 2.8% of direct tax, indirect tax, and other taxes respectively. In 10th plan government has been targeted to register 3,00,000 in achieved. The target VAT contribution to the 10th plan is an average of 3.77%. From the study of 10th planning commission report, the

targeted 14% on GDP has not been met by on 2% of internal revenue collection. From the above table, it is clear that target amount of collection of VAT, it also declared by the 10th planning commission report.

4.2 Empirical Investigation

Analysis of the data and interpretation of result are fact and figure with a view to reducing them to manageable proportion. The collected data is checked complied and presentation in appropriate tables to facilitate analysis and interaction. Analysis has done descriptively as well as statically.

4.2.1 Analysis of Questionnaires

In the beginning, VAT was imposed by Nepal Government against the strong opposition of business man. So it was not easy task to implement it successfully. Despite of all this, VAT was served. VAT is well received by the consumer as well as business and industry communities. In such situation empirical study is done to know the views of different persons related to their field and job toward the VAT. The sample of this survey is given below.

Table 4.15

Sample Size of Field Survey

S.N.	Group of respondent	Sample Size
1.	Officers	20
2.	Businessman	30
3.	Consumer	40
	Total	90

Source: Field survey.

Q. No.1. Which of the following categories best suit your education level?

First of all, to implement the VAT effectively, we should know that the term of VAT is derived from the destination of the educated world. That mean for the proper knowledge of VAT, the people should be educated. Here in the survey results we have found literate, illiterate, college level student, and school level educated persons. We mean not that illiterate person does not know about VAT. There are some difficulties to them too understood and to maintain VAT account.

S.N.	Group of respondent	Sample Size
1.	Illiterate	20
2.	Literate	30
3.	School Level	20
4.	College Level	20
Total		90

Source: Field survey.

Q.No.2. Do you have knowledge about the VAT?

Unless and until without knowledge of VAT, we cannot implement it. So we all should know about VAT. In field survey, the people generally heard the word VAT but all of them actually do not have a knowledge that how VAT collected and returned. As this survey was done in the cities most of people knew about VAT but non-conscious to VAT.

Q.No.3. VAT as an appropriate tax system

Value Added Tax is modern system of tax in revenue collection. In our country, VAT is implemented in turn of sales tax, entertainment tax, and freight tax. As VAT has been successfully implemented in more than 135 countries in the world and emerging in many countries these years too. As per this concept, Nepal also spent 11th years in its implementation. We had taken some observation that is it VAT appropriate tax system in Nepal? Different views are presented below.

Table 4.16

Suitability of VAT in Nepal

Respondent	Yes	%	No	%	I don't know	%
Officers	18	90	-	-	2	10
Businessmen	20	66	6	20	4	14
Consumer	28	70	6	15	6	15
Total	66	73	12	13.5	12	13.5

Source: Field survey 2009

From the above table it denotes that VAT is known to people and they agree to implement so that it is suitable tax system in Nepal. From the study, 90 percent officers generally all of them said VAT is appropriate tax system in Nepal. 66 percentage business men are also in agreeable VAT as tax system. 70% of consumers are also feasible in implement of VAT. It is not that there is no objection to approval of VAT but they are in low percentage. In the study it shows 73 percentage of people said that VAT is the appropriate tax system in Nepal.

Q.No.4 Knowledge about the threshold amount of VAT registration

VAT is not a whole tax system in which all business, firm and taxable person are intercourse. It is the part of tax system where the business house or organization of annual turnover of Rs. 2 million are only associated in this tax system. On the observation and suggestion we found there are many persons who did not know the threshold amount also.

Q.No.5. Which of the following books of account must be maintained by the VAT registered sellers?

The VAT registered sellers should maintain the books of account are purchase book, sales book, stock books, and VAT accounts etc. In field survey, we found that the sellers had not kept the proper VAT accounts and book. They only pretend to maintain the book and prepared the VAT statement as per the accountant said as per VAT office's rule.

Q.No.6. What type of VAT is imposed in Nepal?

VAT is a modern tax system in the world. There are mainly three types of VAT. They are consumption type Gross National type and income. In Nepal Consumption type of VAT was imposed in Nepal. In field survey, most of the respondent as business and consumers did not knew about VAT types. Only few officers and businessmen knew about the types of VAT.

Q.No.7. Will price rise due to VAT system?

VAT is the tax paid to the government which was written after cost and services. It definitely shows the increment in price. But customer should know that VAT is only implementing in the place of sales tax, hotel tax, contract tax and entertainment tax. There should not be any rise in price. Businessmen always pretend customer that there would be rise in price if they demand for the bills. The observation also shows that their will rise in price according to field survey.

Table 4.17

Price Rise due to VAT

Respondent	Yes	%	No	%	I don't know	%
Officers	-	-	10	67	5	33
Businessmen	5	16.5	20	67	5	16.5
Consumers	20	44	20	44	5	12
Total	25	28	50	55	15	17

Source: Field Survey 2009

From the above table average of said that there will be no increase of price due to VAT implement action i.e. 28% respondent says Yes, 55% of respondent says No and 15% of respondent says they do not know. Here we could not found that there will not be rise in price as satisfactory results. This is due to the awareness of VAT accounts. There are 44% of consumers and 16.5% of businessman said that VAT will rise the price.

Q. No. 8. What reward can we receive if we inform the tax office about tax evasion?

For the effective implementation of VAT in Nepal the government had provided the reward if we inform tax office is informed about tax evasion. We will receive 20% of the as payable as prize. This rewarding system is not known to the people. Some of the person also had taken reward as informing about tax evasion also. They are few numbers of people.

Q.No.9. Name any three VAT exempted goods and services.

We should be afraid to hear the word VAT. There are also the VAT exempted goods and services. Government provided us VAT exempted in the case of rather than the business and immovable properties and daily necessities. Basic agriculture product like paddy rice, wheat, maize, barley, millet, and similar unprocessed food materials. Others are discussed and for further are listed in appendix.

Q.No.10. What do you think about Upahar program?

VAT now steps on it's 11th year of it's implementation, but still most of businessmen and consumers are not aware of it. They are not taking it as their responsibility. They feel it as burden. Moreover, they think that VAT raised the price of product, it is not appropriate for consumers. Consumers are exploiting in the name of VAT etc. So to get out from such type of mirage and with a purpose of spread awareness about VAT, government launches the Upahar program for the consumers.

Table 4.18

Public view toward Upahar program

Respondent	Awareness program		To make billing system effective		Control over tax evasion	
	No.	%	No.	%	No.	%
Officers	4	20	14	70	2	10
Businessmen	14	47	16	53	-	-
Consumers	12	30	22	55	6	15
Total	30	33	52	58	8	9

Source: Field Survey 2009

In the above table, 20% of officers, 47% of businessmen and 30% of consumers said that the upahar program is to give awareness to people. Whereas 70% of officers, 53% of businessmen, and 55% of consumers give the view on upahar program is to make billing system effective. Only 9% of respondent are in favor of control over tax evasion through upahar program. That means most of respondent 58% said that upahar program is helpful tool to make billing system effective. And they all are on the behalf of operation of such type of encouraging program.

Q.No.11. How can we make return process easier?

VAT has some features like VAT return. Excess amount of VAT paid to the government and exemption of VAT are returnable. There are some difficulties in return of VAT due to lack of proper billing and VAT account in the VAT office. So there are some suggestions given to VAT office which discussed below.

Table 4 .19

Suggestion for Return Process Easier

Respondent	Computerized		Add manpower		Time frame	
	No.	%	No.	%	No.	%
Officer	15	66	5	34	-	-
Businessmen	20	50	10	25	10	25
Consumer	15	50	5	17	10	33
Total	50	55	20	22	20	28

Source: Field Survey 2009

From the above table, 66% of officers, 50% of businessmen, and consumer suggested that system should be computerized 34% of officers, 25% of

businessmen and 17% of consumer suggested that the manpower should be added. Here some of the 33% of consumer and 25% of businessmen suggested enlarging the time frame. Average respondent suggested as 55% in computerized, 22% in adding manpower and 28% in the incremental of time frame.

Q.No.12. Do you think VAT office is successful to get expected revenue?

Nepal government expenditure is always increasing but the revenue collection is not increasing as required to finance the government expenditure. Now VAT becomes the part of government revenue. Theoretically VAT is the best form of taxation but practically it's success depends on it's collection.

Table 4.20

VAT office is successful to Collect expected revenue

Respondents	Yes		No		I don't know	
	No.	%	No.	%	No.	%
Officers	6	30	14	70	-	-
Businessmen	12	40	10	33	6	27
Consumers	12	30	8	40	12	30
Total	30	33	42	47	18	20

Source: Field Survey 2009

From the above table, 30% of officers, 40% of businessmen, and 30% of consumers agree that VAT office is successful to get expected revenue. 70% of officers, 33% of businessmen and 40% of the consumers are not agreed that VAT office is successful to get expected revenue. 27% and 30% of businessmen and consumers denied about VAT revenue collection. From above study, it was clear that VAT office is not successful in expected revenue.

Q.No.13. Please suggest for effective implementation of VAT

Many respondents wrote that billing system should be effectively implemented. Consumer awareness is also must. There should be introduced effective education program for the awareness of taking and giving bill through advertisement so that all people feel paying tax is the responsibility towards nation. Lottery program should be continued. Government should take step to reduce tax corruption. Reward should be given to the honest taxpayer and tax officer. Registration return and refund process should be easy and simple. High penalty should be charged at spot if it is found that businessmen are cheating. Encourage the businessmen also for giving bill to the consumer in every purchase even if the consumer did not ask for a bill. And moreover government should invest tax in public interest area. This will encourage paying tax to the government VAT administration should be actively involved in VAT implementation.

Table 4.21

Public challenges and awareness toward VAT

Respondent	VAT rate	Threshold	Reward	VAT exempted	Types of VAT
Officers	20/20=100%	18/20=90%	3/20=15%	5/20=33%	10/20=50%
Businessmen	20/20=100%	30/30=100%	2/30=6%	20/30=66%	18/30=60%
Consumers	35/40=88%	22/40=55%	6/40=15%	4/40=10%	5/40=12%
Average	96%	81%	12%	36%	42%

Source: Field Survey 2009

Act says the VAT is dangerous revenue collector system which is burden to the public consumer. Even though they did not know about the VAT. They only

think it as ghost which was launched by government to be looked the consumers. On the topic public challenges and awareness toward VAT in above table, officers were aware about 90% of threshold, 100% of VAT rate, 15% had take reward, 33% knew about VAT exempted and 50% knew about types of VAT implemented.

In case of businessman 100% knew VAT rate, 100% knew the threshold, 6% had taken reward, 66% knew the exempted goods of VAT and 60% knew about types of VAT implemented in Nepal.

In case of consumer, 88% of consumer knew the rate of VAT and 55% had heard the threshold of VAT, 15% had taken reward and only 10% knew about VAT exempted goods and rare less of consumer knew about the types of VAT implemented was 12%. It was found that consumers were least aware of VAT. The average rate of challenges and awareness of VAT were 96% of VAT rate, 81% of threshold, 12% of reward receiver, 36% of exempted goods and 42% of types of VAT were the awareness about the VAT.

Table 4.22

Awareness of penalty and timely payment of VAT.

Respondent	Penalty not for maintaining proper books of account		Timely Paid of VAT	
	No.	%	No.	%
Officers	-	-	18/20	90
Businessmen	8/30	27	22/30	73
Consumers	15/40	37.5	25/40	62.5
Average	15/40	37.5	25/40	62.5

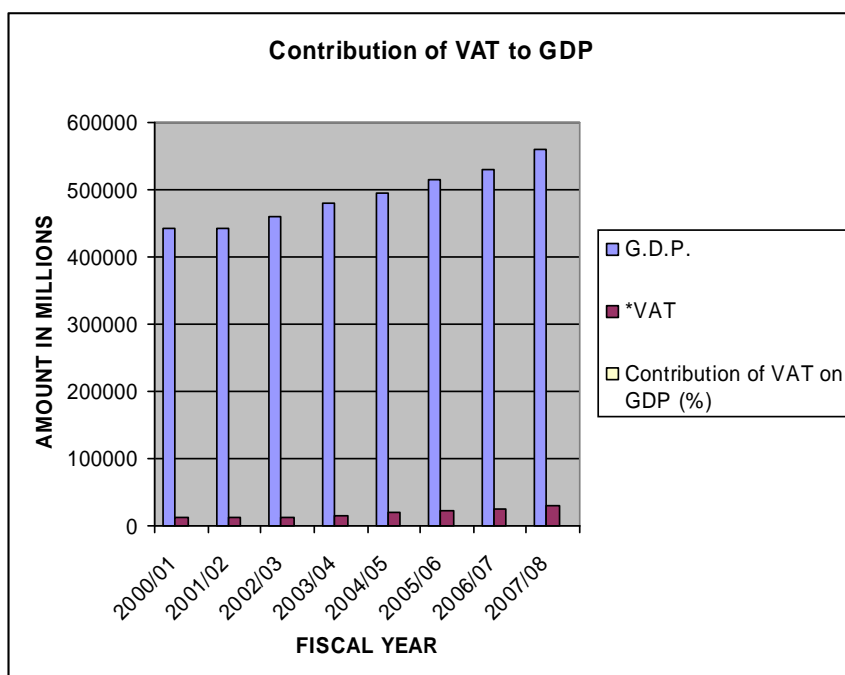
Source: Field Survey 2009

The VAT holder had to maintain the account and submit in VAT office in the valid time otherwise he/she should pay penalty for not maintaining proper books and payment as per time period. From the above table it should penalty for not maintaining proper books of account by officer and businessmen and consumers are zero, 27% and 37.5% respectively. The statement submitted i.e. not paid as in time period is 90%, 73%, and 62.5% by the officers, businessmen and consumers respectively. The average of them for penalty not maintaining proper account were 32% and 68% were the person timely paid of VAT.

4.2.2 Analysis of Strength and Weakness of VAT Implementation by Chart

Analysis of strength and weakness of VAT Implementation by chart. The collected raw and crude data are managed and analyzed. Most of all data from secondary are used to analysis the strength and weakness of VAT Implementation. These resources and Inland Revenue Department, Central Bureau of Statistics, Ministry of Finance, Economic survey report and Budget speech report. Here Analysis of strength and weakness of VAT Implementation is shown through bar diagram, pie chart and trend analysis.

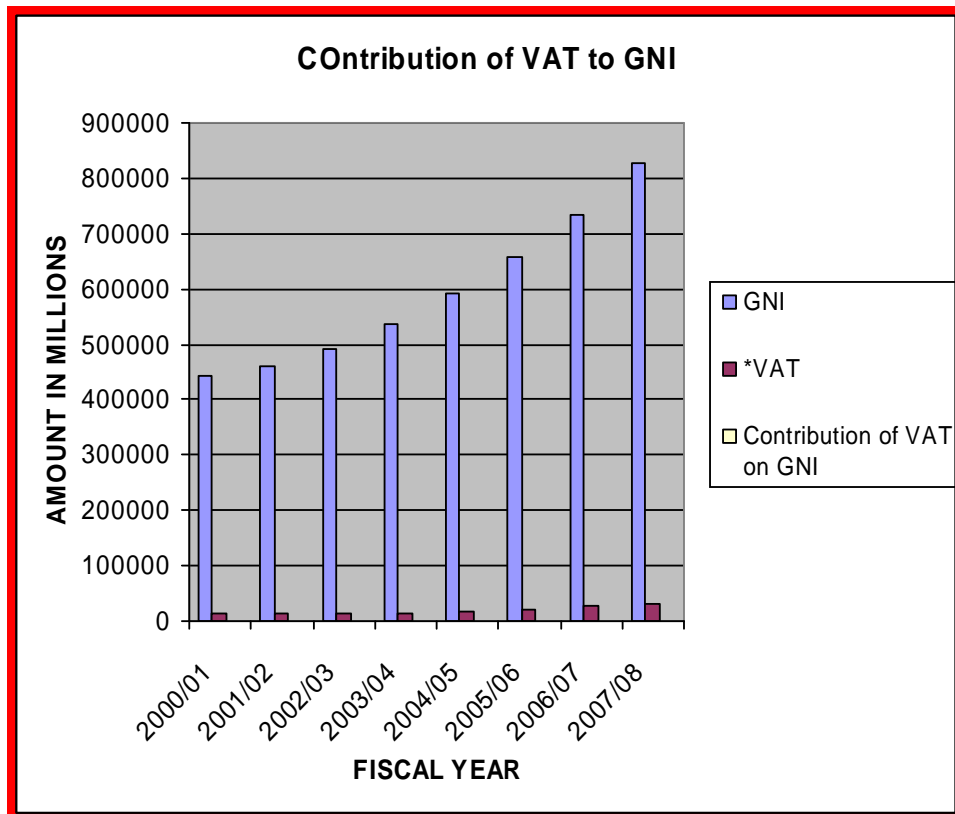
Chart 4.1



In the 10th plan the government has been targeted to raised revenue up to 14% on GDP VAT is also one of the part of revenue collection

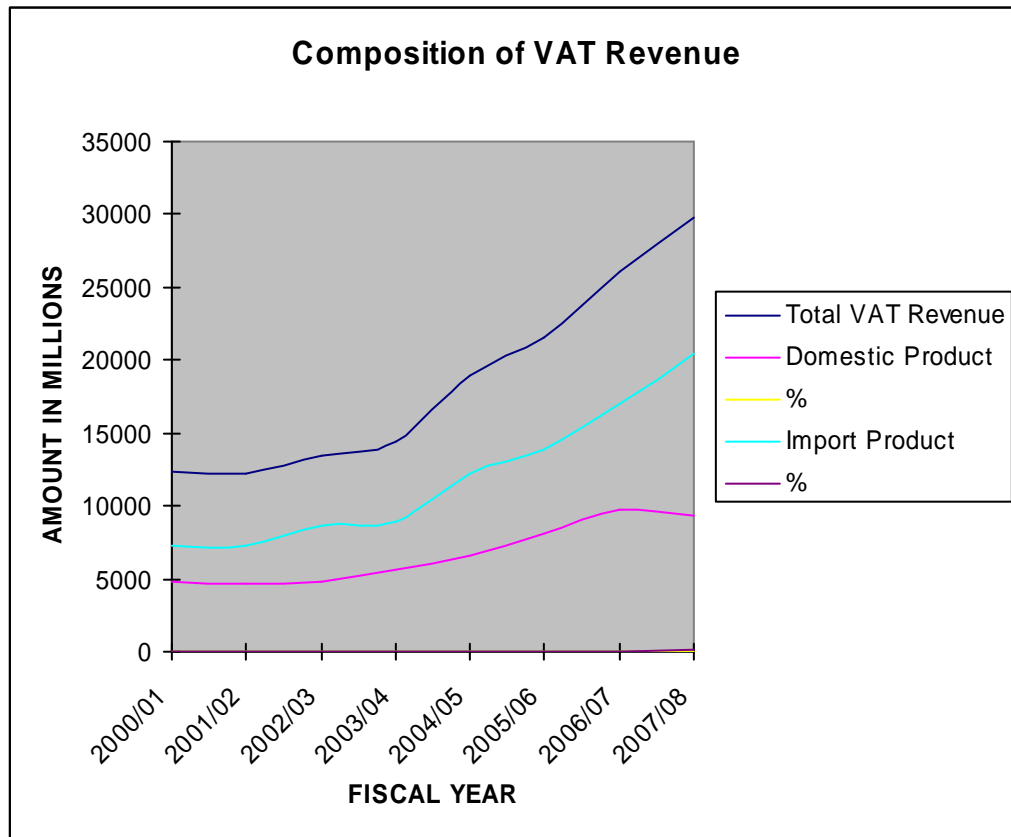
In the chart, the contributions of Value Added Taxes to Gross Domestic Product from FY 2000/01 to 2007/08 are shown through bar diagram. The contribution of Value Added Tax was not satisfactory; there was average of only 3.72% through the studied period. Through it was not satisfactory, there was gradual increment in the VAT collection up to 5.32% contribution on GDP in FY 2007/08.

Chart 4.2



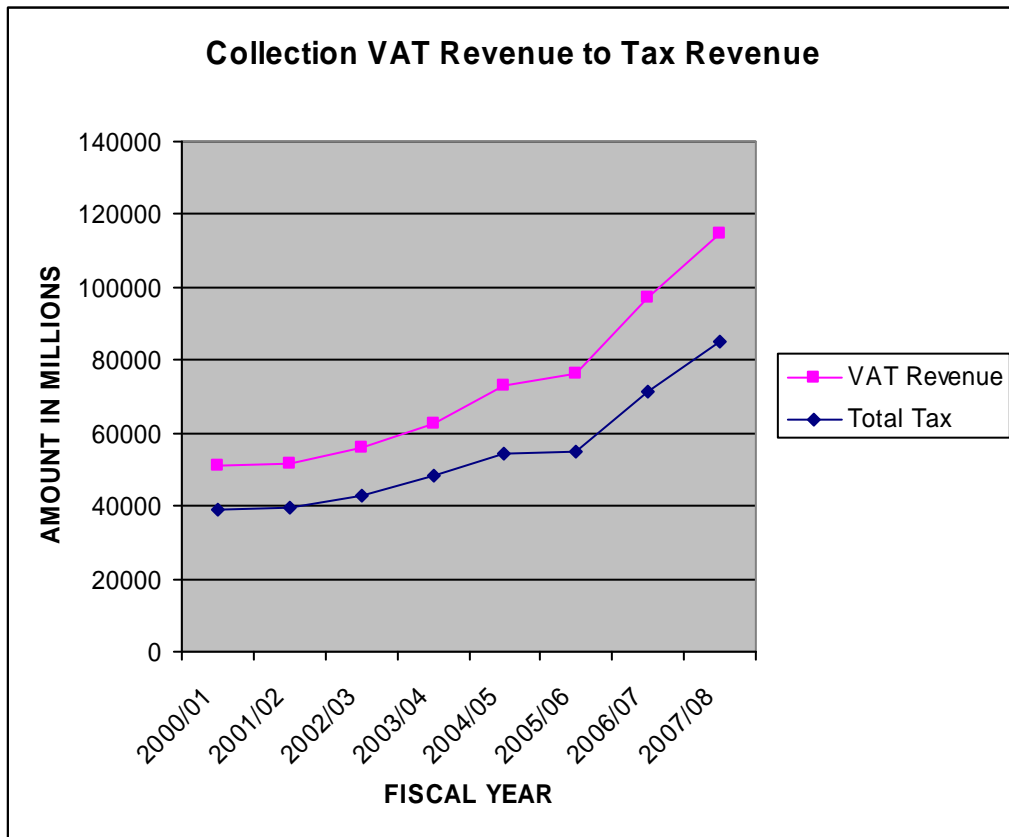
VAT was the source of government revenue for its expenditure. So it was the part of Gross National Income. In the above chart the contribution of VAT on the Gross National Income is represented by column diagram. Its contribution was very low but contribution trend was in increasing trend. The contribution of VAT on Gross National Income from FY 2000/01 to 2006/07 were 2.79%, 2.73%, 2.71%, 3.20%, 3.28% ,3.55% and 3.61% respectively.

Chart 4.3



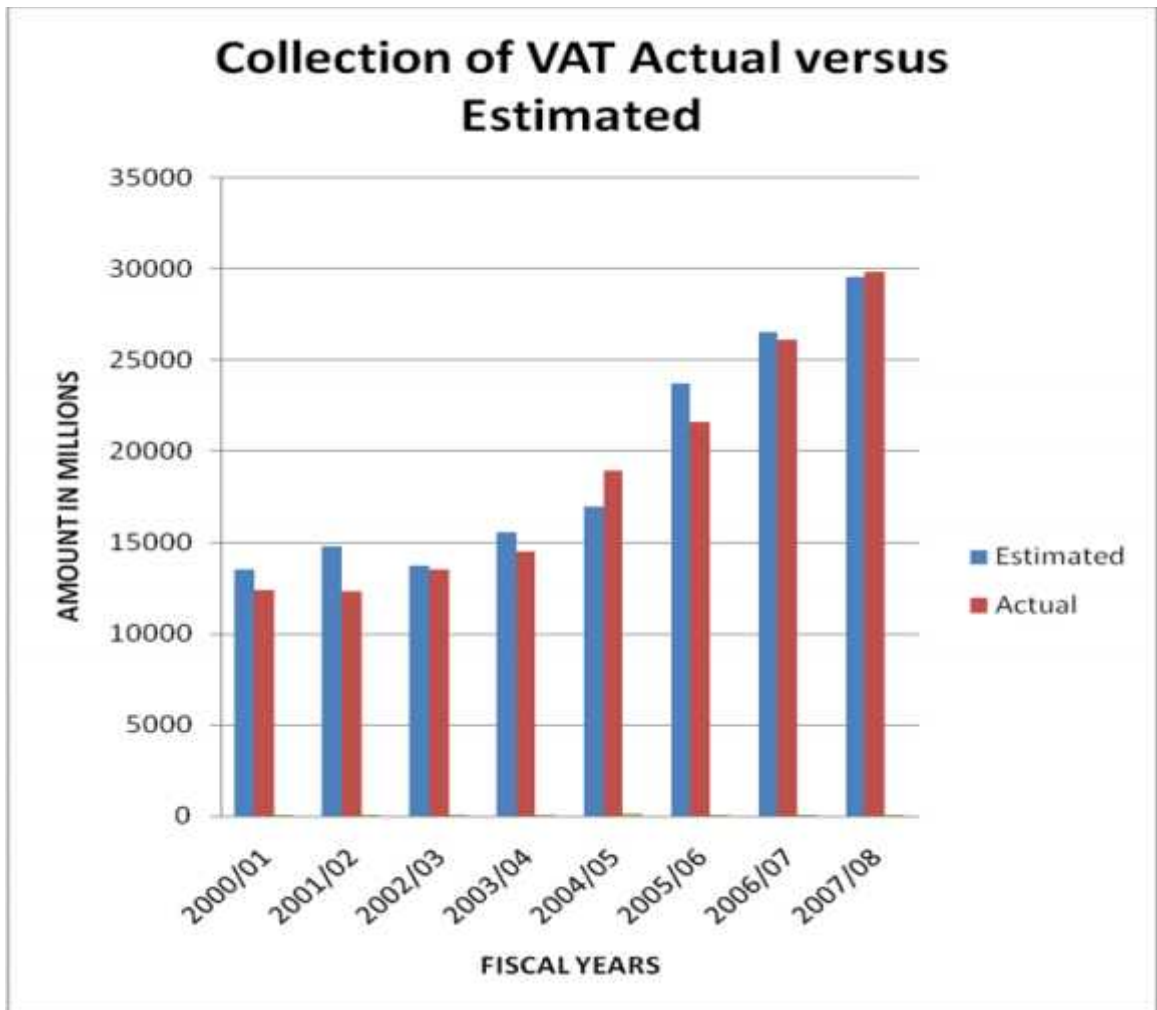
VAT is collected through the domestic product and import product. In above chart, the diagram represents the composition VAT revenue from fiscal year 2000/01 to 2007/08. VAT collection was higher in import product than domestic product. The composition of them was 36:63 ratios in average. The bar shows higher composition of domestic to import in FY in 2000/01, 2001/02 and 2003/04 are 36:61 ratios and highest composition of import to domestic in FY 2004/05 was 65:35 ratios. From this it was clear that we have low production in our country and have higher demand in importing product.

Chart 4.4



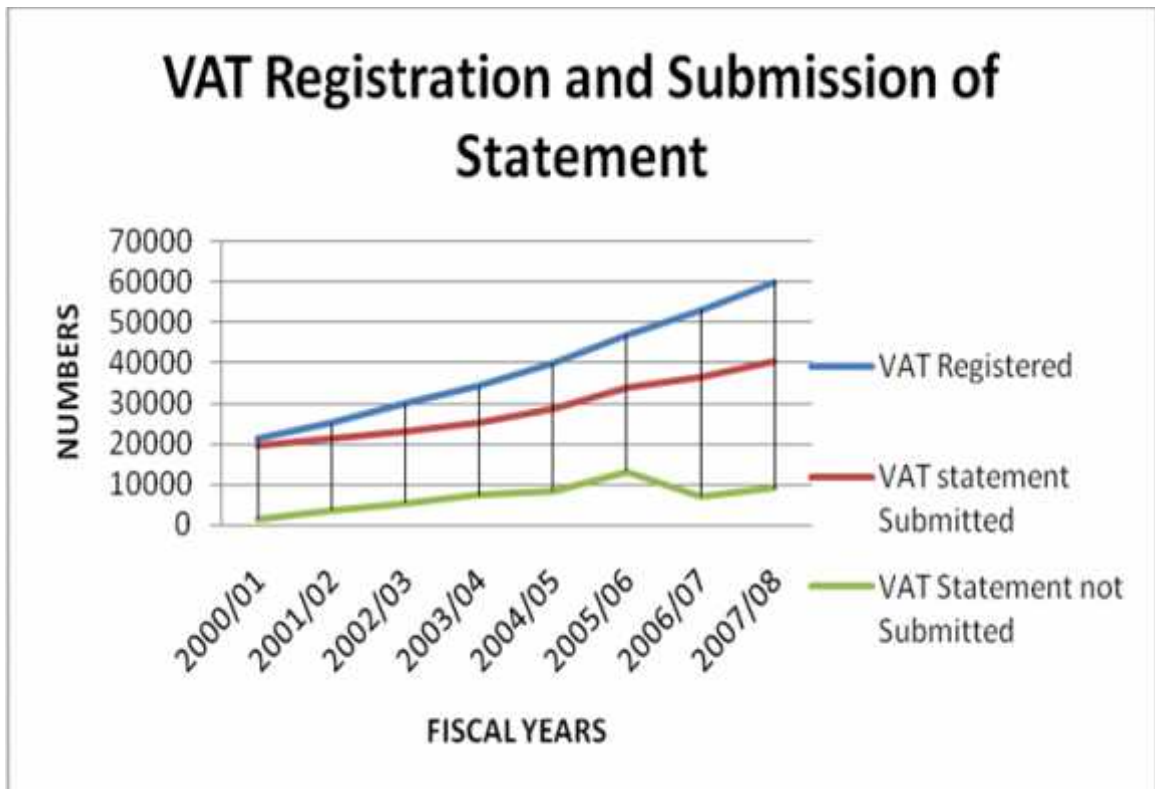
VAT is a source of revenue. In above chart, the collection of VAT to the total tax revenue is represented by line diagram from FY 2000/01 to 2007/08. The collection of VAT in the FY 2000/01 was 32, which was same as in FY 2002/03. The collection of VAT was highest in 2005/06 i.e. 39% to the total tax revenue. The average collection of VAT to the total tax revenue was 33.88%. It means to half of total tax revenue was covered by the VAT revenue.

Chart 4.5



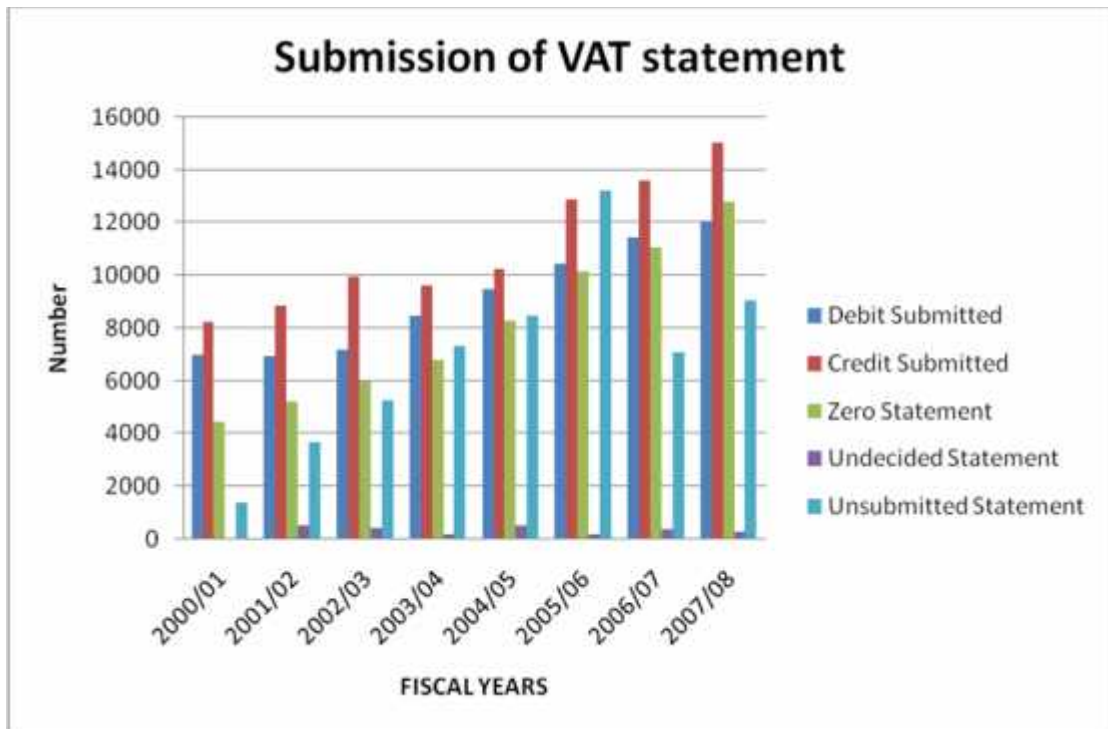
As VAT is source of government expenditure, it is estimated each year for collection. In above chart, the bar diagram shows achievement of VAT collection to the estimation i.e. actual versus estimated from FY 2000/01 to 2007/08. From the beginning of VAT collection there was always near to the estimated. In FY 2000/01, 92% of VAT collected as per estimated, there was little deficit in collection. The higher deficit in FY 2001/02 was 19% to the estimated. But in the FY 2004/05 and 2007/08, the actual collection of VAT was over the estimated, it means achievement of 111% and 101% respectively. From this achievement, bar diagram clears that there are no high deviation between estimated and actual these years.

Chart 4.6



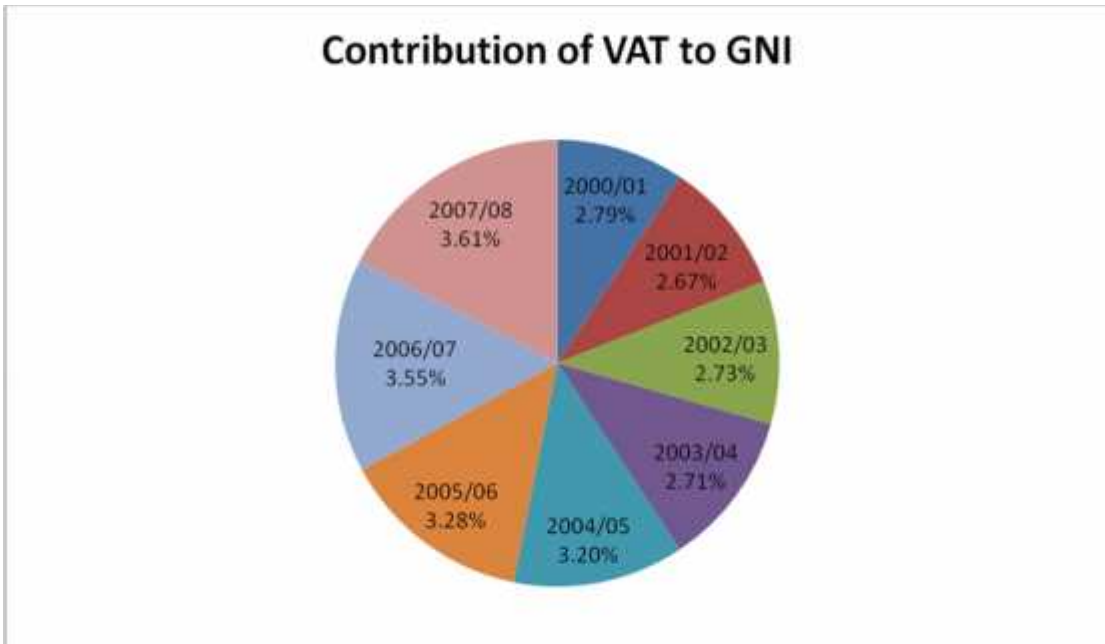
VAT registration is not only enough; the VAT statement should be submitted to the Inland Revenue Department for payment of VAT either it is credit or debit statement. In the chart the line diagram shows the VAT registration, VAT statement submitted and person or company not submitted VAT statement during 200/01 to 2007/08. VAT registration was in increasing trends 21093 to 59907 during the studied period. Submitted statement was also in increasing trend that are from 19710 to 40139. But the numbers of taxpayer who doesn't submit were in haphazard trend. The highest statement not submitted were 13198 in 2005/06 and decreased up to 7098 in FY 2006/07.

Chart 4.7



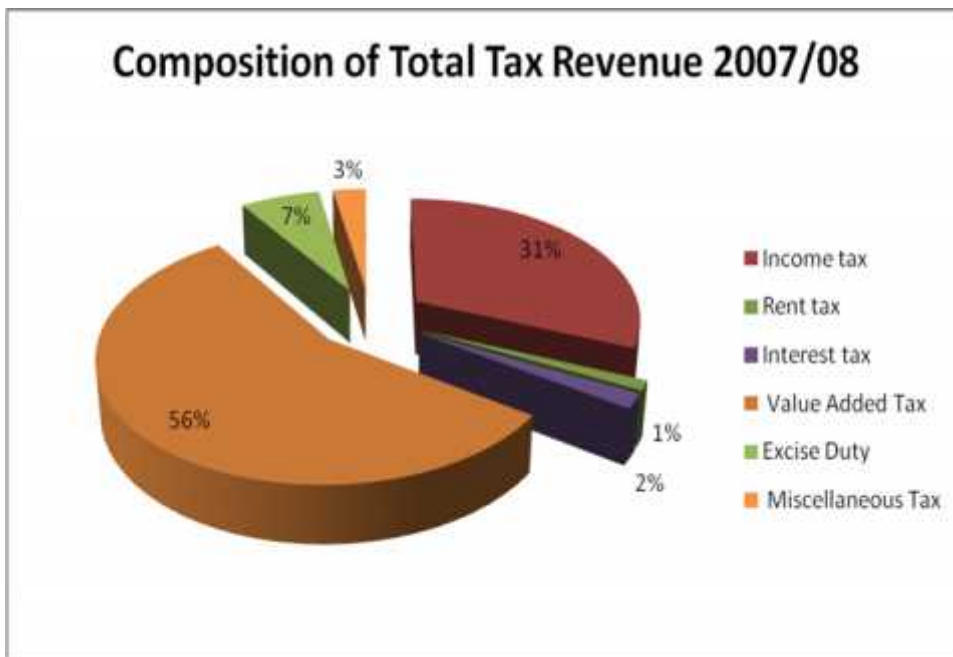
In the above chart, the submissions of VAT statement from FY 2000/01 to 2007/08 are shown. The statement may be either debit, credit, or zero statement. There are undecided and some unsubmitted statement also. According to chart, the debit statement submitted is low than the credit statement submitted to VAT office. The zero statement is presented in large number as shown in the diagram. It is record that in FY 2005/06 the unsubmitted statement is 13198. The comparison to debit, credit and zero statement submitted, unsubmitted statements are increasing rapidly up to 2005/06 . The undecided statements are also found which has maximum 516 in FY 2004/05 and least statements are present in FY 2000/01 i.e only 14. From the study, it is found debit, credit, and zero statement are increased in same ratios.

Chart 4.8



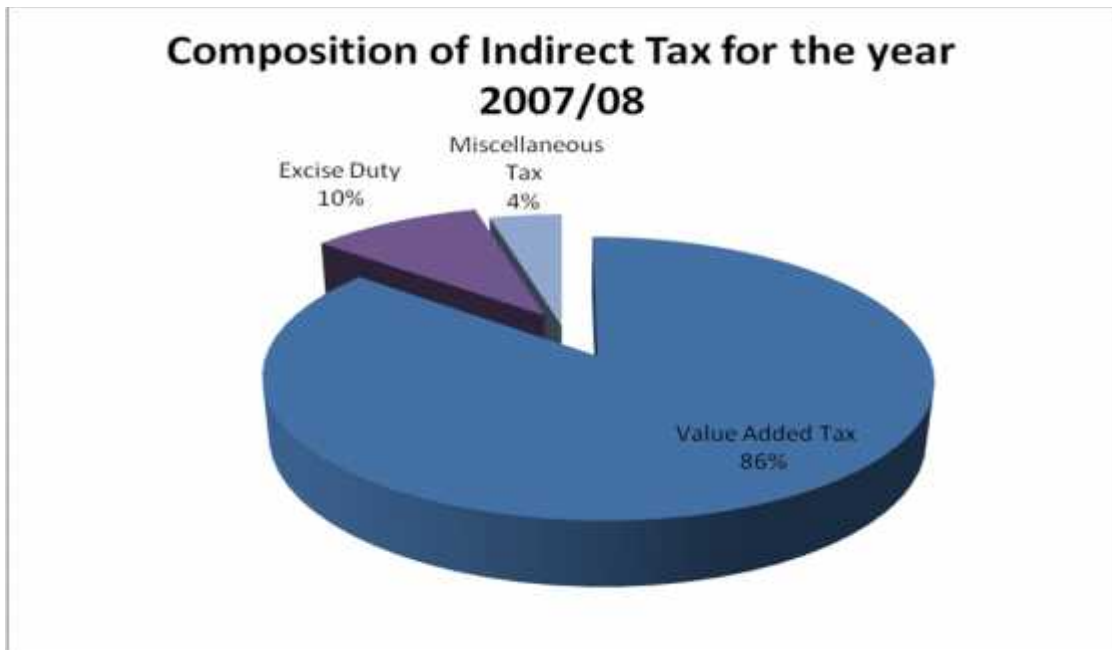
In the above chart, the contributions of VAT on Gross National Income are shown from FY 200/01 to 2007/08. In FY 2000/01 the contribution is 2.79% and this is decrease in FY 2001/02 to 2.67%. Then the contributions are in increasing trend as 2.73%, 2.71%, 3.20%, 3.28%, 3.55% and 3.61% from 2002/03 to 2007/08 respectively. The study showed that the highest contribution of VAT on GNI is 3.61% in FY 2007/08.

Chart 4.9



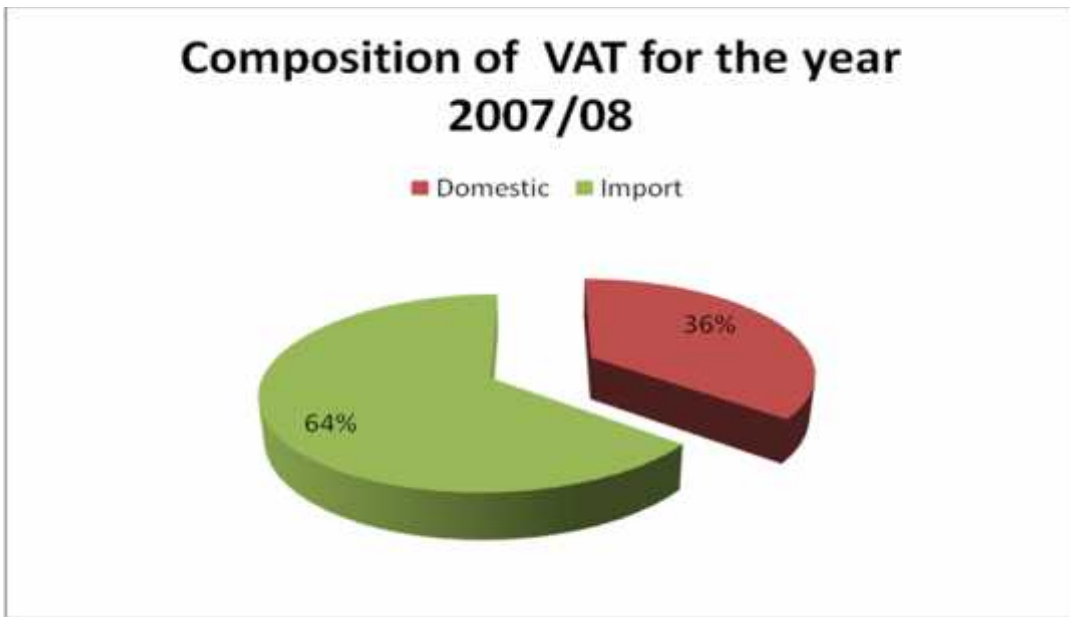
The compositions of total tax revenue are direct tax, indirect tax and miscellaneous tax. The direct tax includes income tax, rent tax, and interest tax. Indirect tax includes VAT and Excise Duty. In above pie chart, the compositions of total tax revenue are shown for the FY 2007/08. VAT is the large composition of total tax revenue of 56%. The income tax contributed of 31% to total tax. The rent tax and interest tax contributed 1% and 2% to total tax. The contributions of indirect tax are of VAT, Excise Duty and miscellaneous tax 56%, 7%, and 3% respectively to the total tax revenue.

Chart 4.10



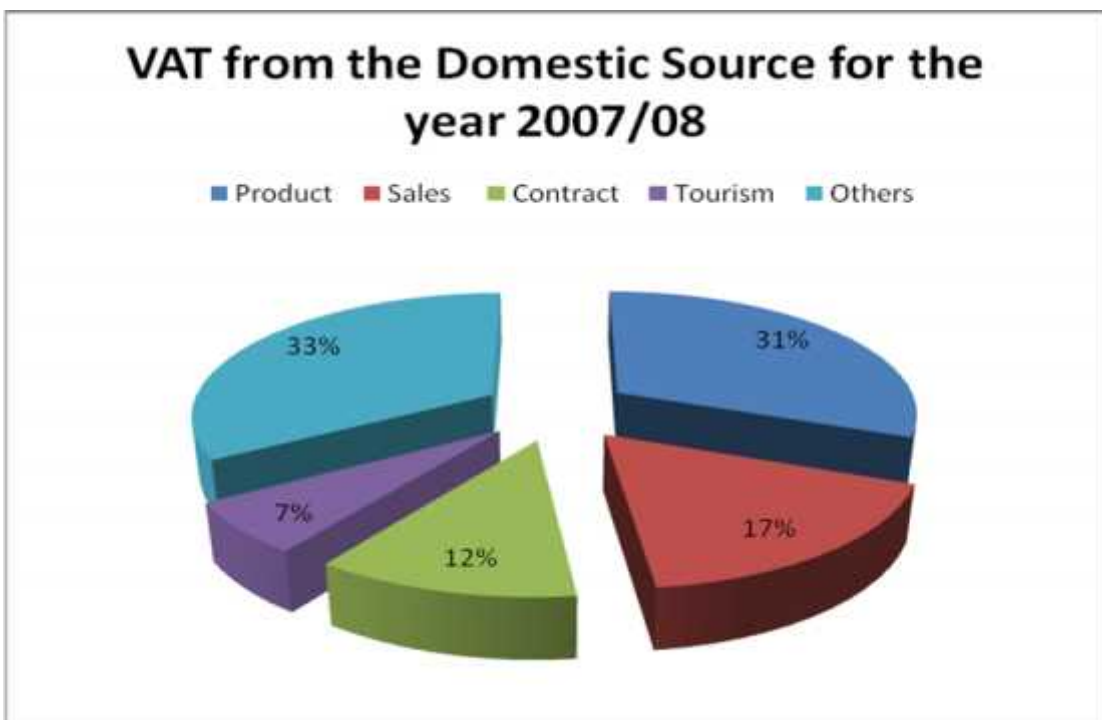
Indirect tax was composition of VAT, Excise Duty and Miscellaneous tax. The above pie chart shows the highest contribution was 86% of VAT, then 10% of Excise Duty and 4% of miscellaneous tax to the indirect tax in the fiscal year 2006/07.

Chart 4.11



The above pie chart shows the composition of VAT collected through domestic and import in the fiscal year 2007/08. The contribution of import source is high in turn of the contribution of domestic where ratios were 64:36 respectively.

Chart 4.12



VAT was collected through two sources mainly domestic and import. Here in the above chart the VAT from the domestic source was shown. The VAT collected from other services was highest of 34%, then VAT collected from sales was 17%, the collected from contract was 12%, the VAT collected from tourism was 7% and 31% from the production in FY 2006/07.

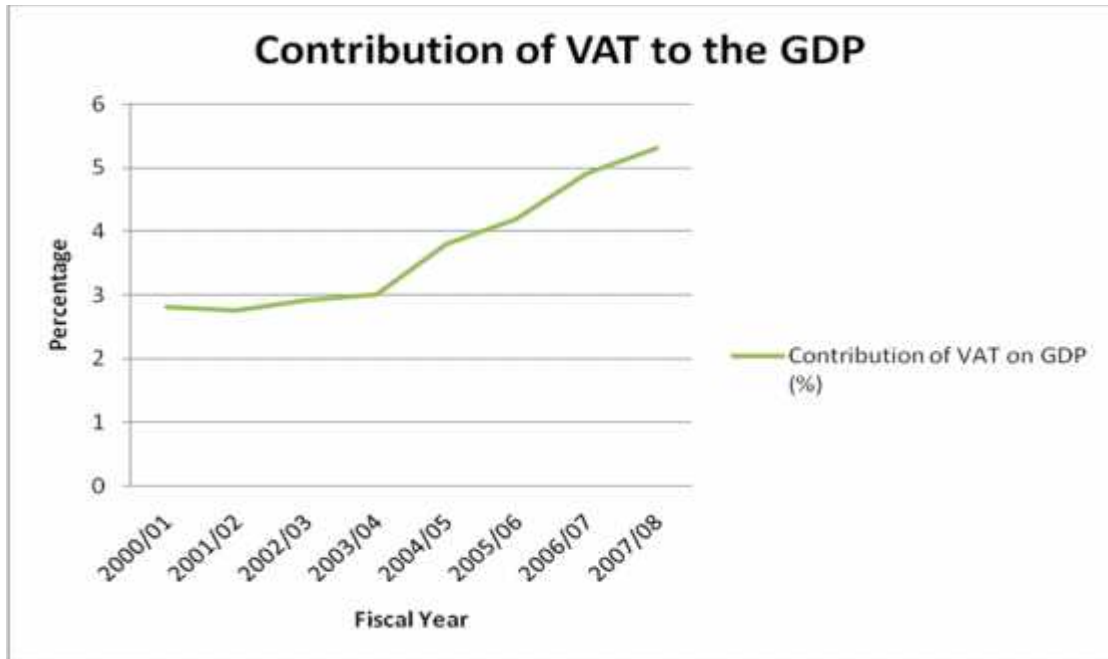


Chart 4.13

In the above chart, the increasing trend shows the contribution of VAT on the GDP from FY 2000/01 to 2007/08. The contribution of VAT on GDP begins with 2.81% which is slightly decreased to 2.76% in 2001/02 again increased up to 5.32% in FY 2007/08. The trend showed gradual slow increment to 2003/04 and then trend started rapid grow up to FY 2007/08 till study period. The contributions of VAT on GDP are no so satisfactory.

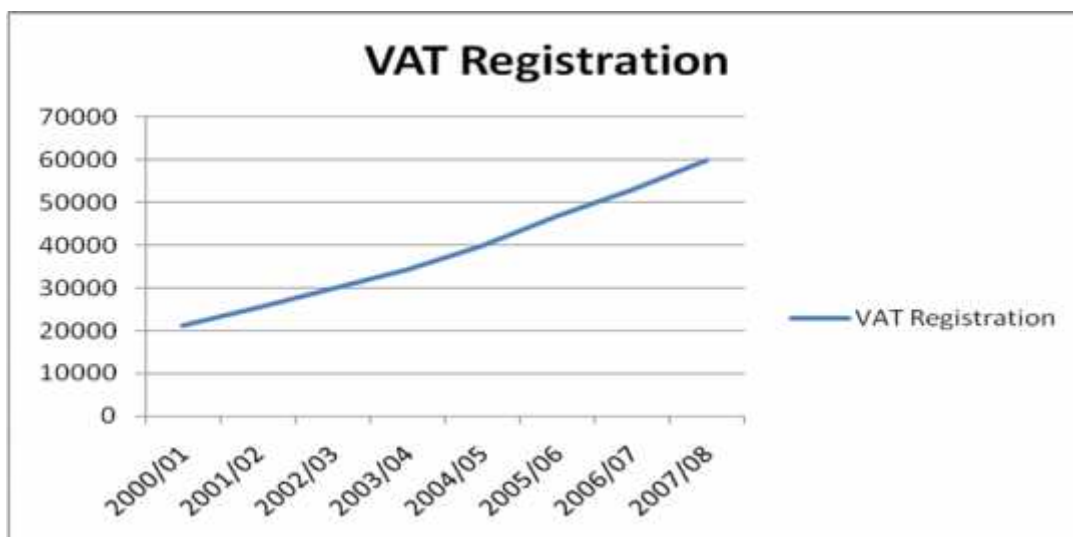
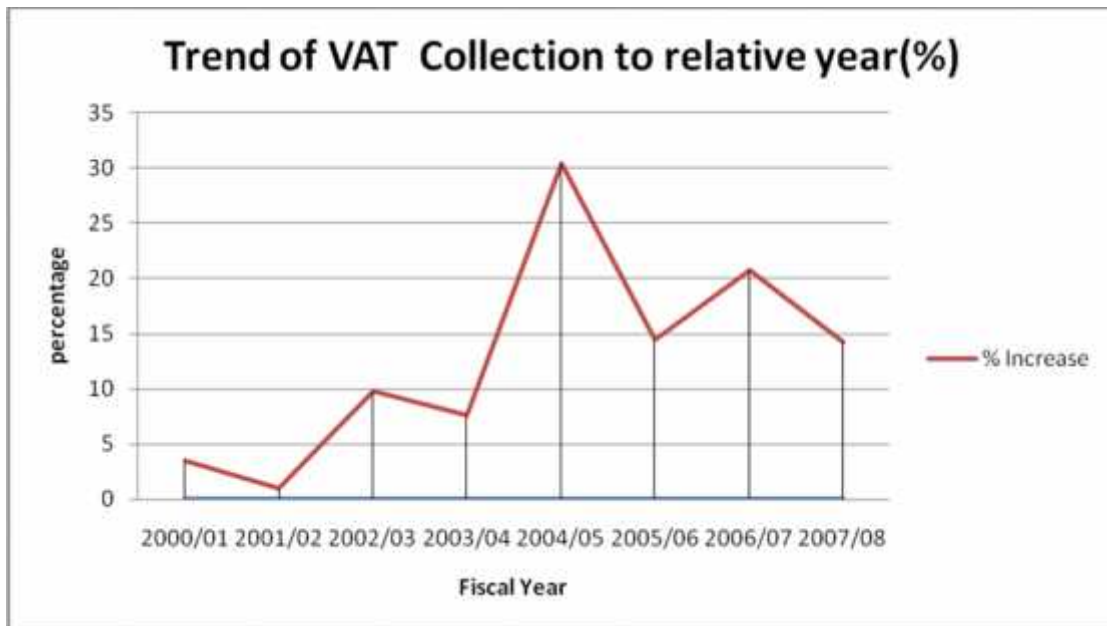


Chart 4.14

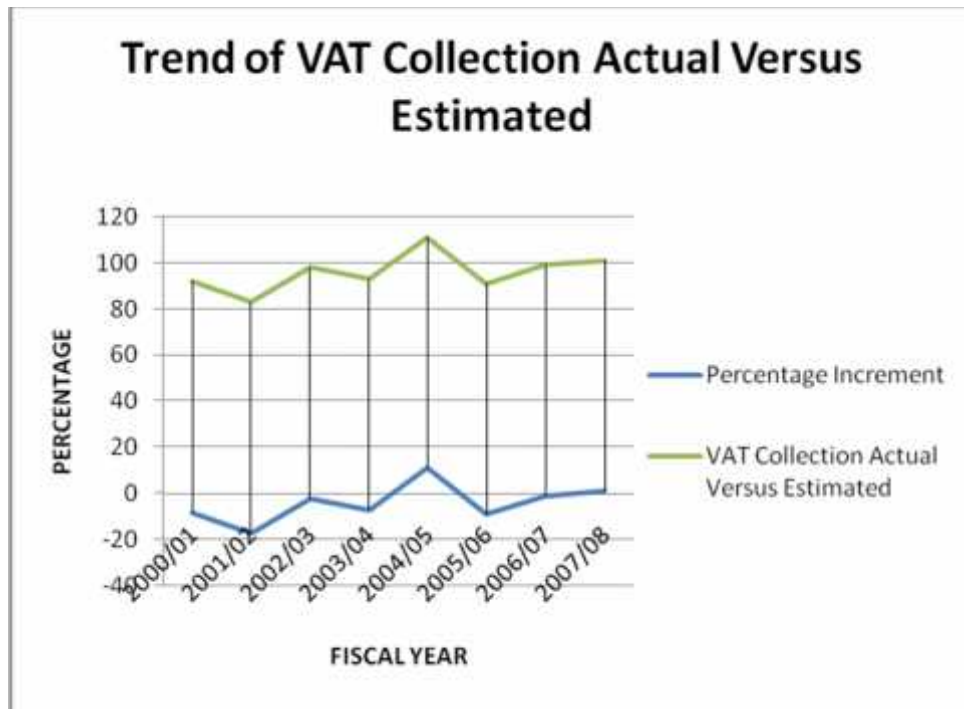
It is a plan to increase the sector of inter source in revenue collection from tax widening the area and flexibility. In 10th plan of government, it has targeted 40,000 stakeholders to be registered in VAT. During 10th plan government has achieved its targeted registration. In above chart, the trends show in increasing trend from FY 2000/01 to 2006/07 in percentage. The highest increment was in FY 2003/04 as 20.53% and lowest increment was in FY 2006/07 as 4.19%. the fluctuation of VAT registration are not so high because the average increment was 14.48% during the study period.

Chart 4.15



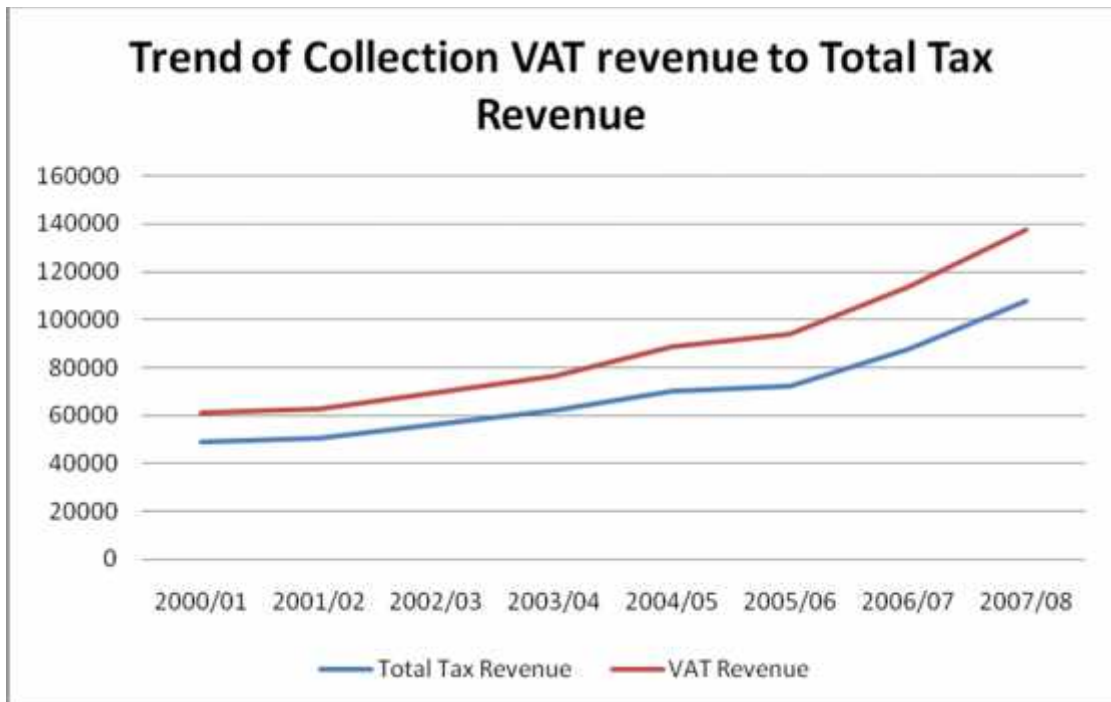
VAT is one of the most dependent sources of internal from revenue collection for government's expenditure. It helps government's dependency in foreign loan and grants. In chart, the trend shows fluctuating collection of VAT from FY 2000/01 to 2007/08. Due to the instability of politics, and environment, there are highly fluctuations in VAT collection trends. In FY 2000/01 the trends increased to 3.42% which continuously failed to (0.93%) within FY 2001/02. From then increment of VAT collection continues up to 30.43% in FY 2004/05. After that, it is decreases to 14.43% in FY 2005/06. The increment in FY 2006/07 was 20.75%. Then in the FY 2007/08, it was slightly dropped by 14.26%. In the graph, the highest peak of increment was 30.43% in FY 2004/05 and lowest peak in FY 2001/02 (0.83%). The average increment trend was 12.69% during the study period.

Chart 4.16



Registration in VAT is not sufficient. Government has to collect its estimated VAT to meet its expenditure. In the chart, the trend analysis shows highly fluctuation. Government was not successful in collection of VAT during FY 2000/01 to 2007/08. Government is always under deficit as estimated. In only FY 2004/05 and 2007/08, it meets estimated collection. The trends begin deficit of 8% in 2000/01, 17% in 2001/02, 2% in 2002/03, 7% in 2003/04 and 9% in 2005/06. The actual versus estimated trends showed positive value in 2004/05 and 2007/08 with 11% and 1% increment. So trend analysis shows most of peak in negative part. It means collection of VAT Actual versus Estimated were not satisfactory.

Chart 4.17



VAT is the part of total tax revenue. The government has the target always to raise revenue to meet its expenditure. The above chart, the trends are of total tax and VAT is shown. The trends of both are in gradual increment as parallel in 2000/01 to 2002/03. Then the trend of total tax revenue rapidly increased to 2007/08. Though, the trend of VAT collection is increased, it could meet the trend of total tax revenue as total tax revenue increased. There is average contribution of VAT to total tax revenue is 49.80% during the studied period.

4.2.3 Analysis of strength and weakness of VAT Implementation by statistical tool

The collected raw and rude from questionnaires and secondary sources are discussed and managed in table. These collected data are analysis the strength and weakness of VAT Implementation by statically tools such as Hypothesis test, mean standard deviation, correlation coefficient, coefficient of variation regression analysis and times series.

4.2.3.1 Hypothesis Test in opinion field survey

In an opinion survey, 65 people are found that VAT is not effectively implemented in Nepal. Does this opinion survey information support the conclusion that the VAT is not effectively implemented in Nepal?

Solution

Here,

Number of people taken as sample (n) = 100

No. of people who said that VAT is not effectively implemented in Nepal (x) = 65

Proportion of people who said VAT is otherwise effectively implemented (P) = $x/n = 65/100 = 0.65$.

Null Hypothesis (HO): $P = 0.5$

Alternative Hypothesis (AH): $P > 0.5$ (the majority of people are against that VAT is effectively implemented)

Under Null Hypothesis,

We have $Z = \frac{p-P}{\sqrt{PQ/n}}$

Where Z = large sample test

p = proportion of people who said VAT is effectively implemented.

n = number of people.

It is assumed that the VAT is effectively implemented $(P) = 50\% = 0.5$ and VAT is not effectively implemented $Q = (100-P)\% = (100-50)\% = 50\% = 0.5$

$$\begin{aligned} Z &= \frac{0.65-0.5}{\sqrt{0.5 \times 0.5/100}} \\ &= 0.15/0.05 \\ &= 3 \end{aligned}$$

Therefore $Z_{cal} = 3$.

$Z_{tab 5\%} = 1.645$

Decision,

Here $Z_{cal} (3) > Z_{tab} (1.645)$. So Null Hypothesis (H_0) is rejected i.e. alternative Hypothesis is accepted. This concludes that the majority of the people said that the VAT is not effectively implemented in Nepal.

4.2.3.2 Karl Pearson's Coefficient of correlation (r)

In data analysis and examining activities, the estimated and actual data are comparatively fitted in various forms. The basic purpose of computing coefficient of correlation is to justify whether the data are significant for future

activities or not and whether the actual data are fair from targeted data of not. So to find out the position of both targeted and actual data, we can use this tool. It has been calculated in appendix no (4a)) and summary.

Table 4.23

Analysis of estimated to actual VAT collection (2000/01 to 2006/07)

Particular	Estimated	Actual
Mean	1779	1706
S.D	504.816	523.516
C.V	28.38	30.69
P.E	0.0258	
r	0.948	

This analysis shows that the actual and estimated revenue fluctuates from year to year. The standard deviation and coefficient of variation is higher than the estimated. The value of r is positive within the +1 it shows positive correlation between estimated and actual revenue. It means if the presentation of actual and estimated revenue continues, the actual revenue will increase in the same ratios of estimated revenue.

The calculation of Mean, Standard Deviation, Coefficient of Variation, and correlation are shown in Appendix No. 4.b

4.2.3.3 Regression and Time Series Analysis

Regression is the determination of statistical relationship between two or more variable. The regression used in the study determine the statistical relationship between independent variable X (i.e. Budgeted sales) and dependent variable Y

(i.e. Actual sales). The basic relationship between X and Y is given by; $Y_c = a + bx$

Where, Y_c denotes the estimated value of Y for given value of X.

"Time series analysis shows the relation between two variables, on being the time. It helps in understanding the pass behavior of a variable in the time series. Further, it helps in future forecasting and evaluating the present accomplishment."

$$Y = a + bx,$$

Regression Analysis can be used to analysis the trend of actual revenue to estimate the possible revenue of times in year and actual revenue.

Fiscal year 2003/2004 is assumed to be base year straight line trend $y = a + bx$

The value of a & b is calculated in Appendix No. 4 b

Where,

$$a = 1706$$

$$b = 247.96$$

$$\text{Thus, } y = 1706 + 247.96x$$

The trend line shows the positive revenue figure and the revenue with increasing by 247.96 every year.

The estimated revenue for 2007/2008

$$= 1706 + 247.96 \times 4$$

$$= 2697.8572$$

If other factors remain same direction as previous year, the actual revenue collection for the fiscal year 2007/08 will be Rs. 26978572 thousands.

4.3. Major Findings of the study

The major findings are drawn from the literature review; data presentation and analysis are as follows:

1. Nepal has adopted destination based consumption type VAT with credit mechanism extending through the retail level. The rate of tax was 10% in its introduction now increased to 13% chargeable on the value added each level of production and distribution stages of the goods and services. It includes sales tax, entertainment tax, hotel tax, air flight tax, and contract tax.
2. A taxpayer shall have to pay the tax for each month within twenty-five days of the close of the month. If a taxpayer does not pay the tax within the time limit specified under sub-section, an extra charge of 10% shall be imposed on the tax due until the end of the close of the first full month from the date the tax first becomes due. If the tax is not paid even within the time specified. In sub-section, another 10% shall be imposed on the tax due at that time.
3. A person who provides information with evidence showing that taxpayer has evaded or attempted to evade all or some portions of tax shall be rewarded as reward the equal amount to 20% of the amount of tax collected on the basis of that.
4. A tax officer may make an assessment in any of the following cases.

If a return is not submitted within the time limit.

If an incomplete or erroneous return is filed.

If fraudulent return is filed.

If the tax officer has a reason to believe that the amount of tax was understated or otherwise incorrect.

5. Most of the traders, businessmen, officers, and consumer general public do not have sufficient idea regarding to VAT system. They have been encountering many problem like pricing, accounting and more over billing problem. However, the government has now started to introduce special package programs but that is not sufficient.
6. Billing system is the major aspect for effective and efficient implantation of VAT but businessmen hardly issue bills to consumers and consumers too are not more interested in taking bill due to misconception of increase in the price of goods. Such practice has discouraged the consumers to demand VAT bill and is the root cause of the failure of the billing system.
7. Administration system has a great importance in effective implementation of VAT. Some aspect with private sectors, organizational structure, audit and inspection system, reward and punishment, political intervention, selection of skilled and experienced manpower are needed to improve for the effective operation of VAT in Nepal.
8. There is huge resource gap because the economy is suffering from the persisting resource gap, revenue expenditure, saving investment and import-export. Beside these the country is also facing the increasing burden of foreign loan.
9. There is a greater share of tax revenue in total revenue than non-tax revenue. The contribution of tax revenue is 79.12% and non-tax revenue is 20.88% in FY 2007/08. It shows the total revenue is on increasing stage of 21.35% in the FY 2006/07 but is decreasing stage in FY 2007/08.
10. The contribution of VAT revenue to tax revenue from FY 2000/01 to 2007/08 are 25.33%,24.32%, 23.94%, 23.23%, 26.93%, 29.90%, 29.75% and 27.70% The average contribution of VAT to tax revenue was 26.39%.

11. Even though VAT/GDP ratio is in increasing trend but it is not satisfactory because contribution of VAT revenue to Gross Domestic Product is comparatively low this is not more than of 5.32% in the FY 2007/08. The contribution of VAT to GDP from 2000/01 to 2007/08 are 2.81%, 2.76%, 2.93%, 3.01%, 3.80%, 4.2%, 4.92% and 5.32% respectively. The average contribution of VAT on GDP was 3.72%.
12. The contribution of VAT to the Gross national Product is low which is of average 3.07%. The contribution from 2000/01 to 2006/07 to Gross National Product are 2.79%, 2.67%, 2.73%, 2.71%, 3.20%, 3.28%, 3.55% and 3.61% respectively.
13. The trend of collection of VAT was in increasing from 2000/01 to 2007/08. The amount collected in percent were 3.42%, 0.93%, 9.72%, 7.57%, 30.43%, 14.43%, 20.75 and 14.26% respectively. In FY 2001/02, the trend was in decreased by 0.93% and in FY 2004/05, the highest increment of 30.430%. The average increment was 12.69%.
14. The VAT was collected from domestic and import product. The ratios of import product are higher than VAT collected from domestic product. The ratios of them were 36.38:63.38 in average.
15. According to the economic survey 2008/09, the contribution of VAT to the total tax revenue from 2000/01 to 2007/08 are 32%, 31%, 32%, 30%, 35%, 39%, 37% and 35% respectively. It shows 33.88% in average contribution.
16. The VAT was collected as per estimated in FY 2004/05 and 2007/08. In the rest Fiscal Year, it was collected as under estimated. There was deficit in FY 2000/01, 2001/02, 2002/03, 2003/04, 2005/06 by 8%, 17%, 2%, 7%, 9%, and 1% respectively.
17. The composition of tax revenue was of direct tax, indirect tax composed of income tax, rent tax, and interest tax, is 31%, 1%, and 2% respectively. Indirect tax composed of value added, Excise Duty, and Miscellaneous tax

is 56%, 7%, and 3% respectively in the FY 2007/08 as per Economic Survey.

18. The composition of indirect tax in FY is Value Added Tax, Excise Duty, and Miscellaneous tax are 70.99%, 25.56%, and 3.45% respectively. It was clear that two-third of indirect tax is covered by VAT.
19. Registration in VAT is increasing trend from FY 2001/02 to 2007/08 are 17.2%, 19.27%, 18.78%, 14.40%, 16.39%, 17.73% ,13.16% and 13.1% respectively. The average of increasing was 16.25%. Deregistration were 170, 80, 18, 30, 30, 36, 31 and 150. Business closed was 172, 360, 531, 570, 445, 647, 793 and 863 in VAT from the FY 2000/01 to 2007/08.
20. In VAT, the submission of VAT statement is necessary. There was not satisfactory statement is submitted. In VAT debit statement, credit statement, and zero statement is submitted and out of them unsolved statement also found. There are also in large number who does not submit the statement of VAT from the FY 2000/01 to 2007/08.
21. In the study, it was known that 73% knew the word VAT, 13.5% does not knew the VAT and 13.5% said they do not know the VAT. It meant that 26% does not know what VAT. is
22. In field survey, the VAT will rise the price, 28% of them said yes it will 55% said it will not rise the price and 17% said they does not know that the price will rise or not.
23. In the field survey, the upahar program, the people thought it would be better in awareness program as 33%, 58% said it would make billing system compulsory and rest of 9% said it would control over tax evasion.
24. In field survey, to make easier return process, 55% of them suggested the mechanism should be done through computer, 22% suggested adding skilled and talented manpower and rest of 28% suggested to enlarge the time frame so all submitted VAT statement could be studied in detail and make return process fast.

25. In field survey, it is successful to get expected VAT revenue, 33% said yes, 47% said no and 20% said they do not know. The major person of 47% said no it meant that it was not successful to get expected VAT revenue which was also shown in annual report of Inland Revenue Department 2006/07.
26. In field survey, public challenges and awareness toward VAT in VAT rate, threshold, reward, VAT exempted goods and types of VAT shows 96%, 81%, 12%, 36%, and 42% respectively.
27. In field survey, Awareness of penalty and timely payment toward VAT in penalty not for maintaining proper account and timely paid of VAT are 32% and 68% in average.
28. There are various problems regarding to tax refund at the IRD office IRD and taxpayers level. In order to avoid there problems, a new system should be introduced that does not require the taxpayers to submit a separate application for refund but can apply in tax return form it-self.
29. In the opinion field survey, $Z_{cal} (3) > Z_{tab} (1.645)$. So, Null Hypothesis (H₀) is rejected i.e. Alternative Hypothesis is accepted. This concludes that the majority of the people said that the VAT is not effectively implemented in Nepal.
30. In analysis of estimated and actual VAT collection from 2000/01 to 2006/07, the Karl Pearson's coefficient of correlation (r) is 0.948; it means variation lies between +1 and -1 shows the positive correlation. So the trend of VAT collection will increase each year.
31. Using Regression Analysis, we found straight line equation and from time series, we also forecast VAT collection for the FY 2007/08 which is 26978572 thousands.
32. For effective implementation of VAT in Nepal, the following suggestions are obtained from the studies which are as follows:
 - a. Billing system should be effectively implemented.

- b. Trained and experienced staffs should be hired without discrimination.
- c. Books of account should be properly maintained.
- d. Timely monitoring and supervision should be done.
- e. Public awareness program regarding to VAT and tax system should be launched as far as possible.

Chapter 5

Summary, Conclusion and Recommendation

5.1 Summary

VAT is a recent and an important innovation in the field of modern taxation system. After its origin in Germany it gained worldwide popularity at the academic as well as practical level, so in more than 135 countries VAT has already implemented.

VAT is a tax i.e. based on goods and services. The base of VAT is the value addition that takes place during process of production and distributions. Since this tax is based on consumption, the burden of this tax has to be borne by the consumer.

VAT is based on self assessment system. Under the self-assessment system, a taxpayer is required to keep a proper account of all business transactions. Therefore, the Tax returns filed by the taxpayers by assessing his/her tax liability have to be adopted by the tax administration not only in principle but also in practice. VAT has done away with administrative procedures such as taking approval of price for purpose of sales tax, submission of annual statement of accounts, tax assessment by the tax officers, stamping of invoices, submission of invoices at the tax office along with the tax returns etc.

VAT is transparent tax-system that is based on the taxpayer's transaction. VAT is not only transparent in itself but also demands transparency in other tax system as well. Unless such an environment is created VAT cannot implemented effectively. In order to implement this tax system effectively the

system of creating an artificial price for the purpose of custom duty and assessing the income tax on the basis of negotiations schedule must be replaced by the provision to levy custom duty on the actual transactions value and the acceptance of VAT accounts for the purpose of income Tax.

In order to make VAT effective, it is essential to create an environment in which invoices are issued properly, accounts are maintained accurately, Tax is based on transactions, there is acceptance of the tax payer's correct accounts, and a fair competition among industrialist and businessman is established with respect to tax. Until and unless such a situation is created, VAT implementation will not be easy and pressure will be created in some or another way.

While comparing VAT with other form of sales Tax, it is so far superior on many grounds such as economic efficiency, revenue productivity, and administrative simplicity. However retail level sales tax is only the nearest competitor of VAT extended through the retail level and both will generate equal revenue with similar coverage and rates. If VAT can be implemented effectively along with its different provision like exemptions, threshold, Zero-rating, it will be more suitable. Avoidance of pyramiding and cascading effects and providing cross auditing, self-policing and catch-up effects are the most favorable features of VAT which makes it superior even than retail sales tax.

Although from the legal point of view, VAT has crossed its eleventh years of implementation. In the first two years, since many compromises were made in the principle of VAT due to political instability and frequent change in Government, VAT could not be fully implemented. In our environment where the tax awareness is minimal, the practice to maintain tax account is negligible or improper, smuggling and under valuations is rampant, and tax leakage takes place with negotiations between the taxpayer's and the Tax administration, it was not easy to implement VAT and the political instability only aggravated the situation and made it more complex.

Like the other countries of the world, Nepalese VAT is of consumption type and method used for calculation is tax credit method. Further the VAT is subject to destination principle, currently threshold limit is 2 million and it is subject to flat rate of 13% with zero percent rates on exports. Some selected goods are completely out off VAT net base basically due to the administrative complexity and equity consideration.

Tax revenue is a major source of public revenue of any country. The contribution of VAT revenue on tax revenue is about 30% and remained more or less constant during the study period in our country.

Naturally, to introduce new system replacing old one would be surrounded many complications and oppositions even if the new one is improved one. The same condition was of the VAT. Because of these and many other reasons before introduce any new system it will be better if it is implement after adequate preparations. The implementation of VAT does not seem effective in Nepal till now as the gap between the potential and actual VAT is large and widening every year at the rate of 13%. Lack of conscious consumers, effective implementation of threshold, lack of coordination for between custom and VAT related office. Corruption, lack of transparency is other threat for effective implementation of VAT.

Due to lack of Experts and manpower developed considering IT in VAT administration, the auditing system, major operation tools of VAT, is not effective. Refund system is not operating in expectation of business person that is why the businessmen are feeling harassment and creating negative thought regarding VAT.

As the public conscious level is very low, businessmen are cheating consumers charging high price in the name of VAT. Businessmen also cheating the government, as they are not issuing proper bills in their sales and hence do not pay real VAT amount.

It was expected that after implementation of VAT, problem of Tax evasion, undervaluation would be automatically abolished as it is transparent and all transactions would be recorded in computer. But the exciting large amount of unauthorized trade to/from India has been posing a great threat due course of VAT implementation. The smuggling of good and services are creating loss of revenue. On the one hand, it is not coming through custom point and on the other hand it discourages the genuine traders and loss of revenue.

Whatever the present situation of VAT, the future seems very bright. There is eminent prospect of revenue mobilization if it is implemented effectively.

If provision of zero-rate is to be removed and all sectors including agriculture is to be bring under VAT net then adequate revenue could be mobilized through VAT which would be necessary for all economic as well as social welfare program and the Nepal could be independent for growing expenditure needed for development activities.

5.2 Conclusion

The ultimate objectives of any tax policy in developing countries like ours are a) to increase the growth rate, in relatively short to the maximum possible extent. b) to have built in-flexibility into the tax structure and to provide maximum revenue productivity continuously and consistently with optimum growth rate. c) to act as instruments for combating inflationary pressure in the initial stage of economic development and d) to remove the inequality of income and wealth in society.

All economic indicators show that our economy is passing in low level of equilibrium trap. To escape from this trap it needs huge amount of investment in economic and social overheads. Because of low income and low marginal propensity to save there is little scope fro voluntary saving and investment. External source of financing would reduce the capital formation at the time of repayment of principle and payment of interests. Thus, in this context taxation have vital role to give the movement to the economy. But analyzing the

revenue and expenditure of Nepal, there seems a trend of persisting recourse gap along with the huge amount of saving-investment and export-import gaps.

Regarding the current status of domestic revenue mobilization, it has only support fund for foreign aid and loans but also insufficient for meeting day to day expenditure of government. So, that the government has to depends on external source of financing and other inflationary financing, which are not desirable from welfare and other grounds.

This proves that the government is getting bigger without better and which causing fiscal crisis in the economy.

In the process of tax reform, VAT has introduce in the year 1997 expecting to give speed for revenue mobilization, by creating good environment for tax payers and authorities. VAT was expected have high revenue productivity due to its broader coverage and base. Elimination of economic distortion caused by tax system, elimination of cascading and pyramiding effects, creation of competitive business environment, strengthen the foreign trade etc were other spare of VAT that were expected to fulfill after implementation of VAT. VAT has crossed eleventh years of its implementation. But could not get expected result, which are getting in other countries that are implementing VAT.

It was not unwise to expect VAT have a revenue performance at least as much as the growth rate of GDP. In the context of Nepalese economy, performance of VAT revenue does not seem satisfactory. The contribution of VAT revenue as percent of GDP remained around 5% after the implementation of VAT and the performance does not show improving. The revenue performance of tax which was replaced by VAT was even more than the replaced taxes with respect to GDP over the eleventh years of VAT implementation. This indicates that there is still many challenges and needs more efforts to make the VAT success.

Considering the present economic conditions growing needs of government expenditure, other source of domestic revenue, negative impact of external

sources of revenue, present status of VAT, it seems most essential to rethink about VAT threshold rate, list of exempted goods and sectors etc.

VAT base can be increased significantly after designing the VAT structure properly when there will be fair and capable administration and it will be supported by the general public and the business community. But before modify any structure either it may VAT rate, base, threshold or any other it will be better to make this issue public issues. So, that it will be easy to get the support from either side. This will helps to make VAT broad based and revenue productive in future.

Theoretically VAT is a modern and in general, the best from sales tax, but all its negative and positive aspect mostly depends upon the implementation aspect. The administrative capacity of the Tax authorities, level of awareness of general public and taxpayer, honest and loyal tax collectors, nature and status of development etc are the prerequisite to make the VAT effective. Without all these and other any prerequisites none can analyze and comments either the VAT sits in the economy or not because the economy can not experience all the aspects of VAT.

Thus the implementation aspect has vital role to play, which is dearth in most of the developing countries like Nepal.

Thus the study concludes that there is immense scope of VAT in Nepalese economy which can give right direction to the tax revenue and can be perennial source of domestic revenue, if the VAT is to be implementing effectively it will not so far to meet our objectives of taxation as well development which the study mention above. This can be claimed after looking the figure of potentiality of VAT revenue. But the present situation of VAT is not according to our expectation and the requirement of the economy. Inefficient tax authorities, low level of public and tax payers awareness, insufficient and inefficient manpower, lack of IT system, lack of research on about the weakness of existing VAT system low level of implementation of

findings of scholars, lack of political commitment absent of proper mechanism for monitor and audit, etc are creating hurdles and obstacle on the path of VAT implementation. Because of these the economy is unable to experience positive impact of VAT.

5.3 Recommendation

In order to give motion for Nepalese Tax, government decided to implement VAT in Nepal, as an improved and scientific tax and implementation of VAT has crossed its eleventh years. In due course ups and down appeared, to make VAT as a perennial source of revenue many preparatory programs were lunched in different levels and places. VAT Act, rules and regulations have been setup in line of international standard and its preparation had been made comprehensive and much more extensive.

Since VAT is a modern tax, it demands modernization in all spares to give output as expected. If we implement a scientific tax like VAT but all our behaviors, attitudes and thinking remains pragmatic then it produces less output that a non scientific tax like turnover Tax.

Therefore to achieve result according to our expectations from VAT it is essential to change our attitudes and behaviors towards VAT. Moreover the study indicates following recommendation that should be adopt to get result

- 1) As all of us know success demands labor, continuity, passion and commitment. By the same reasoning a strong commitment from the grass root to the top level prerequisite to make VAT success, which seems lack in Nepalese tax environment. Only the political parties and leaders of opposition in the parliament show their commitment but intentionally nobody have strong commitment to make the system more effective and successful. Also there is lack of proper coordination among the government and other political parties, and among the government offices. Hence the government should create an environment that could include all

the communities and strong commitment for effective implementation of VAT.

- 2) One of the reasons of slow pace of development is the interventions of political parties on making policy and implementing them. Political parties and leaders give unnecessary pressure. Many political leaders who are reached into the cabinet seem not capable for the position. They are strongly motivated for their own benefits rather the national problem, which are the primer cause for the failure of policies instead of implementation. Political leaders are giving their arguments without considering the actual facts, which is creating negative thought upon VAT. Hence, there should not interventions from the political leaders to the policy makers and others in implementing policies and go to the public after full or operation and implementing accordingly.
- 3) An efficient, strong and fair administration is the most crucial for the proper implementation of VAT. But VAT administration is still weak, traditional, corrupted and even physical infrastructures are not available properly. While comparing VAT with the sales tax, job requirements of the tax officials has been changed from physical control to audit base control system and they have to deal with the tax credit, tax refund tax audit etc. instead of this there is lack of expertise, well trained and skill officers in the VAT administration. The informative program such as seminars, training, discussion etc. should be organized to make the tax officers skilled and capable in their field of job and service minded attitude needs to be developed in the mind of tax officers making the provision of prize and punishment.

The tax administration can be improved through an appropriate organization structure compatible with the changing circumstances. The Department of Inland Revenue should give thrust to strengthen the physical facility inclusive of vehicles, photocopies, developing from and

manuals, simplifying procedures, and educating the taxpayers. The system can be improved through developing manuals and work procedures, and maintaining archives and macro films. Tax authorities should develop the long term tax policy.

- 4) VAT is based on the self assessment by the taxes that are required to pay tax on the amount of total value added in their business transactions. Thus VAT is an invoice based and account based system implying a most significant role of business men as well as the general consumers for the effective implementation. But the public conscious level about VAT is very low in Nepal. Very large numbers of businessmen are still unknown about the procedure and accounting system of VAT. So, it is necessary to continue the programs to educate taxpayer as well as consumers and general public and make them known about the system and its significance. This can be done by publishing and providing tax related information through articles, journals, magazines, manuals, brochures, radios, television, discussion programs etc.
- 5) Lack of clarities in the tax laws and regulations are the great issues within business and industrialists. They are arguing that the language used in tax laws and regulations are very complex and ambiguous. They lack clarity and often full of discrepancies and much interpretation can be made out of same law.

To remove such ambiguity government should take some steps immediately. The principal of taxation without representation should be strictly observed. The change in tax rates or base of valuation of commodities should be strictly based on the provisions of law and not on circular, ordinance or executive order. The VAT Act should adjust to the legal provisions made the annual finance bills. Simplify the language for clarity thereby reducing ambiguity in the tax law. The computation of

taxable products and transactions should be done in accordance with the provisions of the VAT Act.

- 6) Human resource is the prime factor of sustainable development of any faculty. But human resource that is needed in the tax system does not seem adequate in Nepalese context. This is the main problem of tax authorities. The Inland Revenue Department should give thrust for manpower development with reference to IT, subjective knowledge of Tax, law, auditing and accounts and training and observation/study tours for the staffs. The department urgently requires support for the manpower development especially through providing training and workshop both for senior and junior staffs with in gain knowledge of tax system, audit, tax laws, investigation techniques practicing in other countries too, by providing training, interaction etc programs. Manpower development is also necessary to support the enforcement activities. Human resource development is also significant for sustainable quality services that could be possible through improving curricula by the Public Service Commission. A separate entrance examination is highly essential for those aspiring for revenue service before the final examination.
- 7) There is crisis of confidence between the government and private sectors i.e. VAT payer and controller. Without close cooperation between those two sectors, VAT can not implement effectively. There were made much agreement between the private sectors and the government but they are not seen in the practice. Person of each are blaming to the person of another. There is a loss of revenue due to the understated value by the taxpayers on the one hand and on the other taxable value is arbitrary fixed by the tax.

Hence, it is necessary to incorporate the private sector with the government through the civil society, FNCC and other different associations.

- 8) There is huge scope for Institutional and Infrastructure reforms. The level of skills and knowledge of the staff at the revenue office should be enacted by continuous training programs. Good governance should flow from top to bottom. Existing excess, inefficient, and unproductive staffs in the various tax offices should be replaced by highly qualified, professional staff that have adequate training in the revenue system.
- 9) Improving the capacity of the Department of Revenue Investigation. The Department of Revenue Investigation has been assigned a crucial role to fight unauthorized trade and control revenue leakages. This department is not functioning in a well manner. There is speculation that this organization might go under the control of Prime Minister Office or merge with the Commission for Investigation of Abuse Authority. Thus, there is urgent need to clarify the status of Department of Revenue Investigation.
- 10) Even if the VAT system is based on the computerized system the data arrangement is not so good. It is necessary to develop and expand the networking of data base and information system at all levels. VAT would be success only if there is perfect computerized system. Therefore it is necessary to promote IT in tax system so that the existing problems such as under-invoicing, non-issuance of Bill, education of taxpayers, and enforcement of law would be automatically solved. Infrastructure development also required especially for the maintenance of IT. In addition, information campaign should be intensified through opening website, organizing seminars symposia and training programs and advertisement on media.
- 11) During the study period, the views are collected which showed monitoring system in the VAT is not so effective so that the taxpayers are encouraged for tax evading practices. Many businessmen don't issue invoice and most of others issues improper invoices. This is not only contrasting the tax

base and thus losses in the tax revenue but also results inequity since who issue proper invoice are discriminated against. So, this system should be checked through an effective monitoring system.

- 12) Some businessmen having tax able transactions are still beyond the tax net. So, the enforcement should be made more effective and voluntary compliance should be encouraged. The level of the voluntary compliance could be raised through a set of promontory and regularly measures including positive and services minded attitude of the tax personnel, rationalization of tax structure simplification of tax procedures and forms, strengthening tax administration, conducting audit ad investigation in an effective manner and penalizing those who break the rules. The procedures regarding registration, collection, interest, penalty, audit and appeal should be simplified and improved.
- 13) Tax system can be rationalized by lowering the level and number of tax rates. Thus it is necessary to lower the import duties on some selected items to discourage smuggling and under valuation by making it less profitable and more risky.
- 14) The existing long open border is the main cause of smuggling and undervaluation in the border sides. So open border should be systematized to greater extend.
- 15) Threshold and tax refund are two possible gates for tax evasion. An effective efficient tax auditing, investigation and monitoring system should be developed. Refund system should be made simple and effective and the period of such refund should be minimized.
- 16) Most of the taxpayers as well as publics are still unknown about VAT and its effects on various aspects. They have developed a kind of misconception regarding to VAT. They do not think that sellers already include VAT in their goods price rather they do think VAT as an extra

charge. Thus, proper publicity regarding to VAT is the fundamental tools for the success of VAT.

- 17) The administration should be very watchful to prevent any kind of malpractice, fraud and tax evasion. Utmost care should be taken to prevent any kind of bribery and corruption. Tax officials should be effectively monitored.
- 18) Consumers should create awareness for taking invoice for every taxable purchase by comprehensive advertisement programs.
- 19) There should be a close cooperation between the private sector and government sector for the successful implementation of VAT in Nepal. Both sectors should always be taken into confidence by each other.
- 20) The implementation of the VAT provides an opportunity to sweep away the cobwebs and revamp a substantial part of the tax administration.
- 21) There are no examples in the world taxpayer sing a song to welcome the new tax system and come in front in line to pay the tax for the government. Most of all their nature is not to pay tax. Tax is not a self-respected donation, it is the payment most to be paid as revenue to the government which is the duty of each and every citizen of the country.

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Appendix 1

Questionnaire

This questionnaire has been prepared for conducting a study titled “Challenges for Implementation in Nepal” as a partial fulfillment for the degree of master in Business Studies. Please choose the best which you think is the appropriate on your opinion.

Personal Details

(i) Name: (ii) Gender: Male/Female

(iii) Age: (iv) Marital Status: Married/Unmarried

(v) Address: (vi) Response Group: Community, Businessman

(vii): Profession:

1. What of the following categories best suit your education level ?

(a) Illiterate () (b) Literate ()

(c) School () (d) College ()

2. Do you know about VAT?

(a) Yes ()

(b) No ()

(c) I don't know ()

3. Is VAT appropriate tax system for Nepal ?

(a) Yes ()

(b) No ()

(c) I don't know ()

4. Which is the threshold amount of VAT registration?

- (a) Annual turnover 10 lakhs ()
- (b) Annual turnover 20 lakhs ()
- (c) Annual turnover 30 lakhs ()
- (d) I don't know ()

5. Which of the following books of accounts must be maintained by the VAT registered sellers ?

- (a) Purchase book ()
- (b) Sales book ()
- (c) VAT account ()
- (d) All of them ()

6. What type of VAT is imposed in Nepal ?

- (a) Community type ()
- (b) Gross National type ()
- (c) Income type ()

7. Will Price rise due to VAT system ?

- (a) Yes ()
- (b) No ()

(c) I don't know ()

8. What reward can we receive if we inform the tax office is informed about the tax evasion?

(a) 20% of the tax payable ()

(b) 15% of the tax payable ()

(c) 10% of the tax payable ()

(d) 5% of the tax payable ()

9. Name any three VAT exempted goods and services.

(a)

(b)

(c)

10. What do you think about Uphar program ?

(a) Awareness program ()

(b) To make billing system effective ()

(c) Control over tax evasion ()

(d) All of them ()

11. How can we make return process easier ?

(a) Computerized ()

(b) Add manpower ()

(c) Time frame ()

(d) All of them ()

12. Do you think the VAT office is successful to get expected revenue?

(a) Yes ()

(b) No ()

(c) I don't know ()

13. Please suggest for effective implement of VAT.

--

Appendix 2

No. of office wise VAT registration

Office Name	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Bhadrapur	873	1036	1069	1265	1400	1547	1590
Biratnager	1539	1685	1667	2008	2291	2609	2506
Dharan	796	874	891	1076	1208	1357	1376
Janakpur	771	839	852	994	1185	1336	1309
Lahan	654	700	722	943	1098	1258	1287
Simara	507	550	557	683	826	928	862
Birgunj	1185	1462	1634	1868	2114	2467	2401
Hetauda	385	449	458	567	717	892	872

Bharatpur	662	735	744	912	1046	1303	1209
Dhangadhi	379	414	442	665	823	1057	1217
Mahendranagar	318	348	362	474	530	657	754
Pokhara	1183	1471	1654	1969	2269	2573	2733
Lalitpur	988	1271	1416	1707	2130	2590	2772
Bhairahawa	1256	1480	1478	1763	2091	2359	2369
Kathmandu-3	2490	3072	3787	4660	5560	6642	7132
Nepalgunj	659	778	832	1030	1315	1620	1808
Kathmandu-1	2975	3482	4537	5326	6273	7394	8072
Kathmandu-2	2722	2806	3410	3854	4247	4956	5019
Bhaktapur	794	965	1106	1255	1444	1787	1916
Krishnanagar	259	311	327	398	456	498	510
Dang	386	421	409	513	603	835	894
Large tax office	0	0	0	244	150	166	188
Total	21781	25149	28354	34174	39776	46831	48796

Source : Annual Report 2006/2007, IRD

Appendix 3

No. of Non Filer as per office wise

S.N.	Office	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
1	Bhadrapur	24	64	130	156	64	137
2	Biratnagar	96	143	203	269	97	180
3	Dharan	74	76	113	165	112	131
4	Janakpur	75	137	129	203	149	240
5	Lahan	99	93	142	168	174	236
6	Simara	45	97	82	106	69	137
7	Birgunj	230	280	392	538	193	325
8	Hetauda	14	39	499	90	74	77
9	Bharatpur	48	83	45	80	62	142
10	Dhangadhi	52	56	94	140	114	261
11	Mahendranagar	65	52	88	118	77	88
12	Pokhara	108	201	242	400	245	323
13	Lalitpur	131	244	380	581	267	325
14	Bhairahawa	55	118	181	224	162	302
15	Kath-3	673	1034	1561	1627	772	1239
16	Nepalgunj	89	133	165	226	154	158
17	Kath-2	1012	725	821	966	1483	1888
18	Kath-1	562	1410	1668	1910	300	454

19	Bhaktapur	178	206	262	314	134	271
20	Krishnagar	31	28	29	44	22	36
21	Dang	19	36	77	158	155	179
22	Large tax office	-	-	19	9	0	0
Total		3680	5255	7322	8492	4879	4879

Source : Annual Report 2006/2007, IRD

Appendix 4a

Calculation of Mean, S.D., C.V. P.E of Estimated and Actual

Fiscal	Estimated			Actual			
Year	(X)	$x=X-\bar{X}$	x^2	(Y)	$y=Y-\bar{Y}$	y^2	xy
2000/01	1350	-429	184041	1204	-502	262144	215358
2001/02	1475	-305	92416	1194	-512	252004	155648
2002/03	1373	-594	352836	1344	-362	131044	215028
2004/04	1550	-229	52441	1447	-269	72361	61601
2004/05	1695	-84	7056	1889	183	33489	-15372
2005/06	2365	586	343396	2194	488	238144	285968
2006/07	2646	867	751689	2670	964	929296	835788
	ΣX		Σx^2	ΣY		Σy^2	Σxy
	12454		1783875	11942		1918482	1754019

Estimated Revenue

$$\text{Mean } \bar{X} = \frac{12454}{7} = 1779$$

$$\text{Standard Deviation (s)} = \sqrt{\frac{(\Sigma x^2)}{N}} = \sqrt{\frac{1783875}{7}} = 504.816$$

$$\text{Coefficient of Variance (C.V.)} = \frac{s}{\bar{X}} = \frac{504.816}{1779} \times 100 = 28.38\%$$

Actual Revenue

$$\text{Mean } \bar{Y} = \frac{11942}{7} = 1706$$

$$\text{Standard Deviation (} \dagger \text{)} = \sqrt{\frac{(Y - \bar{Y})^2}{N}} = \sqrt{\frac{1918482}{7}} = 523.516$$

$$\text{Coefficient of Variance (C.V.)} = \frac{\dagger}{\bar{Y}} = \frac{523.516}{1706} \times 100 = 30.69\%$$

Correlation Coefficient (r_{xy}) =

$$\frac{\sum xy}{\sqrt{\sum x^2} \sqrt{\sum y^2}} = \frac{1754019}{\sqrt{1783875} \times \sqrt{1918482}} = \frac{1754019}{1335.62 \times 1385.09} = 0.948$$

The result shows that there was positive relation

$$\text{Calculation of P. E} = 0.6745 \times \frac{1 - Zr^2}{\sqrt{\rho}} = 0.6745 \times \frac{1 - Z(0.948)^2}{\sqrt{7}} = \frac{0.0683}{2.646} = 0.0258$$

Again,

6 x P.E

$$= 6 \times 0.0258$$

=0.1548

$r > 6P.E$

$0.948 > 0.1548$

Here, r is greater than $P.E$, so it is significant.

Appendix 4b

Calculation of Estimated VAT Revenue for 2007/2008

Fiscal Year	Actual	$X - \bar{X}$ X2003/04	X^2	XY
X	Y	(X)		
2000/01	1204	-3	9	-3612
2001/02	1194	-2	4	-2388
2002/03	1344	-1	1	-1344
2003/04	1447	0	0	0
2004/05	1889	1	1	1889
2005/06	2194	2	4	4388
2006/07	2670	3	9	8010
	ψ X11942		ϵ^2 X28	$\epsilon \psi$ X6943

$$a = \frac{\psi}{\rho} X \frac{11942}{7} X1706$$

$$b = \frac{\epsilon \psi}{\epsilon^2} X \frac{6943}{28} X247.9643$$

The estimated revenue for 2007/08

$$y = a + bx = 1706 + 247.9643 \times 4 = 2697.8572$$

...The estimated VAT revenue for 2007/08 will be Rs 26978572 thousand

APPENDIX 5

List of VAT exempt goods and service

1. Basic Agricultural Products
 - a. Paddy, rice, wheat, maize, barley, millet, pulses, flour, and similar unprocessed food materials.
 - b. Green and fresh vegetable, fresh fruits, fresh eggs and similar products (except used in hotels, restaurants, bars, guest house, cafeteria and other similar organization.
 - c. Unprocessed cereals,(such as sugarcane, tea leaf, tobacco, cotton, cardamom, jute, oil, seeds, soyabean)
 - d. Herbs.
2. Goods of Basic Needs:
 - a. Unprocessed edible oil,
 - b. Piped water, including water supplied by tankers.
 - c. Fuel wood and coal.
 - d. Salt.
3. Live Animals and animal products:
 - a. He goat, sheep, yak, he buffalo, bore, pigs, rabbit, and similar other animals, their fresh milk and uncooked/ unprocessed varieties.
 - b. Cows, she buffalo, and she goat.
 - c. Ducks, hens, cocks, turkey and similar other birds and other fresh meat, eggs, and similar uncooked varieties.
 - d. Fresh or dried fish(other than packed)

4. Agriculture input
 - a. seeds of any plants listed in Group I
 - b. Manure, fertilizer and oil conditioners.
 - c. Agriculture hand implements.
 - d. Pesticides made mainly for use of crops.
 - e. Agriculture equipment, including tractors.
 - f. Birds and animal feed.
5. Medicine, Medical and Similar Health service.
 - a. Medical or surgical services provided by Government Institutions.
 - b. Human blood and products derived from human blood.
 - c. Human or animal organs or tissue for medical research.
 - d. The supply of services by persons on the register of veterinary surgeons and veterinary doctors.
 - e. The supply of goods made for, and suitable only for the use of disabled persons.
 - f. X-rays films and oxygen gas to be used for treatment.
 - g. Raw materials purchased or imported by the drug industries to the extent approved by the department of drugs management.
6. Education
 - a. The provision of research in a school or university.
 - b. The provision, otherwise than for profit, of professional or vocational training or refresher training.
 - c. The provision of education in a school or university and supply of goods made in connection with such service.

7. Books, Newspaper etc

a. Books, newspaper, newsletters and periodicals.

b. Newsprint.

8. Artistic and Cultural goods and services, carving services

a. Paintings, handicraft, carving and related services.

b. Cultural program.

c. Admission to libraries, archaeology, museum, zoos and botanical gardens.

9. Personal or Professional services

Air transport, non-tourist passenger transportation (except cabal car) and goods carrier (except transportation related to supply)

10. Personal or Professional services

Personal services rendered by artists, sportsmen, authors, writers, designers, translators and interpreters instructionally or individually)

11. Other goods or services.

1) Postal Service(provided by Nepal Government only)

a. The service conveyance of letter, money and packets by the post office.

b. The supply by the post office of any service in connection with the conveyance of letter, money and postal packets.

c. Postage stamps.

2) Financial and insurance services.

- 3) Bank notes and cheque books.
 - a) The printing and issue of bank notes.
 - b) The supply of bank notes from outside the kingdom of Nepal to the kingdom of Nepal.
 - c) Cheque book.
- 4) Gold and silver.
 - a) Gold, gold coins and gold ornaments.
 - b) Silver and silver cons(other than ornaments and goods made or silver)
- 5) Electricity
- 6) Raw wool
- 7) Battery operated tempo, their chassis and battery,
- 8) Bio-gas, solar power and wind power operated power generation plant and their main parts on the recommendation of the alternative energy centre.
- 9) Aero plane, Helicopter, fire Bridge and Ambulance.
- 10)Jute goods.
- 11) Industrial machinery included in section 84 of custom tariff and subject to 5% TRAIFF.
- 12)Woolen carpet & woolen carpet weaving, dying, washing, knitting.
- 13)Aluminum, copper, scrape, circle, plate and utensils.
- 14)Cotton yarn.
- 15)Woolen yarn to be used in hand knitting sweater (except artificial & acrylic) domestically.

16) Donated goods received for calamities or Phil and tropic purpose approved by ministry of finance.

12. Land & Building:

Purchase and rent of land and building (accept the rental service provided by hotel, guest house or similar organization.)

13. Betting, Casinos, Lotteries

- a. The provision of any facilities for the placing of bets or the playing of games of chance.
- b. Lottery

Zero Rates

Goods or service payable at zero rates

1) Export of goods.

- a. Goods exported outside the kingdom of Nepal ;
- b. Goods shipped for the use as stores on a aircraft to an eventual destination outside the kingdom of Nepal
- c. Goods loaded for use stores on aircraft to a destination outside the kingdom of Nepal or as merchandise for the sale by retail or supplied to person in the course of such a flight.

2) Export of service

- a. A supply of services by a person in the kingdom of Nepal to a person outside the kingdom of Nepal and having no business establishment, agent or legal representative acting on his behalf in the Kingdom of Nepal.
- b. Where goods are supplied in hire or loan basis by a registered person resident in Nepal to a person outside the kingdom of Nepal.

3) Import of goods and service by accredited diplomats.

Appendix – 6

VAT rate in Non- European Countries

Country	Rate	
	Standard %	Reduced %
Argentina	21	10.5 or 0
Australia	10	
Bosnia and Herzegovina	17	
Canada	6 or 14	4.5
Chile	19	
People's Republic of China	17	6 or 3
Croatia	22	
Dominica Republic	6	12 or 0
Ecuador	12	
Et Sawador	13	
Gyeyane	16	
Iceland	24.5	14
India	12.5	4, 1 or 0
Israel	15.5	

Japan	5	
Kazakshtan	15	
Lebanan	10	
Moldova	20	5
Republic of Macedonia	18	5
Malaysia	5	
Mexico	15	
New Zealand	12.5	
Norway	25	13 or 8
Paraguay	19	
Philippines	12	
Russia	18	18 10 or 0
Serbia	18	8 of 0
Singapore	5	
South Africa	14	
Republic of Korea	10	
Srilanka	15	
Switzerland	7.6	3.6 or 2.5
Thailand	7	

Turkey	18	
Ukraine	20	
Venezuela	16	

Appendix – 7

VAT rate in European Countries

Country	Rate	
	Standard %	Reduced %
Austria	20	12 or 10
Belgium	21	12 or 6
Bulgaria	20	
Cyprus	15	5
Czech Republic	19	5
Denmark	25	
Estonia	18	5
Finland	22	17 or 8
France	19.6	5.5 or 2.1
Germany	19	7
Greece	19	9 or 4.5 (reduced by 30% to 13, 6 and 3 on islands)
Hungary	20	5
Ireland	21	13.5, 4.8 or 0
Italy	20	10, 6 or 4
Latvia	18	5
Lithuania	18	9 or 5

Luxemburg	15	12, 9, 6 or 3
Malta	18	5
Netherlands	19	6
Poland	22	7, 3 or 0
Portugal	21	12 or 5
Romania	19	9
Slovakia	19	
Slovenia	20	8.5
Spain	16	7 or 4
Sweden	25	12 or 6
United Kingdom	17.5	5 or 0

Acronyms

ADB	=	Asian Development Bank
APC	=	Average Propensity to Consume
BOP	=	Balance of Payment
CBS	=	Central Bureau of Statistic
CEDA	=	Central for Economic Development
DANIDA	=	Danish International Development Agency
EEC	=	European Economic Community
ESAF	=	Enhance Structural Adjustment Framework
EU	=	European Union
FNCCI	=	Federation of Nepalese Chamber of Commerce
FY	=	Fiscal Year
GATT	=	General Agreement of Tariff and Trade
GC	=	Government Consumption
GDP	=	Government Domestic Product
GEV	=	Government Expenditure Variable
GNI	=	Gross national Income
GNP	=	Gross National Product
GTT	=	Government Total Trade

HDR	=	Human Development Report
HIID	=	Howard Institute for International Development
HMG	=	His Majesty's Government
IMF	=	International Monetary Fund
IRD	=	Inland Revenue Department
LDC	=	Least Developed Country
MDG	=	Millennium Development Goal
MoDVAT	=	Modified Value Added Tax
MOF	=	Ministry of Finance
NPC	=	National Planning Commission
MST	=	Multistage Tax
NRB	=	Nepal Rastra Bank
OECD	=	Organization for Economic Cooperation and Development
RLST	=	Retail Level Sales Tax
SAARC	=	South Asian Association for Regional Cooperation
SAFTA	=	South Asian Free Trade Area
TFP	=	Total Factor Productivity
TPIN	=	Tax Payer Identification Number
UK	=	United Kingdom
USA	=	United State of America

USAID = United States Agency for Intentional Development

VAT = Value Added Tax

WB = World Bank

WLST = Wholesale Level Sales Tax

WTO = World Trade Organization