

***VAT Collection System and its Legal Provision in
Nepal***

A Thesis

**Submitted to
Office of the Dean
Faculty of Management
Tribhuvan University**

**Submitted by
Suresh Kumar Pun
T.U. Regd. No. 38101-94
Exam Roll No. 4480034/066
New Horizon College
Butwal, Nepal**

**In Partial Fulfillment of the Requirements for the Degree of
Master of Business Studies (M.B.S.)**

March, 2013

RECOMMENDATION

This is to certify that the thesis

Submitted by
Suresh Kumar Pun

Entitled
**VAT COLLECTION SYSTEM AND ITS LEGAL
PROVISION IN NEPAL**

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

Mr. Lalitman Shrestha
Supervisor

Mr. Bharat Bhusal
Coordinator

Date:

VIVA-VOCE SHEET

We have conducted the viva-voce examination of the thesis presented by

Suresh Kumar Pun

Entitled

VAT COLLECTION SYSTEM AND ITS LEGAL PROVISION IN NEPAL

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

Viva-Voce Committee

Head of Research Department :

Member (Thesis Supervisor):.....

Member (External Expert):.....

Date:

DECLARATION

I hereby declare that this thesis entitled “**VAT COLLECTION SYSTEM AND ITS LEGAL PROVISION IN NEPAL**” submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my Original work done in the form of partial fulfillment of the requirement for the Master in Business Studies (MBS) under the Supervision of Mr. Lalitman Shrestha, New Horizon College.

Suresh Kumar Pun
New Horizon College
March, 2013

ACKNOWLEDGEMENTS

It is my great opportunity to complete this thesis under the supervision of Mr. Lalitman Shrestha, New Horizon College, for generous encouragements and undertaking of the supervision of my entire research work. This form of the report is the outcome of his continuous encouragement, helpful suggestions and comments.

I am also grateful to all staffs of Inland Revenue Department for providing the information and necessary data sincerely and timely and other all staffs of the library and administration of New Horizon College and Central Library of Tribhuvan University. I am also grateful to respondents for providing the information and necessary data sincerely and timely.

I also extend my hearty thanks to my friends for providing me valuable suggestions. I would like to express hearty thanks to my family members.

Suresh Kumar Pun
New Horizon College

TABLE OF CONTENTS

Recommendation	
Viva-Voce Sheet	
Declaration	
Acknowledgements	
Table of Contents	
List of Tables	
List of Figures	
Abbreviations	

CHAPTER I : INTRODUCTION

1.1 Background of the Study	1
1.2 Role of VAT Collection and Legal Provision	5
1.3 Statement of the Problem	5
1.4 Objectives of the Study	7
1.5 Significance of the Study	7
1.6 Limitations of the Study	7
1.7 Organization of the Study	8

CHAPTER II : REVIEW OF LITERATURE 9

2.1 Conceptual Review	9
2.2 Origin and Development of VAT	10
2.3 Concept of VAT	13
2.4 Methods of Computation of VAT	18
2.5 Principles of VAT	19
2.6 VAT and Other Former of Sales Tax	20
2.7 Structure of VAT	28
2.8 Operation of VAT	34
2.9 Legal Provision Relating To Vat Collection System	37
2.10 Review of Empirical Studies, Books and Thesis	45
2.11 Research Gap	55

CHAPTER III: RESEARCH METHODOLOGY	56
3.1 Introduction	56
3.2 Research Design	56
3.3 Sources of Data	56
3.4 Data Gathering Procedures	57
3.5 Data Processing Procedures	57
3.6 Statistical Procedures	57
CHAPTER IV : DATA PRESENTATION AND ANALYSIS	58
4.1 Introduction	58
4.2 Analysis of Government Expenditure, Revenue and Deficit	58
4.3 Structure of Tax Revenue in Nepal	60
4.4 Tax Revenue Structure of Nepal	62
4.5 Revenue Collection from VAT	65
4.6 Contribution of VAT to Total Revenue	67
4.7 Contribution of VAT to Total Tax Revenue	68
4.8 Contribution of VAT to Indirect Tax Revenue	69
4.9 Contribution of VAT to GDP	70
4.10 VAT Registration	72
4.11 Major Empirical Findings	73
4.11.1 View on VAT as appropriate means of raising the public Revenue	73
4.11.2 Views on superiority of VAT to the areas it has replaced	74
4.11.3 View on Sufficiency of Legal Provision Concerning to VAT Collection System	75
4.11.4 Views on Collection System	76
4.11.5 Views on Revenue Collection from VAT	77
4.11.6 Views on problems in the process of VAT collection in Nepal	77
4.11.7 Views on most important factor for the effectiveness of VAT collection	78
4.11.8 Views on effectiveness of VAT in the future	79
4.11.9 Views on VAT Collection System and Legal Provision in Nepal	80
4.12 Major Findings of the Study	81

CHAPTER V: SUMMARY, CONCLUSION AND RECOMMENDATIONS	83
5.1 Summary	83
5.2 Conclusion	86
5.3 Recommendations	87
Bibliography	
Appendix	

LIST OF TABLES

Table No.	Title	Page No.
4.1	Government Revenue, Expenditure and Deficit	59
4.2	Structure of Tax Revenue in Nepal	60
4.3	Structure of Tax Revenue	63
4.4	Revenue Collection from VAT	66
4.5	Contribution of VAT to Total Revenue	68
4.6	Contribution of VAT to Total Tax Revenue	69
4.7	Contribution of VAT to Total Tax Revenue	70
4.8	Contributing of VAT to GDP	71
4.9	Total No. of VAT Registrants	72
4.10	VAT as appropriate Mean of Raising Public Revenue	74
4.11	Views on superiority of VAT to the areas it has replaced	75
4.12	Sufficiency of Legal Provision Regarding to VAT Collection	76
4.13	Degree of Liberalism in Collection of VAT	76
4.14	Satisfactory Towards Collection of Revenue from VAT	77
4.15	Problems in the Process of VAT Collection in Nepal	78
4.16	Views on most Important Factor for the Effectiveness of VAT	79
4.17	Effectiveness of VAT in the Future	80

LIST OF FIGURES

Figure No.	Title	Page No.
4.1	Government Revenue, Expenditure and Deficit	59
4.2	Tax, Non-Tax and Total Revenue	61
4.3	Tax and Non-Tax Revenue	62
4.4	Structure of Tax Revenue	64
4.5	Trend of Direct Tax and Indirect Tax with Respect to Total Tax Revenue	65
4.6	Bar Diagram of VAT Collection	66
4.7	Trend Lines of VAT Collection	67
4.8	Contribution of VAT in Total Revenue	68
4.9	Contribution of VAT in Total Tax Revenue	69
4.10	Contribution of VAT in Indirect Tax Revenue	70
4.11	Contribution of VAT Revenue to GDP	72
4.12	Total Number of VAT Registration	73

ABBREVIATIONS

F/Y	Fiscal Year
GDI	Gross Domestic Income
GNP	Gross National Product
G/N	Government of Nepal
Inp.	Input
IRD	Inland Revenue Department
MOF	Ministry of Finance
MST	Manufacturing Level Sales Tax
PAN	Permanent Account Number
RST	Retail Level Sales Tax
Ref.	Reference
TU	Tribhuvan University
UK	United Kingdom
USA	United States of America
VAT	Value Added Tax
WTO	World Trade Organization
WST	Wholesaler Level Sales Tax

CHAPTER I

INTRODUCTION

1.1 Background of the Study

Every government needs adequate resources for successful implementation of all the development activities in the country. Nepal is no exception to the category of welfare state. She has to perform all the duties of a welfare state. Therefore, the economic growth of Nepal in the fiscal year 2001/02 was negative, for the first time after the year 1989/90(MOF, 2011)..On one hand the recurrent government expenditure is rapidly increasing, because government has to spend a lot of fund for security provision relief packages for Maoist victims etc. On the other hand, the development expenditure is decreasing day by day. In order to meet the growing need of public expenditure, government has to generate resources from various sources. The sources of government revenue are mainly of two types. They are:1) Internal (2) External.

Because of the insufficiency of internal resources mobilization and the reliance on external resources for financing, it is certainly not desirable to depend excessively on foreign assistance for a development effort. The increasing dependent external sources of funding including resources for meeting the current expenditure is equally worsening as it would create serious anomalies and distortion in the economy. This situation has already enunciated the fact that a proper utilization of available resources needs to be emphasizes as much as the search for the additional resources while formulation resources mobilization policy.

While considering the ration of tax revenue to national production, that tax collection has been insignificant in comparison with tax potential. While little attention is being paid to revenue collection, equal weakness in tax related law, rules, procedures and administration have caused huge leakages in revenue. Taxpayers have not been able to pay taxes due to legal and procedural difficulties. Such problems are made prevalent particularly in the case of direct taxation. Due to this, our dependency on indirect tax has been very high and its impact

on low income group is very high. Nepal government is committed to mobilize revenue in accordance with tax paying capacity of the people by changing revenue structure and administrative procedure. For this, the government review laws, rules and administrative procedures related to tax.

Due to the limitation of direct tax and its low performance in revenue collection indirect tax has been given preference by Nepal government. So to enhance for revenue mobilization VAT was introduced in Nepal. Income tax and custom administration made more transparent and supportive, attracting all entrepreneurs and the business communities to come under the network of VAT. Since, the VAT is one of the components of indirect taxes developed in past is probably the best tax system that had never been at the top of tax system.

“Valued added tax is a twentieth innovation in the tax system. This tax is based on goods and services. VAT is regarded to be a member of the sales tax family since it is imposed on the sale of goods and services. Since VAT is levied only on the value addition made at each stage in the process of production and distribution, this tax system is more neutral, efficient, elastic and fair and is said to be improved version of the sales tax” (Khadka, 2001 p. 92). So, this is reformed sales tax that avoids cascading effects and provides tax credit facility of refund.

VAT is a sales tax in advance forms. It is imposed on different stages. It is the tax imposed on added value of good and services. Encyclopedia of taxation and tax policy says, “Value Added Tax is a broad based tax on business designed to measure net value generated in a country.” Indian tax institute defines VAT as “a tax imposed on the seller of goods and services based on value added by their respective units.” “Value added tax is also known as goods and services tax or added value tax. It is tax system that aims to minimize tax evasion and increase resource mobilization” (Kandel, 2006 p. 37).

Economic development has been major issue for the countries all over the world. The proof of the government existence lies in its activity for social and economic upliftment of the nation along with life standard of the peoples. In order to realize goals, the government lunches several economic social, cultural and other development activities. The successful lunching of these activities depends on the sufficiency of various types of resources like man, machine, materials, money etc. the most crucial resources is financial resource. This can be

derived internally and externally. Internal resources consist of tax revenue and no tax revenue where as external resources consist of foreign subsidy, foreign loan etc.

Generally there are two types of tax, Direct tax and Indirect tax. Direct tax is really paid by a person to whom it is legally imposed while an indirect tax is imposed on one person but partly or wholly paid by another. Income tax, property tax, gift tax, interest tax, expenditure tax etc are direct tax where as entertainment tax, sales tax, hotels, excise duty, custom duty etc are indirect tax.

Indirect tax is commodity tax. It tends to be shifted an indirect tax which is partly or fully passed on by forward and backward shifting process. Most of the developing and least developed countries including Nepal have been basically depending upon indirect tax for internal revenue generation because of administration inefficiency lack of tax culture and awareness of tax payers very low per capital income etc.

Here, Nepalese government indicate its intention to convert the import/ manufacturing actuating level, sales tax into VAT in the eighth plan (1992-97). Document, subsequently, the then state minister of finance in this 1992/93 budget speech announced that the principle of value added tax on domestic production would be applied on an experimental basis from the fiscal year 1992/93 when a two-tier sales tax system was adopted under this system dealers and distributors of nine selected items in addition to manufacturing were required to register of sales. They were however allowed to credit the amount of tax paid to the manufactures. The scope of the two-tier tax was further expanded in 1993-94 when it was extended to five more items further sole distributors or agents of the foreign firms or companies and their wholesalers were required to register as secure of sales tax purpose and collect sales tax on their sales.

A VAT task force was created in the sales tax and excise department in September 1993 in order to make the necessary preparation for introduction of VAT. Financial assistance was granted by USAID and technical assistance by the Harvard Institute for International Department of the Harvard University, USA; the VAT tax force examined various aspects relating to the structure and operation of VAT and prepared the draft VAT legislation. Comments on this draft were invited from industry and trade sectors. The VAT task force organized discussion programmes on VAT for the representatives of the industry and trade

sectors in different parts of the kingdom. It also prepared a VAT introductory brochure which was distributed widely to the potential taxpayers, tax administrator and other. The VAT tax force was dismantled. The coalition government formed in September 1995 indicated its commitment to introduce VAT in its 1995-96 budgets, which was presented to the parliament on 15 October 1995.

VAT is levied on the value added to goods and services. The value added for a firm is the gross receipts from sales minus all expenditure on goods and services purchased from other firms. In the production and distribution process a firm buys materials from other firms. These materials may include principle raw material, auxiliary raw materials, chemicals, electricity and capital goods, such as machinery, equipment these purchased materials by processing or handling them with the help of its own factors of production, such as labor, land, capital etc. This increase in the value of output over input is the value added by a firm. In other words, looked at from one angle value added by a firm is the sum total of the incomes paid out by the firm to factors employed. This means that the value added by a firm is equivalent to its payment of wages, salaries, rent and interest plus its profit and this value added is the base of VAT.

VAT is indirect tax. This tax is used in product and services for every channel like producer, wholesaler, retailer and customer. In practical and principle VAT is regressive tax and its final weight bear by a customer. The main objective of VAT is to mobilization the resources.

So our study is concern: how should the VAT collection and what are the legal provisions regarding to the VAT collection system.

Legal provision will be the main subject of this study. In case of provision in Nepal while collecting VAT, the tax payer should pay after 25 day of each month. Otherwise 10% delayed charge is added to the VAT due. But, if the taxpayer submits the reasonable reason to the administration this charge will not be charged. There are other lots of provision like registration of small firms, transaction lower the threshold, selling of ownership, agriculture etc. To make VAT transaction and practical it has categorized non VAT items such as agriculture, foods etc.

1.2 Role of VAT Collection and Legal Provision

As stated above collection of VAT is affected by the VAT collection system whereas the legal provision concerning to the VAT collection system has crucial part. Through VAT, internal revenue is increased which is very important for the development of nation.

It plays a vital role for the economic development of nation, Resources mobilization is compulsory for the economic development as well as smooth operation of any country. Nepal has adopted planned development since 1956, from that time need for mobilizing additional financial resources has been growing. Financial resources can be mobilized internally as well as externally. External resource includes foreign loan and grants. Internal financial resources can be obtained from tax measure and non-tax measure. Tax measure includes direct tax and indirect tax. Direct tax which is paid by taxpayer directly, where as indirect tax measure includes government charges, fees, fines, forfeitures, receipt from sale of commodities, fixed assets and services, dividend, royalty etc.

1.3 Statement of the Problem

In own aspect and condition of the developing countries in the world, Nepal has been suffering from resources constraints, massive poverty, rapid growth of population, increasing frictional and seasonal unemployment, disease, aggressive dependent on the agriculture, subsistence living standard and poor infrastructure despite over five decades planned development efforts. The government has to allocate large amount of money to uplift the socio-economic status of the people. Hence the government expenditure is growing. So, government revenue must be increased. Income tax is the best source of government revenue. It is good in the sense that only capable taxpayer has to pay income tax. Income tax is a powerful instrument for mobilizing internal resources. It is also an instrument of economic growth and social justice.

Nepal is very poorest country situated between China and India. Like other developing country of the world Nepal is also rapid population growth, increasing unemployment, resources constraints and high dependency on an agriculture, low living standard and poor infrastructure. In order to solve the above problem, it needs huge amount of resources and such resources can be obtained internal as well as external sources. In Nepal resources

mobilization is still poor and is not able to cover the growing expenditure. In order to match expenditure and income foreign loan is increasing aids are not sound a way of resources collection and such collection will affect economy badly. In loan we should pay interest which waste huge amount of money.

In fact foreign source should not give priority and should focus on domestic source in order to run economy smoothly. In fact value added tax should be developed as good sources of internal resources.

Due to internal conflict not established government, in this time Nepal is suffering from huge resource gap. Most of developing expenditure has cut and security expenditure has increased, tourism one of the most important areas of economy is declining and due to this reason big part of resources is decreasing. The condition of trades, investment and industries are becoming terrible. Nepal is second richest country in water resources in the world but due to lack of resources, these resources not utilizing properly. Despite being richest country in water resource only 41% of Nepalese has access of electricity and condition of irrigation is also terrible. These all indicate that Nepal needs huge amount of resource and such resources internally we should focus on various tax. Infrastructure and value added should be developed as an affective source of resource. From early time Nepal is suffering from resource gap and such gap was caused of poor tax system. Now, Nepal has been adopted VAT system was 8 years ago. But it has been not implementation so smooth. There was highly debate and discussion while implementing VAT but now such discussions are not taking place but in order to make VAT effective the concerned body should be listen the suggestion of various concerned sector and should implement such effective and reliable suggestion. The research question is as follows:

- 1) What is the structure of tax in Nepal ?
- 2) How much revenue is collected from VAT ?
- 3) What is the VAT collection problem in Nepal ?
- 4) What is the level of taxpayer's satisfaction ?

1.4 Objective of the Study

The basis objective of this research study is to examine the practice of value added tax in Nepal. However, the objectives of this study are pointed out as follows:

- 1) To review the structure of tax in Nepal.
- 2) To analyze revenue collection from VAT.
- 3) To examine VAT collection problem in Nepal.
- 4) To examine taxpayers' satisfaction..

1.5 Significance of the Study

About nine years have been passed since VAT came into operation, but many Nepalese people are unknown about various aspects of it. VAT being itself a complicated and modern tax system, more efforts should be made on actual circumstances. Theoretical and practical knowledge are required to collect VAT properly and provide detailed information to tax payers. So, this study analysis VAT collection system and legal provision concerning to it in Nepal. Because of this reason the study will directly beneficial to policy maker, private sector, researchers and other general people. It will also provide an idea and knowledge to these persons who are interested but confused about VAT collection system and legal provision. Nowadays there are so many consumers who do not want to pay VAT and the businessman want to avoid VAT, but the administrators are not responding totally to these problems. This study helps to improve such type of problems and similarly, it will be valuable reference to the further researchers. So, the study has a great significance.

1.6 Limitation of the Study

- a) This study confine to Nepalese laws, acts, rules and regulations to the VAT.
- b) Only those factors which are contributing the government revenue from VAT have been considered.
- c) This study will focus the period from 2002/2003 to 2010/2011

1.7 Organization of the Study

The whole research is divided into five chapters which are as follows:

The first introduction chapter includes: background of the study, statement of the problem, objectives of the study, limitation of the study, significance of the study, and organization of the study.

The second chapter review of literature is done to know what research had been done in the related topic in previous days and what is to be done at present or in future. This chapter has been divided into two main aspects conceptual review and review of related materials i.e. review of books review of thesis and review of research paper and articles etc

The third chapter includes research methodology. It includes research design, sources of data, data gathering procedure, data processing procedure and statistical procedure

The fourth chapter includes government expenditure, revenue and deficit; structure of tax revenue in Nepal; revenue collection from VAT; contribution of VAT in government revenue; VAT registration and empirical findings.

The fifth chapter consists of brief summary, conclusions and recommendations of the study. Bibliography, appendices and other supporting documents have also been incorporated at the end of the study.

CHAPTER II

REVIEW OF LITERATURE

2.1 Conceptual Review

The term Value Added Tax has been taking important role in taxation field in order to raise tax scientifically in simple manner. Most of writers in connection with this subject are in a position to start it as a term of sales tax. Most of countries replaced sales tax by introducing the new concept of Value Added Tax. The most important factor found in VAT is the mechanism imposing tax to the tax payer by making tax liable to only in the value added at each stage of business transaction such as production and distribution of goods and services VAT can be taken as multiple stage tax which has grown as a hybrid of turnover tax and retail sales tax. VAT is similar to turnover tax as the tax is imposed at that stage. "It is similar to a turnover tax in the sense that both these taxes are imposed at each stage while the former is imposed only on value added tax at each stage of production and distribution process. VAT however different from the turnover tax as the later is imposed in total value each stage while the former is imposed only on value added at this stage" (Khadka, 2001, p. 24).

From above statement it is clear that tax is imposed value added only at each stage of production and distribution under value added tax where as the tax is imposed on total value at each stage of production and distribution under turnover tax.

"Value Added Tax is the twentieth century innovation in the tax system, which is considered as a member of sales tax family. It is imposed on the value added of goods and services. Since VAT is levied only on the value addition made at each stage in the process of production and distribution. This tax system is more neutral, efficient, elastic and fair. VAT is also said to be improvised version of sales tax" (IRD& VAT Project, 2001, p. 95).

"In practice the VAT is collected from producers and distributors at many points and treated as multiple stage commodity tax. It is different from turnover tax" (Subedi, 1998, p. 86).

VAT can be taken as similar to retail tax. The tax base of VAT is consumption and retail sales tax is based on consumer goods and services. Regarding consumption factors both VAT and retail sales tax is identical, there can be found the difference of imposing tax on stage only between these taxes.

“VAT is similar to retail stage sales tax because the base of VAT and of the retail level sales tax on consumer goods and services are identical. VAT however varies from retail level tax in the sense the former is imposed at each stage of production and distribution while the later is imposed only a one stage, which is the final stage” (Khadka, 2001, p.2).

“VAT is levied on the valued added to goods and services. The value added for firm is the gross receipts from sales minus all expenditure on goods and services purchased from other firms” (Khadka, 2001 p.2).

In this connection it makes proof that the tax payer will get chance to deduct the tax paid on purchase of materials from sales tax have, the valued added tax is more concerned with net value added tax, those goods receipt minus all expenditure on purchase of goods and services.

“VAT as an indirect tax, imposed upon production or sales collected from seller and presumably passed forward to the consumers of the goods and services or burden borne by consumers in its consumption form, and designed to avoid taxation of intermediate inputs i.e. raw materials and producer goods, it is regarded as consumption related tax or as form of sales tax because a VAT is regarded as comprehensive one since it covers all economic activities right through to retail level” (Subedi, 1988 p.87).

2.2 Origin and Development of VAT

VAT is the most recent innovation in the field of taxation. The concept of VAT was proposed for the first time by Dr. Wilhelm Von Siemens in Germany in 1919 as an improved turnover tax. The improvement consisted in the subtraction of previous outlays from taxable sales with the results that the tax base of each firm would be reduced to the value, which is added to the product. In 1921, VAT was suggested by Professor Thomas S. Adams for United States of America who observed sales tax with a credit or refund for taxes paid by the producer or dealer on goods bought for resale or for necessary use in production of goods for sales.

Further, VAT was developed in 1949 by a tax mission led by Professor Carl S. Shoup for the purpose of reconstructing Japanese economy by avoiding then existing defects of turnover taxes. These proposal and recommendations were not brought into practice by any country. VAT remained only the topic of academic interest and limited only in theory until 1953.

France led the way in 1954 by adopting a VAT covering industrial sector alone and the tax was limited up to the wholesale level. The tax was limited to the boundaries of France until the fifties. Ivory Coast followed France by introducing VAT in 1960. Senegal also introduced VAT in 1961.

Since 1960's VAT became a popular subject matter of taxation in many countries. Denmark and Brazil also adopted VAT in the year of 1967. In 1968, France redesigned the then existing VAT system and extended it to retail level. Germany implemented VAT in 1968. Since 1969, VAT was in operation in Netherlands and Sweden. Luxembourg adopted VAT in 1970. Belgium in 1971, Ireland in 1973. Portugal and Spain brought VAT into operation in 1986 while the same was adopted by Greece in 1987.

Vietnam was the first country in Asia to introduce VAT in 1973. South Korea introduced VAT in 1977, China in 1984, Taiwan in 1986, Philippines in 1988, Japan in 1989, Thailand in 1992 and Singapore in 1994.

In South Asia, Pakistan, Bangladesh and Sri-Lanka started in 1990, 1991 and 1998 respectively. India introduced VAT in a different way under the name of modified value added tax (MOD VAT) in 1996. Nepal has fully implemented VAT since 16 November 1997 (1 Mangsir 2054).

VAT became popular in the decade of 1970s. The popularity of VAT increased worldwide. Different countries of Asia, Africa and North America & South America started to adopt VAT one after another. This tax system became a popular worldwide measure to bring about tax reforms and its adoption soon gathered global momentum. Later on adoption of VAT was made as a requirement to acquire European Union membership. Among the member countries of OECD, all have adopted VAT except the USA. Except Brunei and Malaysia all member countries of ASEAN have adopted VAT. Among the nations of SAARC Region, Pakistan, Bangladesh, Sri-Lanka and Nepal have already adopted VAT. India has adopted

VAT in the name of Modified Value Added Tax (MODVAT) since 1986. Voices towards VAT are increasing day by day in India. Our next neighboring country, China also adopted partial VAT in 1984, which in 1994, was introduced in a full-fledged way.

“This tax system became a popular worldwide measure to bring about tax reforms and its adoption soon gathered global momentum. This fact can be justified by the increase as follows in the number of countries that adopted this tax” (IRD & VAT Project, 2001, p.98).

2.2.1 VAT Regarding in Global Context

“VAT is the youngest member of the sales tax family. The concept of this tax was first proposed by Dr. William Von Simons in Germany in 1919 to replace the multistage turnover tax in order to avoid the undesirable effects. During the First World War, the German Government introduced a multiple stage states tax as a temporary measure to mobilize the much-needed resources. In 1921, VAT was suggested by S. Adams for the United States of America. Likewise, in 1949, the tax reformed commission, which was constituted under the leadership of Professor Car S. Shop, had proposed broad structure of VAT for Japan in order to avoid the undesirable and unintended effects of the Japanese enterprise and turnover taxes in place at that time. While the tax was considered seriously, it was decided not to introduce a VAT at this time VAT was not introduced by any country unit 1953” (Khadka, 1997, p. 10).

In real practice, France launched the VAT in 1954, till 1959 France was only one country who had adopted VAT as a tax reform program. After 1960, this tax crossed the boarder of France and spread all over the world to all countries whether small or big, developed or developing, capitalistic or communistic. Now VAT becoming an inseparable part of the tax reform program and more than 130 countries has adopted it and trend of adaptation in increasing.

“It can say that VAT is common worldwide and another important feature of VAT is its consistency in comparing to other tax system. Many of countries who had introduced various taxes including Income Taxes, have been abolished and reintroduced several times and some have introduced and abolished and never introduced back again. But in the case of VAT, the situation is different, in total more than 130 countries has implemented it but only five countries, namely Vietnam (in the 1970s), Grennanda (introduced 1986 and gradually

dismantled), Ghana (introduced March 1995 and removed two months after), Malta (introduced 1995 and removed 1997) and Brazil (introduced 1986 and removed 1999) have abolished tax system. Three of these, however have introduce VAT, Ghana in 1998, Malta and Vietnam in 1999. These countries which abolished VAT by their internal reason not by the default of VAT. The abolishment cause of Vietnam was political reason, in Ghana the tax was implemented without much preparation and with in government there was different view regarding the implementation of VAT. In Malta tax was abolished due to the change in the government” (Khadka, 2001, p. 19).

After the introduction of VAT various countries gained high revenue and only few countries abolished. Among the successful country Singapore can be taken as example and the implementation of VAT in Ghana for the first time was not a good example. The experience of Ghana and Singapore can be taken as two different experiences in the world context.

“Singapore adopted VAT as an important part of broad tax reform programmed. Before implementation of VAT Singapore was suffering from high rate of income tax which had negative impact on saving, investment, production etc. In order to avoid these negative impacts of high rated income tax, it was necessary to decrease rate of income tax but alternative source of revenue generation had to be found and VAT was introduced to generate source of revenue. In 1994, Singapore reduced individual income tax from 33% to 30%, increase tax exemption limit from \$ 2000 to \$ 3000, reduce corporate income tax from 30% to 27% and made policy to reduce property tax from 16% to 12% in three to five years. In the same telephone fee was cancelled and converted into VAT” (Khadka, 2001, p.21).

2.3 Concept of VAT

The concept of VAT is cleared from its meaning, definition and elaborations.

2.3.1 Meaning

VAT is the form of indirect tax. It is an improved and modified form of sales tax. VAT is not a genuinely new form of taxation but merely a sales tax administered in different form. It is

levied on value added on goods and services at each stage in the process of production and distribution chain. These stages can be import, manufacturing, wholesale and retail. Value added from a firm is sales value minus all expenditure on goods and services purchased from other firms plus profit. The value added can be obtained by adding payments to factors of production i.e. wages and salaries, rent, interest and profit. This value added is the base of VAT. Although VAT is eventually borne by final consumers, it is collected at each stage of production and distribution chain.

“VAT is the 20th century innovation in the tax system, which is considered as a member of sales tax family. It is imposed on the value added of goods and services. Since, VAT is levied only on the value addition made at each stage in the process of production and distribution, this tax system is more neutral, efficient, elastic and fair. VAT is also said to be improvised version of sales tax” (IRD & VAT Project, 2001 p.95).

VAT is one of the forms of indirect taxes. *Encyclopedia of taxation and tax policy* says “VAT is a broad based tax on business designed to measure net value generated in country”. *Indian Tax Institute* defines VAT as “a tax imposed on the seller of goods and services based on value added by their respective units”. VAT is known as goods and services tax or added value tax. It is a multistage, which has grown as hybrid of turnover tax and retail level sales tax.

“Value added tax is a tax imported on value added on goods and services by business firm at the successive stage of production and distribution value added tax is the excess of sales value over purchases by a manufacturing or trading firm during a period of time” (Subedi. 1998, p.78).

This definition gives emphasis as the tax is imposed on value added on goods and services at each stage of production and distribution value added is the addition of figure in sales form purchase.

Table 2.1

Structure of VAT					
VAT at 13%					
Particulars	Sales value	Value added	Tax in sales	Tax in purchase	Total tax
Producer	200	200	26	-	26
Wholesaler	300	100	39	26	13
Retailer	400	100	52	39	13
Total					52

In the case, government raises Rs.52 as a tax from different level of producer of Rs.13 and retailer of Rs.13 of Rs.200 Rs.100 and Rs.100 at value added tax as Rs.26, Rs.13 and Rs.13 respectively. However the tax in purchase of materials production and producer has not got chance to reduce tax paid on purchase from the sales in above illustration where as most of wholesalers and retailers have got chance to deduct the tax on purchase from sales.

2.3.2 Nature of VAT

The nature of VAT can be seen with the points given below.

Modern innovation in taxation filed VAT is in nature can be taken as the new innovation filed regarding the way of imposing the tax on only on the VAT where the traditional method will be taxed on total value for example of turnover tax. The value added tax is the most important tax innovation of the second way of the 20th century.

1) Not Taxed Twice

“The tax under value added tax is not imposed twice. It removes the duplication of paying tax.” In this case, the same value added is never taxed twice that is cumulative effects do not occurs (Subedi. 1999, p.86).

2) Consumption Related Tax

“VAT is imposed on value added right from manufacturing level to consumer’s level at least the burden of tax will shift to consumers under value added tax. Benefit of VAT can be taken as low percentage or rate and taxing mechanism effects not to increase the price level of market. A VAT is almost universally regarded as nearest form of consumption” (Subedi, 1999, p.87).

3) Comprehensive Nature

“It is easy to understand the mechanism of VAT for burden economic activities because all of the countries followed it in simple manner. A VAT is regarded as comprehensive one since it covers all economic activities right through to retail level” (Subedi, 1999, p.88).

4) Self-policing

In traditional method there would be under valuation or over valuation at the time of making bills, but in VAT the change of making such situation will be less, because to the requirement of details records to be maintained in those concerned office such as value added tax department.

5) Transparency

As transactions must be disclosed by the vendor’s regarding the paying of tax under VAT. Records are maintained scientifically for the purpose of raising VAT. All required records can be found easily through the help of computer with regards the VAT hence it is more transparent in compassion to traditional sales tax.

2.3.3 Types of VAT

There are three types of VAT

Consumption type:

Under consumption type VAT; all capital goods purchased from other firms, in the year of purchase, are excluded from tax base while depreciation is not deducted from tax base in

subsequent years. The base of tax is consumption since investment is relieved from taxation under this type. Thus,

Base of VAT = Gross National Product - Gross Investment = Total Consumption Expenditure

Income type:

The income type VAT does not exclude capital goods purchased from other firms from the tax base in the year of purchase. Depreciation in the subsequent years is allowed to deduct from the tax base in this variant. The tax falls both on consumption and net investment. The tax base of this type is the net national income.

Base of VAT = Gross National Product – Depreciation = Net Investment + Consumption = Net National Product (NNP)

Gross National Product type

Under this type; capital goods purchased by a firm from other firms are not deductible from the tax base in the year of purchase. It also does not allow the deduction of depreciation from the tax base in subsequent years. Tax is levied on consumption and gross investment. The tax base of this type is gross domestic product.

Base of VAT = Consumption + Gross Investment = Gross Domestic Product (GDP)

Among three types of VAT, the consumption type has been widely used in several countries. Nepal has also adopted the consumption type VAT. The reasons for popularity of this type are that this type does not affect the decisions regarding investment and growth since it relieves investment from any tax burden. Since the tax does not discriminate capital – investment techniques from labor-intensive techniques, the firm does not need to switch over from capital to labor intensive technology. Also, gross national product type creates a substantial disincentive for saving, investment and capital-intensive production. Income variant is consistent with the original principle of taxation. Where the goods are taxed in the country of production and hence exports are taxed while imports are relieved from tax. Because of the nature of income variant it is difficult to make exports tax free completely. But exports are relieved completely while imports are faced under consumption type VAT.

The consumption variant is attractive from the point of view of tax administration too. This is because it simplifies tax administration, as there is no need to distinguish between the purchase of intermediate goods and capital goods under this variant. This is why consumption variant has been selected by most of the countries and therefore the term VAT basically means the consumption type VAT.

2.4 Methods of Computation of VAT

There are two frequently used alternative methods of computing VAT: the tax credits (also known as the invoice) method and the subtraction method. A third method, known as the addition method, is rarely used.

2.4.1 Addition Method

Under this method, tax base is obtained by adding the payments made by the firm to the factors of production employed in production processes such as wages, rent, interest and profit. This method is suitable for income type VAT.

2.4.2 Subtraction Method

Under this method, value added is determined as net turnover. The net turnover is obtained by subtracting the cost of materials from sale proceeds. This method is suitable for consumption type VAT. The tax revenue under this method can be calculated by using this formula.

$$T = t (SV - CPI)$$

2.4.3 Tax Credit Method

Under this method, tax is imposed on total value of sales and taxpayers are allowed to deduct from their gross tax liability the taxes already paid by their suppliers and pass on to them. As compared to subtraction method, which deducts purchases from sales and levies tax on the difference, tax on purchases is subtracted from the tax on sales under this method. This method is also known as invoice method. Since value added (VA) is sale value (SV) minus cost of purchased inputs (CPI), a given tax rate, say (t) the tax revenue (T) will be,

$$T = t.SV - T_{cpi}$$

2.5 Principles of VAT

The following are the principles which govern value added tax (VAT).

2.5.1 Making Tax System More Transparent

Nepalese economy is some extent is not transparent because it is no base on accounting system. All the economic activities are no under the accounting system and there is heavy chance of tax evasion. Those businessmen who keep account also keep double accounting system one for themselves and another for the purpose of tax or government. Those accounts which are made for tax is always under valued their business transaction in order to show minimum profit. Since, VAT is an account based tax system; the objective of using this tax is also to make tax system more transparent.

2.5.2 Maintaining Neutrality

VAT is neutral regarding economic activities i.e. VAT does not discriminate one economic activities against others. Any sound tax system does not disturb production, distribution and consumption pattern of the economy and VAT is considered sound tax system in sales tax family is sales this regard.

2.5.3 Removing Cascading Effects

VAT removes cascading effect. Cascading effect means tax on tax i.e., tax is charged on the value including tax. But VAT has removed this effect by not including the VAT in the cost price to the second stage of this distribution channel. But under sales tax system, sales tax paid at one stage is included in the cost price for another stage.

2.5.4 Increasing Tax Base

Nepal is suffering from low tax base and tax evasion practice is common in Nepal. It has estimated that 50% of Nepalese tax is evaded. Tax GDP ratio is negligible in Nepal in

comparison to developed countries. That's why, one of objective of value added tax in Nepal is to increase tax base.

2.5.5 Encouraging the Export

Under VAT system the tax export become zero. In zero rating exporters should not pay tax for his value added. In spite of paying VAT on export they can claim for return which they had paid for the purchase of their goods. In this way VAT promote export.

2.5.6 Taxing either on Origin or Destination

“There are two principles regarding at which point the VAT should be imposed. This principle is basically used in case of international trade. These principles, here denotes that goods and services are taxed in that country where it is produced irrespective of where they are consumed. It means all exports are taxable and all imports are non-taxable. EU countries tax under this principle. In contrast to this theory, if goods are taxed at the point where it is consumed it is called destination principle. Under this theory, goods imported are taxed where goods exported are not taxed. The VAT used in most of the developing countries including Nepal is of this type” (Kandel, 2005, p. 272).

2.6 VAT and Other Former of Sales Tax

Sales taxes have been taken as most established tax and regarded as consumption related taxes. Sales taxes have greater revenue potentially power due to its broad based coverage and most of the underdeveloped countries are survived by the sales taxes and other kinds of its developed forms. Sales taxes are directly imposed up on production and distribution process and collected by the seller. With the flow or 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 arises choose between VAT and single stage sales tax such as manufacture's sales tax, wholesale level or retails sales tax. In general, VAT should be taken on the grounds of revenue consideration, neutrality on relative prices and production consideration, consumer's and producer's choice, no excess burden etc. the prime concern of evaluating between VAT and other kinds of sales taxes are above criteria.

2.6.1 VAT vs. Turnover Tax

Turnover tax is a form of sales tax, which applies to the selling price of each point of sale. In this sense, a turnover tax is the multiple stage cascade tax. This means that the effective tax rate applies to all stages of production and distribution.

The turnover tax, the earliest form of the sales 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 sale to the consumers. Thus, the burden of tax as a percentage of consumer expenditure vary widely on different goods because of the varying number of transaction involved in different commodities between initial production and final sale to the consumer. Since, turnover tax 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 from an outside supplier.

On the other hand, value added tax do not provide this artificial inducement 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 for the revenue productivity 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.

Since the turnover tax applies to the total value 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 encourage integration discourages specialization. Such artificially encouraged integration results in loss of efficiency and lower output and growth rate and may in any case lead to undesirable concentration 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 same in the production and distribution system and the taxable price is always equal to the final price of the product. Thus, from view point of neutrality, VAT is so far superior to the turnover tax.

The turnover tax is comparatively easy to administer as it applies only on gross sales 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 view point 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 consumers. 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 later. VAT avoids this problem since the imported goods will either bear tax on their full value at the time of importation or (under tax credit method) have this value taxed at the first subsequent sale and then subsequent value added will be taxed in the same fashion as with domestic goods. Once the tariff protection is eliminated, the humanization of sales taxes becomes essential in a common market area, which is severed 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, Netherlands and Austria but has been superseded by the VAT. Similarly in many developing countries, the turnover tax will do less than where there is little manufacturing and exports consist of primary products or the output of integrate enterprises then in countries with more diversified economics (Richard, 1984, p.24).

The working system and turnover tax and value added tax can be elaborated in the table below.

Table 2.2

Working of Turnover and VAT						
Figure in Rs						
Stages	Purchase price	Sales price	Turnover Tax		Value Added Tax	
			VAT	Gross Price	Tax @13%	Gross Price
Ref.	Inp =1	Inp =2	2*13% =3	2+3 =4	Inp =5	2+5 =6
Farmer	-	200	26	226	26	226
Spinner	200	500	65	565	39	539
Wholesale	500	600	78	678	13	613
Retailer	600	700	91	791	13	713
Total			260		91	

According to the above table, under turnover, tax is levied on every stage of production and distribution. So, tax burden is high, which results higher price level. But under value added tax system tax is levied only on value added of each stages of production and distribution, here gross price is lower than turnover tax system and tax burden is also low.

2.6.2 VAT vs. Manufacture's Sales Tax (MST)

Manufacture's Sales Tax (MST) basically applies in the sales at the door of domestic manufacturing factory as well as import points with single stage and it excludes the later stages of business process. Further, VAT would bring more goods and services under its tax net than the MST. VAT expands the tax coverage not only on manufacture level but wholesaler and retailer level too, which includes services. In this way, VAT is likely to generate more revenue with lower rate compared to the existing MST. In the case of import, sales tax determined by sales price is including excise duty. MST makes the tax base limited but some how it can decrease to cascade evil and covers more organized firms. So, this type is more favorable in many developing countries due to administrative point of view. The operation of VAT is more complex than the MST because VAT would bring a larger number of vendors including retailers, within the tax net. VAT also includes more complex procedures like tax credit, refund, cross-checking , zero rating book-keeping etc. in this MST system, one serious defect, cascading becomes inevitable when goods and services are

purchase from registered firms by non-registered firms and supplies again to registered firms. In practice, it is possible in many developing countries, where importer, directly sell their imports to non-registered firms or persons, which may be raw materials for manufacturing industry. Even the purchase of raw materials from registered firm's primary producer are also taxed which further extend the cascading effect and hence strike a growing economic sector. Further, his refund system is not perfect in NST. In contrast, VAT does not suffer from cascading or pyramiding effects and it does not affect economic growth negatively.

Table 2.3

VAT vs. Manufacturer's Sales Tax						
Figure in Rs.						
Stages	Purchase price	Sales price	Turnover Tax		Value Added Tax	
			VAT	Gross Price	Tax @13%	Gross Price
Ref.	Inp =1	Inp =2	2*13% =3	2+3 =4	Inp =5	2+5 =6
Farmer	-	200	26	226		226
Spinner	200	500	39	539	65	539
Wholesale	500	600	13	613		613
Retailer	600	700	13	713		713
Total			91			

Under a VAT, the taxable price always equals to the final sales price of the goods so that net tax liability can not 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 and further the taxpayer are in large number than the MST.

Under MST, tax burden on domestic product is more than imported goods because importer's profit remains cut of tax net and producer's profit margin includes under tax net.

2.6.3 VAT vs. Wholesaler Level Sales Tax (WST)

Simply, the wholesale level sales tax (WST) means the taxation on sales to retailers by wholesaler. So, wholesaler's sales tax, as such as, 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 and collect tax on their sales to unregistered buyers, including retailers and consumers.

Table 2.4

VAT Vs. Wholesaler Level Sales Tax				
Figure in Rs				
Stages	Purchase Price	Sales Price	WST (13%)	VAT (13%)
Ref.	Inp =1	Inp =2	2*13% =3	(2-1)*13% =4
Minor	100	500	-	52
Manufacturer	500	1000	-	65
Wholesale	1000	1250	162.50	32.5
Retailer	1250	1500		32.5
Total	2850	4250	162.50	182

WST encourage manufactures or importers to sell directly to the retailers or consumers so that remains beyond the tax net. This results a loss in the revenue on the hand and on the other it discriminated against those product by means of competitive advantages, which bears the tax burden, favoring those firms and products which do not pay or ear the tax burden. In contrast, VAT does not create such discriminations 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 choice. Operation of WST and VAT are visualized in Table 2.4.

2.6.4 VAT vs. Retail Level Sales Tax (RST)

Retailer's 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 all types of single stage 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 turnover tax and the VAT, 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 similar rate and coverage would raise the same amount of revenue. However, the tax levied only on single stage under RST and on multiple stages under VAT. From the administrative point of view, RST seems to be simple as compared with VAT because their records and audit are sufficient to keep the single stage. And the number of taxpayers remains more under VAT and RST. RST is based on the suspension principle, in which tax retailers are required to register for sales tax purchases. This means that the RST is levied only on the sale which is registered to be sold to consumer. Such provision is required to facilitate cross checking. Even under the VAT, producer, wholesaler and retailer are required to register for both sales and purchases, issue bills, collect tax on their value added, deposit it to the treasury and submit returns but records of purchases may not be that important under the RST. In this sense, RST is more similar than VAT. Further, tax credit and tax refund systems are absent under RST, which make the tax administration more easy.

VAT and RST both are vertically neutral with respect to production and distribution. As total tax on a given commodity depends on the final price under both RST and VAT, imports and domestic products are treated equally under both systems. On the other hand, VAT and RST both are able to avoid the problem of cascading effect since there is no possibility for tax imposed on tax. However, both taxes are likely to provide attraction in international trade consideration because it is possible to refund the exact amount of tax levied on export under the VAT. While RST directly relieves exports from the taxation using suspension system so there is no need to refund tax on exports under the RST and VAT provides tax credits.

Table 2.5

VAT vs. Retail Level Sales Tax (RST)					
Figure in Rs.					
Stages	Purchase Price	Sales Price	RST (13%)	Value Added Tax	
				Value Added	VAT
Ref.	Inp =1	Inp =2	2*13% =3	(2-1) =4	4*13% =5
Minor	-	1000	-	1000	130
Manufacturer	1000	2000	-	1000	130
Wholesaler	2000	2500	-	500	65
Retailer	2500	3000	390	500	65
Total			390		390

Despite these few similarities, there are many disparities between RST and VAT. The collection of a retail sales tax places the entire impact of the sale tax upon retailers while much of VAT is collected at pre-retail levels. Under the RST, if the manufacturer or wholesalers or importers directly sell to the consumers, the whole tax amount from that commodity is lost, under a VAT and it will reduce only a part of total tax liability that is the amount of VAT liable at that stage. In developing countries most of the retail traders are small entrepreneurs with relatively inadequate records and high propensity to evade tax. Thus, particularly in developing countries, the danger of complete evasion is far less with VAT. Since sales can be collected more effectively from manufacturers and wholesalers than from retailers. The working process of RST and VAT is shown in the table above.

From the above table comparison, VAT is definitely meritorious and desirable than turnover tax and other single stage levies, however the RST is the nearest popular type. VAT is perfectly neutral a tax, which has not any discrimination regarding the producer's and consumer's choice. Due to the broader coverage of VAT, it is more productive and does not carry any undesirable evils in the economy like others.

2.7 Structure of VAT

2.7.1 Tax Base

Theoretically, the taxable base of VAT is all types of expenditure on final consumer goods. Hence, the aim of the VAT is reach much of the consumption expenditure making the tax base as broad as possible. The tax base of a VAT depends on its scope or coverage, which defines what kind of goods and services or business activities are included into tax base. The scope or coverage of VAT is defined with reference to both taxable transitions and taxable persons. Taxable transitions are defined broadly as supplies made by their persons engaged in industrial and commercial activities. Taxable persons are those who independently engage in supplying goods and services including imports. it is desirable to include all kinds of goods and services of business activities into the scope of VAT is so that all the consumption expenditure comes under the taxable base of VAT is not as broad as to cover all exemption expenditures.

The taxable base is only largely determined by the treatment of different economic activities from a substantial part of consumption expenditure, special problem arise in treatment of those activities, and exclusion of those activities from coverage of VAT considerably records the tax base making it than what is desirable.

In many countries, particularly in developing countries, agriculture sector (or sales by farmers) is exempted. It is because taxing agriculture is not administratively feasible and economically desirable. Similarly, services are generally exempted or taxed on selective basis. Exclusion of services is mainly due to administrative applicability problems. Many services e.g. financial services are exempted because they are difficult to take under VAT due to conceptual difficulty in determining VAT liability and inapplicability of tax credit principle. However, some selected services like telephone, electricity and entertainment, advertisement hotels and restaurants etc; are taxed. The inclusion of construction industry, which generates a substantial portion of GDP into VAT base, also creates a host of problems as mentioned for agriculture and services. In many cases, the construction industry is exempt from VAT, where as the construction materials are subject of VAT. Even though the scope of VAT is limited by the exemption of agriculture, services, construction etc. a substantial part of output of the exempted sector enters into the production process of taxable sector as its

input and it brings no credit with it. For example, when agriculture output further goes in to processing stage it comes into the VAT net.

2.7.2 Freeing from VAT

Some goods and services are left free of VAT or they are not taxed. The theoretical base of VAT is largely reduced because of such exclusions from the scope of VAT. Freeing from VAT may be justified for three sets of reasons: pure administrative reason (that taxing some goods makes the tax system much inequitable) and economic reasons (that production and consumption of some sort of goods and services are included). In general, these are three methods of freeing from VAT. They are:

a) Exemptions

Exemption and zero rating are two popular method of escaping from VAT. Exemption and zero rating are not the same method they are different to each other. The transaction of tax-estimated goods and services remains outside the preview of VAT. The exempted taxpayer does not have to collect tax on sales and they can not claim for a refund of the tax paid in purchases and imports. Thus, the exempted taxpayers are treated as final consumer. If on the transaction of certain goods and services zero rated tax is levied then such goods and services or transaction are kept which in the preview of VAT. The dealing in such transaction has to be registered under VAT and fulfill all other formalities that are applicable to other registrants. Such registrants have to collect VAT at the rate of zero percent on their sales and can deduct the tax incurred on their purchases. This means that the zero-rated goods and services do not bear the burden of VAT but should follow all formalities of VAT. On the tax exempted goods and services the output tax can not be collected and non-cash the input tax be claimed but on the zero rated goods as and services a zero rated tax is levied which actually is equivalent to none and the input tax can be claimed. This means that in the zero rated goods and services although VAT is not levied on the sales the VAT burden paid on inputs remains. If it is administratively difficult to apply VAT on certain goods and services, exemption is given where as zero rating is applied on certain goods, if they are necessary to free from tax burden.

b) Threshold Business Persons

Small businesspersons having annual turnover up to certain amount are not required to register under VAT. The amount fixed for this purpose is known as threshold. To keep small businessperson outside the tax preview a threshold has been specified under the VAT system. The wholesaler, retailers, dealers or producers who sell goods and services below the threshold level do not have to be registered under VAT and neither do they have to collect VAT on their sales. Thus, threshold is a kind of exemption, which is based on the amount of the transaction but not on the kind of goods and services. Therefore, the threshold must be set based on the nature concerned and the status of education and record keeping at various levels of volume among business firms.

c) Taxable Value

VAT should be levied on the gross price (excluding VAT) for the supply of goods and the rendering of services. The gross sales price should be considered and the amount of money that the buyer has to pay to the seller under normal conditions. In the case of imported goods, the taxable value should include prices of goods plus all costs up to the point of importation such as commissions, packing, transport, insurance and other cost and all taxes, duties and charges levied except VAT.

VAT is expected to minimize the problem of the understatement of the sales price due to several reasons. Firstly, as the tax would be levied right through the retail stage, taxpayers would think that they would be caught as a later stage if they evade tax at an earlier stages even if it is evaded at the retail; only the retailer's margin would escape tax, not the whole of a given commodity. Secondly, VAT would provide a self-policing mechanism since "evasion by suppliers through understating tax collected is counteracted by the purchaser's interest in insuring that all tax paid is recorded. Similarly, evasion by purchasers in overstating tax paid runs counter to the interests of suppliers". Thirdly, VAT provides less incentive to the vendor to understate the sales price due to the catch up effect. This is because under VAT any understatement of sales prices at an earlier point would be corrected on subsequent sale since the credit for taxes paid on purchases would be correspondingly lower.

However, the possibility of understatement of the sales price can not be eliminated under VAT cross-checking at the level is impracticable since the final purchaser will have no incentive to insist on tax paid invoices. Further, since the 'catch up' effect does not occur at the final stage, vendors are likely to show a lower price than the actual one on invoices in order to reduce their tax liabilities. So, the tax officer should be given power to determine the arm's length price in a doubtful case. In such cases the tax base should be the open market price. Similarly, in those cases where supply is made for no consideration or less than full consideration, the tax should be levied on the market value. This principle should also apply in the case of barter exchange and inventories when a business is closing down. In the case of credit sales, the cash price disclosed in the credit contract should be considered as the tax base.

2.7.3 Coverage

The base of VAT should be made as broad as possible. It should be levied on the value added at each stage in the process of production and distribution. Each person carrying on taxable business or transaction should be made liable to VAT. The term person should be defined broadly to include, besides a natural person, all forms of business, including partnerships, corporations, co-operatives, government, local bodies and other organizations regardless of whether there is a profit motive. Taxable transactions should be defined as the supply of goods and services. It is desirable to make the commodity coverage of VAT as wide as possible. So, all goods and services should bring into the VAT net unless there is strong justification for their exclusion (Khadka, 2004, p.25).

2.7.4 Zero rating

Zero rating means taxing goods or services with zero rates. If zero is granted for a particular goods, the goods is technically taxable and the taxpayer (supplier of goods) is required to fulfill all the formalities like that of a regular taxpayer with or difference that the supplier of zero-rated goods is not required to pay tax and he is allowed to claim back to tax, if any on his purchases. For example if exports are zero rate, the exporter is able to get the refund of the tax on his purchases, which he has used for producing the export items.

Zero-rating is an actual rate of VAT against which credit for VAT paid on inputs can be claimed and there by a full rebate obtained. So, zero-rating a VAT rate has a rate of zero percent, which is imposed on the selected goods and services. It is nothing, except a tax-free provision of VAT especially for the selected goods and services.

In most of the countries exports are zero-rated so that the exporter is able to get the refund of the tax of his used, for producing the exportable items. As zero-rated items or transactions are within the tax net, although effectively they do not attract any VAT, a purchaser will obtain a repayment of input tax borne on his purchase of goods and services, meaning that zero-rating instead of exemption if the objective to full exempting. Zero-rating is also desirable tax to tax the poor either to tax the poor either not at all or relatively less than well to do. If the zero rates are applied only at the first stage, the tax credit method works satisfactory, there is no over taxation. A zero-rate goods does not bear any tax at all while an exempted goods may bear a tax element in its price. Further, differentiation between these two aspects is based on the administrative work. Business enterprises concerned with the zero-rated goods and services are the formal member like all other VAT registered members and hence have to fulfill the entire formalities associate with the VAT operation. But happiness enterprises having the transaction of only exempted goods and services have no concern with VAT administration.

2.7.5 Tax Rates

It is desirable to levy VAT with a single positive rate in order to make the VAT system simpler. This is because multiple rates make tax administration more complicated since, under this system; there is a need to classify commodities into different groups according to their rates. Businessman have to keep separate records and have to supply more pieces of information while preparing their tax returns, resulting in higher burden on the businessman and tax administration. Moreover, in a developing country like Nepal, many small vendors who may not be sufficiently literate sell number of commodities. They may no be able to apply properly the different rates to various goods they sell. It not only creates inconvenience but becomes unequal in effect since a dealer may charge different rates of the same goods sold to different buyers. Similarly, there is the possibility of dealer charging a higher rate for good subject to lower rate and vice versa.

Multiple rates make the tax system inefficient from the economics point of view. They give incentive to producers to divert their resources from higher rated to lower rated industries to save on tax payment even resources. Similarly, they stimulate a consumer to divert some of his purchases from higher rated to lower rated commodities. Thus, multiple rates create scope for tax evasion that may result in considerable revenue loss.

On the other hand, single rate makes VAT less costly, easy to comply with and easy to administer. Tax rate must be mentioned in the VAT Act in order to make VAT as a political football every year.

“The above discussion indicates that if Nepal wishes to create progressively through commodity taxes, then it is preferable to levy a special consumption tax on some luxury items rather than complicate the VAT structure by introducing exemptions, zero rating and multiple rates. It will be still better to try to solve distribution issues by income taxation and by carefully targeted transfers to the households; it is required to help” (Khadka, 2004, p.26-27).

2.7.6 Taxable Supply

VAT is levied on taxable supply which is defined as the process of selling, exchanging or delivering goods or services or the grant of permission there to or a constant three of for a consideration. To be a taxable supply the consideration can be in money's worth.

2.7.7 Place of Supply

Under the Nepalese VAT system, the following places are considered as the place of supply: For movable goods, the place where the goods were sold or transferred, for the goods, supplied by producer or vendor to himself the place where the producer or vendor of the goods resides, for the imported goods, the customs points of Nepal where the goods first enter into Nepal, for immovable goods, the places where the goods are located, for services, the place where the benefit from services is received.

2.7.8 Time of Supply

The time of supply is also important under VAT in order to establish the VAT liability. For most of the practical purpose, the time of supply will be the date of invoice. However, under

Nepalese, VAT the time of supply will be that one, which happens earlier among the followings: The time of issue of an invoice by the supplier, the time when the supplier receives the point for goods and services, in case of the goods the time which the receiver receive or taken away the goods from the transaction place of the supplier, in case of the services the time when the services, the time when the services are performed. However for the certain goods and services the following period provisions are made:

The time of supply regularly provided services such as telephone and similar other public services are that time when an invoice is issued for the service provided. If the point for goods and services is partially made the earliest day on which the point is made. In case of the goods or services having no tax credit facility the time when the goods or services are used. Among the above two conditions, if two or more occur at same time, the time of supply is objectively determined by the director.

2.8 Operation of VAT

2.8.1 Registration

All vendors carrying on taxable business in Nepal must be required to register for VAT. However, register must not be made mandatory for small vendors having an annual turnover below the threshold. Annual turnover can be determined on both the retrospective and the prospective calculated on the basis of the last 12 months figure, while under the prospective basis the taxpayer has to prove that in the next 12 months his turnover will be below the threshold.

Small vendors having annual turnover below thee threshold may apply for voluntary registration and the VAT officer, satisfied, may register them for VAT purposes. Like other registered vendors, small vendors, who are registered voluntarily, will be able to claim back input tax paid on their purchases, to collect VAT on their sales and to hold the collected tax until the date of its payment of the concerned tax offices. The voluntarily registered vendor must remain registered for a minimum period of one year. VAT registered vendor should get a VAT registration certificate, which must be prominently displaced in the public area of his business. In the case of all other places of business, copies of this certificate must be displayed.

2.8.2 Tax Invoice

The tax invoice is a crucial document for VAT as it establishes the seller's liability for tax and the purchaser's entitlement to credit. It should be able to provide necessary information required by the VAT Act and regulation. It is, however; not necessary to specify the format and content of the tax invoice; taxpayers may be allowed to prepare former of tax invoice according to their requirements.

“A vendor should issue a tax invoice in respect of each sale exceeding Rs. 20. It should be issued in three copies: original and first copy to be given to the buyer and second copy to be retained by the seller. Vendors may be allowed to issue simplified invoices in the case of their sales to the unregistered buyers in order to enhance the level of compliance” (Khadka, 2004, p.28).

2.8.3 Account

“It should be made mandatory for a VAT registered vendor to keep clear accounts of his purchases and sales which are subject to positive rate, zero rate, and exemption. Accounts with all supporting documents should be preserved for four years. In general, accounts must be maintained on the accrual basis. VAT liability should be calculated accordingly. This is because if it is levied only on the cash basis taxpayers might delay payment. Small vendors, public or local bodies and non profit organizations, however, may be allowed cash basis accounting i.e. they may be allowed to account for their output tax and input tax only receipt or payment. This is intended to ease the cash flow problems of small vendors” (Khadka, 2004, p.28).

2.8.3 Tax Credit

Tax credit is one of the important features of VAT. Taxpayers are allowed to deduct their input tax from their output tax. The calculation is made for a taxable period, not on transaction basis or line-by-line basis; in other words, it is not necessary to match supplies for the reporting period is deducted form the output tax of the same period.

2.8.4 Tax Returns and Payment

The standard tax period should be one month. This seems to be ideal since a period shorter than this would increase the workload of both the taxpayers and tax collectors while a longer period would allow taxpayers to hold unnecessary the large revenue collected from their buyers and could create a cash flow problem for the government. However, an alternative tax period of three months may be provide for small vendors whose annual turnover is below the threshold, i.e. VAT officer may allow small vendor to submit returns on quarterly basis.

“Taxpayers must file VAT returns and pay the tax with one month of the end of each tax period. In the case import duties by all sorts of importers, whether registered or not. It is the ability of the liability of the sellers or the importers to pay VAT; but purchasers will have to be made liable to pay VAT in such circumstances where it will be difficult or impossible to levy VAT on sellers” (Khadka, 2004, p.30-31).

2.8.5 Tax Refund

In the case of exporters, refund should be made within one month form the date of submission of the return. In other cases, if the input tax is more than the output tax, the balance should be carried forward up to the six month period. The excess credits for a continued period of six months should be refunded to the vendor concerned within a month from the date of submission of the return. It must be remembered that an efficient system of refunds is an integral part of VAT. Many tax administrations however, are not well known for providing quick refunds. In Nepal, refunds are not provided promptly and the system is subject to many abuses. This should not be repeated under the VAT system. Refund should be made promptly. Interest should be paid on refunds that are not made within a month of the receipt of a return provided that the return is completed satisfactory. Such a provision would help to settle accounts for each taxable period. However, it is necessary to examine returns in detail in the case of large and abnormal claims. “This is a prudent requirement in any VAT system” (Khadka, 2004, p. 31).

2.9 Legal Provision Relating To Vat Collection System

This chapter reviews only the Legal Provision Relating to VAT, referring Value Added Tax 2052 and VAT Rules and Regulation 2053. VAT was introduced in the fiscal year November, 1997 in Nepal. Till 2-3 years of later the VAT was introduced, it could not be practiced in full phase Legal Provisions Relating to VAT is listed below.

2.9.1 VAT Act 2052

a) Bill made to impose and Collect VAT Preamble:

Whereas, for increasing revenue mobilization by making effective the process of collection revenues required for the economic development of the country, it is expedient to impose a VAT on all transactions including the sale, distribution, delivery, importation, exportation of goods or services and to collect revenues effectively by regulation the process of collection. Now, therefore, parliament has made this act in the twenty fourth year of the rule of Late King Birendra Bir Bikram Shah Dev.

b) Imposition of Value Added Tax (Section 5)

Under this section VAT is imposed on goods or services supplied, imported into the kingdom of Nepal and exported outside the Kingdom of Nepal. Tax shall be levied on the taxable value of every transaction. No tax shall be levied on the transactions of goods or services set forth in schedule 1, provided that any tax applicable on such goods or services at the time of purchase.

c) Assessment of Tax and Collection (Section 8)

There is compulsion for registered person to assess and collect tax at the taxable value, people who are outside the Kingdom but receipts the services in Nepal also has to assess and collect tax at the taxable value in accordance with the Act and Rules there under.

d) Exemption for Small Vendor (Section 9)

A person having a transaction below the threshold should not need to register. But he can register if he wishes voluntarily. So, voluntary registration states often allow those who are

not required to be registered to register voluntarily. Person can get registered number after the completion of registration process.

e) Registration (Section 10)

Three months (90 days) are given to the person engaged in any transaction from the commencement of this Act. Every person has to fill up the prescribed form for registration. A unique register number is given to such person in time with the registration certificate. After the registration he can display attested copy by the tax officer in different places of his transaction. This number is applicable for all types of transaction then-after. A person should inform the tax officer within 15 days of any changes in the information pertaining to the application for registration as required under sub-section 1 and 2.

f) Cancellation of Registration (Section 11)

There are three main conditions for the cancellation of VAT registration. The first case is where a person has been registered for VAT properly, but where the registration is no longer appropriate. This will occur where a person was required to register because the person's business activities exceed the threshold but where, subsequently, the person's level of business activities has declined to below the threshold. The second case is where the person has ceased to carry on business activities. The final case is where the person has been registered by mistake or by misrepresentation on the part of the person.

g) Invoices to be issued except otherwise prescribed (Section 14)

Every registered person is required to issue an invoice to the recipient, in the process of supplying any goods or services. It's a duty of recipient to obtain invoice. The specimen of an invoice is prescribed in the VAT Act.

h) Unregistered person not to collect tax (Section 15)

Unregistered person not to need to issue an invoice or other documents showing the collection of tax. If he collects tax so collected shall be assessed and collected from him.

i) Accounts of transactions to be kept (Section 16)

There are four conditions in this section. First deals about up to date accounts of his transaction. These accounts should be available for inspection to tax office upon his request. Second deals the content of accounts, in which date and value of transaction and registered number of party if any should be included. Thirdly, registered person may use authorized sells and purchase book and lastly every tax payer should preserve the accounts of transaction for a period as prescribed.

j) Tax offset (Section 17)

A registered person can offset the amount of tax he has collected against the tax paid or tax due in importing or receiving goods and services related to his own taxable transactions. No offset or only partial offset is given in the case of airplanes, automobiles, computers and high priced other items as prescribed in act. Offset is given only in the following conditions; i) must be a registered person and ii) should provide essential documents.

k) Assessing VAT (Section 20)

Where a taxable person has not made a return for a period for which a return should have been made, the tax authorities should be given reserve powers to impose an obligation on the taxable person to pay VAT to the tax authorities.

l) Tax collection (Section 21)

Each taxpayer has to pay tax within a specified period. If it has not been paid within the specified period the tax officer, on the approval of the director general may collect the tax by using any of the following methods: i) Offsetting the amount, if any is refunded to the tax payer, ii) Seizing the assets (moveable and immovable) of the tax payer, iii) Selling the parts or full assets at a time or in a series, iv) Deduction of amount is made from a corporate body owned by Government or local bodies, v) Deduction of amount from tax payer's bank account, vi) Deduction of amount from third parties, vii) Withholding imports, exports and other transaction of the tax payer.

Under the subsection and it is stated that tax shall not be collected past six years from the date the tax was assessed.

m) Value Added Tax rules, 2053(1997)

In exercise of the power conferred by section 41 of the value added tax act, 2052 (1996). Government has framed the following rules.

2.9.2 Provisions Relating To Registration

a) Application for registration (Rule 3)

Any person engaged in any transaction at the time of the commencement of the act shall submit an application for registration to the concerned tax officer, in the format as set forth in schedule -1 within 90 days of the commencement of the act. A person intended to engage in any transaction after the commencement of the act shall submit an application for registration to the concerned tax officer, in the format as set forth in schedule -1 prior to the commencement of such transaction In the case of partnership in the format as set forth in schedule -2.

b) Investigation into application (Rule 4)

The tax officer may for additional documents for the process of registration. It shall be the duty of the applicant to submit such additional details and documents to the concerned tax officer within seven days of such demand. In case of a registrant which is not required to be registered as set forth in sub-section (3) of section 10 of the act, the concerned tax officer shall give a notice setting out that he is not required to be registered, to the applicant within seven days of the application.

c) To grant certificate of registration (Rule 5)

The concerned tax officer shall, if he deems it proper to register, upon making investigations pursuant to rule 4 into the application submitted for 2 registration pursuant to rule 3, register the transaction which the applicant has carried out or intends to carry out the transaction and grant the certificate of registration bearing registration number as well in the format as set

forth in schedule -3 to the applicant, within thirty days of the date on which the application was submitted.

d) Entrepreneur carrying out small transactions need not to be registered

(Rule 6)

Any person carrying out transactions not exceeding one million rupees within the last twelve month as set forth in section 9 of the act need not have registered his transactions. Provided that any 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 his transactions, but he can register voluntarily after completing the procedures of investigation.

e) Cancellation of Registration Process (Rule 12)

In case the registration of any registered person is cancelled due to the conditions referred to in sub-section (1) of section 11 of the Act and such a registered person or his successor in the event of his absence submits to the concerned tax officer an application, setting out the conditions for cancellation of registration, accompanied by the Tax Return referred to in Schedule-11 as well as the payable tax amount, for the cancellation of registration, within thirty days of the date on which the condition for cancellation of registration occurred, or the concerned tax officer is satisfied that the registration of a registered person in existence of the conditions set forth in sub-section (1) of section 11 is to be cancelled; he (the tax officer) shall cancel the registration of such person, upon getting him to pay the remaining tax amount, and give notice thereof to the concerned registered person or his successor and the Department.

f) Tax Invoices (Rule 17)

Mainly there are two conditions relating to tax invoices. At the time of supplying any goods or services by a registered person, he shall give tax invoices to the recipient. Three copies of tax invoices are essential, and the original copy is given to the recipient, the second copy to be separately recorded so that it can be recorded by the registered person for the purpose of his transaction.

g) Abbreviated Tax Invoices

To conduct retail sales of any goods and services, he should take permission from tax officer by submitting application. Then after he can use abbreviated tax invoices. When low priced goods are sold in large quantities abbreviated tax invoices is used expressing the names grossly.

A registered person who gives an abbreviated tax invoice to the recipient should maintain records thereof as below: i) To prepare and maintain a duplicate copy of the original invoice, ii) Where a transaction has been carried out by maintaining a duplicate of the roll, the total thereof must be calculated and maintained every day, iii) To maintain records of the value, including tax, of each transaction.

There is provision of cancel the permission granted if registered person is found not to have maintained the records required to be maintained necessary documents to the tax officer.

h) No need to give Tax Invoices

A person who carries out transactions of used goods of a value exceeding ten thousand rupees, need not issue a tax invoice in such cases where the selling price is less than the buying price of the goods supplied by him.

i) To Submit Tax Return of Tax Period (Rule 26)

For the purpose of tax return a registered person should submit to the concerned tax officer the tax return of one month tax period according to the Bikram Era, within 25 days of the expiry of that period. The tax period of a taxpayer who has registered voluntarily may be fixed at four months. But the registered person is liable in the tax expiry period of 25 days.

j) To Require Submitting a Tax Return through the Heir of Legal Representative (Rule 27)

In case any registered person dies or becomes mentally or physically incapacitated to submit the tax return, the tax officer may, considering him to have supplied the goods or services till the day preceding his death or becoming mentally or physically unable, require his heir or legal representative to submit a tax return for that period.

k) To Submit a Tax Return Individually or Jointly (Rule 28)

There is a provision of tax payment jointly or superlatively. The conditions are listed below:

i) Any taxpayer becomes incapable to submit a tax return or he dies; his heir or guardian, ii) Any taxpayer is a legal person, any director, executive chief or any employee appointed by the management, on behalf of such a taxpayer, iii) In case any taxpayer is a legal person and such legal person is dissolved or liquidated by the liquidator, iv) In other circumstances other than those mentioned above, the person concerned with the taxpayer and prescribed by the tax officer.

l) Tax Officer May Assess Tax (Rule 29)

If a tax officer does not satisfied with the documents of the taxpayers he may asses the tax liability. The concerned taxpayer is given a time limit of seven days to submit evidence in his favor against the tax assessment order issued by the tax officer. If tax is not collected, an order including description of additional charge is issued.

m) To Pay Tax, Additional Fees and Interest Amount (Rule 30)

The concerned taxpayer shall deposit the tax, additional fees and the interest amount referred to in the tax assessment order within seven days of receipt of such an order to the concerned Tax Office.

n) Procedure of Sending Notices of Tax Assessment Order (Rule 31)

If the order is sent by Tele-fax, telex or other similar electronic devises installed at the address of such taxpayer or such order is delivered to himself or at his office or through registered post to his address, it shall be deemed to have been duly delivered. In case of order not received by the taxpayer he should inform the tax officer.

o) Assessment and Recovery to a Tax Collected by an Unregistered Person (Rule 32)

Unregistered person having collected tax should assess and recover within seven days of the issue of the tax assessment order.

p) To Submit a Tax Return Prior to Filing Appeal (Rule 34)

Prior to filling an appeal by a taxpayer against a tax assessment order made, he must submit his tax return of that period to the concerned tax payer.

q) Time-Limit for Applying for Remission of Additional Charges (Rule 36)

For the remission of the additional charges, an application shall be submitted to the Director General within thirty days of the expiry of time-limit prescribed for payment of tax. But additional charge should be granted if an application is not submitted within the time-limit.

r) Tax Assessment Period (Rule 37)

While calculating the period in case a petition has been filed with any court in regard to tax and a stay order has been issued, the period shall be calculated by deducting the period until which the petition is decided.

s) Time-Limit for Collection of Tax (Rule 38)

While calculating the time-limit, in case an appeal has been filed, the period from the date of filing such appeal to the date of decision shall not be included.

t) Application to be submitted (Rule 43)

For the deduction of sale tax application should be submit to the tax office in the format prescribed by the Act and Rules. And for a claim to deduct Sales Tax or tax, the concerned taxpayer must also submit invoices of payment of sales tax or and other documentary evidence within 15 days of registration. In absence of the documentary evidence tax shall not be necessary action against such tax payer. But if the application is accepted the tax payer may deduct such taxes.

u) Provision Regarding Goods or Services to be supplied within the Nepal (section 56)

While purchasing or acquiring the goods or services on which tax of value of ten thousand rupees is payable at a time within the Kingdom of Nepal by Nepal Government or the association, organization or office owned by Nepal Government or constitutional bodies, such goods or services shall be purchased or acquired only with a registered person.

Since the process of VAT accounts begins from the issuance of invoices, a provision has been made under section 14 of Act for registered person to issue an invoice to the buyer while selling any goods or services and for the buyer to receive the incomes. Rule 17 deals the regulation of the section 14. Therefore mainly these two sections are reviewed in this chapter.

2.10 Review of Previous Studies

Various researchers have been conducted in Nepal as well as foreign countries about value added tax (VAT). But only few researchers and studies are available focusing internal issues of VAT in Nepal. Here, some relevant books, university, dissertations, journals and other reference materials were reviewed exclusively. Essence of some useful and relevant ones in presented below in brief.

VAT is a new concept in Nepalese context. It has become sixteen years since VAT was fully implemented in Nepal. It is therefore, there have been few studies carried out on VAT. A VAT is a tax assessed at each steps of production and distribution process, levied in the difference between purchase price of goods and services and the price at which it is sold i.e. the amount of value added on it. Tax is added to a product's price each time it changes hands till the delivery to final consumer takes place, when the final tax is paid.

Shoup (1969) explains that value added tax is the latest and probably the final stage in a historical development of sales tax, which is imposed on the value added by the business firms. VAT is imposed on the difference between sales proceed and the cost of materials etc. purchased from other firms. A firm adds value increased by processing or handling these purchased items with its labor force and its own machinery, building or other capital goods.

VAT is a multiple stage consumption tax. It is in principle introduced at all stages of production and sales. It is modern type of consumption tax. It intends to collect taxes on the

consumption by private consumers. Inland Revenue Department administers VAT in Nepal. VAT is collected from each and every distribution stage from production to final sales to consumers. Each distribution stage collects VAT from the value added at its own stage. Practically it is arranged that the supplier collects output tax from the total value of the supplied goods or services and deducts the VAT he has paid when purchasing the goods or services. By using this principle each distribution stage collects the VAT from the value added at its own stage.

Khadka, (2000), VAT expert, has explained the concepts of VAT and application of the same in Nepalese context in his book entitled “VAT in Nepal”. VAT is the most recent innovation in the field of taxation. VAT is levied on the value added to goods and services. The value added for a firm is the gross receipts from sales minus all expenditure on goods and services purchased from other firms. In the production and distribution process, a firm buys materials from other firms. These materials may include principle raw materials, auxiliary raw materials, chemical, electricity and capital goods such as machinery, equipments, building, furniture, vehicles etc. The firm adds value to these purchased materials by processing or handling them with the help of its own factors of production such as labor, land, capital etc. This increase in the value of output over inputs is value added by the firm and this value added is the base of VAT.

Silwal (2002), define “VAT is an all stages non cascading tax system. It extends to all levels of production and distribution. Any discrimination in taxing goods or services or exempting any of them proves VAT ineffective”.

Mr. Silwal suggests that factors affecting VAT design should also take into consideration. A poorly designed VAT accompanied by weak administration would just drain the treasury. So, almost care is crucial while designing VAT system. According to him the following issues have been considered while designing VAT in Nepal.

- a) Tax base issues,
- b) Rate structure issues,
- c) Exemption issues,
- d) Threshold issues.

Finally Mr. Silwal has reached a conclusion that the introduction of VAT provides an opportunity to revamp a substantial part of the tax administration. In every country where VAT has been implemented efficiently. It has proved itself as a major revenue productive instrument of tax.

The famous pair modern economists Musgrave and Musgrave in their book, 'Public Finance in theory and Practice', suggests that in among three types of VAT, i.e. GNP, Income and consumption types the latest type is for practical consideration for both efficiency and quality criterion and tax based on consumption similar to the retail sales tax especially for the poor countries. The invoice method for calculation is more preferable and advantage of the value added approach.

Pandit (2001), emphasizes for a visit to a tax payers premises, if any irregularity resulting in tax evasion is found while conducting a tax audit, then the tax officers assesses the tax amount that has evaded (IRD/DANIDA Report. 2001 p. 25).

Joshi (2001), stressed the tax refund process appears to rather lengthy in his opinion. He disclosed that there has been an increase in the amount refunded each year (IRD/DANIDA Report, 2001, p. 26).

The third article, "VAT Assessment, Penalties and the Appeal Procedure," is written by Mr. Ratna Raj Bajracharya, a Seniors Practicing Charter Accountant. He opined that the requirements of VAT registration for marginal entrepreneurs are not very much conducive for entrepreneurs (IRD/DANIDA Report, 2001 p.27).

The fourth articles, "Value Added Tax: A Retrospection," written by Mr. Nabaraj Bhandari, Director of IRD, describes the mounting enthusiasm and zeal of the staff to the support of the MOF, the VAT Department and the DANID VAT Project (IRD/DANIDA Reports, 2001, p.29).

The fifth articles, "Implementation of VAT in Nepal: In Evaluation", is written by Govinda Bahadur Thapa, the director of foreign currency exchange department of NRB. The article points towards the weakness inherent in the value added tax system in Nepal. He 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 the long open borders with India and Tibet. The lack of highly motivated tax administration and proper accounting system are also impeding the functioning of VAT in Nepal (IRD/DANIDA Report, 2001 p.30).

The sixth article, “Value Added Tax in the University Curriculum”, is written by Puspa Raj Kandel, Lecture at the Saraswati Multiple Campus, T.U. His opines that an uncoordinated working atmosphere with the government and the universities, blowing their own trumpets, is not going to benefit the nation in any way (IRD/DANIDA Report, 2001, p.31).

The eighth article, “Value Added Tax and the Practice of Issuing and Receiving Invoices in the Context of Market Economy”, is written by Vidhyadhar Mallik, Director of the IRD. He believes that if market runs in a fair manner, the market principle will bring welfare to much happiness to many. He clearly points out his weaknesses on the part of the government, the business community and the general public. This tax system deserves concerted effort of all stakeholders. The business community may use cash machines and inexpensive billing software. They can develop the habit of quoting the price inclusive of VAT and remind customers to take invoice by displaying notices. He urges for black listing and transparency on the part of the business community. Customers can inform the tax authorities about the fraudulent transactions. The tax administration should increase surveillance and consumer education level (IRD/DANIDA Report, 2001, p.32).

The ninth article entitled, “Value Added Tax in Nepal: Analysis and Suggestions”, is written by Rup Jyoti, a leading industrialist of Nepal. He suggests that the practice of under invoicing should be discouraged and the same time the custom duties must be gradually decreased (IRD/DANIDA Report, 2001 p.33).

Value added tax is relatively new concept in the tax history in Nepal, though some studies have been carried out mainly in the field of its relevancy and theoretical aspects. Some studies relating to its practical (i.e. numerical) performance have also been carried out. Some selected national and international literatures are reviewed below.

A study of 'VAT in developing countries', was undertaken by the IMF staffs (Caseenegra and Guerard 1973, p.318-378) at the time when the introduction of it was gaining a momentum in developed as well as in developing countries. The study examines the applicability of VAT in seven developing countries (Brazil, Ivory Coast, The Malagasy, Republic of Morocco, Senegal, Uruguay, Ecuador), which have adopted the VAT considering the fact that many uncertainties arise in the introduction of any major new tax especially with which developing countries have very limited experiences. According to the study, the most important feature of VAT in developing countries is its conceptual basis such as taxable base, exceptions, treatment of all small traders' etc. problems of implementing a VAT in developing countries depend largely upon the ability of those countries to administer it. The administrative efficiency is also influenced by the structure of VAT employed and the economy's social and economic environment. The problems should also be viewed from the angle of taxpayers compliance, as the cost of doing business tends to increase with VAT because of the need to adopt new accounting producers. The study shows that VAT producers between 10-30% of government revenues of the seven developing countries covered by the study and the VAT revenue in these countries is expected to increase at faster rate than rate of growth of the country. His recommendation is as follows:

- a) There is neutral effect of applying VAT on the ground of production, distribution and consumer prices,
- b) Sufficiency of record maintains and book keeping by firm is indispensable,
- c) To adopt VAT without previous experience with a sales tax and strengthened administrative services is inadvisable,
- d) For the level of tax rate that would justify introduction of VAT rather than alternative forms of sales tax. The degree of fulfillment of above conditions determines the comparative success of implementation of VAT against other sales tax.

A cross section analysis 'Determinants of value added tax Revenue' was under taken by World Bank staffs (Bogetic & Hasan 1993, p.34), working papers, by using data from 34 countries to answer certain key questions:

- a) What empirical relationship emerges from existing data on VAT revenue and VAT rates for countries with a single VAT rate?

- b) How much on average, can a 1% increase in the VAT rate be expected to raise VAT revenue as measured by VAT to GDP ratio?
- c) What key determinants of VAT revenue emerge from a cross-country analysis of full sample of countries?
- d) Is there a statistically significant difference in VAT revenue performance between countries with a single VAT rate and countries with multiple VAT rates?

The result of their regressions generally confirms the conventional views on the key variables influencing VAT revenue performance: the rate, the base and rate dispersion. The rate and the base coefficients are significant and with the expected positive sign in all of the estimated versions of the model. An estimated model is used with appropriate caveats to predict VAT revenue potential in countries (such as Bulgaria) that are thinking of introducing a single rate VAT. They also find that other things being constant VAT generates higher revenue in countries with a single VAT rate than in countries with multiple VAT rates. The difference in the estimated models for the two country groups is spastically, indicating a structure/change. However this change in the pattern of VAT revenues can not be explained exclusively in terms of differences in rate structure. A satisfactory explanation must include other factors, such as the base and tax administration capacity. The suggestions of the analysis are:

- a) To provide superior revenues,
- b) VAT should be levied in a single rate on as broad a base as possible and
- c) Tax administration and enforcement must be thought to ensure compliance.

Khadka (1994) indicates several limitations in Nepalese tax system. The major issues are.

- a) Narrow tax base
- b) Less productive
- c) Inelastic distortions
- d) Inequality
- e) Complicate procedures
- f) Lack of coherent and stable tax policy
- g) Weak tax administration
- h) Low level of voluntary tax compliance

The recommendations relating to his research were as follows:

- a) Necessary to launch a comprehensive long-term tax reform program with the aim of establishing an ideal tax system over the years
- b) Improving tax administration
- c) Raising the level of voluntary tax compliance

Sharma (2004) has conducted a Dissertation about value added tax in Nepal, issues and options. He accessed following conclusions:

Any policy change would not yield the desired results. The implementation of VAT is not likely to yield ideal results. Lack of seriousness of the government, poor planning and implementation, backward and inefficient administration and underdeveloped economic and business structure would make the tax fall short of the various results that are generally expected from the introduction of VAT may be, would not be really a better tax in Nepalese context because of the general characteristics of the country would not it to be so. However there is no reason for being so pessimist that everything would happen worse rather, there is a need to be more serious about the situation and conscious efforts should be made for the countries better future, for that enough intelligence should be acquired breaking the wall of poverty in thinking.

In his study he has recommended various points. Main points are as follows:

- a) before implementation, low level of administrative capability should be increased,
- b) commodity wise implementation of value added tax should never be tried,
- c) instead of adopting full fledged VAT from the beginning its implementation should be in phases,
- d) tax preference to the exempted traders should gradually be eliminated,
- e) close co-operation between private sector and government in the VAT implementation process,
- f) import tariff should be reduced along with the actual valuation of imports,
- g) special consumption tax on luxury items should be levied along with the VAT to increase the equity aspect of VAT,
- h) A moderate rate of VAT should be design initially.

Bista (2006), focused the need of VAT in Nepal for several reasons. They are effective revenue mobilization, industrial development, strong administration, transparency and avoiding all tax loopholes. VAT helps to reduce the resource gap by broadening the tax base and mobilizing additional resource by controlling tax leakage, smuggling, unofficial trade and corruption through transparency and account based cross-checking. Positive and favorable effects of VAT administration with effectively and efficiently.

In his research, the following findings can be seen:

- a) The sales tax system is failure to several cases: narrow tax base, inelasticity of tax rate, incapable and weak administration, tax leakage, corruption and political intervention. So, the entire tax reform is needed.
- b) VAT mobilizes the additional resources and the rest of internal resources by broadening tax base and by discouraging the existing tax loopholes,
- c) A VAT account based, invoice based and record based, it checks the tax, loopholes such as under valuation, non-recording and unauthorized trade. It discourages such issues and problems existed in the sales tax system,
- d) For implementation of VAT, the public awareness level relating VAT and VAT administration should be good and it is a prerequisite in the preparation of VAT.

VAT administration should be strong and efficient in order to implement properly. But in Nepal, VAT administration has been facing the problems like corruption, incapability, inefficiency, delaying, ineffectiveness, inadequate physical environment, inexperienced and untrained employee and weak organizational set up.

Laudari (2007) have the objective to review historical background of VAT, to examine the structure of VAT in Nepal, to absorb the contribution of VAT to resource mobilizations analysis the existing problems of VAT in Nepal through the primary and secondary data and information, has concluded that the main problem for business houses are accounts keeping and billing and the weakness of VAT administration are lack of motivation and services minded attitude among tax officials lack of honesty in VAT officers. Though from the theoretical point of view, it is a sure that VAT system is the best and advanced fiscal tools, its effect in the context of Nepal is not as expected because of the lack of strong and honest tax administrator, lack of the cooperation of business community, lack of strong political

commitment and weak public consciousness. He has further recommended some suggestion for better solution of these problems. Tax related information should be published regularly. Interview programs with professor, researchers, tax experts and economists should be conducted and published through advertising media. Often escape away from actual custom duty, as under valuation of the goods has been tradition. Thus to overcome from these problems, the government either has to collect the custom duty of the actual price of the goods in the market. Enforcement should be effective through more audits, investigation and collection visits and integrated approach to total tax system should be introduced for successful implementation of VAT.

Gurung (2009), having the main objective to analyze the present position and future prospect of VAT by using primary and secondary data information's conducted a research and concluded that successful application of VAT, will require assessment of fundamental pillars, in hour context with the view to gradually overcome inherent deficiencies in each these sectors with a positive. Despite a face any problem in the early years, VAT is now accepted by the business community and general people and each here to remind in Nepal. The issue today is not weather VAT or no VAT but how to make the implementation of VAT effective and efficient. He has further suggested and recommended some point for further prospect of VAT in Nepal. Those points are:

- a) The government should apply compulsory use of computerized billing system or use of automatic each register by large and medium business and effective control measure to certain leakage like over claim of inputs,
- b) Falsified input claim,
- c) Omission of sales etc.

Finally, the effective and efficient implementation and development of VAT is only possible when they have fare understanding among the government, tax administration, taxpayer and other concern parties also. So, they must have commitment, deduction and self motivation to implement VAT in future prospect.

Thapa (2010), define the basic objective of the study is to assess the actual raising of VAT as an instrument to collect revenue in Nepal and factors affecting the collection of VAT, by applying Shaota method to obtain adjusted revenue series for the calculation of elasticity and

buoyancy coefficient of the tax in relation to GDP for the whole study period (1996-2009) conducted the research and concluded that theoretically, VAT is the attractive alternative of sales tax on the ground of economic growth without economic distortion, exports promotion, price stability and neutrality on production etc. Empirically, it is found that VAT has high revenue potential power. The broad coverage of VAT would generate more revenue without addressing the equity norms. Practically, it is found that the VAT is going to become the 'hot milk in mouth' due to inefficient tax administration. The analysis of elasticity coefficients of overall selected taxes is less than unity, means inelastic in nature. His recommendation in his research for better implementation of VAT is that the concentration must be given to bring the use of billing in trading concern, making tax officers more responsible, accountable as well as competent and honest instead of powerful authorization by balancing the rights and duties mentioned in acts. There is no defining course about the degree of tax reform. Thus, the implementation of VAT by superseding sales, hotel and entertainment and contract taxes is only the partial reform that can not address the equality aspects. Therefore, VAT should be extended into excise and non-tax portions.

Kuikel (2011) focused on effectiveness of revenue collection from VAT. Besides this he tried to analysis the major problems of VAT implementation. His main conclusions are listed below:

- a) Nepal is suffering from fiscal crisis,
- b) To achieve higher growth of revenue, Nepal needs to reform some of its tax system,
- c) The first and major problem relating to VAT is lack of proper invoicing system,
- d) Over valuation is another problem,
- e) Tax education is important to implement VAT effectively,
- f) By the support from all level effectiveness of VAT will increase.

On the basis of his study, he has listed the following recommendations:

- a) VAT administrators should be strong and committed towards the effective implementation of VAT,
- b) Without lack of publicity of VAT it is not implementing effectively,
- c) In the process of revenue collection, the focus should be on transparency fairness and timely and quality production in administration instead of simple collection,

- d) Due to geographical barriers many businessmen are still beyond the tax net. So, the government should provide services to their approach. So, they can come under the tax compliance,
- e) Strong administrative mechanism must be established to achieve the effectiveness of VAT as it's has been expected.

2.11 Research Gap

About twelve years have been passed since VAT practice came into operation but very few studies had undertaken on the topic of VAT in Nepal. Among the studies most of the studies are theoretical. Even though, the researchers try to identify existing problems of Nepalese VAT system. In all the studies, market area is only Kathmandu valley and are based on field survey, in order to know some how about the practices and experiences of VAT. All the research have conducted in different topic and different sense but this research as tried to analysis VAT collection system and review of legal provision concerning to VAT.

CHAPTER III

RESEARCH METHODOLOGY

3.1 Introduction

It is necessary to increase the internal revenue in order to operate nation and develop the economy and to decrease the dependency on foreign loan, grant, and technical assistance. VAT is the best and reasonable source of national revenue in Nepal. The trend of VAT realization and associated problems should be studied time to time to find out the ways for proper solution and to collect maximum VAT revenue. The tax could be adjusted as to except the lowest income groups from the operation for the tax and make the richer groups bear the burden of tax according to their income.

Research methodology generalizes the way of solving the research problem systematically. Therefore, research methodology is used for the achievement of the objectives of the study. It includes Research Design, Sources of Data, Data Gathering Procedures, Data Processing Procedures, and Statistical Tools. The study is mainly concentrated on VAT Collection System and Legal Provision in Nepal.

3.2 Research Design

As per nature of study survey research design was followed with descriptive and analytical approach. Thus, research design is the overall frame work for the achievement of the goals and objectives of the research.

3.3 Sources of Data

Data, which is essential to analyze the study, are collected from primary sources. The primary sources of data are the opinion survey through questionnaire, field visit and information received from the respondents.

Secondary data are those data which has been used previously. So, published newspaper, budget speech, websites of Ministry of Finance, Inland Revenue Department, previously conducted research work were the main source of secondary data.

3.4 Data Gathering Procedures

As the study was based on primary data, information was collected developing a scheduled questionnaire and distributing it to administrators, VAT collectors and tax payers. Nine tick mark, two ranking type and one open ended questions were included in the questionnaire (see appendix: 3). All together 50 questions were distributed to different 3 groups i.e. Administrative, VAT Collectors and Tax Payers. The number of individual groups was 20 from Administrative, 10 from VAT Collectors and 20 from Tax Payers.

3.5 Data Processing Procedures

Data obtained from different sources have no meaning unless they will be arranged and presented in a systematic manner, was further needed to be verified and simplified for the purpose of analysis. Moreover, data and information so gathered will be checked, edited and tabulated in such a way that can provide convenience for at the last part of the study. Questionnaires were distributed to administrators, VAT collectors and taxpayers.

In this way, the primary data were collected and thus collected data was noted down to use during analysis and interpretation of data.

3.6 Statistical Procedures

Simple percentage were used as arithmetic tool to interpret data. For the interpretation of the responses three types of groups were made such as administrators, VAT collectors and tax payers.

CHAPTER IV

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

This chapter is the heart of research. This is the origin of all concepts, suggestions, analysis and interpretation. So, collected data were tabulated and analyzed in such a manner that a non mathematical person can understand the meaning of data.

4.2 Analysis of Government Expenditure, Revenue and Deficit

Expenditure, revenue and deficit are the most related in the economic perspective. There exists governmental expenditure in each state of activities; either collecting revenue or distribution of governmental services. When revenue exceeds the expenditure then profit arises. In Nepalese context, it is just opposite. Here, expenditure has exceeds revenue in each fiscal year.

To fulfill the gap of expenditure and revenue administrative efforts can play important role in some extent. Otherwise, there is needed huge amount of external resources like foreign aids, multinational investments etc.

The following table shows the governmental expenditure and deficit for the different fiscal year.

Table 4.1

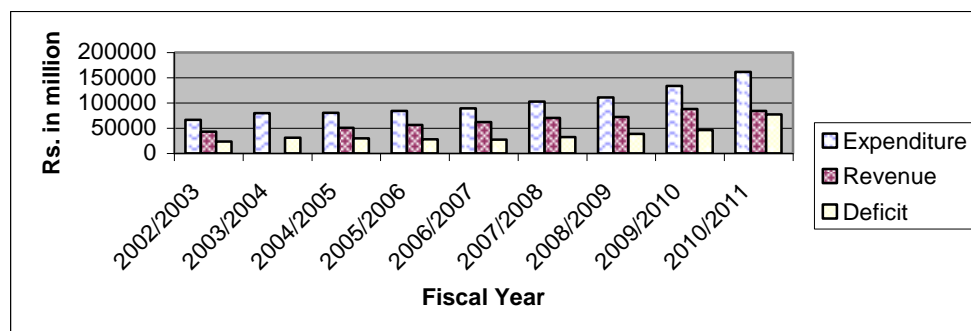
Government Revenue, Expenditure and Deficit			
(Rs. In millions)			
Fiscal Year	Expenditure	Revenue	Deficit
2002/2003	66272.5	42893.7	23378.8
2003/2004	79835.1	48893.9	30941.2
2004/2005	80072.2	50445.6	29626.6
2005/2006	84006.1	56229.7	27776.4
2006/2007	89442.6	62331.0	27111.6
2007/2008	102560.4	70122.7	32437.7
2008/2009	110889.2	72282.1	38607.1
2009/2010	133604.6	87712.1	45892.5
2010/2011	161349.9	84203.2	77146.7

Sources: MOF/GN, Economic Survey 2010/11

From the above table it can be seen that the revenue is increasing continuously. In the fiscal year 2003/2004 revenue and expenditure were 48893.6 and 79835.1 respectively and deficit was 30941.2. Increasing rate of expenditure was greater than increasing rate of revenue. There was a highest deficit in the fiscal year 2010/2011.

Figure 4.1

Government Revenue, Expenditure and Deficit



Above table shows that there was a highest gap between the expenditure and Revenue in the fiscal year 2010/11 which indicates that there highest deficit and lowest gap between the expenditure and Revenue in the Fiscal Year 2005/06. For the better improvement of the nation deficit should be converted into surplus.

4.3 Structure of Tax Revenue in Nepal

Every state in the world performs numerous activities for the betterment of economical, social condition. For these activities huge amount of resources is necessary. So, every state collects revenue from internal as well as external resources. In Nepal, revenue is collected through grants, administrative incomes, businessman incomes and taxation. Generally the government revenue is classified into two categories such as tax revenue and non-tax revenue.

It can't be said that there are not other resources. Nepal has other resources like repayment of loan, grants for the improvement of the existing condition. These sources are desirable to meet the fiscal deficits.

Contribution of tax revenue and non tax revenue, trend analysis and the percentage description is presented below in the form of table, diagram and in paragraph:

Table 4.2

Structure of Tax Revenue in Nepal					
(Rs. In Millions)					
Fiscal Year	Total Revenue	Tax Revenue		Non-tax revenue	
		Amount	% as to Total	Amount	% as to total
2002/2003	42893.7	28752.9	77.2	8498.4	22.8
2003/2004	48893.9	33152.1	77.3	9741.6	22.7
2004/2005	50445.6	38865.1	79.5	10028.8	20.5
2005/2006	56229.7	39330.6	78.0	11115.0	22.0
2006/2007	62331.0	42566.0	75.7	13663.8	24.3
2007/2008	70122.7	48160.0	77.3	14142.6	24.7

2008/2009	72282.1	54104.8	77.2	16017	22.8
2009/2010	87712.1	57430	83.5	14849.1	16.5
2010/2011	84203.2	71168	81.1	16544.1	18.9

Source: MOF/NG, Economic Survey, 2010/11.

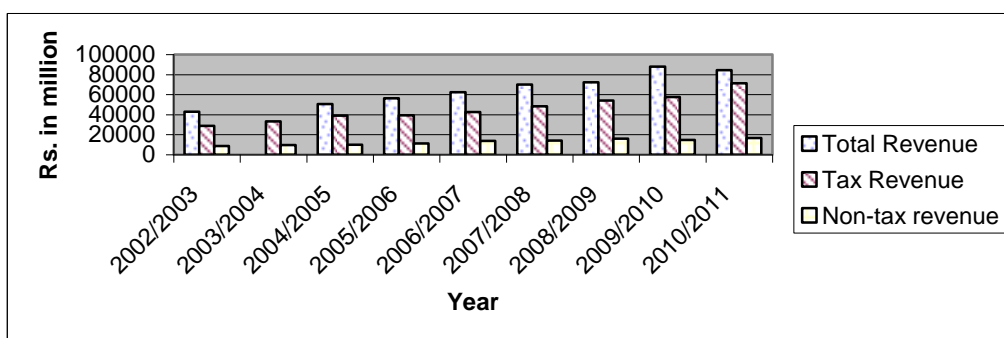
From the above table, it can be clearly shown that total revenue is increasing from the fiscal year 2002/2003 to 2009/2010. Contribution of tax revenue has huge share as compared to the non-tax revenue.

The contribution of non-tax revenue to total revenue is very poor. It is approximately one third of the total revenue. For the betterment of the economic condition it should be increased. In the context of Nepal it is in the satisfactory level.

The clear picture of the non-tax contribution to the total revenue is presented in the following diagram.

Figure 4.2

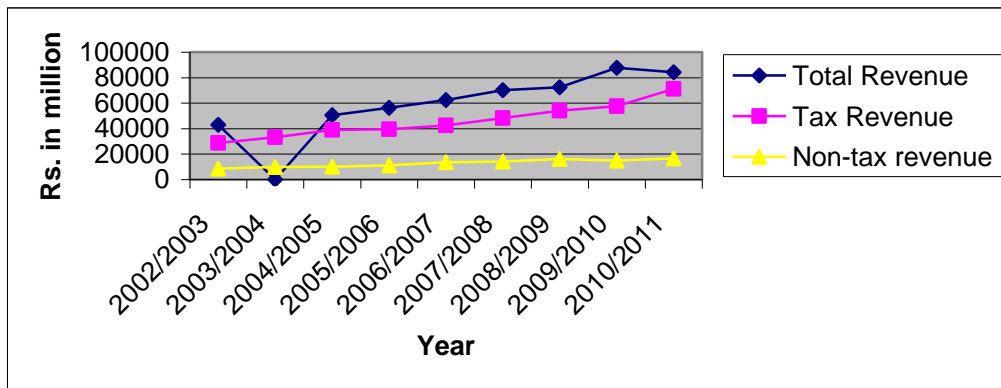
Tax, Non-Tax and Total Revenue



From the above diagram it is shown that the contribution of non-tax revenue is very low as compared to the tax revenue. In the fiscal year 2002/03 to 2009/10 the tax revenue has increased and the non tax revenue has increased in fiscal year 2002/03 to 2007/08. But in the fiscal year 2008/09 the non tax revenue has decreased. So, it can be said that there is no relationship between Tax Revenue and Non-Tax Revenue. Trend analysis of tax and non tax revenue are presented in the following diagram.

Figure 4.3

Tax and Non-Tax Revenue



The gap between the Tax Revenue and the Non-Tax Revenue is in increasing trend but in fiscal year 2007/08, the Non-Tax Revenue has decreased trend for the better improvement of the economic development trend of tax revenue should be shift upward.

4.4 Tax Revenue Structure of Nepal

From, November, 1997, VAT was introduced in Nepal. It is compulsory contribution that the taxpayer to the government. There were a lot of resources of income generation. But taxation is the main sources of income. Tax Revenue comprises compulsory, unrequited, non-payable receipts collected by the government for public revenue. It concludes interest collected on tax arrears and penalties collected on non-payment or late payment of taxes. Tax revenue is the principle source of the government revenue; however its contribution differs significantly in different countries. In Nepal, tax revenue is major source of government to mobilize internal source effectively and properly as it has been dominating the government revenue by contributing around three quarters of total revenue. In the revenue trend of Nepal, tax revenue structure is a combination of two tax elite, one is direct tax and another is indirect tax.

Table 4.3

Structure of Tax Revenue					
(Rs. In Millions)					
Fiscal Year	Total Tax Revenue	Direct Tax		Indirect Tax	
		Amount	%	Amount	%
2002/2003	28752.9	7516.1	26.14	21236.8	73.86
2003/2004	33152.1	8951.5	26.99	24200.6	73.01
2004/2005	38865.1	10159.4	26.13	28705.7	73.87
2005/2006	39330.6	10597.5	26.94	28733.1	73.06
2006/2007	42566.0	11799.3	27.72	32486.7	72.28
2007/2008	48160.0	11895.5	24.70	36264.5	75.30
2008/2009	54104.8	13071.8	24.16	41032.9	75.83
2009/2010	57430	13968.1	24.33	43461.9	75.67
2010/2011	71168	18980.3	26.67	52187.7	73.33

Sources: MOF/GN, Economic Survey, 2010/11.

From the above table it seems that the whole Nepalese tax structure is dominated by indirect tax revenue. On the other hand the share of indirect tax as percentage of total tax revenue is firstly decreasing and then in increasing trend. Where the direct tax revenue is first increases and then decreases trend.

Total tax revenue is composed of direct tax and indirect tax. During the study period, there has been simultaneous increase in total, indirect and direct tax revenue as shown in table 4.3 and figure 4.4. In FY 2002/03 the amount of total, direct and indirect tax revenue were Rs. 28752.9 million, Rs. 7516.1 million and 21236.8 million respectively. These amounts were increased to Rs. 48160 million, Rs. 11895.5 million and Rs. 36264.5 respectively in the FY 2007/08. In the FY 2010/11, these amounts were Rs. 71168 million, Rs. 18980.3 million and Rs. 52187.7 million respectively.

Though the indirect tax revenue in absolute term increased during the study period, its contribution in total revenue in percentage term declined from 73.86 percent in FY 2002/03

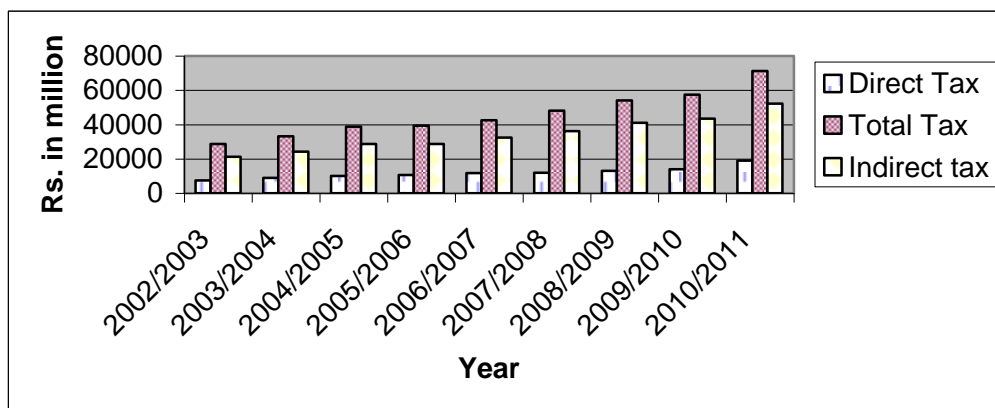
to 73.28 percent in 2006/07. But the share of indirect tax in total tax revenue again increased to 75.30 percent in FY 2007/10. Similarly, in the FY 2009/10 increased to 75.67 percent.

Nevertheless, the indirect tax revenue still contributes about three quarters of total tax revenue while direct tax revenue represents only about one quarter of total tax revenue. It would, however not be very difficult to understand as to why the indirect tax has got the lion share in the total tax revenue. The industries have not developed adequately. The population is dominated by the subsistence section whose per capita income is very low.

In the Nepalese perspective, while the direct tax seems to be justified, the indirect tax is unavoidable. The direct tax is justified because it helps to mobilize revenue for the national exchequer and also assists to narrow the gap in the distribution of income and wealth between the richer and the poorer sections of the society, which is essential for development. However, under the existing circumstances, the direct tax cannot generate sufficient revenue to the national exchequer. It is only through the indirect tax that adequate revenue can be mobilized and the consumption of harmful commodities or the investment in the unproductive sectors of the economy can effectively be discouraged. Thus, though there is the need for Nepal government to rely upon the direct tax, which would have a more dominating role in the Nepalese economy, at least for mobilizing adequate resources for development.

Figure 4.4

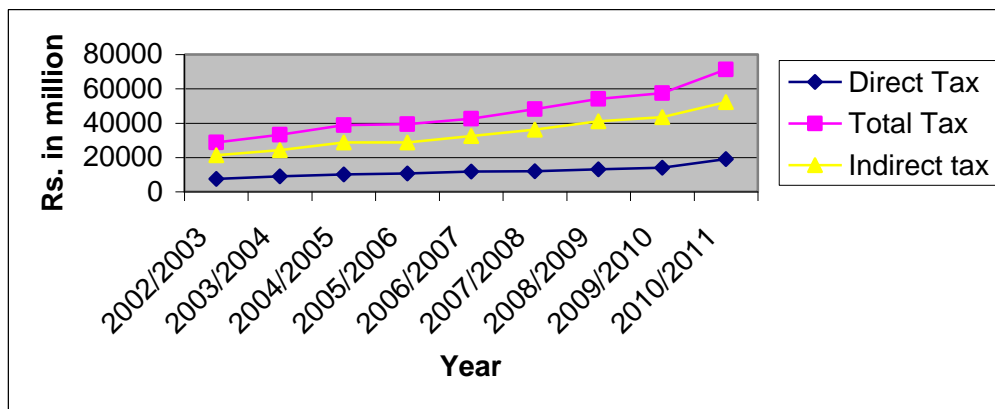
Structure of Tax Revenue



Above bar diagram clearly shows that amount of indirect tax are increasing continuously and the direct tax is also decreasing and increasing trend.

Figure 4.5

Trend of Direct Tax and Indirect Tax with Respect to Total Tax Revenue



Previously presented trend of direct tax and indirect tax clearly shows that the gap between these two revenue sources is in increasing trend, which is good indicator for economic development. For the economic growth of developing country like Nepal it is necessary to increase direct tax. Then the share of direct tax to the total tax revenue will be increased and ultimately share of indirect tax will be decreased in some extent.

4.5 Revenue Collection from VAT

From the literature of review and case study it is clear that the VAT which is practiced during past 10 years is best form of sales tax. VAT is neutral regarding method of production and helpful in generation of more revenue collection. Because of its broad coverage, neutrality, transparency and fairness, VAT will generate more revenue with less distortion. The revenue collection from VAT in different fiscal year is presented in the following table:

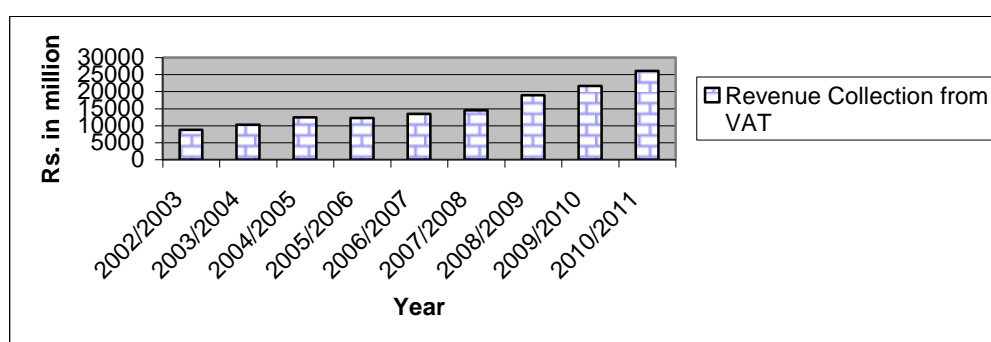
Table 4.4

Revenue Collection from VAT		
(Rs. In millions)		
Fiscal Year	Revenue Collection from VAT	Percentage change
2002/2003	8765.9	-
2003/2004	10259.7	17.04
2004/2005	12382.4	20.68
2005/2006	12267.3	-0.92
2006/2007	13459.7	9.72
2007/2008	14478.9	7.57
2008/2009	18885.4	23.33
2009/2010	21610.7	14.43
2010/2011	26095.6	20.75

Sources: MOF/GN, Economic Survey, 2010/11.

Figure 4.6

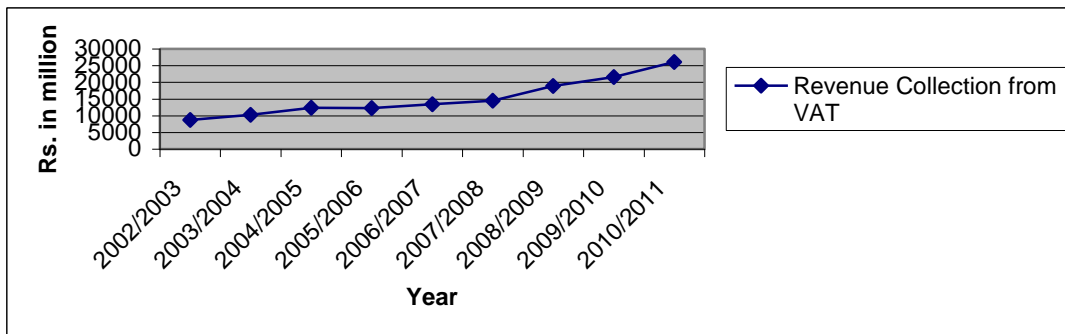
Bar Diagram of VAT Collection



From the above table and diagram it shows that the revenue collection from VAT is in increasing trend except in fiscal year 2005/06 in which there was decreasing trend in VAT collection. In fiscal 2007/08 there is lesser amount of increase in VAT by 7.57 percent from the preceding fiscal year. There was a highest revenue collection in the fiscal year 2010/11.

Figure 4.7

Trend Lines of VAT Collection



Above trend of revenue collection from VAT shows that this was a high degree of slope in between the first two fiscal years, which indicates the improvement of revenue collection. There was highest difference between two fiscal years 2006/07. At the same period there was highest percentage change figure which is 23.33. But in the fiscal year 2005/06 there was negative percentage change. This shows poor revenue collection in that period. Then after the amount of revenue collection from VAT was in increasing trend.

Since VAT is a main source of governmental revenue it provides suitable base revenue to the government. Though there was a fluctuating trend of VAT collection it is not so bad. It is expected that VAT will generate more and more revenue in the coming days. It will be better when there exist positive percentage change in the revenue.

4.6 Contribution of VAT to Total Revenue

The percentage contribution of VAT revenue to total revenue is presented in the following table and bar diagram.

Table 4.5

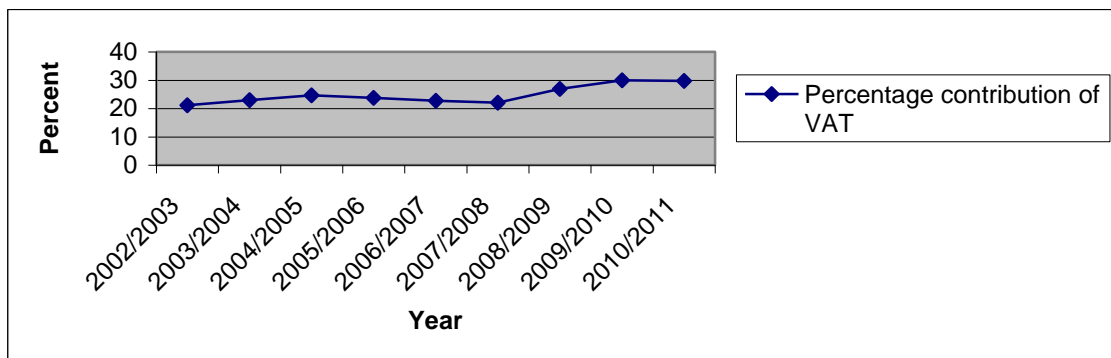
Contribution of VAT to Total Revenue			
(Rs. In Millions)			
Fiscal Year	VAT Revenue	Total Revenue	Percentage of VAT
2002/2003	8765.9	37251.3	21.16
2003/2004	10259.7	42893.7	22.97
2004/2005	12382.4	48983.9	24.64
2005/2006	12267.3	50445.6	23.71
2006/2007	13459.7	56229.8	22.67
2007/2008	14478.9	62302.6	22.01
2008/2009	18885.4	70122.7	26.93
2009/2010	21610.7	72279.1	29.89
2010/2011	26095.6	87712.1	29.75

Sources: MOF/GN, Economic Survey, 2010/11.

From the above table it is clear that the contribution of VAT revenue to total Revenue increased from 21.16% to 29.89% in the fiscal year 2002/03 to 2009/10. But there is decreasing trend in the fiscal year 2005/06, 2006/07, and 2007/08 and there was in increasing trend in the fiscal year 2003/04 and 2004/05 respectively.

Figure 4.8

Contribution of VAT in Total Revenue



4.7 Contribution of VAT to Total Tax Revenue

The percentage analysis of VAT to Total Tax Revenue is presented here in below:

Table 4.6

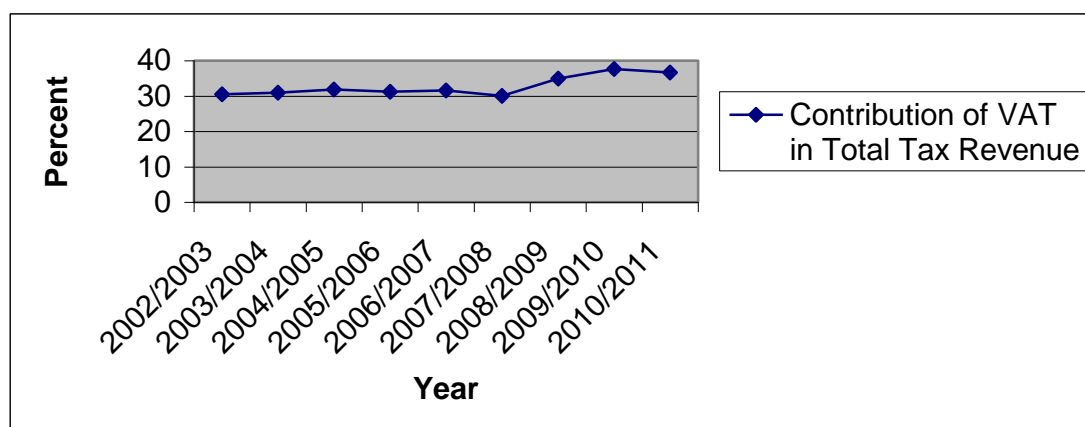
Contribution of VAT to Total Tax Revenue			
(Rs. In millions)			
Fiscal Year	VAT Revenue	Total Tax Revenue	% of VAT
2002/2003	8765.9	28752.9	30.48
2003/2004	10259.7	33152.1	30.94
2004/2005	12382.4	38865.1	31.85
2005/2006	12267.3	39330.6	31.19
2006/2007	13459.7	42566.0	31.62
2007/2008	14478.9	48160.0	30.06
2008/2009	18885.4	54104.8	34.9
2009/2010	21610.7	57430	37.62
2010/2011	26095.6	71168	36.66

Sources: MOF/GN, Economic Survey, 2010/11.

The contribution of VAT to Total Tax Revenue is not smooth; it is fluctuating from the fiscal year 2002/03 to 2010/11. Firstly it was decreased and then increased. There was highest contribution of the VAT to Total Tax Revenue in the fiscal year 2009/10 of 37.62% and lowest in the fiscal year 2007/08 of 30.06%.

Figure 4.9

Contribution of VAT in Total Tax Revenue



4.8 Contribution of VAT to Indirect Tax Revenue

The percentage contribution of VAT Revenue in Total Indirect Tax Revenue is presented in the table below:

Table 4.7

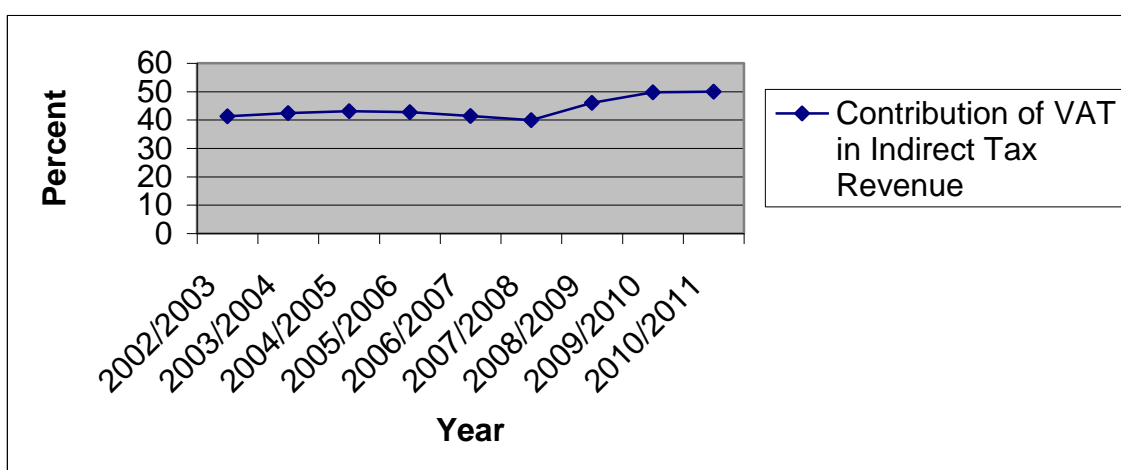
Contribution of VAT to Total Tax Revenue			
(Rs. In millions)			
Fiscal Year	VAT Revenue	Total Indirect Tax Revenue	% of VAT
2002/2003	8765.9	21236.8	41.27
2003/2004	10259.7	24200.6	42.39
2004/2005	12382.4	28705.7	43.13
2005/2006	12267.3	28733.1	42.69
2006/2007	13459.7	32486.7	41.43
2007/2008	14478.9	36264.5	39.92
2008/2009	18885.4	41032.9	46.02
2009/2010	21610.7	43461.9	49.72
2010/2011	26095.6	52187.7	50.00

Sources: MOF/GN, Economic Survey, 2010/11.

From the above table and trend presented below it shows that there was contribution of 41.27% to Total Indirect Tax Revenue in the fiscal year 2002/03. In the fiscal year 2003/04 it has increased to 42.39%. After then in fiscal year 2005/06 and 2006/07 it reduced to 42.69% and 41.43% respectively. Then it was continuously increased after 2006/07. At the end i.e. in the fiscal year 2009/10 and 2010/11 it reached to 49.72% and 50.0%, which is very good in comparison to the fiscal year 2002/03

Figure 4.10

Contribution of VAT in Indirect Tax Revenue



4.9 Contribution of VAT to GDP

The percentage contribution of VAT in Gross Domestic Product is presented in the following table. The share of VAT in GDP does not show even trend. As shown in table 4.14, the share of VAT revenue as percentage of GDP is 2.46 percent in FY 2002/03 increased to 2.96 percent in FY 2006/07 and slightly decreased to 2.90 percent in FY 2008/09. The share of VAT revenue as percent of GDP in the FY 2010/11 was 3.58 percent. The fluctuating trend in VAT in GDP is due to fluctuation in VAT collection

Table 4.8

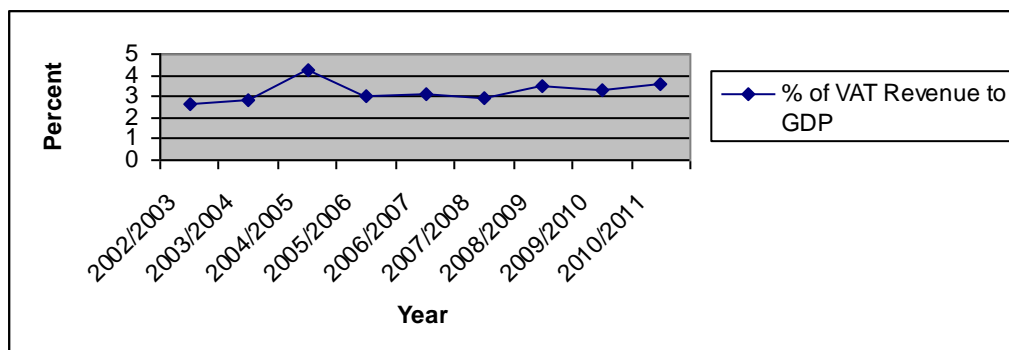
Contributing of VAT to GDP			
(Rs. In millions)			
Fiscal Year	VAT Revenue	GDP	% of VAT Revenue to GDP
2002/2003	8765.9	330018	2.65
2003/2004	10259.7	366251	2.80
2004/2005	12382.4	293566	4.21
2005/2006	12267.3	404482	3.03
2006/2007	13459.7	435531	3.09
2007/2008	14478.9	496745	2.91
2008/2009	18885.4	533538	3.53
2009/2010	21610.7	654055	3.30
2010/2011	26095.6	727089	3.58

Sources: MOF/GN, Economic Survey, 2010/11.

As shown in above table it can be clearly shows that the Contribution of VAT to GDP is very low. There was no higher fluctuation in the increasing and decreasing trend. There was a highest contribution in the fiscal year 2007/08 which is 4.24% and lower contribution was in the fiscal year 2003/04 which is 2.78%.

Figure 4.11

Contribution of VAT Revenue to GDP



4.10 VAT Registration

The operation of VAT in Nepal was started by addressing the sales tax registrants to register in the VAT department. The registration is compulsory for these business enterprises that have taxable transaction and taxable capacity; however the traders falling below the threshold limit can register voluntarily. Under the existing sales tax system, there were nominal registrants but VAT was in existence the number of registrants increased significantly. However, when VAT was introduced in 1997/98, there was strict opposition from the business community so VAT could not be implemented in full form. But after different provisions and aspects of VAT, business community and the government reached to an agreement in 1999/2000. There after, VAT was implemented in its full form so that the number of VAT registration is below in the following table:

Table 4.9

Total No. of VAT Registrants	
Fiscal Year	Total No. of VAT Registrants
2002/2003	9082
2003/2004	18,204
2004/2005	21,781

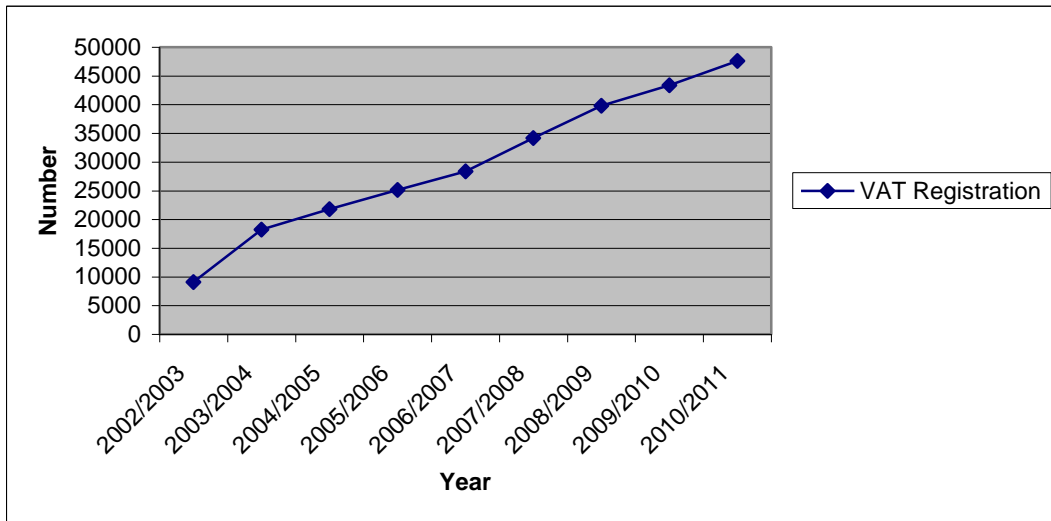
2005/2006	25,149
2006/2007	28,354
2007/2008	34,174
2008/2009	39,776
2009/2010	43352
2010/2011	47602

Sources: Internal Revenue Department, 2010

This number of registrants can be shown by following trend analysis.

Figure 4.12

Total Number of VAT Registration



Despite having several problems in its operations, the total number of VAT registrants has reached exactly 39,776 in the span of last eight years. As shown in table 2.9, the number of VAT registrants has increased consistently in the last eight years from 4959 in FY 2001/02 to 9082 in FY 2003/04 to 18,204 in FY 2004/05 to 21781 in FY 2005/06 to 25149 in FY 2006/07 to 28,354 in FY 2007/08 to 34,174 in FY 2008/09 to 39,776 in FY 2009/10 to 47,602 in FY 2010/11. This shows that the increase in the number of VAT registrants is impressive.

4.11 Major Empirical Findings

All together 50 questions were distributed to different three groups i.e. Administrators, VAT Collectors and Tax Payers. The number of individual groups was 20 from Administrators, 10 from VAT Collectors and 20 from Tax Payers.

4.11.1 View on VAT as appropriate means of raising the public Revenue.

Contribution that may be from internal or external is used for the development of nation by the government. All the sources are the mean of increasing the public revenue. There was highest contribution of VAT on public revenue of 37.63% in the fiscal year 2007/2008.

The field study shows that the following results which presented in the tabular as well as descriptive form below:

Table 4.10

VAT as appropriative Mean of Raising Public Revenue					
Respondents	YES		NO		TOTAL
	Number	%	Number	%	
Administrators	17	85	3	15	20
VAT Collectors	9	90	1	10	10
Tax Payers	9	45	11	55	20
Total	35	70	15	30	50

Source: Field Survey, 2012

85% of administrators, 90% of VAT Collectors and 45% of tax payers said that VAT is the appropriate mean of raising public revenue. Where as 15% of administrators, 10% of VAT collectors and 55% of tax payers said that VAT, is not appropriate mean of raising public revenue. Most of the tax payers are not favor of raising the public revenue.

So, it can be said that VAT is the appropriate mean of raising the public revenue. Though there are large numbers of tax payers who are not in the favor. They are not well familiar to the phenomenon of VAT

4.11.2 Views on superiority of VAT to the areas it has replaced.

VAT is advanced form of sales tax. It is indirect tax. Among the other taxes like hotel taxes, entertainment taxes, and sales taxes it is superior. The same question was asked to the respondents at the time of field survey. Their attitudes towards the superiority of VAT than other taxes are presented in the following table:

Table 4.11

Views on superiority of VAT to the areas it has replaced					
Respondents	YES		NO		Total
	Number	Percent	Number	Percent	
Administrators	18	90	2	10	20
VAT Collectors	8	80	2	20	10
Tax Payers	13	65	7	35	20
Total	39	78	11	22	50

Sources: Field Survey, 2012

From the above table it can be said that VAT is superior to the other taxes like sales tax, hotel tax and entertainment tax. Majority of the respondents proved this statement although there was a negative aspect of tax payers. Out of 20 taxpayers 13 were in the favor and rest was in negative aspect which holds 65% and 35% respectively. 90% of administrators and 80% of VAT collectors shows positive opinion on the superiority of VAT to the area it has replaced.

4.11.3 View on Sufficiency of Legal Provision Concerning to VAT Collection System.

Before implementation of VAT, the government has prepared VAT Act 2052 and VAT Regulation 2053. But the legal provision and rules in general different to understand by all. The documents of these enactments carry all the matters such as VAT administration and its operation, the tax officers and its authorities (duty and responsibility) tax payers and its responsibility, the procedure of VAT collection, identification of new tax payers, monitoring, cross-checking, penalties and punishment. The field survey has been conducted to find out whether the present Act and Regulation are sufficient or not with reference to current system of VAT. The outline/attitude of the respondent on this aspect is presented in the following table:

Table 4.12

Sufficiency of Legal Provision Regarding to VAT Collection									
Respondents	YES		NO		I DON'T KNOW				Total
	No.	%	No.	%	No.	%	No.	%	
Administrators	13	65.00	7	35.00	0.00	0.00	0.00	0.00	20
VAT Collectors	6	60.00	4	40.00	0.00	0.00	0.00	0.00	10
Tax Payers	7	35.00	6	30.00	0.00	7	35.00	0.00	20
Total	20	52.00	17	34.00	0.00	7	35.00	0.00	50

Sources: Field Survey, 2012

The field survey shows that 65% administrators, 60% VAT collectors and 35% tax payers were in the favor of existing legal provision relating to VAT in Nepal. On the other hand 35% of administrators, 40% VAT collectors and 30% of the tax payers were unknown about the legal provision relating to VAT. So, finally it can be said that the legal provision relating to VAT collection system in Nepal are sufficient. There is only lack of proper implementation.

4.11.4 Views on Collection System

It is clear that VAT in Nepal not implementing effectively. On the assistance of the Revenue Department random monitoring is conducted which indicates that there is some effort to make VAT system tighten. The activities like preparation of documents, timely payment of tax, proper valuation of goods and services are lies in the VAT collection system. Also invoices making and taking is the important one. A question that relates VAT collection system was asked to the respondent. The question was what degree of Liberalce is used when VAT is collected? The views of different respondents are presented in the following table:

Table 4.13

Degree of Liberalism in Collection of VAT							
Respondents	Strict		Medium		Low		Total
	No.	%	No.	%	No.	%	
Administrators	12	60	6	30	2	10	20

VAT Collectors	5	50	3	20	3	30	10
Tax Payers	15	75	2	15	2	10	20
Total	32	64	11	22	7	14	50

Sources: Field Survey, 2012

60% of administrators, 50% of VAT collectors and 75% of tax payers said that VAT is strictly collected where as the percentage of medium are 30% administrators, 20% of VAT collectors and 15% of tax payers where as 10% of administrators, 30% of VAT collectors and 10% of tax payers said that the implementation of VAT collection system is low.

4.11.5 Views on Revenue Collection from VAT.

In the early stage of the VAT implementation in Nepal, there was low contribution of VAT on total revenue, indirect tax and domestic production. Now it has been increased in some extent. Governmental expenditure is also increasing trend of expenditure. When VAT is collected as it had been expected, there will be a probability of surplus.

Table 4.14

Satisfactory Towards Collection of Revenue from VAT					
Respondent	YES		NO		Total
	No.	%	No.	%	
Administrators	2	10	18	90	20
VAT Collectors	2	20	8	80	10
Tax Payers	7	35	13	65	20
Total	11	22	39	78	50

Sources: Field Survey, 2012

From the field survey, 78% respondents argue that revenue collection from VAT is not satisfactory as it has been expected, 90% and 80% of administrators and VAT collectors says that VAT is not getting expected amount of revenue. But 35% of tax payers said that VAT is achieving expected amount of revenue.

4.11.6 Views on problems in the process of VAT collection in Nepal

Expected revenue from VAT is not collected due to existing various first of all problems should be avoided. The major problems may be lack of knowledge about VAT to the tax payers, tedious work, administrative problems, lack of skilled manpower and improper billing system. To find the major problems respondents were requested to rank their responses on the given choice. In case of analysis every rank has some score with it 6 marks are given to the most important problem and 1 to the least important problem. The survey result is presented here below:

Table 4.15

Problems in the Process of VAT Collection in Nepal				
Problems	No. of respondents	Score	%	Rank
Lack of Knowledge	50	157	17.44	3
Tedious Work	50	112	12.44	5
Administrative Problems	50	176	19.56	2
Lack of Skilled Manpower	50	140	15.56	4
Improper Billing System	50	248	27.56	1
Others	50	67	7.44	6
Total		900		

Sources: Field Survey, 2012

From the above table it is clear that improper billing system is the important problem in the process of VAT collection which holds 27.56%. Similarly tedious work holds 12.44%, ranked 5.

Thus problems are ranked here in this way:

1. Improper Billing System
2. Administrative Problems
3. Lack of Knowledge
4. Lack of Skilled Manpower
5. Tedious Work

4.11.7 Views on most important factor for the effectiveness of VAT collection.

There are so many problems existing in the VAT collection system. To make it effective, it is necessary to identify the problems and then solve successfully. These problems may be effective and efficient administration, broad coverage, tax education, proper implementation of rules and regulations and clear VAT rules and regulations. The opinions of the respondents on these aspects are presented in the following table:

Table 4.16

Views on most Important Factor for the Effectiveness of VAT				
Problems	No. of Respondents	Score	%	Rank
Effective & Efficient Administration	50	90	10.00	5
Broad Coverage	50	120	13.33	4
Tax Education	50	176	19.56	3
Implementation of Rules & Regulations	50	250	27.78	1
Clear VAT Laws and Regulations	50	214	23.78	2
Others	50	50	5.56	6
Total		900		

Sources: Field Survey, 2012

From the above table we can conclude that proper implementation of rules and regulation is the most important factor for effectiveness of VAT collection system. On the basis of result obtained from investigation we factors for effectiveness of VAT collection system are ranked as:

1. Proper Implementation of Rules & Regulations
2. Clear VAT Laws and Regulations
3. Tax Education
4. Broad Coverage

5. Effective & Efficient Administration
6. Others

4.11.8 Views on effectiveness of VAT in the future

An international experiences shows that VAT is an appropriate method to achieve better revenue generation. Due to its advantages it should be effective in the future. But it depends on its implementation. If implemented properly, it will be more effective in the future. The views of respondents are presented in the following table:

Table 4.17

Effectiveness of VAT in the Future							
Respondents	YES		NO		I DON'T KNOW		Total
	NO.	%	No.	%	No.	%	
Administrators	16	80	2	10	2	10	20
VAT Collectors	7	70	1	10	2	20	10
Tax Payers	12	60	3	15	5	25	20
Total	35	70	6	12	9	18	50

Sources: Field Survey, 2012

From the above table, 70% of respondents agree that VAT will be more effective in the future, 12% respondents were negative about the effectiveness of VAT in the future and 18% were unknown about this question. From the survey we can conclude that most of the respondents view VAT will be more effective in the future. From the study it is found that 80% administrators, 70% VAT Collectors and 60% tax payers accepted the fact that VAT will be more effective in the future.

4.11.9 Views on VAT Collection System and Legal Provision in Nepal.

There was a question on the questionnaire “Do you have any other suggestion for the VAT collection system and legal provision in Nepal? This was an open ended question. Most of the respondents answered the question. There were different suggestions from different respondents which are listed below:

- Stable/permanent government with similar commitment about national policy.
- Require pay for public service holder.
- Improvement ethics of business holder.
- Proper implementation of billing system.
- No security for employee to implement the VAT law forcefully.
- Reduce tax rate and enlarge tax base.
- Avoid under valuation and improper billing system.
- Exempt should be thinned.
- Boarder area should be tightened.
- Valuation should be real based.
- Billing enforcement should be effective.
- VAT laws and regulations should be clear and transparent.
- VAT administration should be efficient and effective.
- Sound tax policy is necessary.
- It should be clear and efficient in all levels.

4.12 Major Findings of the Study

On the basis of chapter V (presentation and analysis of data) some finding can be drawn which are listed below:

- Nepal is suffering from fiscal crises, because governmental expenditure leads the income. The increasing trend of expenditure is greater than that of income.
- Due to income generation Nepal has to depend on foreign aids, grants etc.
- In the total revenue the contribution of tax revenue and non-tax revenues are in the range of 75% and 25% respectively.

- There is one forth contribution of direct tax to the total revenue. For the better improvement of the economic condition it should be increased.
- Besides the problems of implementation of VAT in Nepal. It has increased in amount except in the fiscal year 2003/2004. In the fiscal year 2003/2004 it was Rs.12382.4 and reached to 21610.7 in the fiscal year 2008/2009.
- The numbers of new registrants are increasing.
- Contribution of VAT to total tax revenue and indirect tax revenues are in decreasing trend. Even the decreasing trend is not so high; there is need of effective VAT collection system.
- Contribution of VAT to GDP is very low with lower fluctuation.
- From the field survey it is known that 70% of the respondent's belief that VAT is the appropriate mean of raising public revenue.
- 78% of the respondents are in the favor about the view of superiority of VAT to the area it has replaced.
- Most of the respondents are in the favor of existing legal provision concerning to VAT collection system. There are 35% of the tax payers who does not agree in this statement.
- 78% of the respondents reached to the conclusion that revenue collection form VAT is not satisfactory as it has expected.
- It known that improper billing system is main problem that arises in the process of VAT collection system. Other problems ranking is administrative problem, lack of knowledge, lack of skilled manpower and skilled manpower.
- Most of the respondents agree to proper implementation of rules and regulation is the most important factor of effectiveness of VAT collection system.
- 70% of the respondent's belief on improvement of VAT collection system in the future and 9% don't know whether it will or not.

It can be said that if VAT system is effectively implemented it will definitely increases the tax revenue.

CHAPTER V

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

Value Added Tax is latest innovation in the field of taxation. Actually, VAT is considered as the most important tax reform in the 21st century, which has already been implemented popularly in more than over 130 countries in the world. VAT is multi-staged; commodity and services based tax which is levied on the values added of business enterprises at different stages of production and distribution. It affects only the added portion of price i.e. the value of goods and services added in various stages of transition. It has nothing to do with the rest of the prices. Purchases pay VAT to the sellers and sellers transfer it to government, deducting VAT paid on their business purchases from VAT amount collected from the consumers on their sales. The ultimate burden of VAT is shifted to the consumers. In this system, every person or business firm, which is above threshold limit should compulsorily be registered in VAT office. Registered person/business firms get credit facility on tax paid, on their purchases of raw materials, semi-produced goods and overheads. Small vendors whose annual taxable turnover is below threshold and business firms that deal with exempt goods only need not registration. The firms, below threshold, could be registered voluntarily.

After five decades of the evolution of the concept of VAT, France took the courage to put VAT into practice. France introduced VAT in 1954 at the wholesale level in the industrial sector. Up to 1959, this tax was confined to the boundary of France. In 1960 this tax was adopted by the Ivory Coast, in 1961 Senegal followed suit and in 1967 Brazil and Denmark adopted this tax system. Thereafter, many countries started adopting this tax.

In the 1960's in process of establishing the European Community (EU), the policy to adopt a standard tax system among the members of the community was also adopted. In this context, it was decided that all member countries of the EU should adopt VAT by replacing their various types of indirect taxes. Since it became a pre-condition to adopt VAT to become a

member of the EU, the member countries started to introduce VAT into their tax systems and gradually this became the standard tax system of the European countries.

In the decade of the 1970's VAT started to spread worldwide. VAT system is a completely new system of taxation for Nepal. Government of Nepal has adopted VAT system in the year November 16, 1997. The international of introducing VAT was initially expressed in 1992; VAT task force was created in 1993. After several years and preparation, VAT Act was finally passed through parliament in December 1995. VAT becomes effective through the Finance Bill of 1997. After that, formulation and passage of VAT Act, design of VAT regulations and its final approval preparation of VAT all has been done by Nepali standard. Due to effective VAT Act and regulation make well preparation for VAT in Nepal which has made VAT successful today. It was partially implemented till 1993. A good harmony between VATS continued spreading the misinformation that VAT would increase the price.

VAT is not applicable for all transaction. An annual threshold of Rs.2 million in transactions has been specified for this purpose. In other words, any business with an annual transaction of less than 2 million need not be registered under VAT.

Rule 56 of VAT Regulation has provided that all organizations, associations, officers and constitutional bodies of His Majesty Government shall purchase goods or services within the kingdom of Nepal worth in excess of Rs.25000 per time from only those registered under VAT. This provision is supposedly applicable in the case of government agencies only. However, section 6 and section 37 of the finance Act 2001 has made additional provisions for VAT registered organizations, companies, firms or individuals requiring them respectively to procure consulting services for business than Rs.100,000 and purchasing VAT able goods and services for business purposes worth more than Rs.25000 from only those registered under VAT.

VAT registration is not made compulsory for transaction below the threshold but on other hand, restriction has been imposed for dealing with such non registered vendors. The restriction put against dealing with those who are granted exemption for VAT registration by the main Act is total amount to unequal treatment towards such enterprises. Where the tax officer has the reason to believe that a business is being carried out without registration, which otherwise requires registration as per Section 23 and wishes to investigate, impending

such act would attract penalty of Rs.5000 per time under Section 29(1) clause 'H'. During such investigation, where it is proved that such business requires registration but has been carried out without registration, a fine of Rs.10,000 plus the tax amount for the period under Section 29 (1) 'A' would be attracted for violating Section 10 (2).

The main Act has made no specific provision in respect of under invoicing. However, for such as offensive, Finance Act 2001 has provided for a fine of Rs.2000 for each invoice or the fine as may be applicable under Section 29 (2), whichever is higher. Even in the absence of this specific provision penalty for making false invoice is covered under Section 29 (2). However, this new provision has fixed a minimum fine of Rs.2000 for this kind of offense.

The first step towards VAT operation is registration of vendor who is legal taxpayers. Each and every registered vendor should received and given the bill while purchasing and selling the goods respectively. Each VAT registrant should keep records of all tax invoices they issue and receive, including the serial number and data of the invoice, the amount changed and the VAT changed. If a registrant's output tax liability is greater than his input tax credit, he required to limit of output tax and input tax to the authority within specified time period. VAT is self assessed tax. Tax payer does not assess this income himself and does not file his returns within specified time; he is termed to be a non filer. In such cases, VAT officials may have to a tax assessment; penalties are designed to punish tax payers for their VAT offences and to recoup the revenue losses due to the mal-function of tax payers.

Despite having too many challenges regarding in the implementation of VAT, it has been generating public revenue. The revenue structure shows that the contribution of indirect tax to the total tax revenue has increased with some fluctuation.

5.2 Conclusion

VAT collection process is the origin of indirect tax revenue. For the improvement of the economic condition of Nepal it has been increased. To achieve higher growth of revenue, every country needs to reform some of its tax system. In the context of present world VAT is one of the best alternatives of tax reform process. There were four taxes i.e. sales tax, hotel tax, entertainment tax and contract tax which is replaced by the VAT in Nepal. VAT is the most innovative, scientific and powerful tax system which eliminates various defects of sales tax by replacing it such as pyramiding and cascading effects. VAT is broad based indirect tax. Nepal has adopted consumption type tax with tax credit mechanism.

Proper invoicing system is the major problem of VAT in Nepal. Under valuation is another problem. The main reason of weakness of VAT is the lack of publicity and effective monitoring. In the implementation of VAT the main glitch has been in terms of the lack of public awareness. Until a time when a situation is created where the consumer himself/herself is self motivated to task to ask for an invoice, it will be an uphill road for VAT.

In the process of preparation for VAT, the seminars, workshops, interactions were mainly organized for specific sectors. But unless and until the general consumers are directly made conscious and alert regarding this tax, the time to time random visits and investigations alone by the government authorities will not regularize the billing process.

There are lots of elements which increase the effectiveness of VAT. Clear VAT rules, effective and efficient administration, honest tax payer, tax education and establishment of proper invoicing mechanism and extension of tax coverage are most important factors which obviously increase the revenue.

To make VAT effective and transparent, sudden inspection on the road of goods being transported from time to time would discourage incorrect business transactions. If, with the support of the Revenue Investigation Department, such campaigns could be operated only in Dhulikhel and Thankot this would prevent and discourage major sources of unreal business transactions.

5.3 Recommendations

On the basis of analysis of data, findings and conclusion following recommendation have been drawn which could be useful to concerned authorities relating to VAT collection system and legal provision concerning it in Nepal.

- In the process of VAT collection system, the focus should be on transparency, fairness and timely and quality production in administration instead of simple collection.
- Non tax revenue is very low as compared to tax revenue. For the betterment of the nation it should be increased.
- As increasing trend of government expenditure is higher than that of government revenue, it should be increased to make governmental surplus.
- VAT registration is not made compulsory for transaction below the threshold but on other hand, restriction has been imposed for dealing with such non-registered vendors.
- Contribution of VAT to total revenue and total tax revenue is very low and is in decreasing trend. This negative trend should be stopped recently.
- There is a high share of indirect to total tax revenue. For the economic development of nation the gap between the direct tax and indirect tax should be decreased down with positive.
- General public must be given must the government that the tax paid by them is being spent on national welfare and further development projects.
- Tax refund procedure should be made simple and less time-consuming.
- Most of the tax payers are unfamiliar to the legal provision relating to VAT collection system. This is due to lack of publicity of VAT and its feature. So, programmes that can aware, conscious the tax payers should be recently implemented.
- By providing facilities to the taxpayers, it is necessary to encourage the non-tax payers to pay tax.
- Improper billing system is the most important in the process of VAT collection. So, computer billing system should be implemented.
- The manufacture should quote the price of the product as inclusive of VAT.
- All the registrants should be well known to the process of registration by which they can maintain the records and accounts as per the legal provision of VAT collection system and ultimately revenue from VAT will be increased.

- Separated legal provision should be made in VAT laws to avoid the situation of taxation and tax exempted goods and double tax system.
- VAT rate should be different for different type of products. High rate should be imposed on luxurious goods and low rate for basic goods to make the VAT system broad.
- For collection, processing, analyzing and using of market information, effective system should be developed. Expert should be deployed for maintaining effective tax database.
- Inland Revenue Department should give instruction to its officers not to demand irrelevant document.
- Tax net should be extended to small vendors and retailers to increase the taxable amount of VAT.
- VAT system must not be influenced by political instability.
- The concept and method of collecting revenue by VAT system should be changed according to the changing environment. Illusive provisions and complication in the prevailing Act should be made clear.
- Those business persons having taxable capacity should bring in tax net. So, the enforcement should be made more effective and voluntary compliance should be encouraged.
- Existing threshold is a possible gate for evasion. So, effective steps must be taken for implementing the threshold accurately.
- Government should pay attention to design strong tax administration, well trained, qualified and intelligent administrator can reduce corruption and maintain healthy tax environment.
- Government has to improve the administrative capability, regular and close monitoring and direct supervision should be made.
- Open boarder is the main reason of smuggling and under valuation system. So, gradual regulation of all imports specially those from India must be established.
- The government must keep cooperative relationship with tax payers. It is essential to make attempts to win the trust of industrial and trade organization as well as professional communities.
- Kathmandu is a centre area of VAT collection. If regular monitoring with the support of the Revenue Investigation Department, and campaigns are operated in Dhulikhel and

Thankot this would prevent and discourage major sources of unreal business transactions.

- Who honestly takes the responsibilities should be rewarded by means of promotion and enhance which enhance the effectiveness of VAT.
- Every actor of VAT should be conscious towards effective implementation of VAT.
- There is still confusion about theoretical and practical aspects of VAT system among businessmen. The confusion should be removed and decision should be strictly implemented.
- All consumers should not forget to take the invoice after shopping. The concerned government authority should be informed if any vendors hesitate to issue invoice. The government should give priority to conscious consumer prizing program.

BIBLIOGRAPHY

- Adhikari, Chandra Mani. (2003). *Value Added Tax in Nepal (Theory and Practice)*. Kathmandu: Pairavi Prakashan.
- Bista, Raghu Bir. (2006). *Value Added Tax in Nepal: Its Issues and Effects*. An Unpublished Master's Degree Dissertation, CDE, T.U., Kathmandu.
- Bogetic, K. and Hosan, S. M. (1993). The Equity Impact of The Value Added Tax in Bangladesh. *IMF Staff Papers*, Vol. 42, No.2 Washington D.C.: International Monterey Fund.
- Caseenegrad A. and Guerand, Luduow (1973). *Tax Return Package on VAT for Pakistan Institute of policy Studies. Working paper* Vol. 20.
- Dhakal, Kamal Deep. (2001). *Income Tax and House and Compound Tax Law and Practice*, Kathmandu: Kamal Parkashan.
- Dhungana, Yadab Prasad. (2003), *VAT and Its Legal Scruting*, Business Age, Nepal.
- Dhungana, Bhavani. (1980), *Indirect Taxation in Nepal*, CEDA, Kirtipur, Kathmandu.
- Gorkhapatra Corportation, (1994). *The Rising Nepal*, 22 May, Kathmandu, Nepal.
- Gorkhapatra Corportation, (1994). *Rising Nepal*, 16 June, Kathmandu, Nepal.
- Gorkhapatra Corportation, (1994). *The Rising Nepal*, 28 May, Kathmandu, Nepal.
- Gurung, Kul Bahadur. (2009), *VAT Implementation in Nepal: In Reference to Present Position and Future Prospect*, An Unpublished Master Degree Thesis, Faculty of Management, Tribhuvan University.
- Inland Revenue Department (2001). *Value Added Tax (VAT), Four Years Implementation, DANIDA VAT Project*, Kathmandu, Nepal.
- Inland Revenue Department, Lazimpat (2002). *Annual Report 2063/2064*.
- Inland Revenue Department (2001). *Value Added Tax Four Years of Implementation of VAT, VAT Project* Kathmandu.

- Kandel, Puspa Raj. (2006). *Tax Laws & Tax Planning in Nepal*, Kathmandu: Buddha Academic Enterprises Pvt. Ltd.
- Kandel, Dinesh. (2005), *Value Added Tax in Nepal: A Cross-Check Analysis*, An Unpublished Masters Degree Dissertation, CDM, T.U., Kathmandu.
- Khadka, Rup Bahadur. (1997). *Value Added Tax in Nepal: Theory and Practice*, Kathmandu: Ratna Pustak Bhandar.
- Khadaka, Rup Bahadur. (1997). *Value Added Tax and its Relevancy to Nepal*, Kathmandu: Ratna Pustak Bhandar, Kathmandu, Nepal.
- Khadka Rup Bahadur. (2000). *Value Added Tax in Nepal: Theory and Practice*, Kathmandu: Ratna Pustak Bhandar.
- Khadka, Rup Bahadur. (2001), *VAT in Nepal*, Kathmandu: Ratna Pustak Bhandar.
- Khadka, Ramesh., (2004). *VAT Implementation in Nepal Problems and Prospects*, A Dissertation Submitted to the Central Department of Management T.U.
- Koirala, Girija Prasad and Bhattarai Ishwari (2004). *Tax Laws and Planning*, Kathmandu: Dhulagiri Books and Publishers.
- Kuikel, Rabin. (2011). *Effectiveness of VAT in Revenue Collection in Nepal*, A Dissertation Submitted to Central Department of Management, T.U.
- Laudari, Raju. (2007). *VAT in Nepal: An Analysis of Its Problems and Prospects*, An Unpublished Master's Degree Dissertation, CDE, T.U., Kathmandu.
- Ministry of Finance, (2009). *Economic Surveys (Various Issues)*, Government of Nepal, Kathmandu.
- Nepal Chamber of Commerce (1997). *Study Report on Possible Effects of VAT on Different Areas (Nepali)*. Nepal Chamber of Commerce, Kathmandu.
- Prasai, Iswar Kumar., (1998). *Appeal System in VAT Act 2052*, Rajashwa, Kathmandu: MOF.
- Sharma, Krishna Prasad. (2004). *Value Added Tax in Nepal: Issues and Options*, An Unpublished Master's Degree Dissertation, CDE, T.U., Kathmandu.

- Shoup, Carl S. (1969). *VAT and Developing Countries*, Research Observer (Vo.13, No.2), The World Bank and Washington D.C.
- Shrestha, Ishwor Kumar. (2004). "An Analysis of Appeal System in VAT Act, 2052" *RAJASWA*.
- Silwal, Narayan Prasad. (2002). *Value Added Tax: A Nepalese Experience*, Kathmandu, Nepal.
- Subedi, B.R. (1988). *VAT and its Applicability in Nepal*, Bhrikuti Academic Publications, Exhibition Road, Kathmandu, Nepal.
- Subedi, B.R. (1999). *VAT and its Implementation in Nepal*, Bhirkuti Academic Publications, Exhibition Road, Kathmandu, Nepal.
- Thapa, Govinda Bahadur. (2003). *Nepal's Budget Deficit and Debt Burden: Some Analysis, Business Age*, Kathmandu, Nepal.
- Thapa, Govinda Bahadur. (2001). *Implementation of VAT in Nepal: An Evaluation*, Published Article in the book titled "VAT Four years of implementation" The IRD and VAT Project.
- Thapa, Mohan. (2010). *Research Mobilization through VAT in Nepal*, An Unpublished Master Degree Thesis, Faculty Management, T.U. Kritipur, Nepal.
- World Bank (2006). *World Development Report*, Washington D.C: Oxford University Press for the World Bank.

Appendix-I

Dear Sir,

I would like to introduce myself as a student of New Horizon College, MBS Final Year, engaged in a research work. In order to fulfill the partial requirement of Master's Degree in Business Studies (MBS) of Tribhuvan University of Nepal, I am going to prepare a dissertation on VAT.

I humbly request for your valuable comments, views, suggestions and information on this issue which could prove very useful for my study. So, I request you to fill up the following questionnaire. Please tick (✓) the answer of your choice or wherever appropriate put in order of preference from 1 to last number on the basis of alternatives.

I assure that the information you provide me will solely be utilized in research work. I hope for kind co-operation and support with many thanks as soon as possible.

Suresh Kumar Pun

QUESTIONNAIRE

Name of the Respondent :

Office/Organization :

Designation :

Occupation :

Please tick the best answer of your choice:

1. How do you know about VAT?

- a) Media () b) Personal Communication ()
- c) Lectures/Seminar () d) others, please Specify.... ()

2. Do you think the VAT collection system practiced now is appropriate mean of raising the public revenue?

- a) Yes () b) No ()

3. Is VAT more appropriate / superior to the areas it has replaced (such as sales tax, hotel tax, entertainment tax and contract tax)?

- a) Yes () b) No ()

4. Among the various taxation methods which one is practiced now?

- a) Addition () b) Subtraction ()
- c) Tax Credit ()

11. Do you think that VAT will be more effective in the future?

- a) Yes () b) No () c) I don't know ()

12. Do you have any other suggestion for the VAT collection system and legal provision in Nepal? If yes, please specify.....

- a) Effective and efficient administration

- b) Broad coverage

- c) Tax education

- d) Proper implementation of rules and regulation
- e) Clear VAT laws and regulations
- f) Others please specify.....