

CHAPTER 1

INTRODUCTION

1.1 Background of the study

Economic development of the country is, no doubt, the most important concern & the target of the government policy in undeveloped countries. To maximize the welfare of the people, efficient allocation of resources, reduction of income disparities & poverty, improvement of the living standard of people are some of the economic development strategies towards which most of the government efforts have been directed in developed countries. For the implementation of these strategies and to achieve the goals of economic development, Nepal needs large volume of resources/revenue. Government collects revenue from various sources such as tax revenues from public enterprises, special assessment, fees, grants, gifts, business income, fine & penalties etc. Among of them, tax is the main source of government revenue. Since it is the permanent instrument of collecting revenues, it occupies the most important place in government treasury.

Tax is a means to collect the revenue from the people, business and other organization of the country by the government. It is the most important source of fund for the government. It is used to provide good governance and to develop infrastructures like electricity, communication, transportation, and other facilities to the people and its country.

Taxes as major fiscal policy instrument and important government policy tools have an important role in increasing the rate of capital formation and thereby achieving the rate of economic growth. The role of taxation in economic development of country lies in its functions of raising a minimum volume of resources and direct flow of resources that country's production capacity is enhanced. Ultimately it can be conclude that the government should be aware for the collection of tax.

Revenue is generally categorized in two groups:

A. **Tax revenue** means that kind of revenue which is compulsory contribution to the government without pro-quo i.e. direct return in benefit to the taxpayers.

B. **Non-tax revenue** is that which collects in government funds except tax revenue. Some examples of non-tax revenue are licenses fees, permits, fines, grants, gift etc. Basically we can categorize the taxes in to two forms, they are:

- a. **Direct taxes:** Taxes which are collected directly from the concerned person or organization are known as direct taxes. Thus, tax is collected from the person or organization considering their ability to pay as per their income or wealth. The main sources of direct taxes are income tax, salary tax, land and revenue tax etc.
- b. **Indirect taxes:** Taxes which are collected from the service or goods used are known as indirect taxes. Such types of taxes are collected by the organization and pay the amount to the government. Excise duty, entertainment tax, value added tax etc. are some examples of such taxes. This type of tax is transferred by the producer to the wholesaler, the wholesaler to the retailer and retailer to the consumers. But tax payers have not been able to pay taxes due to legal & procedural difficulties. Such problems are made prevalent particularly in the area of direct taxation. Due to this our dependency on indirect tax has been very high.

Due to limitation of direct tax & its low performance in revenue collection indirect tax has been given preference by Government of Nepal. So to enhance for revenue mobilization VAT was introduced in Nepal. It has very prominent role in a country's revenue collection. The value added tax is indirect tax that is levied on the purchase value of goods or services at the time of sale. This tax is collected when a person purchases certain goods or services. The overall burden of this tax goes to ultimate consumer.

Value added tax is the most recent innovation in the field of taxation. It is the tax imposed on value added by the business firms or goods and service at the successive stages of the production and distribution. Value addition on a commodity or service is simply the excess of sales value over business purchases by a business entity. During the successive stages of production and distribution processes, business enterprises add value to their purchase by processing or handling them by their own machinery, building or other capital goods. VAT considered as an improved, scientific, fair & proper method of indirect tax on consumption. It is an improved & modified form of sales tax. It is the multiple stage tax which has grown as a heterogeneous or turnover tax and retail level sales tax. Thus, VAT is the multiple stage tax, which is lived on the value added of 16 business enterprises at different stages of production and form of old sales tax.

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

The parliament of Nepal enacted VAT Act 1995 in 1995. Subsequently VAT Regulation was made in 1996. Although the Act was passed in 1995, its implementation was delayed due to political instability & strong opposition from the business community. VAT with single rate of 10% has been fully implemented with effect from 16th November 1997 (1st Mangsir 054). It has replaced sales tax, hotel tax, contract tax & entertainment tax. VAT has been justified in the light of government fiscal balance and need for extra revenue mobilization through an efficient tax system. Government of Nepal/Nepal has increased VAT to 13% with effect from 1st Magh, 2061. Taxes as major fiscal policy instrument and important government policy and tools have an important role in increasing the capital formation and achieving the high rate of economic growth without inflation.

1.2 Statement of the problems

Heavy burden of regular expenses in comparison to the revenue is the main reason that government is failed to achieve its target result for the economic development. So, government requires more revenue for its development work. While internal source of revenue is inadequate & depended on external sources (foreign grants & loans). Too much dependency on the foreign grants can never be fruitful & effective way to collect the capital as required by the nation's development programme.

To reduce the economic dependency on foreign assistance for development expenditure, the government needs to continue its efforts to mobilize domestic resources. So in this context it is essential to introduce a reliable tax system that would enable a natural growth of economic activities along with increasing the income of Government of Nepal. And VAT is only the solution in this aspect. Effective implementation of VAT can be the major way in front of the government to meet the growing development expenditure. But the government has not been able to collect the expected revenue from VAT. And its main cause is widespread poverty,

illiteracy, lack of information, creation of confusion & ignorance. Due to the absence of clarity regarding VAT, it was opposed by businessman, professional & other sectors. VAT Act 2052 & VAT Regulation 053 have not been able to bring more business organization into the tax net. The evasion of VAT has been in the increasing rate since the beginning of its implementation. Government of Nepal is hurry to introduce VAT without adequate preparation & consulting the business community. Administration is inefficient. Many businessman & tax collectors are ignorant about this. They are confused which shop or what goods VAT is levied. Consumer is in still dilemma that which shop issue VAT bill & which not & those who demand invoice has to pay 13% more price. Businessman does not think that they are just agreeing to collect VAT in respect of government rather “the businessman thinks that is unnecessary botheration. The consumer accuse businessman of evading the administrators are mute spectators & the businessmen for pretty selfishness say that it is difficult to achieve fair competition due to non implementation of VAT completely . The business man does not stop complaining that if VAT is added then the price of goods will increasing & the business will become dull and the consumers do not take invoices”.

Government of Nepal first applied VAT without any formal agreement hoping the positive result but various problem have been appeared on the process of implementation of VAT as a result the outcome of implementation & experimentation of VAT is not as prosperous as is was expected. Moreover several tax payers have been maintaining two sets of account, issuing two types of invoices , collecting VAT from the buyers but not depositing them to the treasury and collecting VAT without being registered seen as major problem in VAT, due to which goods are coming through illegal means and the government loose the revenue.

Considering above problem regarding the effective implementation of VAT in Nepal, this study will tries to focus on the implementation of VAT and its contribution to government revenue. This study will also make to know the government effort to make VAT more effective.

1.3 Objectives of the study

The general framework of the study is to examine the various problems of VAT and suggest the useful alternative solutions to the problems. However, the main objectives of this study are:

- J To find out the contribution of VAT in government revenue generation.

- J To examine the implementation scenario of VAT
- J To analyze the government's efforts for effective implementation of VAT.
- J To identify the major issues involved in the process of VAT implementation
- J To provide suggestion for the improvement on VAT system in Nepal.
- J To identify effective measures that the government should introduce for effective return from VAT.

1.4 Significance of the study

VAT is considered as an improved, scientific and proper method of indirect tax on consumptions. It plays a vital role on government tax collection. It has become the subject of interest to business entrepreneurs, consumers and other interested individuals. Various researches are conducted on VAT abroad as compared to Nepal. About 12 years have been passed since VAT came in operation but many Nepalese are unknown about various aspects of it. VAT, being itself a complicated and modern tax system more effort should be made on actual circumstances. Theoretical and practical knowledge are required to implement VAT properly. So this study analyses Nepalese VAT system with its problems with its revenue contribution. Because of this reason, the study will directly benefit policy makers, private sectors, researchers and other general people. Policy makers will be able to identify the areas requiring improvement for the proper implementation of VAT in Nepal. It will also provide clear idea and knowledge to those people who are interested and confused about VAT system. Recommended options will help to make the decision about effective implementation of VAT in Nepal. From such stand points, the study deserves great significance.

1.5 Limitations of the Study

As every study has its own limitations so as this study is not away from this limitations. Basically, the study has been conducted as partial fulfillment of the requirement of the "Master of Business Studies". So this study has the following limitations:

- a. Lack of time and resources are the major limitations.
- b. This study covers and depends only on limited data.
- c. The extent of this study is based on the availability of reliable data and the sufficient literature.

- d. There are limited publications of books, journals, articles, papers etc regarding VAT.
- e. Due to small samples size, it may not fully represent Nepal as whole.
- f. Primary data is collected only from Kathmandu valley so it does not represent country as a whole.
- g. It covers only the implementation of VAT and its contribution to government revenue and step taken by government to make VAT more effective.

1.6 Organization of the Study

The whole study and findings will be divided into five different chapters for easy follow up.

Chapter 1: Introduction

It serves as an orientation for readers of the report, providing them perspective view of the report for better understanding. It also gives the preliminary introductory detailed information, which would be dealt in later chapters.

Chapter 2: Review of Literature

This chapter presents the review of literature dealing with theoretical review of the study along with related studies like relevant books, journals, research as well as thesis, published and unpublished and so on.

Chapter 3: Research Methodology

It deals with research design, nature and source of data, population and sample, data collection procedure and the financial and statistical tools used in the study.

Chapter 4: Data Presentation and Analysis

Data so collected would be carefully examined and conclusion would be drawn so that it could be presented. It deals with the presentation of related data collection in figure or table and its analysis using statistical tools (i.e. Karl Pearson's coefficient correlation, regression analysis, time series analysis, hypothesis test) and interpretation of the result.

Chapter 5: Summary, Conclusion and Recommendations

On the basis of the data analyzed the research would reach in final phase after providing recommendation on implementation aspect of VAT.

CHAPTER 2

CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE

2.1 Conceptual framework

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

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

VAT, like other sales taxes, is classified as an indirect tax because it is paid by business firm to the government and shifted to the purchasers of the product, rather than be collected directly by the government from the purchases, goods and services constitute base of VAT and it is shifted forward to the consumers.

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

while the former is imposed only on the value added at each stage. VAT is similar to the retail stage sales tax. Theoretically, VAT is broad-based as it covers the value added to each commodity by a firm during all stages of production and distribution process. There is presumption that VAT is shifted completely to the consumer.

2.1.1 Origin and Development

Value-added tax, a recent innovation in the field of taxation, is being a major step in process of tax reform in many countries in the world. Such widespread popularity of VAT in last some years has become one of the most astonishing phenomenon of public finance. The evolution of VAT is the most significant event in the history of commodity taxes and the speed with which the Value Added Tax has spread around the world is unmatched by that of any other tax in modern time (Shoup, 1969)

While going to the origin point of the VAT, it was proposed for the first time by Wilhelm Von Siemens for Germany in 1919 as an improved turnover tax. The improvement consisted in the subtraction of previous outlays from taxable sales with the result that the tax base of each firm would be reduced to the value, which is added to the product. Thereafter in 1921, Prof. Thomas S. Adams suggested the tax for the United States of America to replace the existing corporate income tax. Further, same tax was recommended in 1949 by the Shoup Mission for the purpose of reconstructing the Japanese economy by avoiding the existing defects of the turnover taxes. Although, these proposal and recommendation were not come into practice, Argentina and Brazil instead, introduced a partial value added form to the existing manufactures' sales tax respectively in 1935 and 1948 by allowing manufactures to pay tax on the excess of sales over their purchase. However, VAT was not actually introduced by any country till 1953. Thus, the development of VAT remained limited only in theory up to the early years of 1950s.

Real practice of VAT started since 1954 in France; however it covered only the industrial sector and was designed only up to the wholesale level. After a gap of six years, Ivory Coast becomes first follower of France when it adopted VAT in 1960. Next African country, Senegal also implemented VAT since 1961. VAT in these both African countries limited to import and manufacturing stage only. Since the 1960s VAT become a popular subject matter of taxation in many countries. In the year of 1968, France redesigned the existing VAT system and extended to the retail level. Germany also adopted VAT in the same year. Since 1969, VAT was in operation

in Netherlands and Sweden and also other three Equador, Luxembourg and Norway included VAT in their tax system. VAT was also effective in Belgium and Ireland since 1971 and 1972 respectively. Thus, the trends showed that VAT become most popular in the Europe, where VAT was suggested and implemented for the first time.

Vietnam was the first Country in Asia to introduce VAT, which introduced it in 1943. Pakistan introduced VAT in 1990 as the first among the SAARC countries. In this process Nepal adopted VAT since 1997. However, India, the biggest in the SAARC, has following only MODVAT since 1996. The basic purpose of this kind of system is to relive inputs from taxation so that production distortional due to taxation is avoided. In the system of MODVAT, the excise duty and countervailing duty of custom in respect of inputs used in manufacturing process are allowed to subtract from taxes on outputs. Further, American tax system has not included VAT until now.

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

Table no. 1: Countries implementing of VAT in different year

Year	Name of the Country
1954	France
1960	Ivory Coast
1961	Senegal
1967	Brazil, Denmark
1968	Germany, Uruguay
1969	Netherland, Sweden
1970	Ecuador, Luxemburg, Norway
1971	Belgium
1972	Ireland
1973	Austria, Bolivia, Italy, USA, Vietnam
1975	Argentina, Chili, Colombia, Kostunica, Nicaragua
1976	Honduras, Israel, Peru

1977	Korea, Panama
1980	Mexico
1982	Haiti
1983	Dominical Republic, Guatemala
1984	China
1985	Indonesia, Turkey
1986	Morocco, New Zealand, Nyzar, Portugal, Spain, Twain
1987	Granada, Greece
1988	Hungary, Philippines, Tunisia
1989	Japan, Malabi
1990	Iceland, Kenya, Pakistan, Trinidad, Tobago
1991	Bangladesh, Benin, Canada, Jamaica, Mali, South Africa, Egypt,
1992	Algeria, Armenia, Azerbaijan, Belarus, Cyprus, Alsalvador, Estonia, Fiji, Kazakhstan, Kirgiz Republic, Russia, Tajikistan, Thailand, Turkmenistan, Ukraine, Uzbekistan, Moldova
1993	Burkina Faso, Check Republic, Magnolia, Paraguay, Poland, Romania, Jarjiya, Slovakia, Venezuela
1994	Bulgaria, Finland, Lithuania, Singapore, Western Samoa, Madagascar, Nigeria
1995	Gawain, Ghana, Switzerland, Zambia, Malta, Mauritania, Togo, Latvia
1996	Albania, Guyana, Uganda
1997	Warwedos, Congo Republic, Nepal
1998	Croatia, Mongolia, Srilanka, Tanzania, Vanuatu
1999	Cambodia, Cameroon, Mozambique, Netherlands Anthills, Papua, Newgenia, Slovenia
2000	Australia, Chad, Myasidoniya, Namibia, Sudan
2001	Rwanda
2002	Lebanon
2003	Ethiopia, Lesotho, Serbia, Montenegro

Source: VAT project

Origin and Destination Principle

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

imports or taxing all the imports and making exempting for all exported goods and services to the foreign countries.

Origin Principle

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

As the country can enforce jurisdiction over firms located within its jurisdiction, the principle is much simpler and there would be no export rebates on sale delivery within the Common Market countries, rather each country would give credit for tax imposed in the country of origin. Under such circumstances, the origin principle has gaining more importance in EEC countries to achieve the ultimate objectives. The three methods-subtraction, addition, and tax credit; are all equally well adopted to use of a single rate origin-principle value-added tax with respect to exports. Imports, in contrast, are bound to present a difficult problem for the origin principle if the tax credit method is used (Shoup, 1969). Administrative complexity widens when the tax credit method is adopted along with an origin-principle VAT having different rates at different stages.

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

sense that the rate of tax of country of importation determines the combined tax of both countries.

Destination Principle

Destination principle includes all the imports in the tax net while exports are free from tax. As the principle taxes imports and exempts exports, it will have favorable effect on the country's BOP. Under these principles, tax would be collected at importation and the firm would receive credit for this tax and a refund when the products are exported. This means tax levied on the import of the basic raw materials, semi-manufactured goods etc., which are imported for the production in the domestic market will be refunded when the product is exported. Indeed, by principle, no tax is collected upon importation at all, other than by the ultimate user. The broad result is that the relative ability of one country to another will be unaffected by a destination arrangements which treats imported and home prepared goods. Thus, neutrality, one of the essential features of the goods taxation, is provided by the destination principle by means of no discrimination between imported and domestic product.

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

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

2.1.2 Historical Background

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

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

2.1.3 Adoption of VAT in Nepal

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

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

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

2.1.4 Need to introduce VAT

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

VAT broadens the tax base as it could levy up to the retail point. To a certain extent, VAT is a self policing system because any understatement would disadvantage the buyer since the credit for input tax would be affected, while any over statement would result in higher tax liability for the seller. VAT was also expected to make exports tax free through zero rating and the refund mechanism for excess credit. Furthermore, the import or manufacturer level sales tax as unequal in the sense that it put proportionately higher burden on items that didn't have a high value added in the distribution process as compared to items that had a high value added. This meant that the tax burdened domestic products more than the imported luxury items. It was further discriminatory since it had more control on domestic products than imports, as manufacturers were required to be registered, maintain records of sales, obtain approval for their selling prices & submit monthly and annual returns where as importers did not have to fulfill of any of these formalities. This kind of system encourages import & discourages to use domestic products. So VAT need to be introduced to avoids such kind of difficulties.

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

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

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

In summary, VAT needs to be introduced for

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

2.1.5 Basic Features of VAT in Nepal

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

Table no. 2: Basic features of VAT

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

2.1.6 VAT Records and Accounts

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

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

Purchase Book

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

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

- J “Purchase of non taxable” implies purchase of import of the items listed in the Schedule 1 of the VAT Act. This list includes primarily goods and services related to basic needs, social welfare service, goods made for the use of disabled persons, educational and cultural goods and services, etc.
- J “Purchase of taxable: implies the purchase of those goods and services within the county. Taxable import implies the import of goods and services that is in the “tax exempted” list of goods and services.
- J The purchase book does not have to be submitted at the VAT office, but has to be shown at the time of inspection or if when the tax officer wishes to see it.

-) The person has to get the purchase book certified by the tax officer either by taking it to the Inland Revenue Office or at the time when the tax officer comes on business inspection.
-) The purchase book has to be maintained safely up to a period of six years after the transaction period is over.

Sales Book

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

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

VAT Accounts

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

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

Tax Invoice

There are two types of tax invoice:

) Tax Invoice

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

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

An example of Tax Invoice

Invoice number: Transaction date:

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

Seller’s name:

Address:

Buyer’s name:

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

) “Tax Invoice” should be stated as title only in the first original copy of the invoice.

) Issuing and receiving invoice is one of the prime duties of a VAT registrant.

) If a tax invoice is not issued, the VAT registrant has to face penalty and will also fore go the facility of tax deduction.

) Abbreviated Tax Invoice

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

An example of an Abbreviated Tax Invoice

Date:

Invoice Number:

Seller's Name: Address:

Taxpayer identification Number:

Tax Rate (%):

-) IN cases where most sales comprise of small items and low costs, the invoice can be issued by combining the items as "some goods" under particulars.
-) If the buyer demands a tax invoice instead of an abbreviated one then a tax invoice has to be issued

Credit or Debit Note

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

When an Item Purchased is to be returned?

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

-) If an item purchased is damaged, torn or stained and is exchanged with the same or similar item, the same tax amount stated in the tax invoice has to be maintained. Or, since the tax invoice has already been issued, preparing a credit note and issuing a new invoice can exchange the item.
-) If an item purchased is damaged, torn, or stained and is exchanged with the same or similar item, the same tax amount stated in the tax invoice has to be maintained. Or, since the tax invoice has already been issued, preparing a credit note and issuing a new invoice can exchange the item. If the item is similar but the cost is different:
-) Let us assume that the cost of the item purchased was NRS. 100. But at the time of exchange, if for some reason the cost has come down to NRS. 75, then a credit note has to be issued.
-) If for some reasons the cost of the above item purchased at NRS. 100 have reached NRS. 150 at the time of exchange, then the tax amount on the additional NRS. 50 have to be charged and a reference to the tax invoice number has to be made.

Others

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

Most states are obliged by international agreement not to discriminate against supplies by ways of import. The primary source of this obligation is Article III of GATT. A growing number of

states are also under other obligations include the terms of customs unions and free trade area agreements, double tax agreements, and bilateral trading and investment agreements.

2.1.7 Types of VAT

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

The Gross National Product Type

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

$$\text{Base of VAT} = \text{GNP} = C + I_g$$

Where, C = Consumption; I_g = Gross investment

The Income Type

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

$$\text{Base of VAT} = \text{NNP} = C + I_n;$$

Where C = Consumption; I_n = Net investment

The Consumption Type

All capital goods purchased from other firms in the sense tax year are allowed to deduct from the sales value while calculating the base under the consumption type VAT. The description in the

subsequent years can not be beyond the tax base. As the consumption is only the case of VAT, this type is known as the consumption type. Under the destination principle, this type of VAT has an identical base with the retail sale tax on consumer goods and service. No distinction is made between parts and materials physically incorporated into the product, supplies and fuel and durable capital goods. Among this three types VAT and GNP type has broader base than the remaining two and has received serious consideration in various countries. In GNP type both capital goods and depreciation goods are under the tax net while the income type exclude depreciation and consumption type excludes capital goods from the tax base, in the recent years, the consumption type of VAT has gaining popularity in several countries in Europe and elsewhere. The reason for the popularity of this type is that this variant doesn't affect decision regarding investment and growth since it relieves investment from any tax burden. Since the tax does not discriminate against the capital intensive techniques in favor of labor incentive technique, there is no need for a firm to switch over from capital to labor incentive methods. But GNP type of VAT discourage firm to use capital incentive methods of production and encourage using the methods, which don't involve frequent year to year fluctuation in physical volume of inventories. Moreover, this GNP type creates substantial disincentive for saving and investment for which reason the tax is not accepted by the countries. From the economic growth perspective both the income and gross product VAT has an anti investment bias. The distinction between the purchase of Capital Goods and intermediate goods is not needed under consumption variant, which is essential under other two variant. The income type also needs the computation of depreciation in subsequent year, which further complicate administration. Thus consumption variant is attractive from the point of tax administration. Even from the consideration of foreign trade, consumption variant is more attractive than the income variant since the former is compatible with destination principle and later with origin principle. Thus, the consumption variant is most desirable than the other two variants in several respect.

VAT can also be classified on the basis of the vertical coverage through production and distribution stages. Under this classification extent of vertical coverage forwarded from manufacturing has more practical importance which has three sub-divisions with different bases. Firstly, the value-added principle may be used within the manufacturing sector only, with tax applying to each manufacturer on his value-added but not by wholesalers or retailers, except to a limited degree. Secondly, the tax may be extended through the last wholesale transaction usually

called a pre-retail VAT. Lastly, VAT may be extended through the retail level from the earlier stages of production. This type of VAT is known as comprehensive or full-fledged VAT. Under the same classification, next type is based on the extent of vertical coverage backward from manufacturer. Under this type, VAT may be extended to all producers of basic raw materials including farmers. However, this type creates administrative difficulties due to the large number of small establishments and scattered units.

2.1.8 Methods of VAT Computation

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

Addition Method

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

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

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

Subtraction Method

Under this method, value added is determined as net turnover which is obtained by subtracting the cost of materials from sales proceeds (Khadka, 1997) and the procedure was used in the Michigan VAT. Value added is obtained by subtracting purchases of produced goods from the figure of sales during the period, as given in functional form by,

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

Where, Sv = Sales value; Pv = Purchase value

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

Tax Credit Method

Tax credit method is also known as the invoice method and uses as indirect subtraction technique to compute the tax liability. Value added, as such, is never calculated at all, in this method, but the effect is exactly the same as if the figure was calculated and the tax rate applied. Since, the firm deducts the amount of the tax paid on its purchases during the period from the figure calculated by applying the tax rate to its figure of taxable sales for the period. Under this method, tax payers are allowed to subtract the taxes already paid by their suppliers and passed on to them from the gross tax liability which is levied on the total value of their sales. Thus, in contrast to the subtraction method, which deducts purchases from sales and levies taxes on the differences, tax on purchases is subtracted from the tax on sales under the tax credit method (Khadka 1997). Hence, net tax liability is given by

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

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

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

Table no. 3: Calculation of VAT Liability by Different Methods (13% VAT)

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

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

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

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

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

From the above table, it is clear that VAT liability calculated by any of the three methods is same that Rs. 1040. In the table, VAT rate is same that is 13% for all methods. However, if there is rate differentiation in different stage VAT liability will differ for different method. Although, the change in the VAT liability will be same under both the addition and subtraction method, as there is same amount of value added at each stage of production and distribution. Assuming that the transactions(Figure) presented in the table are for economy as a whole in a specific period of time, a VAT of 13% rate gives Rs. 1040 as tax under the first two methods having the amount of value added Rs. 8000. In tax credit method, value added, as such is never calculated, however VAT liability exactly equals to that by other methods. Thus, VAT is levied on the basis of value added but not directly.

2.1.9 VAT as a substitute of sales tax

A tax based on the sale of goods and services imposed for generating revenue is sales tax. There are three types of sales tax, namely, multiple stage sales tax; single stage sales tax & VAT. The tax imposed on each stage of sales is multistage sales tax, whereas the tax imposed on only one stage is single stage sales tax. In other words, if tax is imposed on manufacturer wholesaler &

retailer, it is multistage sales tax. In contrast, where the tax is imposed either on manufacturer, wholesaler or retailer, it is single stage sales tax.

The nature of sales tax is that the tax in case of sales tax is levied on the total amount of cost of sales & the tax amount of earlier stage becomes the cost of the goods or services for next stage. VAT, in opposite, is levied on every business as a fraction of the price of each taxable sales they make, but they are in turn reimbursed VAT on their purchases, so the VAT is applied to the value added to the goods at each stage of production.

Sales taxes are normally only charged on final sales to consumers, because of reimbursement, VAT has the same overall economic effect on final prices. The main difference is the extra accounting required by those in the middle of the supply chain; this disadvantage of VAT is balanced by application of the same tax to each member of the production chain regardless of its position in it & the position of its customers, reducing the effort required to check and clarify their status.

Sales tax in the world of taxation was introduced during 1st world war due to severe need of revenue. Up to 2nd world war this tax has been indispensable part of most of the tax system in the world. However, after 1955 sales tax was gradually replaced by the VAT. In Nepal sales tax was introduced in 2022B.S. At first in Nepal it was levied on retail stage. Nevertheless, in 2025 B.S., Wholesalers were the point of taxation. In 2031B.S. the system was again changed & the sales tax was imposed on manufacturer stage. Since 1st Mangsir, 2054B.S. Sales tax was replaced by VAT in Nepal.

The standard way to implement of VAT is to say a business owes some percentage on the price of the good minus all taxes previously paid on the good. If VAT rates were 13%, retailer would pay 13% on value added Rs. 200 (Rs.26) minus taxes previously paid by the wholesaler on value added by importer Rs. 100 (Rs.13). In this example, the wholesaler would have a Rs. 13 tax liability. Each business has a strong incentive for its suppliers to pay their taxes, allowing VAT rates to be higher with less tax evasion than a retail sales tax.

Table no. 4: Calculation of Tax Liabilities under Sales Tax

Channel	Cost Price	Profit under Sales Tax	Selling Price	Sales Tax @13%	Selling Price including Sales tax
Importer to Whole Seller	5000	500	5500	715	6215
Whole Seller to Retailer	6215	621.5	6836.5	-	6836.5
Retailer to Consumer	6836.5	683.65	7520.15	-	7520.15

Above table shows the calculation of tax amount under the sales tax. Under the sales tax, tax is calculated on first channel i.e. importer to wholesaler and levied on total cost after adding the value added or profit.

Table no. 5: Calculation of Tax Liabilities under VAT

Channel	Cost Price	Value Added	Selling price excluding VAT	VAT @ 13	Selling price including VAT	VAT payable to government
Imported goods	5000	-	-	650	-	650
Importer to Whole seller	5000	500	5500	715	6215	65
Whole seller to Retailer	5000	550	6050	786.5	6336.5	71.5
Retailer to Consumer	6050	605	6655	865.15	7520.15	78.65

From above table, it is clarified that tax can be collected more from Value Added Tax than sales tax; however, consumer paid same cost price in both types of tax. The reason is, in sales tax is only levied on a single where as Value Added Tax levied on each stage from production to sale. Sales tax is imposed on total amount of cost of sales & tax amount of earlier stages is included in cost of sales. On the other hand, Value Added Tax is levied not on the total cost of sales but on the amount of value added in each stage & consumer know the amount of tax contribution made by them.

2.1.10 Treatment of Imports

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

Taxable supplies

A taxable supply is the supply or transaction on which VAT is imposed. When taxable supply is made and then a taxable person must be imposed and collect VAT and account for it to the tax

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

Payment for a Supply

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

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

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

Transaction where no payment is payable

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

Supplies where payment is not full

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

consideration that should or might be paid in the open market. If some payment is made, then supply is within the scope of VAT.

Exempt supplies

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

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

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

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

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

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

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

2.1.11 Taxable Value Supplies

Charge to VAT

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

Value of international supplies

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

Tax inclusive Vs. Exclusive Base

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

Fair market Value of Supply

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

Value of imports

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

2.1.12 Payment of VAT

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

Rates of VAT

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

Zero Rates

A zero rate means that, while no VAT is due on the supply, the supplier remains entitled to claim any tax incurred in making that supply and is therefore entitled to a refund of that input tax if there is no output tax against which to offset the input tax. From one point of view a tax rate of 0% is nonsense. It is not a rate of tax, and no tax is collected. A zero rate is therefore an exemption of the supply from output tax.

Zero Rating exports and international supplies

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

Paying VAT to tax authorities

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

Entitlement to Credit for Input Tax

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

Partial Exemption

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

Disallowed Input Tax

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

Capital Goods

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

2.1.13 VAT Registration

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

of Nepal goods valued at one hundred thousand rupees or more per annum for commercial purpose shall have to register.

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

In case of non taxable and exempt taxable persons

The VAT Act sec 5 (3) and schedule-1, contains a number of possibilities according to which supplies of goods or services under specific provisions are considered to be non taxable or exempt from VAT. Persons making such non taxable or exempt supplies cannot be registered for VAT & cannot deduct input VAT or claim a refund.

In case of private persons

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

In case of employees

Income from employment is not subject to VAT.

Procedures of VAT registration

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

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

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

Deregistration

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

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

2.1.14 Tax Plate

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

- A. The size of the tax plate should be 30 cm long and 10 cm width.
- B. Information to be shown on the tax plate:
 - i. Taxpayer's Identification Number (TPIN)
 - ii. Taxpayer's Name.
- C. The tax status of the taxpayer will be identified on the basis of the following background and the color of the tax plate:
- D. (i) Bush green background and letters in white color: VAT registered tax payers.
 (ii) Lemon yellow background and letters in black color: Tax payers dealing in VAT able goods and services but whose transaction is the below threshold i.e. Rs. 2 million per year.
 (iii) Signal red background and letters in red color: Tax payers dealing in non – VAT able goods and services.

2.1.15 Return

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

Debit Return

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

Credit Return

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

Nil or Zero Return

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

2.1.16 Non Filing

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

2.1.17 Tax Assessment

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

VAT officer can assess tax within under the noted circumstances.

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

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

Computer assessment

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

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

Management assessment

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

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

2.1.18 Collection of VAT

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

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

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

2.1.19 Tax Credit

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

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

Full credit facility will be given to those businesses whose purchases are fully taxable. In case of mixed transaction i.e. both taxable and non taxable then business man allowed to credit in only taxable purchases and sales. In case of partial use (i.e. used goods for personal and business purpose) only partial input tax credit can be taken.

2.1.20 Tax Audit

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

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

A special enforcement task force under strengthening revenue program was established to conduct investigation tax audit for assessing properties, making search and seizure and for procuring goods under invoiced. Administrative review in the cases related to income tax and

Value Added Tax without deposit to safeguard the interest of tax payers. Arrangement has been made to decide upon the application within sixty days and notify the tax payer. In order to make tax audit simple, transplant, quick and effective and to avoid delays and unnecessary hassles, tax payers intimated of the selection for tax audit. Arrangements was be made to complete tax audit within three months of the selection. A tax audit manual developed to make the process of tax audit transparent as well. Chartered accounts firms registered to accelerated tax audit system was introduced.

Tax Investigation

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

2.1.21 Tax Refund

VAT Act has made provision regarding tax refund also. The registered businessmen are entitled to recover the tax paid on their purchases from the VAT collected from sales. If the tax on sales is less than the tax on purchases, the person claims a refund for the difference. According to Section 17 of the Act, a registered person can offset the amount of tax he/she has collected against the tax he/she had paid or due in importing or receiving goods or services related to his own taxable transactions.

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

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

Refund to Exporters

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

Refund to Non-exporters

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

Refund to Diplomats

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

Refund to Tourist

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

Refund to foreign aided projects

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

The procedure for refund will depend on the status of the person or organization. If the person or organization is registered for VAT the claim will be made on monthly or 6 monthly basis in accordance with the procedures fix for other registered tax payers. If the person or organization is not registered for VAT, the person or organization will be required to make a claim on Schedule -18. The claims must be made within three years from the date of transaction.

2.1.22 Provisions for Penalty

1. Business unit should apply for registration before starting a business. No- compliance with this provision will attract a penalty of Rs. 10,000.

2. If tax invoice is not issued for any taxable transaction, a penalty of Rs. 5,000 will be charged U/s 29(1) (b). If an invoice is raised without proper VAT registration, the VAT department can levy a penalty of 10,000 plus VAT on that sale.
3. A taxpayer who fails to use registration number or to clearly display the registration certificate or to inform the changes, if any, regarding business transactions within 15 days of such change, such tax payer is liable to pay Rs. 1,000 for each offence.
4. If account books are not maintained properly, penalty of Rs. 10,000 & on non-allowing the books for inspection, Rs. 5,000 per occurrence U/S 29(1) (c) will be levied.
5. On violation of the VAT laws, a penalty of Rs. 1,000 per occurrence is charged.
6. If the taxpayers do not pay a tax in time then 10% of tax payment amount will be charged.
7. As per Sec.29 (2) in following cases 100% of VAT or six months' imprisonment or both will be charged.
 - J Tax evasion by maintaining fraudulent accounts.
 - J Evasion of VAT by any reason.
 - J Non-registered dealer acting as a registered dealer.
 - J Doing business during the order of suspension periods.
 - J Non-allowing to purchase the under invoiced goods.
 - J Tax payer found to have issued an invoice by under invoicing.

2.1.23 Provision for Reward

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

2.1.24 Appeals

A taxpayer may not always agree with the assessment made by the tax officer. In that case, tax payer may file an appeal to the revenue tribunal within thirty five days against a tax assessment

or a penalty order by a tax officer or an order by the Director General relating to the suspension of his place of transaction. Before filing appeal the tax payers must deposit the disputed amount of the assessed tax due, the rest of the amount of tax due plus the whole amount of the fine shall have to be deposited or a bank guarantee of the same has to be provided.

2.1.25 VAT Administration

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

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

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

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

motivated. Due to lack of motivation many officials are not actively engaged in the implementation of VAT. So to motivate them special package should be introduced.

Spot checking unit & warehouse checking unit should be formed to present any kind of illegal trade and under invoicing problems. Physical stock verification of inventories against invoices and checking carrying goods on road should be made effective to protect illegal goods being supplied.

2.1.26 Problems in implementation of VAT effectively

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

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

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

Small Traders

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

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

Tax Evasion

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

A VAT brings large number of tax payers into tax net & the tax liability would be distributed among the many less sophisticated and difficult to control group like including illiterate, unorganized retailers. It becomes a great difficult to control and deal with them. Most of them could not present required formalities that are necessary to summit VAT offices. VAT system needs expert and efficient personnel. But Nepal administration can't produce such type of staff. Most of them are not well motivated and corrupted. Inspection and special checking stock verification are the duty of tax inspectors at related field have done not fairly. Therefore most of businesses are relaxing from these weaknesses of tax administration.

Most business man has been evading VAT by non registration at related office in name of small vendors who are liable to register. Some businesses have shown their turnover below threshold limit for purposes reduce liability. They can evade tax by under reporting of sales and purchases.

Another common idea to evade tax in Nepal is unrecorded trade. Due to weak administration, a channel of unrecorded trade is developed and made a large amount of revenue loss in the system of VAT. Vendors don't show their record of some purchases and claim no credit. Such goods are purchased and sold with full trade value added but without any invoice and record. Traders are collecting VAT from the consumer by fake invoice and pocket large amount of profit. So the authorities should check inventories and warehouses stock to catch these evasions.

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

Consciousness of people

Value Added Tax is transparent in which every consumer know the amount they have paid for but such transparency will be useless until people themselves would be aware and conscious about their duties and rights. VAT system will not be successfully implement if people do not feel that they should pay to the government and their contribution are really goes on right way through right person .For this first of all public should be aware that they should take a VAT bill for every taxable transaction. But consumers rarely have such interest. Consumers purchase goods without invoice. And it will be the great opportunity for seller to evade tax to do cross check stage.

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

Open Boarder and barter System

Because of the open broader people freely move from India and china to Nepal. There is no legal bar and passport system between India and Nepal. People of India and Nepal can easily enter

into each the nation. Often people of both countries go to border town of other country to buy their need because there is no need to pay custom duty for the good, which they have brought for personal use in limited quantities. However, many businessmen misuse such facility and they take a chance of smuggling the business in border side. They follow illegal ways to sell goods in cheap price at Nepal boarder side.

Such type of illegal unrecorded and partly recorded trade is difficult to catch by the administration. If administration finds out such kind of trade, then corruption, bribery and other malpractices further rises. In such condition the self-policing, feature of VAT and catch up effect also would not work and it becomes a great threat to success of VAT. The trade between Nepal and Tibet is based on batter system. There is no system of invoices of goods purchased from the Tibet. Lack of invoice most of transaction are out of the tax net.

2.1.27 Government effort on VAT implementation

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

Consumer consciousness upahar program

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

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

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

Information and Technology

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

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

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

b) e-filing:

One of the main reasons of corruption in tax is frequently visiting the tax officer to the business house in the context of collecting VAT and for VAT auditing. So to minimize the meeting between VAT officers and businessman government bring e-filing system. Businessman can file the VAT in the internet. Through this VAT officer can check the tax by sitting in the VAT office. More over VAT office is planning to set the box (like post box) outside the business house for the purpose of minimizing tax corruption. Businessman will drop the VAT amount in the box

and VAT officer will pick out that box so that VAT officers need not to meet businessman for the tax collection.

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

2.2 Review of previous studies

2.2.1 Review of Books

Dr. Rup Bahadur Khadka (1989) an expert of Nepalese tax system in his book, entitled, “*VAT in Asia Pacific Region*” states VAT is the most recent innovation in the field of taxation, which is levied on the value added on goods and services, and VAT is shifted forward completely to the consumer. The reason of growing popularity of VAT and its neutrality or efficiency is more equitable than other forms of sales tax evasion on its favor. Similarly VAT is disfavored from the administrative point of view. It is complex and difficult to operate. Among these advantages and disadvantage, VAT should be introduced in Nepal.

Rup Bahadur Khadka (2000) published a book entitled, “*The Nepalese Tax System*”. He pointed out the need to introduce of VAT in Nepal after analysis of review the Nepalese tax system. The main reason to introduce VAT in Nepal is to develop a stable source of revenue by broad base tax. After enactment of SAFTA and WTO agreement, the broad base internal tax system of VAT is required. Further the author stresses on the proper implementation of VAT in Nepal. But it isn't so easy to implement due to most of business vendors don't want to register under it. So, the writer goes in conclusion that will generate more revenue in future when it becomes fully implement.

Dr. Rup Bahadur Khadka (1997) in his another book “*VAT and its Relevancy to Nepal*” explains about the general introduction of VAT on the eve of the introduction of VAT in Nepal. He has compared the VAT with the sales tax in the use before the introduction of VAT. Nepal has the experience of implementing import/ manufacturing level sales tax; wholesale level sales tax and retail level sales tax. The Manufacturer's Sales Tax (MST) had narrow base and suffered

from the cascading effects. It also discriminates against the domestic indirect tax system and presents views of various committees and individual on VAT in India.

Narayan Prasad Silwal (2002) published a book entitled “*Value Added Tax: A Nepalese Experience*” on this book he has shown that practical experiences about the VAT system in Nepal. This book has been designed to know about the effectiveness of VAT system in Nepal. This book covers positive and negative aspects of VAT and facing problems in implementation of VAT at initial and current period. This book is concentrated Nepalese tax system and analyzes that, why the government of Nepal introduced in Nepal? Silwal added in this book that the government of Nepal doesn’t have any option this taxing system. To effective implementation of VAT in Nepal, tax administration should be fair and strong. For good implementation of VAT as a modern tax, business community, political parties, consumers must be correlated and coordinate in Nepal. He pointed that the factors should consider for proper implementation of VAT in Nepal are as following.

- Z Tax rate
- Z Tax base
- Z Exemption
- Z Threshold

Silwal concluded that government could collect more revenue from VAT than other existing tax if the government implemented it sincerely.

Dr. P. R. Kandel (2003) published a book namely “*Tax Laws and Tax planning in Nepal.*” He concluded about VAT, it is an advanced form of sales tax, it is the tax imposed on added value of goods or services. Value Added Tax is one of the forms of indirect tax. It is broad based tax and related to goods and services. It is the tax system that aims to minimize tax evasion and increase resource mobilization. It is imposed on added value amount in different stages. It is equivalent to multistage sales tax, in context to sales tax. VAT is imposed on added value of production and distribution. The value added in the form of profit, rent, wage, salaries etc.

Ishwor Bhattarai (2004) published a book namely “*Income Taxation in Nepal with Tax Planning and VAT.*” VAT is an indirect tax and modified form of sales tax. It is levied on value added of goods and services at each stage in the process of production and distribution chain. This stage can be importer, manufacturers, wholesalers and retailers. Value added for a firm is

sales minus expenditure on goods and services purchased from other firms. The value added can be obtained by adding payment to factors of production (wages, Salaries, Rent, Interest and Profit).

Durga Prasad Panthi (2005) published a co-writing book namely “*Shakha Adhikrit Sahayogi Darpan*” (hand book for section officers). He concluded that VAT is most scientific, innovative and powerful tax than other old existing taxing system. So, it is a best taxing system for revenue collection due to its transparency and broad base of indirect tax in Nepal with build in quality of universal application.

2.2.2 Review of Articles

Shakti Prasad Pandit, Under Secretary of the MOF, writes the article “*VAT Accounts and Audit*”. He 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)

Lal Mani Joshi, Deputy Director General of IRD, writes the article, “*Tax credit and Tax refund under the VAT system.*” 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).

Ratna Raj Bajracharya, a Senior Practicing Charter Accountant, writes the article, “*VAT assessment, Penalties and the Appeal producer*”. He suggests that the requirement of VAT registration for marginal entrepreneurs isn't very much conducive for the growth of cottage and small industries as well as marginal entrepreneurs (IRD/ DANIDA Report, 2001).

Nabaraj Bhandari, Director of IRD writes the article, “*Value Added Tax: A Retrospection*” He describes the mounting enthusiasm and zeal of the staff in the support of the MOF, the VAT Department and the DANIDA VAT Project (IRD/ DANIDA Report, 2001).

The article, “*Implementation of VAT in Nepal, In Evaluation*” is written by **Dr. Govinda Bahadur Thapa**, the Director of foreign currency 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 systems are also impeding the functioning of VAT in Nepal (IRD/ DANIDA Report, 2001).

The article, “*Value Added Tax in the University Curriculum*” is written by **Dr. Pushpa Kandel**, Lecturer of the Saraswoti Multiple Campus, T.U. He suggests that an uncoordinated working atmosphere with the government and the Universities, blowing their own trumpets, isn’t going to benefit the nation in any way (IRD/ DANIDA Report, 2001).

The article, “*Value Added Tax: The Road Ahead*” is written by **Mr. Madhu Kumar Marasini**, Director of the IRD, advocates for increasing publicity campaigns based on radio, TV, FM programmes that are popular in the cities where most of the taxpayers reside. He also advises for sudden inspection of goods on the road to check tax evasion (IRD/ DANIDA Report, 2001).

The 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 the general public. The tax system deserves concerted effort of all stakeholders. The business community may use cash machines and in expensive 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).

The article entitled, “*Value Added Tax in Nepal: Analysis and Suggestions*” is written by **Dr. Roop 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)

The article entitled “*Value Added Tax: It’s Past, Present and Future*” is written by **Mr. Narayan Prasad Silwal**, Former Director General of the VAT Department and the current Joint Secretary in the MOF. He points to the lack of ownership after the formation of the IRD (IRD/ DANIDA Report, 2001).

Babu Ram Subedi (1998) in an article, “*VAT and its Applicability in Nepal*” has opined VAT is applicable in Nepal in the sense of tax performance. Neutrality, revenue productivity, fairness and transparency are the desired goals to be achieved from VAT in Nepal. (Subedi, 1998)

An article entitled, “*Tax system and its Reform in Nepal,*” written by **Dr. Govinda Bdr., Thapa**, was published in the *Business Age* in Dec. 2003 views VAT as an important element of tax return programme. **Yadav Pd. Dhungana** has scrutinized the legal aspects VAT in “*Value Added Tax and its legal scrutiny*” published in the same magazine in Dec. 2003. He concludes that as other areas of economy that are heavily influenced by political instability, corruption, bad governance, frequent change government and Maoist revolution; VAT also witnessed weak implementation owing to there hurdles (Thapa, 2003).

2.2.3 Review of Related Dissertation

Karki, Dig B. (2003) “*A Study on Value Added Tax: Problems in Nepal*”, an Unpublished Master’s Thesis, Central Department of Management, T. U. Karki explained in his dissertation, the ultimate objective of the underdeveloped countries is to achieve the economic development and follow a rapid rate of economic growth. It demands huge amount of investment in economic overheads and other development activities for which taxation is the primary sources of revenue to the government. While analyzing the resources gap in Nepal, there is trend of the huge amount of receipts and expenditure. Theoretically, VAT is expected to have revenue performance at least as much as growth rate of GDP. In the context of Nepalese economy, there was a significant increase in the revenue from the taxes replaced by VAT with respect to the GDP and even in actual amount. VAT is the superior than the other types of sales tax. VAT is contributing to its GDP about 3% whereas contribution of sales tax was about 2%, similarly VAT’s contribution in tax revenue increased to 31% whereas contribution of sales tax was about 29%, that’s why, VAT is providing satisfactory contribution to some extent. Coefficient of correlation between VAT and GDP has rapidly positive relationship. Revenue collection from VAT is lower in Nepal than expected due to the various problems related to VAT.

Babu Ram Subedi (1997) “*Applicability of VAT in Nepal*”, an Unpublished Master Degree Dissertation, Central Department of Economics, T.U., has found that VAT is neutral regarding the methods of production and generation of more revenue and hence best form of sales tax. The self-enforcing feature of VAT would make the administrative works easier. The existing sales

tax seems to be inefficient and less productive that has created cascading. So, VAT is found to be best alternative for reducing such inefficiencies, because of, its broad coverage. According to the study, the most important problem for implementing of VAT is administrative inefficiency. The present sales tax administration is not capable of handling VAT. Other problems associated with the application of VAT are: lack of account keeping system, lack of knowledge about VAT, lack of co-operation between the government and private sector, illiteracy and low public awareness. The full advantage of VAT cannot be achieved without extending it to the retail level but the extension of VAT to the retail level is impossible and impractical in Nepalese context.

Khatiwada, Tara N. (2003) “*VAT implementation in Nepal: Problems and prospects*”, an Unpublished Master’s Thesis, Central Department of Management, T.U. Khatiwada had evaluated the effective of VAT on competition of business. VAT has weakened the competitive power of registrants in trading sectors provision of threshold has encouraged for unauthorized trade. Registered firms are having problems to compete with no registered unauthorized business. But due to open boarder with India, closeness with China, ineffective customs administration, tedious custom clearance procedure, prevalence of small traders, street hawkers, traveler vendor, the unauthorized business have flourished even after the enforcement of VAT. So, these problems weren’t created because of VAT but because of ineffective government practices. VAT officials are facing the problems in inspection of records and accounts of the business transaction because of business community’s hesitation to give transparent information and because of unupdated and improper records, ignorance on mechanism of VAT and not keeping supportive documents. Khatiwada had suggested some effective points for the better implementation of VAT in Nepal are:

- z Revenue administration training center should be made well equipped with modern training equipments; experts from outside should be hired to import effective learning that bridges the gap.
- z Separate provision should be made in VAT law to avoid the situation of taxation on tax-exempted goods and doubled taxation. Electronic tax registration, submission of returns and tax clearance provision should be introduced to reduce tax officer’s discretionary power and for taxpayers convenience penal provisions should be reviewed and an efficient appeal system established.

Pathak, Devendra P. (2004) “*Importance and effective implementation of VAT in Nepal*”; An Unpublished Master’s Thesis, Central Department of Management, T. U. In this dissertation, Pathak tried to assess implementation status of the VAT in Nepal. The existing Nepalese sales tax system isn’t efficient, it generated loss of the potential amount of the revenue and it is far from equity norms. Focusing on the ever increasing resources gap, in efficiency in the existing MST (Manufacturer Sales Tax) and growing need of the revenue for handling development works, VAT is applicable in Nepal. Low public awareness as well as the tax payer’s ignorance may create problems for the implementation of the VAT in Nepal. The most serious problem of implementing the VAT in Nepal is the administrative inefficiency. So, the government should pay its attention to design strong administration. Research and investigation should be conducted on various issues, such as the effects of VAT on price, economic growth, investment and measures for solving VAT problems should be recommended by the expert group for the implementation of VAT. For effective application of VAT there should be close cooperation between the private and the government sector in the VAT implementation process. The various issues pertinent to VAT should be resolved through broad discussion and the consulting with the private sector.

Kuikel, Rabin (2004) “*Effectiveness of VAT in Revenue Collection in Nepal*”, An Unpublished Master’s Thesis, Shanker Dev Campus, Faculty of Management, T.U. Kuikel had concluded that the main reasons behind the introduction of VAT in Nepal are to increase revenue mobilization by broadening the tax base to make system neutral and efficient, to establish a fair and transparent and to promote economic growth. The tax revenue structure shows that the share of indirect tax in total tax has continuously declined but the share of VAT to indirect tax has been increasing with some fluctuation. To enhance its revenue collection there is a need to establish proper accounting and invoicing system. Tax administrators, taxpayers and consumers need to be educated about VAT system. He tried to analyze the trend of revenue collection before and after the introduction of VAT in Nepal. He had conducted an empirical investigation regarding to effectiveness and problems of VAT in Nepal. He further explained that VAT eliminates various defects of sales tax by replacing it such as pyramiding and cascading effects, other source of taxation are not able to get required level of revenue generation. So, implementation of VAT for Nepal is both a compulsion and necessity. It is only the preliminary stage of VAT implementation in Nepal. So, the revenue contribution from VAT is not as high as expected due

to various reasons. Availability of clear VAT laws, and rules, effective and efficient administration, honest tax payer, and establishment of proper invoicing mechanism and extension of tax coverage are the most important factors which obviously increase the revenue mobilization through VAT and effectiveness of VAT can be achieved.

Neupane, Ram H. (2005) “*Value Added Tax in Nepal*”, An Unpublished Master’s Thesis, Central Department of Public Administration, T.U. Neupane explained that, the primary reason for growing popularity of VAT in its broad coverage, without distorting the economic efficiency. Most of trading house purchase their goods and make fake bill and most of product are sold without issuing the VAT bill. Narrow tax base, smuggling, under valuation, unauthorized trade, weak tax administration, and lack of public consciousness, open boarder are the major problems of VAT implementation in Nepal. The narrow tax base of the previous sales tax failed to generate the minimum required amount of revenue because it included only import and manufacturing unit. The liberalization and globalization concept has also affected Nepalese tax system. In Nepal share of tax revenue is greater than non-tax revenue. Among total tax revenue indirect tax occupied about two third and share of direct tax is about one third of total tax revenue. The basic reason for low revenue collection from VAT is mainly due to the minimum use of invoice by purchases.

Chauhan, Tara (2005) “*Value Added Tax and it’s Revenue Potential in Nepal*”, an Unpublished Master’s thesis, Shanker Dev Campus, Faculty of Management, T.U. Chauhan explained in dissertation, after the implementation of VAT system in 1997, contract tax, hotel tax, sales tax and entertainment tax have been replaced by it. Looking at the contribution of these replaced taxes in tax revenue and gross domestic product, the implementation of VAT whereas at present their contribution is gradually decreasing. However, during 1999/2000 the contribution of these replaced taxes (mainly VAT) is again being increased. The conducted field survey shows that there will be improvement in revenue mobilization due to VAT system. The reason behind this claim is that theoretically VAT system is transparent; it broadens the tax base and discourages tax evasion. VAT itself not more revenue generator. It needs more administrative efforts. The implementations of VAT in Nepal have very poor results than expected due to poor planning. Bureaucracy and corruption are widely spreading in political as well as administration. People are less conscious and cannot play decisive role whether to implement VAT or not.

CHAPTER 3

RESEARCH METHODOLOGY

3.1 Introduction

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

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

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

3.2 Research Design

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

After formulating the research study the logical step is to construct the research design that refers to the entire process of a planning and carrying out research study. The research design asks what approach to the problem should be taken. What method will be used? What strategies will be most effective? Identification selection and formulation of research problems may be considered as the planning stage of research. The remaining activity refers to the designs, operation and completion of the study.

So a research without a pre-drawn plan is like an ocean voyage without Mariner’s compass. The use of a research design guides to a study to proceed in the right direction. The research work has followed historical as well as descriptive research design to analyze and to interpret the collected

data and information. As the data and information are related to past, the historical research is used to explain those collected information during the study period. Through survey research new information and data are collected to know the effective implementation of VAT in Nepal.

3.3 Sampling Design

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

Population

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

Sampling Size

Sample size is fixed up the sampling frame i.e. the listing of all sampling units with reference to which relevant data are collected. The targeted sample size of the study is large. Keeping this fact in mind, 50 officers, 50 businessmen, and 50 consumers are selected from the Managal Bazaar, Lagankhel, and Kumaripati of the Lalitpur district. Among them, only 90 respondents gave their answers of questionnaires.

Sampling Method

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

3.4 Data Collection Procedure

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

Primary Data

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

Secondary Data

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

3.5 Data Analysis Procedure

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

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

We can work it out as under

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

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

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

n= total number of items.

3.5.2 Karl Pearson's coefficient of correlation: It is most widely used tool to measure the relationship between two variables. It is denoted by 'r'. In this research work, the coefficient of correlation we calculated in order to examine relation between targeted and actual data in various items. The basic purpose of computing coefficient of correlation is to justify whether the planned data significant for future activities or not and whether the actual data are far from targeted data

or not. So, to find out the position of both targeted and actual data we can use these tools. It is calculated by using following formulas:

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

Where, $x = X - \bar{X}$

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

r = Co-relation coefficient.

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

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

$$PE(r) = 0.6745 \frac{r \sqrt{1-r^2}}{\sqrt{n}}$$

Where r = correlation coefficient.

n = number of items.

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

$$\text{Standard deviation} = \sqrt{\frac{\sum (X_i - \bar{X})^2}{N}}$$

$$\text{and } \sqrt{\frac{\sum (Y_i - \bar{Y})^2}{N}}$$

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

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

$$C.V = \frac{\sqrt{\sum x^2}}{\bar{X}} \times 100\%$$

Where C.V. = Coefficient of Variation

$\sqrt{\sum x^2}$ = Standard deviation

\bar{X} = Arithmetic Mean

3.5.6 Regression Analysis: Regression is the determination of statistical relationship between two or more variable. The regression used in the study determines the statistical relationship between independent variable X (i.e. Budgeted sales) and dependent variable Y (i.e. Actual sales). The basic relationship between X and Y is given by; $Y_c = a + bx$ where, Y_c denotes the estimated value of Y for given value of X.

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

$$Y = a + bx,$$

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

CHAPTER 4

DATA PRESENTATION AND ANALYSIS

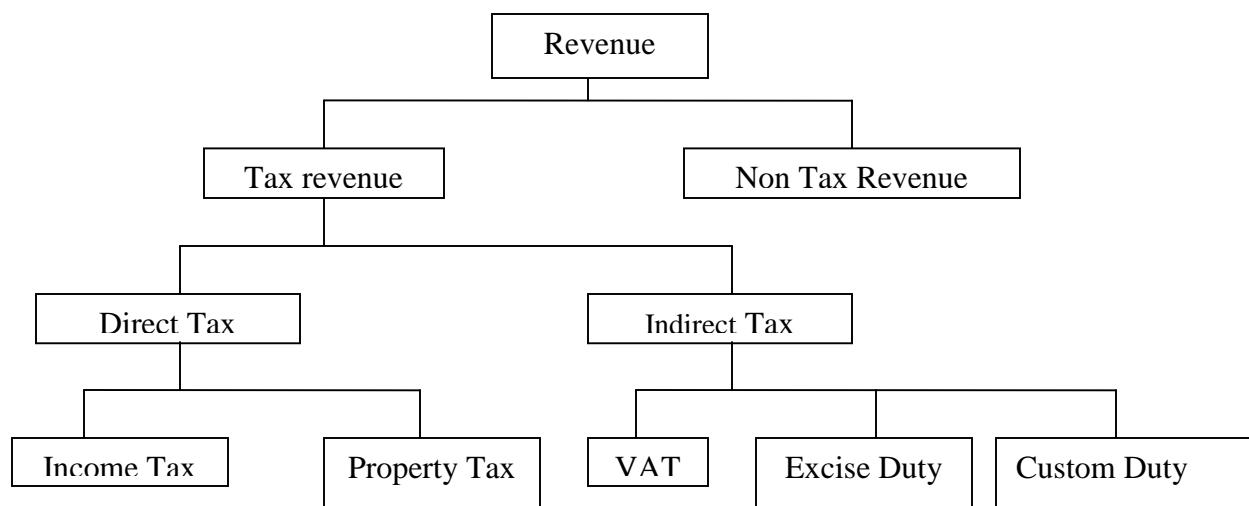
4.1 Presentation of data and its analysis

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

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

Every government is responsible to perform many functions and works for the growth and development of the nation. Government needs a huge volume of revenue to provide social welfare, security, handle the administrative work, to perform different development activities and so on. Therefore, the government collects revenue from various sources. Basic source of revenue can be classified into two categories: - *Tax revenue* and *non-tax revenue*. These both sources are subjected to non-repayment and their sum constitute the government revenue. Besides this source, government has other source which is subjected to repayment such as loans, grants. However, grants are not compulsory repaid.

Total Revenue Structure



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

Table no. 6: Composition of Total Revenue (Rs. in million)

Fiscal Year	Total revenue	Tax Revenue		Non Tax Revenue	
		Amount	As % on TR	Amount	As % on TR
2000/01	48893.9	38865.1	79.5	10028.8	20.5
2001/02	50445.6	39330.6	79	11115.0	21
2002/03	56229.7	42587.0	75.7	13642.7	24.3
2003/04	62331.0	48173.0	77.3	14158.0	22.7
2004/05	70122.7	54104.7	77.2	16018.0	22.8
2005/06	72282.1	54730.4	79.5	14851.7	20.5
2006/07	87713.2	71126.7	81.1	16585.5	18.9
2007/08	89317.2	73621.5	82.42	15695.7	17.58
2008/09	117051.9	90629.4	77.42	26422.5	22.58

Economic Survey Report of 2066/67

Nepalese economy is characterized by a low revenue performance in contrast to the growing public expenditure. The contribution of tax revenue is higher than non-tax revenue to the total tax revenue. In the fiscal year 2000/01, the share of tax revenue was 79.5% and the share of non-tax revenue was 20.5% of the total revenue collection. In FY 2002/03, the share of tax revenue and non-tax revenue were 75.7% and 24.3%. In that year, it was seemed higher contribution of

non-tax revenue. In the FY 2008/09, the share of tax revenue and non-tax revenue were 77.42% and 22.58%

Table no. 7: Contribution of VAT revenue to Total Tax Revenue (Rs. In million)

Fiscal Year	Tax Revenue	VAT Revenue	VAT% as on TR
2000/01	48893.9	12047.7	24.64
2001/02	50445.6	11947.9	23.68
2002/03	56229.7	13449.1	23.91
2003/04	62331.0	14478.8	23.22
2004/05	70122.7	18894.6	26.94
2005/06	72282.1	21940.6	30.35
2006/07	87713.2	26704.1	30.44
2007/08	89317.2	29815.7	33.38
2008/09	117051.9	39700.9	33.91

Source: Economic Survey Report of 2066/67

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

In the FY 2000/01, the tax revenue was Rs. 48893.9 million out of which Rs. 12047.7 million was VAT revenue. That means contribution of VAT revenue was 24.64%. The collection of VAT and tax revenue was at increasing stages as per year. In FY 2006/07 the amount of both tax revenue and VAT increased highly but the contribution of VAT to the tax revenue is at constant rate of 30.35% to 30.44%. In the FY 2003/04 shows the low contribution of VAT i.e. 23.22%. Similarly in the FY 2008/09 shows the high contribution of VAT i.e.33.91%.

Table no. 8: Contribution of Value Added Tax on the GDP (Rs. in million)

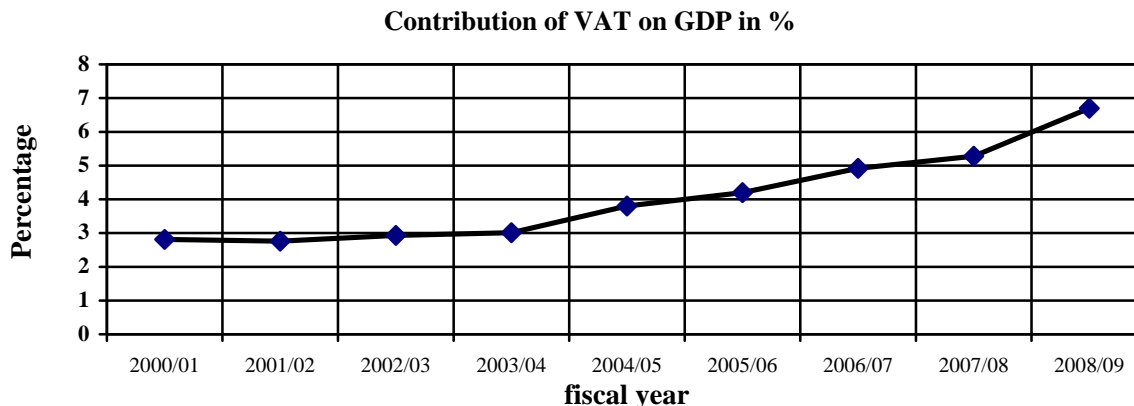
Fiscal Year	G.D.P.	*VAT	Contribution of VAT on GDP (%)
2000/01	441519	12047.7	2.72
2001/02	442048	11947.9	2.70
2002/03	459488	13449.1	2.93
2003/04	481004	14478.9	3.01
2004/05	496026	18894.6	3.80
2005/06	514460	21940.6	4.26
2006/07	530890	26704.1	5.03
2007/08	564516	29815.7	5.28
2008/09	591933	39700.9	6.70

Source: Economic Survey Report of 2066/67

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

The above table reveals the contribution of Value Added Tax (VAT) on the Gross Domestic Product of the country from 2000/01 to 2008/09.

Graph no. 1: Contribution of VAT on GDP in %



The contribution of VAT on GDP was 2.72% in FY 2000/01 but it decreased slightly to 2.70% in FY 2001/02. From FY 2000/01- 2008/09, the maximum contribution of VAT on GDP was 6.70% in FY 2008/09.

Table no. 9: Contribution of VAT on the GNI (Rs. in million)

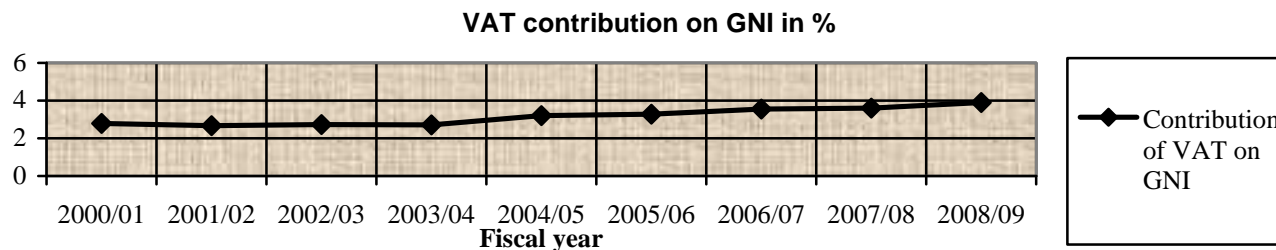
Fiscal Year	GNI	*VAT	Contribution of VAT on GNI in %
2000/01	443220	12047.7	2.71
2001/02	458838	11947.9	2.6
2002/03	491555	13449.1	2.73
2003/04	535065	14478.9	2.71
2004/05	591048	18894.6	3.19
2005/06	659010	21940.6	3.32
2006/07	735259	26704.1	3.6
2007/08	823610	29815.7	3.6
2008/09	1003066	39700.9	3.9

Source: Economic Survey Report of 2066/67

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

The above table shows the contribution of VAT on the Gross National Income of the country from FY 2000/01 to 2008/09.

Graph no.2: VAT contribution on GNI



The above table shows the contribution of VAT on the Gross National Income of the country

from FY 2000/01 to 2008/09. Till 2003/04, there was no noticeable change. But in FY 2004/05, the contribution of VAT to GNI was increased to 3.19%. In FY 2008/09, the contribution of VAT to GNI was maximum i.e. 3.9% during the period of study.

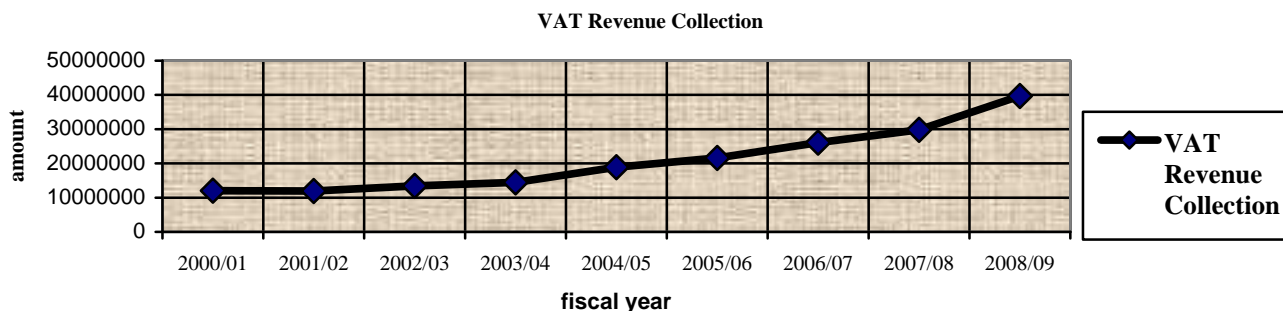
Table no. 10: Collection of Net VAT Revenue Collection (Rs. in thousand)

Fiscal Year	Revenue Collection	% Increase
2000/01	12047760	22.34*
2001/02	11947955	-0.83
2002/03	13449123	12.56
2003/04	14478896	7.66
2004/05	18894627	30.50
2005/06	21940614	16.14
2006/07	26704180	21
2007/08	29815703	17
2008/09	39700921	34

Source: Annual Report of 2008/2009, IRD

* As per previous year recorded.

Graph no.3: VAT revenue collection



Revenue was the source of the government for its expenditure. The trend of collection of Net VAT is increasing stage from 2000/01 to 2008/09. It was found that in the FY 2000/01, it has increment of 22.34 as per previous year record. But in the FY 2001/02, the revenue collection was slightly decreased by 0.83%. In the FY 2003/04 the revenue collection was increased by 7.66%, where as in the FY 2004/05 it was increased by 30.50%. The revenue collection was in increasing trend though it is not satisfactory due to the wide range of fluctuation. The trend of Net VAT Revenue collection was found to be 17.81% in average till the study year 2000/01 to 2008/09.

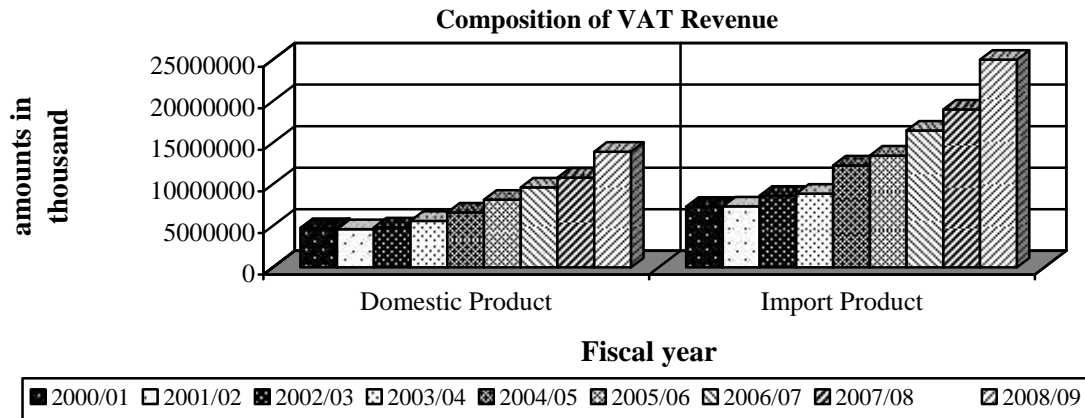
Table no. 11: Composition of VAT Revenue

Fiscal Year	Total VAT Revenue	Domestic Product	%	Import Product	%
2000/01	12047760	4744720	39	7303040	61
2001/02	11947955	4608373	39	7339582	61
2002/03	13449123	4819610	36	8629513	64
2003/04	14478896	5604123	39.61	8874773	60.39
2004/05	18894627	6614973	35	12279654	65
2005/06	21940614	8150502	37.15	13790112	62.85
2006/07	26704180	9631330	36.07	17072850	63.93
2007/08	29815703	10808241	36.25	19007462	63.75
2008/09	39700921	13918493	35	25782428	65

Source: Annual report IRD 2008/09

VAT is the life blood of the government expenditure. It helps the government for its expenditure. VAT is collected from the two sources one from domestic product and other from import product. The composition of VAT revenue from the above table was discussed. It was found that the VAT revenue collected from importer product is high than the VAT revenue collected from the domestic product. In the FY 2000/01 the ratio of domestic and import was 39:61 and in the FY 2004/05, was 35:65 and in the FY 2008/09, it was 35:65 ratio. It was clear that the import amount is always higher than the domestic amount collected.

Graph no. 4: Composition of VAT revenue



The above bar graph shows the composition of VAT revenue from the fiscal year 2000/01 to 2008/09. In FY 2000/01 the domestic product was 4744720 where as the import product was 7303040. Similarly, in FY 2008/09 the domestic product was 13918493 where as the import product was 25782428. This graph shows the import product has contributed more in VAT revenue than the domestic revenue since FY 2000/01 to 2008/09.

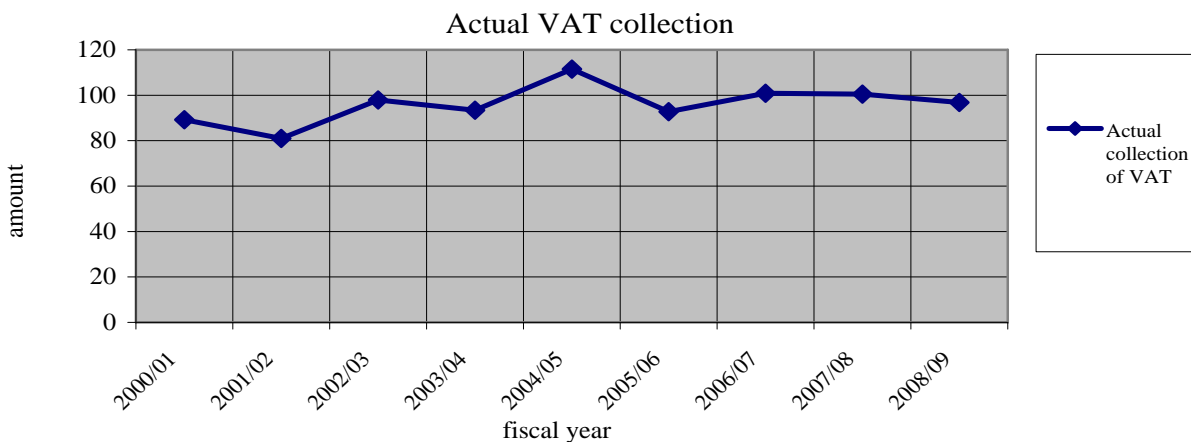
Table no. 12: VAT collection Actual versus Estimated

Fiscal Year	Estimated	Actual	%Achievement
2000/01	13500000	12047760	89.24
2001/02	14750000	11947955	81
2002/03	13730050	13449123	97.95
2003/04	15503500	14478896	93.39
2004/05	16950000	18894627	111.47
2005/06	23650000	21940614	92.79
2006/07	26463000	26704180	100.91
2007/08	29651900	29815703	100.5
2008/09	41000000	39700921	96.83

Source: Annual Report IRD July 2008/09

VAT was collected as revenue for the expenditure of government, so the government fixed its target to collect the VAT. The estimated and actual collection of VAT was shown in the above table. Only in FY 2004/05, 2006/07 and 2007/08, it was found that actual collection of VAT is higher than the estimated collection of VAT i.e. 111.47%, 100.91% and 100.55% respectively. Otherwise, the actual VAT collection was less than the estimated. Only 81% of estimated VAT was collected in the FY 2001/02.

Graph no. 5: Actual VAT collection



The above graph shows the actual VAT collection from the FY 2000/01 to 2008/09. The collection of VAT was least i.e. 81% in the FY 2001/02 whereas it was the highest i.e. 111.47% in the FY 2004/05.

Table no.13: Taxpayer registration and deregistration in VAT

Fiscal Year	Registered in VAT	% Increment in taxpayer	Deregistered	Business closed
2000/01	21093	17.2	170	172
2002/02	25149	19.27	80	360
2002/03	29872	18.78	18	531
2003/04	34174	14.40	30	570
2004/05	39776	16.39	30	445
2005/06	46831	17.74	36	647
2006/07	52965	13.16	31	793
2007/08	59707	12.72	35	823
2008/09	69653	16.65	28	763

Source: Annual report 2008/09, IRD

In the table, it shows the business person and companies registered, deregistered and business closed during the study period 2000/01 to 2008/09. In the FY 2000/01, 21093 registered in VAT; which was slightly increased in 2001/02 that was 25149 and 19.27 in percentage. In FY 2006/07, there was low increment in registration i.e. of 13.16 percent. Similarly, in FY 2008/09, there was slightly increment in registration i.e. of 16.65 percent.

In the table the deregistered in VAT were 170, 80, 18, 30, 30, 36, 31, 35 and 28 as 2000/01 to 2008/09 respectively. The highest deregistration was in 2000/01 and lowest in 2002/03.

In the case of business closed by the firm in 2000/01 to 2008/09 were 172, 360, 531, 570, 445, 647, 793, 823 and 763 respectively. From study, it was found that 172 business were closed in FY 2000/01 and the highest number i.e. 823 businesses were closed in the FY 2007/08.

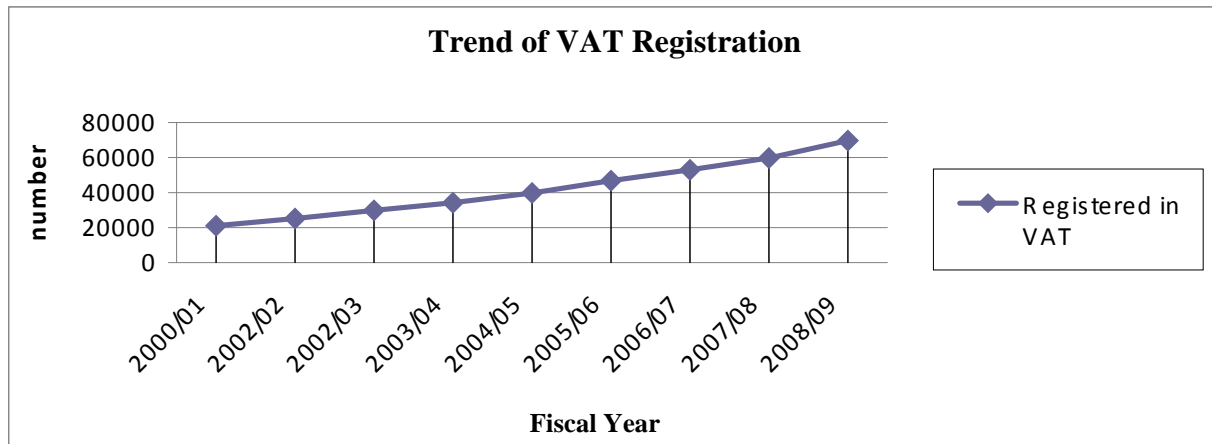
Table no. 14: VAT Registration and Submission of Statement

Fiscal Year	VAT Registered	VAT Statement Submitted	VAT Statement Not Submitted
2000/01	21093	19710	1383
2001/02	25149	21473	3676
2002/03	29872	23099	5255
2003/04	34174	25049	7322
2004/05	39776	28525	8492
2005/06	46831	33633	13198
2006/07	52965	36457	16508
2007/08	59707	47362	12345
2008/09	69653	56419	13234

Source: Annual Report IRD 2008/09

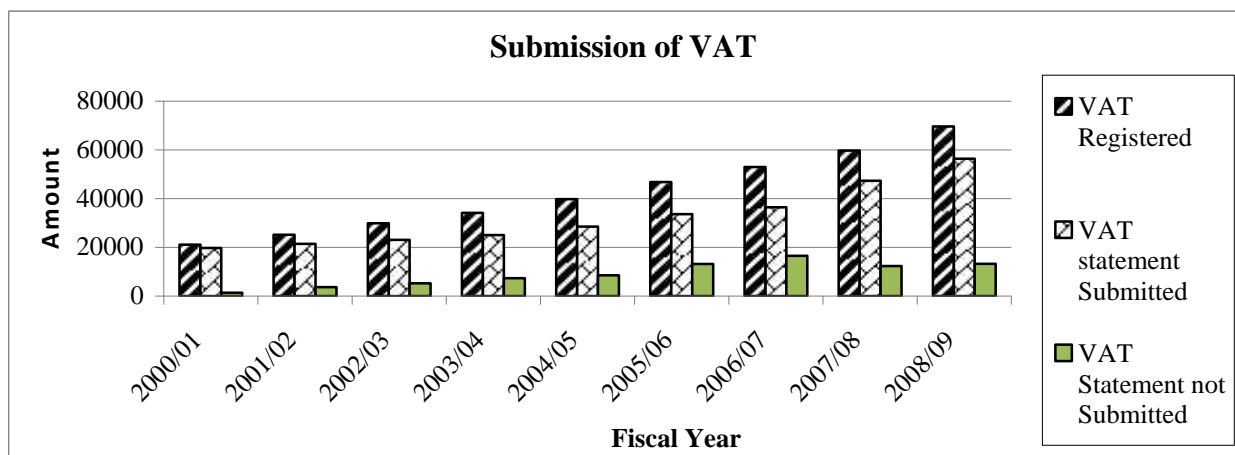
VAT is the source of government expenditure. First of all business firms should register in VAT office. Then they should present the statement for the payment of VAT. In the above table it shows the registration of VAT, statement submitted and statement not submitted from the fiscal year 2000/01 to 2008/09. As country is in developing stage, the business firms are also increasing and definitely the VAT registration was increased. In Fiscal Year 2000/01, VAT registration was 21093 and it was increased rapidly up to 69653 in 2008/09

Graph no. 6: Trend of VAT registration:



The above diagram clearly shows the increasing trend of VAT registration from the FY 2000/01 to 2008/09. Initially, in the FY 2000/01, 21093 had registered for VAT which was increased continuously and was 69653 in the FY 2008/09.

Graph no. 7: Submission of VAT



VAT registration was not quite enough but submission was necessary debit /credit or zero for revenue collection. In FY 2000/01 to 2008/09 the submitted statements were 19710, 21473,

23099, 25049, 28525, 33633, 36457, 47362, and 56419 respectively. There was also the firm who didn't submit the statement. Though they have to pay penalty, they were 1383, 3676, 5255, 7322, 8492, 13198, 16508, 12345, and 13234 in fiscal year 2000/01 to 2008/09 respectively. The highest VAT statement not submitted were 16508 in fiscal year 2006/07.

Table no.15: VAT statement submitted in FY 2000/01 to 2008/09

Fiscal Year	Debit Submitted	Credit Submitted	Zero Statement	Undecided Statement	Unsubmitted Statement
2000/01	6975	8250	4471	14	1383
2001/02	6936	8844	5207	486	3676
2002/03	7178	9953	5972	396	5255
2003/04	8483	9625	6786	158	7322
2004/05	9478	10260	8271	516	8492
2005/06	10449	12882	10139	163	13198
2006/07	13339	15476	12926	444	10780
2007/08	14652	16925	15098	315	12717
2008/09	18491	19952	18371	216	12623

Source: Annual Report 2008/09, IRD

In VAT, submission of VAT statement is most necessary work either it may be debit or credit or zero statement. VAT statement is submitted within twenty five days after completion of the month. From the above table, it shows there was debit, credit and zero statement had been submitted. There also unsolved statement and not submitted stakeholders also in the FY year 2000/01 to 2008/09. The debit statement shown in 2000/01 was 6975 person and it gradually increased up to 18491 in 2008/09. The credit statement shown in the FY 2000/01 is 8250 and 19952 in the FY 2008/09. The zero statement shown was 4471 and 18371 in the FY 2000/01 and 2008/09 respectively. There is also unsolved submitted VAT statement, it was only 14 in the FY 2000/01 but it was 216 in FY 2008/09. There were also large numbers of persons who have not submitted VAT; that was 1383 in FY 2000/01 and it tremendously increased up to 13198 in FY 2005/06, which again decreased up to 12623 in FY 2008/09.

4.2 Analysis of Primary Data:

In the beginning, VAT was imposed by Nepal Government against the strong opposition of business man. So it was not easy task to implement it successfully. Despite of all this, VAT was

served. VAT is well received by the consumer as well as business and industrial sector. In such situation empirical study is done to know the views of different person related to their field and job toward the VAT. The sample of this survey is given below. The questionnaire was distributed to 150 respondents but only 90 respondents gave their views about it. The analyses of data collected from questionnaire are presented below:

Table no. 16: Sample Size of Field Survey

Group of respondent	Sample Size
Officers	20
Businessman	30
Consumer	40
Total	90

Source: Field survey 2010

4.2.1 Educational level of the respondents

First of all, to implement the VAT effectively, we should know that the term of VAT is derived from the destination of the educated world. That mean for the proper knowledge of VAT, the people should be educated. Here in the survey results we have found literate, as well as illiterate people. We don't mean that illiterate person does not know about VAT but there are some difficulties for them to understood and to maintain VAT account. Among the respondents, all the officers and businessmen were educated whereas 16 consumers were found to be illiterate.

Table no. 17: Respondents educational level

Group of respondents	Literate	%	Illiterate	%
Officers	20	100	-	-
Businessman	30	100	-	-
Consumer	24	60	16	40
Total	74	-	16	-

Source: Field survey 2010

Above table shows that among 90 respondents, all the 100% of officers and businessmen were literate. Among 40 consumers, 60% of them were literate whereas 40% were found to be illiterate. This indicates that the educational level of the respondents were satisfactory as 40% of consumers, who should be aware of VAT, were illiterate.

4.2.2 Knowledge about VAT

Unless and until without knowledge of VAT, we cannot implement it. So we all should know about VAT. In field survey, the people had generally heard the word VAT but all of them

actually does not know that how VAT is collected and returned. As this survey was done in the cities most of people knew about VAT but are not conscious to VAT.

Table no. 18: Respondents views about VAT

Respondents	Yes	%	No	%
Officers	20	100	-	-
Businessman	30	100	-	-
Consumer	40	100	-	-
Total	90	100	-	-

Source: Field survey 2010

The questionnaires were distributed to 50 consumers among which 2 were not returned. 8 consumers replied that they don't know about VAT and didn't give answers of the subsequent questions in the survey; so they are not included in the sample size of the study. Above table shows that all the respondents have known about VAT.

4.2.3 VAT as appropriate tax system

Value Added Tax is modern system of tax in revenue collection. In our country, VAT is implemented in turn of sales tax, entertainment tax, and freight tax. VAT has been successfully implemented in more than 135 countries in the world and emerging in many countries these years too. As per this concept, Nepal has also spent 13th years in its implementation. We had taken some observation that is it VAT appropriate tax system in Nepal. Different views of respondent about VAT as appropriate tax system are presented below.

Table no. 19: Respondents views about VAT as appropriate tax system

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

Source: Field survey 2010

From the above table it denotes that 90% officers said VAT is an appropriate tax system in Nepal. Similarly, 66% businessmen also agreed in VAT as an appropriate tax system. 70% of consumers are also feasible in implementation of VAT. It is not that there is no objection to approval of VAT but they are in low percentage. The study shows that, 73% of total respondents said that VAT is the appropriate tax system in Nepal.

4.2.4 Views on taking bill on purchase

Billing system plays the vital role in implementation of VAT. It helps to determine that how much tax the taxpayer has paid on his purchase, how much tax have been collected from sales and refunded. But, in fact the trend of billing system is very low in the market up to yet. Some businessmen haven't been issuing the invoices and some issuing improper and fake bill. Businessmen don't motivate the consumers to get bills on their purchases. Consumers are also not interested to receive bills on their purchase due to lack of public awareness.

Table no. 20: Respondents views on Frequency of bill taking on purchase

Responses	Officer	Businessmen	Consumer	Total	%
Yes, on all purchase	11	12	4	27	30
Yes, on most of my purchases	5	8	6	19	21
Yes, but not regular	3	8	19	30	33
No, I don't get any bill	1	2	11	14	16
Total	20	30	40	90	100

Source: Field Survey 2010

Above table shows that 33% respondents used to take bill on purchase but not on regular basis, 30% respondents used to take bill on all purchase, 21% respondents used to take bill on most of their purchase and 16% respondents does not take bill on their purchase.

4.2.5 Present Implementation Scenario of VAT

The question about present implementation scenario of VAT in Nepal was asked to the respondents with three alternative answers i.e.

Table no. 21: Respondents views about present implementation scenario of VAT

Responses	Officers	Businessmen	Consumers	Total	%
Unsound	1	4	3	8	9
Medium	16	21	34	71	79
Sound	3	5	3	11	12
Total	20	30	40	90	100

Source: Field survey 2010

According to the opinion expressed in survey, 9% respondents expressed unsound, 79% expressed medium and 12% expressed sound. Above table indicates that the implementation scenario of VAT is effective but not satisfactory because most of the respondents expressed medium instead of sound. There might have been some error in government side or business side or both sides. Lack of coordination between government and private sector, due to lack of proper

knowledge to the final consumers may be the cause of ineffective scenario of VAT implementation.

4.2.6 Success of VAT office in collection of expected revenue

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

Table no. 22: Respondents views on VAT office success in collection of expected revenue

Responses	Officers	Businessmen	Consumers	Total	%
Yes	2	4	19	25	28
No	18	24	7	49	54
I don't know	0	2	14	16	18
Total	20	30	40	90	100

Source: Field Survey 2010

From the above table it can be concluded that 54% respondents said that VAT office is not successful to get expected revenue whereas 28% respondents agreed that VAT office is successful to get expected revenue. Similarly, 18% respondents said that they do not have any idea about VAT revenue collection. From above study, it was clear that VAT office is not successful to collect expected revenue.

4.2.7 Rise of price due to VAT system

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

Table no.23: Respondents views on price rise due to VAT

Responses	Officers	Businessmen	Consumers	Total	%
Yes	3	8	28	39	43
No	17	20	4	41	46
I don't know	0	2	8	10	11
Total	20	30	40	90	100

Source: Field Survey 2010

From the above table, it can be concluded that 46% respondents said there will be no increase of price due to VAT whereas 43% respondent agreed that there will be increase of price due to VAT, and remaining 11% respondents said that they do not know whether there will be increase or decrease of price due to VAT.

4.2.8 Present threshold limit for effective implementation of VAT

The question about present threshold limit for effective implementation of VAT was asked to 90 respondents which are given below in the following table.

Table no. 24: Respondents views about present threshold limit for effective Implementation of VAT

Respondents	Low	Moderate	High	Very high
Officers	2	14	4	0
Businessmen	4	21	5	0
Consumer	4	29	7	0
Total %	11.1%	71.1%	17.8%	0%

Source: Field survey 2010

Above table shows that there were four alternatives answers i.e. low, moderate, high and very high in above question. 11.1% respondents expressed low, 71.1%, respondents expressed moderate, 17.8% respondents expressed high and none of them expressed their view on very high i.e. 0% about present threshold limit for effective implementation of VAT.

From this it can be concluded that taxpayers are not satisfied about present threshold limit. So, it is better to divide present threshold limit into domestic goods and services, import business and export business and others if any special for its effective implementation.

4.2.9 Major existing problems of VAT for its implementation in Nepal:

There were many problems, when VAT was implemented since 1997 in Nepal. Among those problems, some are reduced and some are existed till now. So, the implementation side of VAT is yet weak. It should be made stronger and progressive than its present status. The implementation of VAT also affects to other taxes like income tax, custom duty, excise duty etc. So, it is essential to analyze the problems of VAT with its implementation side.

Table no. 25: Respondents views about major existing problems of VAT for its implementation in Nepal

Responses	Officers	Businessmen	Consumers	Total	%
Tax refund process	3	3	4	10	11.1
Billing system	2	1	2	5	5.6
Registration process	5	9	12	26	29
Open boarder of Nepal	3	3	4	10	11.1
Weakness of tax administration	2	2	2	6	6.6
Lack of public awareness	1	3	6	10	11.1
Complex accounting	1	1	1	3	3.3
Lack of trained and skilled manpower	1	2	3	6	6.6
Lack of VAT education	1	4	4	9	10
Unclear VAT rules & regulation	1	2	2	5	5.6
Total	20	30	40	90	100

Source: Field survey 2010

The above table shows that 29% of respondents focused on problem of complex registration process. This table also shows that 11.1% respondents each have indicated that open boarder of Nepal, Tax refund process and lack of public awareness are the main problems for VAT implementation. Likewise, 6.6% indicated weakness of tax administration and lack of trained and skilled manpower as well, as one of the main problems for VAT implementation. Similarly, 3.3% respondents have expressed that complex accounting is the major problem.

Above table concludes that VAT administration should accomplish the several reforms in its overall implementation parts in time with transparent, responsible, efficient, effective, non-corrupt, political intervention free administration with modern and global pole.

4.2.10 Problems in the Process of VAT Implementation

The taxpayers and tax collectors both have to be conscious because VAT is new and advance tax system. Though thirteen years have been already experienced but it is still a matter of challenge especially in the case of implementation.

Table no. 26: Respondents views on problems in the process of VAT implementation

Responses	Officers	Businessmen	Consumers	Total	%
Registration	5	9	14	28	31
Collection	2	3	6	11	12
Tax refund	12	16	19	47	52
Miscellaneous	1	2	1	4	5
Total	20	30	40	90	100

Source: Field Survey, 2010

The above table shows that 52% respondents focused on the problems of tax refund process, 31% respondents focused on the problems of registration process. Likewise 12% respondents focused on the problems of collection process and 5% respondents focused on miscellaneous problems like dishonest in both sides (tax payers and tax collectors), weak regulation, problem on issue of original bill, inefficiency of VAT administration in tax auditing.

4.2.11 Most Important factors for effectiveness of VAT in Nepal

In order to know the most important factor for effectiveness of VAT in Nepal, respondents were requested to express their view about the most important factor for effectiveness of VAT in Nepal. The view of the respondents is shown in the following table.

Table no. 27: Respondents views on most important factors for effectiveness of VAT in Nepal

Responses	Officers	Businessmen	Consumers	Total	%
Honest tax officers	5	8	4	17	19
Honest tax payers	3	3	5	11	12
Clear act rules, regulation	9	14	25	48	53
Effective VAT administration	3	5	6	14	16
Total	20	30	40	90	100

Source: Field Survey, 2010

The above table shows that 53% respondents focused on need of clear act, rules and regulation for effectiveness of VAT. Thereafter 19% respondents focused on honest tax officer, 16% respondents focused on effective VAT administration and 12% respondents focused on honest payers. So, it can be concluded that clear act, rules and regulation are the most important factors for the effectiveness of VAT.

4.2.12 Making return process easier

VAT has some features like VAT return. Excess amount of VAT paid to the government and exemption of VAT are returnable. There are some difficulties in return of VAT due to lack of proper billing and VAT account in the VAT office.

Table no. 28: Respondents views on suggestion for making return process easier

Responses	Officer	Businessmen	Consumer	Total	%
Computerized	10	15	18	43	48
Add manpower	8	10	18	36	40
Time frame	2	5	4	11	12
Total	20	30	40	90	100

Source: Field Survey 2010

The above table shows that 48% respondents suggested that the system for making return process easier should be computerized, 40% respondents suggested that the manpower should be added and 12% respondents suggested increasing the time frame.

4.2.13 Views on effect of VAT in the Economic Development

Table no. 29: Respondents views on effect of VAT in the economic development

Responses	Officer	Businessmen	Consumer	Total	%
Positive	18	27	34	79	88
Negative	0	0	0	0	0
Moderate	2	3	6	11	12
Total	20	30	40	90	100

Source: Field Survey 2010

Above table shows that among 90 respondents, 88% has expressed that the effect of VAT in the economic development is positive where as 12% has viewed that the effect of VAT in the economic development is moderate.

4.2.14 Views on role of billing system

Billing system plays the vital role in implementation of VAT. It helps to determine that how much tax the taxpayer paid on his purchase, collected from sales and refunded. But, in fact the trend of billing system is very low in the market up to yet. Some businessmen haven't been issuing the invoices, some issuing improper and fake bill. Businessmen don't motivate to the consumers to get bills on their purchases. Consumers are also not interested to receive bills on their purchase due to lack of public awareness.

Table no. 30: Respondents views about role of billing system in implementation of VAT in Nepal

Responses	Officer	Businessmen	Consumer	Total	%
Yes	20	29	33	82	91
No	0	0	2	2	2
I don't know	0	1	5	6	7
Total	20	30	40	90	100

Above table shows that 91% respondents expressed positive response whereas 2% respondents expressed negative response about role of billing system in implementation of VAT. Similarly, 7% respondents expressed that they don't know the role of billing system in implementation of VAT in Nepal. From this it can be concluded that effective billing system plays vital role in implementation of VAT.

4.2.15 Measures to Establish VAT as a Major Source of Public Revenue

VAT is the most popular taxation system. VAT can be as a major source of public revenue, when the tax administration will be efficient and effective.

Table no. 31: Respondents views on measures to establish VAT as a major source of public revenue

Responses	Officers	Businessmen	Consumers	Total	%
More trained & qualified officers	5	8	10	23	26
Minimize personal contract with the taxpayers	1	3	5	9	10
Computerized system for the payment of VAT	11	14	15	40	44
Collection of VAT should be given to private sector	2	4	5	11	12
Quick & hassle free service	1	1	5	7	8
Total	20	30	40	90	100

Source: Field Survey, 2010

The above table shows that 44% respondents focused on need of computerized system for the payment of VAT to establish VAT as a major source of public revenue. Likewise 26% respondents focused on need of more trained and qualified manpower, 12% respondents focused on need of private sector's participation in collection of VAT, 10% respondents focused on to minimize personal contract with the taxpayers and 8% respondents focused on need of quick and hassle free service.

4.2.16 Essential Factors for Improvement of VAT Implementation in Nepal

An opinion survey was collected from different sector for improvement in its effective implementation. The respondents' views are shown in the following table.

Table no.32: Respondents views about essential factors for improvement of VAT implementation in Nepal

Responses	Officers	Businessmen	Consumers	Total	%
Develop information technology	1	3	4	8	9
Develop skill manpower	3	6	5	14	16
Improve in administration	5	8	12	25	28
Improve in organization structure	1	1	3	5	6
Political commitment	2	1	1	4	4
Improve in threshold limit	1	1	2	4	4
Coordination with private sector	2	5	4	11	12
Improve in auditing	1	1	1	3	3
Reward and punishment	2	1	3	6	7
Need of training programme	2	3	5	10	11
Total	20	30	40	90	100

Source: Field Survey, 2010

The above table shows that most of the respondents i.e. 28% focused on need for improvement in administration and there after 16% focused on the need to develop skill manpower, 12% to make coordination with private sector, and 11% on need of training programme. It also shows the need focused to develop information technology by 9% respondents, effective management of reward and punishment system by 7%, further improvement in organizational structure by 6% subsequently. It further explains the need to improve in threshold limit and for political commitment by 4% each and the need to improve in auditing by 3% respondents respectively. This table concludes that most of the respondents have pointed the need for improvement in administration whereas least respondents have pointed to the need to improve in auditing for improvement of VAT implementation in Nepal.

4.2.17 Views on attitudes of Tax Payers on VAT Implementation

An opinion survey was collected from different sector on the reasons for not showing positive attitudes towards VAT implementation by the tax payer

Table no.33: Respondents views on reasons for not showing positive attitudes towards VAT implementation by the tax payers

Responses	Officer	Businessmen	Consumer	Total	%
Lack of Value added Tax education	15	18	5	38	42
To hide transaction / tax	2	1	24	27	30
Increase the working capital	3	11	11	25	28
Total	20	30	40	90	100

Source: Field Survey, 2010

On this question, 42% respondents expressed that tax payers are not showing positive attitudes toward VAT implementation due to lack of value added tax education, 30% respondents have expressed that is due to increase the working capital and 28% respondents have expressed that is done to hide transaction / tax.

4.2.18 Suggestion to Broaden the VAT Base

Broadening the VAT base means including sectors as much as in to the VAT net. Even in the low rate high revenue can be collect through expanding VAT base.

Table no. 34: Respondents views to broaden the VAT Base

Responses	Officers	Businessmen	Consumers	Total	%
Reduce custom rate	3	4	17	24	27
Regular promotional campaign	10	11	13	34	38
Increase coordination between public and private sector	4	5	5	14	16
Reducing exemption goods	1	2	1	4	4
Include all sectors	1	5	3	9	10
Reduce threshold	1	3	1	5	5
Total	20	30	40	90	100

Source: Field survey 2010

The above table shows that 38% respondents focused on the need of regular promotional campaign 27% respondents on the need to reduce custom rate, 16% on the need to increase coordination between public and private sector, 10% respondents on the need to include all sectors, 5% respondents on reduce threshold limit and 4% respondents focused on need of reducing exemption goods to broaden the VAT base respectively.

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

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

4.3.1 Hypothesis Test in opinion field survey

In an opinion survey, 65 people out of 100 are found that VAT is not effectively implemented in Nepal. Does this opinion survey information support the conclusion that the VAT is not effectively implemented in Nepal?

Solution

Here,

Number of people taken as sample (n) = 100

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

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

Null Hypothesis (HO):P = 0.5

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

Under Null Hypothesis,

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

Where Z = large sample test

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

n = number of people.

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

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

Therefore Zcal = 3.

Ztab 5% = 1.645

Decision,

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

4.3.2 Karl Pearson's Coefficient of correlation (r)

In data analysis and examining activities, the estimated and actual data are comparatively fitted in various forms. The basic purpose of computing coefficient of correlation is to justify whether the data are significant for future activities or not and whether the actual data are fair from targeted data or not. So to find out the position of both targeted and actual data, we can use this tool. It has been calculated in appendix no (4a) and summary.

Table no. 35: Analysis of estimated to actual VAT collection (2000/01 to 2008/09)

Particular	Estimated	Actual
Mean	2169	2099
S.D	883.31	898.9
C.V	40.727	42.82
P.E	0.007	
r	0.989	

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

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

4.3.3 Regression and Time Series Analysis

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

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

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

$$Y = a + bx$$

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

Fiscal year 2004/05 is assumed to be base year straight line trend $y = a + bx$

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

Where,

$$a = 2099$$

$$b = 330.4$$

Thus, $y = 2099 + 330.4x$

The trend line shows the positive revenue figure and the revenue with increasing by 330.4 every year.

The estimated revenue for 2009/10

$$= 2099 + 330.4 \times 5$$

$$= 3751$$

If other factors remain same direction as previous year, the actual revenue collection for the fiscal year 2009/10 will be Rs.37510000 thousands.

4.4 Major Findings of the study

The major findings of the study have been divided in two parts:

- (a) Findings from secondary data analysis
- (b) Findings from primary data analysis.

(a) Findings from secondary data analysis

- © There is a greater share of tax revenue in total revenue than non-tax revenue. The contribution of tax revenue is 77.42% and non-tax revenue is 22.58% in FY 2008/09 which shows the total revenue is on increasing stage in the FY 2008/09.
- © The contribution of VAT revenue to total tax revenue from FY 2000/01 to 2008/09 was 24.64, 23.68, 23.91, 23.22, 26.94, 30.35, 30.44, 33.38 and 33.91 respectively. The average contribution of VAT to tax revenue was 27.83%.

- © Even though VAT/GDP ratio is in increasing trend but it is not satisfactory because contribution of VAT revenue to GDP is comparatively low i.e. not more than 6.70% in the FY 2008/09. The average contribution was 4.04%.
- © The contribution of VAT to the GNI is low which is of average 3.15%.
- © The trend of VAT collection was in fluctuation from 2000/01 to 2008/09 as the amount collected were 22.34%, -0.83%, 12.56%, 7.66%, 30.50%, 16.15%, 21% 17% and 34% respectively.
- © The VAT was collected from domestic and import product. The ratios of import product are higher than VAT collected from domestic product. The ratios of them were 35:65 in FY2008/09.
- © The VAT was collected as per estimated in FY 2004/05, 2006/07 and 2007/08. In the rest Fiscal Year, it was collected as under estimated.
- © Registration in VAT is in increasing trend from FY 2001/02 to 2008/09. The average of increment was 16.25%. The highest deregistration was in 2000/01 and lowest in 2002/03.
- © There was not satisfactory statement submitted. In VAT, debit statement, credit statement, and zero statement is submitted and out of them unsolved statement were also found. There are large numbers who did not submit the VAT statement from in 2000/01 to 2008/09 fiscal year.

(b) Findings from primary data analysis

- © Among 90 respondents, all the 100% of officers and businessmen were literate and among 40 consumers, 60% were literate.
- © All the respondents know about VAT.
- © The study shows that, 73% of total respondents said that VAT is the appropriate tax system in Nepal.
- © The study shows that 33% respondents used to take bill on purchase but not on regular basis, 30% respondents used to take bill on all purchase, 21% respondents used to take bill on most of their purchase and 16% respondents does not take bill on their purchase.

- © The study indicates that the implementation scenario of VAT is effective but not satisfactory because most of the respondents expressed medium instead of sound.
- © The study concluded that 54% respondents said that VAT office is not successful to get expected revenue whereas 28% respondents agreed that VAT office is successful to get expected revenue. Similarly, 18% respondents said that they do not have any idea about VAT revenue collection.
- © The study shows that 46% respondents said there will be no increase of price due to VAT whereas 43% respondent agreed that there will be increase of price due to VAT, and remaining 11% respondents said that they do not know whether there will be increase or decrease of price due to VAT.
- © The study shows that taxpayers are not satisfied about present threshold limit as 11.1% respondents expressed low, 71.1%, respondents expressed moderate, 17.8% respondents expressed high and none of them expressed their view on very high i.e. 0% about present threshold limit for effective implementation of VAT.
- © The study shows that majority of the respondents (29%) have focused on problem of complex registration process where as the least number of respondents (3.3%) have expressed that complex accounting is the major problem.
- © The study shows that the majority of the respondents (52%) have focused on the problems of tax refund process where as the least number of the respondents (5%) have focused on miscellaneous problems like dishonest in both sides (tax payers and tax collectors), weak regulation, problem on issue of original bill, inefficiency of VAT administration in tax auditing.
- © The study concludes that the clear act, rules and regulation are the most important factors for the effectiveness of VAT.
- © The study shows that majority of the respondents have suggested that the system for making return process easier should be computerized and the manpower should be added.

- © The study shows that 88% respondents have expressed that the effect of VAT in the economic development is positive where as 12% has viewed that the effect of VAT in the economic development is moderate.
- © The study concludes that effective billing system plays vital role in implementation of VAT.
- © The study shows that 44% respondents focused on need of computerized system for the payment of VAT to establish VAT as a major source of public revenue.
- © The study concludes that most of the respondents (28%) have pointed the need for improvement in administration whereas least respondents (3%) have pointed to the need to improve in auditing for improvement of VAT implementation in Nepal.
- © The study shows that the 42% respondents expressed the tax payers are not showing positive attitudes toward VAT implementation due to lack of value added tax education.
- © The study shows that in order to broaden the VAT base respectively 38% respondents have focused on the need of regular promotional campaign where as 5% respondents have focused to reduce threshold limit and 4% respondents focused on need of reducing exemption goods.
- © In the opinion field survey, $Z_{cal} (3) > Z_{tab} (1.645)$. So, Null Hypothesis (HO) is rejected i.e. Alternative Hypothesis is accepted. This concludes that the majority of the people said that the VAT is not effectively implemented in Nepal.
- © In analysis of estimated and actual VAT collection from 2000/01 to 2008/09, the Karl Pearson's coefficient of correlation (r) is 0.989; it means variation lays between +1 and -1 shows the positive correlation. So the trend of VAT collection will increase each year.
- © Using Regression Analysis, we found straight line equation and from time series, we also forecast VAT collection for the FY 2009/10 which is 37510000 thousands.

CHAPTER 5

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

Tax is a compulsory contribution from person to the government to defray expenses incurred in the common interest of all without reference. Tax becomes the main source of revenue of the state. Tax has very prominent role in a country's revenue collection. In every country the largest part of government revenue is raised through taxation. It can be classified into direct and indirect tax in the basis of its nature. Value Added Tax can be taken as the latest innovation in the field of indirect tax. It is considered as the reform tax system of the 21st century, which has already been implemented popularly in more than 135 countries in the world. Value Added Tax is a fee that is assessed against business by a government at various points in the production and distribution of goods and services. In addition to consumers, persons involved in commercial activities are affected by VAT. A person means an individual, firm, company, association, cooperative, institution, joint business, partnership, trust, government body or religious organization. It must be paid by every company that handles a product during its transition from raw materials to finished goods. The real VAT payer is the consumer not the producer. It is a tax on trading transaction. It is a modern tax system which enables to efficient collect system, to increase efficiency and to reduce tax evasion..

In Nepal Value Added Tax Act was enacted by 1995 and started to implement only at 16th November 1997. In fact the implementation of Value Added Tax was not easy in the initial days. It was a great matter of debate. A large number of traders and business community are against of Value Added Tax. The FNCCI, NCC and their affiliated bodies were in the front line of opposition. Despite all this, Value Added Tax was introduced and survived because of its leading to transparency and accountability both on the part of tax payers and tax collectors.

Nepal has adopted a consumption type, tax credit method, principle of destination with international standard, provision of exemption and zero rate goods and service, tax refund facility with single rate (currently 13%) of VAT.

VAT is modified and improved form of sales tax. It is an indirect tax and new tax system.

It is a scientific taxing system. It is a progressive and best source of collecting revenue on taxation in Nepal. VAT is levied on value added goods and services at each stage in the process of production and distribution chain. VAT is one of the most important tools, element and component of indirect tax.

It is broad base tax system. The government of Nepal has been charging 13% VAT rate at present. The level of threshold of is Rs. 20 lakhs. That means, only the business having turnover exceeding the stipulated limit has to be registered compulsory, but less than the limit can also get registered voluntarily.

The main reason of introducing Value Added Tax is to generate more revenue by broadening the tax base, to promote economic development, to become less dependent on international trade taxes for the revenue in future. And it is necessary to introduce Value Added Tax to make tax system more scientific, transparent, fair tax system and so on. Despite having too many challenges it succeeded in generating reasonable revenue So VAT really proved that it is one of the most important part of government revenue.

Although VAT revenue has been increasing but it is still unable to achieve its potential because of various problems and challenges relating its implementations. Value Added Tax faces lack of proper invoicing system, lack of required number of qualified trained tax administrators, lack of coordination between tax payers and collectors. Among of them the great major problem is the lack of people awareness about VAT. So to enhance VAT revenue there is a need to tackle above problems and challenges.

5.2 Conclusions

Economic development is one of the most important indicators of developed country. Each and every country wants to be developed and no doubt tax is the main source of making the country economically strong. Our country Nepal is economically weak due to its more expenditure than its revenue collection. So for more revenue generation tax system should be effective, simple and transparent. Value Added Tax is one of them. It is introduced to increase revenue collection by broadening tax net, eliminating cascading effects, reducing tax evasion and creating investment friendly tax system. It is universally accepted as modern, advanced, simple and transparent tax system. It is regarded as the tools of more revenue collection than sales tax.

We cannot increase revenue through direct taxation due to small scale and undeveloped structure of business and industries. More revenue collection is possible through direct tax. And Value Added Tax is the best form of indirect tax. VAT plays great role in the revenue mobilization in Nepal. The reason behind VAT system, it makes transparency in all kinds of transaction, helps to make a wide area of tax and discourage tax evasion. So it is needless to say that VAT is the most important source of the government revenue. So adoption of VAT for Nepal is both compulsion and a necessity. It is a general, broad based consumption tax assessed in the value added in the goods and services. It applies more or less to all goods and services that are bought and sold for use or consumption.

In the context of Nepal, Value Added Tax is now on the 13th year of its implementation and during this period revenue collection from VAT is not so bad. Theoretically it is the best reform of tax system and practically its success depends upon the environment provided for it. From data we observed that VAT revenue collection is increasing every year. It intends to meet the expected revenue. VAT office is achieving more that 90% of its expectation. VAT does not give the tax burden to one level or one person. It is levied in each level and paid by each person engaged in each level. So investors will be encouraged. And the result is good impact on the economic condition of Nepal.

Empirical findings also show that VAT is an appropriate means of tax collection. All the people are in favor of its implementation. They start to believe that VAT can generate more revenue. At present the issue has become the effective implementation of Value Added Tax system in Nepal. It is not matter that VAT should be removing but the implementation aspect should be managed properly. Every group relating to Value Added Tax, need to take it as a serious matter. The success of Value Added Tax depends upon its sound implementation. And for its sound implementation, good environment is must. But as we know that Nepal has facing so many problems and challenges on its implementation aspect.

Empirical finding shows that the major problem of VAT is lack of public awareness and improper billing system. People don't feel that bill must be taken. They are in illusion that taking VAT bill means pay more. Even the wholesaler & retailer said the same things that issuing VAT bills means charging more prices. They are cheating to the consumer knowingly and unknowingly. So, first consumer needs to be aware about it. They should force seller for correct

VAT bill. Under invoicing is another problem. Other problems are; lack of full support and commitments from the politicians and other government sector, instable government, lack of skilled, trained and honesty manpower, improper account keeping, weak administration etc. Most of people do not consider the tax as their responsible to the nation. They feel it as a burden. So tax education to public is also necessity to feel them paying tax is a responsibility towards the nation.

For business, government needs to make registration, return filing and refund process simple. Government should bring the clear VAT laws and rules, effective and efficient administration. VAT office should create the environment of cooperation between tax payers and tax officers. Government should take a strong action to control the tax evasion, smuggling in border side and corruption. Responsibility and accountability in every sector is its basic requirements well as honesty and confidence between business people and tax administration is must. The government must be curative. Unnecessary hindrances in tax system should be eliminated. It is a time for action and improvement for effective and successful operation of VAT in Nepal to achieve the line of economic development.

5.3 Recommendations

Despite various controversies in the introduction of VAT, the government has been able to enforce a broad based value added tax. There are still so many obstacles to implement it successfully. On the basis of the research study, the implementation aspect of VAT in Nepal is progressive though it has not achieved its objective as intended. So, there are still so many problems which are facing by the government and business sector to implement VAT successfully. On the basis of major findings and conclusion, following recommendations have been made for reformation of VAT:

- © Billing system plays vital role in implementation of VAT in Nepal. So, efforts should be made for actual billing system by adopting following measures:
 - Z Conduct monitoring and follow-up of the market to check whether or not invoices are being issued properly as stipulated in the Act and regulation.
 - Z Expanding audit and investigation.
 - Z Government of Nepal should lunch consumer education campaign regarding the importance of issuing and receiving invoices.

- Z There should be made billing software and entered in computer, there by tax payers would not be able to delete the transaction file.
- © Government should create an environment of strong and full political commitment for successful implementation of VAT.
 - © Open boarder is also a main hindrance for a successful implementation of VAT. So, it should effectively be controlled to prevent the illegal trade and checking should be in practiced.
 - © The VAT administration training centre should be made well with modern net of VAT.
 - © The tax refund procedure should be simplified and provided in time.
 - © The training should be given to the registered businessman in order to make them able to maintain the books records and accounts as per the legal provisions.
 - © The VAT should be implemented to make the corporate sector transparent.
 - © Current fine and penalty is strong so keep it same.
 - © Training program must be provided to tax officers to develop skilled manpower and improve administration with current information technology.
 - © The existing threshold limit is high for considering registration. So it should be reduced to submit the potential registrants tax payers within VAT net.
 - © There are large number of exempted goods and services. So it should be reduced.
 - © VAT system of Nepal is not standing on real ground. It is challenges to create the environment in which tax system. So it should be stand on real ground.
 - © There must be the management of reward and punishment who may be either it may be employee of tax payee who pay tax sincerely, they must be rewarded otherwise they must be strongly fined.
 - © The IRD should conduct regular seminars, meetings and interaction with good coordination business sector to create position attitudes towards VAT.
 - © It should, make the provision of temporary registration of the transaction concerning fair, circus shows and tax refund to the tourist.

- © There is contradiction for current VAT rate. So it should be differentiated with higher rate of luxurious goods and lower rate of essential goods.
- © Tax office should be coordinated with custom office, private sector and other related bodies for information of data and proper implementation of VAT.
- © The technology is changing; it is the challenge of the 21st century. So in the record keeping, computer system and networking program must be developed and linked so as to make the VAT work simple which also helps to make data base system effective.
- © Some of the staffs in the administrative sectors are corrupt. They do as per the businessmen in consideration of kinds and cash. So, the control over such corruption should be done strictly.

Finally, for the effective, efficient and more successful implementation of VAT in Nepal, effective billing system, efficient tax administration, disciplined private sector and tax payer are pre-requisite conditions. The government should apply suitable VAT implementation policies and strategies considering globalization, liberalization, WTO and modern net of VAT for the progress with close co-ordination to the concerned stakeholders.

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Appendix 1
Questionnaire

Dear Sir/madam,

I am doing my Research on “**Implementation of VAT and Its Contribution to Government Revenue**” as a partial fulfillment of the requirement for Master of Business Studies from Shanker Dev Campus, affiliated to Tribhuvan University. In this regards I have prepared a Questionnaire to seek the views. I kindly request you for valuable comments, views, suggestions and information on this issue that could be very useful for my study by filling up the following questionnaire.

Please Tick mark () on the chosen answer. Multiple answers can be chosen as necessary. All the answers will be kept confidential. Please do not mention **NAME** or any **MARK** that reveals the identity of the respondents. Findings of this study also depend upon your honesty in marking the answers.

S. No. :
Respondent’s Occupation :
Respondent’s Designation :
Respondent’s Office/ Organization :

1. Which of the following categories best suit your education level?
 - a. Illiterate ()
 - b. Literate ()
2. Do you know about VAT?
 - a. Yes ()
 - b. No ()
3. Is VAT appropriate tax system for Nepal?
 - a. Yes ()
 - b. No ()
 - c. I don't know ()

4. Do you get bill on every purchase?
 - a. Yes, on all purchase ()
 - b. Yes, most of my purchase ()
 - c. Yes, but not regular ()
 - d. No, I don't get any bill ()
5. What is the present implementation scenario of VAT in Nepal?
 - a. Unsound ()
 - b. Sound ()
 - c. Medium ()
 - d. Don't know ()
6. Do you think the VAT office is successful to get expected revenue?
 - a. Yes ()
 - b. No ()
 - c. I don't know ()
7. Will price rise due to VAT system?
 - a. Yes ()
 - b. No ()
 - c. I don't know ()
8. What do you think about present threshold limit for effective implementation of VAT in Nepal?
 - a. Low ()
 - b. Moderate ()
 - c. High ()
 - d. Very High ()
 - e. Don't know ()
9. What are the major existing problems of VAT for its implementation in Nepal?
 - a. Tax refund process ()
 - b. Billing System ()
 - c. Registration Process ()
 - d. Open boarder of Nepal ()
 - e. Weakness of tax administration ()

- f. Lack of public awareness ()
 - g. Complex accounting ()
 - h. Lack of trained and skilled manpower ()
 - i. Lack of VAT education ()
 - j. Unclear VAT rules & regulations ()
 - k. Others (please specify).....
10. What kind of problems has arisen in the process of VAT implementation in Nepal?
- a. Registration ()
 - b. Collection ()
 - c. Tax refund ()
 - d. Others (Please specify).....
11. What are the most important factors for effectiveness of VAT in Nepal?
- a. Honest tax officers ()
 - b. Honest tax payers ()
 - c. Clear act, rules & regulations ()
 - d. Effective VAT administration ()
 - e. Others (Please specify).....
12. How can we make return process easier?
- a. Computerized ()
 - b. Add manpower ()
 - c. Time frame ()
13. What is the effect of VAT in Economic Development?
- a. Positive ()
 - b. Negative ()
 - c. Moderate ()
14. Is there any Role of Billing system in implementation of VAT in Nepal?
- a. Yes ()
 - b. No ()
 - c. I don't know ()

15. What measures are needed to establish VAT as a major source of public revenue?
- a. More trained and qualified officers ()
 - b. Minimize personal contact with the taxpayers ()
 - c. Computerized system for the payment of VAT ()
 - d. Collection of VAT should be given to private sector ()
 - e. Quick and hassle free service ()
 - f. Others (Please specify).....
16. What should be done for the improvement and more effective implementation of VAT in coming days in Nepal?
- a. Develop information technology ()
 - b. Develop skill manpower ()
 - c. Improve in administration ()
 - d. Improve in organization structure ()
 - e. Political Commitment ()
 - f. Improve in threshold limit ()
 - g. Co- ordination with private sector ()
 - h. Improve in auditing ()
 - i. Effective reward and punishment system ()
 - j. Need of training programme ()
 - k. Launch consumer awareness programme ()
 - l. Others (Please specify).....
17. What can be the reason for not showing positive attitude towards VAT implementation by the tax payer?
- a. Lack of Value Added Tax education ()
 - b. To hide transaction/ tax ()
 - c. Increase the working Capital ()
 - d. Others ()
18. What is your suggestion to broaden the VAT base?
- a. Reduce custom rate ()
 - b. Regular promotional campaign ()
 - c. Increase coordination between public and private sector ()

- d. Reducing exemption goods ()
- e. Include all sector ()
- f. Reduce threshold ()

Appendix 2

No. of office wise VAT registration

Office Name	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Bhadrapur	873	1036	1069	1265	1400	1547	1590	1860	2131
Biratnager	1539	1685	1667	2008	2291	2609	2506	2988	3250
Dharan	796	874	891	1076	1208	1357	1376	1646	1854
Janakpur	771	839	852	994	1185	1336	1309	1639	1857
Lahan	654	700	722	943	1098	1258	1287	1522	1729
Simara	507	550	557	683	826	928	862	1054	1193
Birgunj	1185	1462	1634	1868	2114	2467	2401	2962	3386
Hetauda	385	449	458	567	717	892	872	1183	1341
Bharatpur	662	735	744	912	1046	1303	1209	1632	1868
Dhangadhi	379	414	442	665	823	1057	1217	1510	1883
Mahendranagar	318	348	362	474	530	657	754	929	1099
Pokhara	1183	1471	1654	1969	2269	2573	2733	3170	3564
Lalitpur	988	1271	1416	1707	2130	2590	2772	3444	4170
Bhairahawa	1256	1480	1478	1763	2091	2359	2369	2905	3322
Kathmandu-3	2490	3072	3787	4660	5560	6642	7132	8736	10327

Nepalgunj	659	778	832	1030	1315	1620	1808	2293	2873
Kathmandu-1	2975	3482	4537	5326	6273	7394	8072	9882	11917
Kathmandu-2	2722	2806	3410	3854	4247	4956	5019	5924	6645
Bhaktapur	794	965	1106	1255	1444	1787	1916	2375	2809
Krishnanagar	259	311	327	398	456	498	510	645	724
Dang	386	421	409	513	603	835	894	1140	1368
Large tax office	0	0	0	244	150	166	188	336	343
Total	21781	25149	28354	34174	39776	46831	48796	59707	69653

Source: Annual Report 2008/09, IRD

Appendix 3

No. of Non Filer as per office wise

S.N.	Office	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
1	Bhadrapur	24	64	130	156	64	137	130	201
2	Biratnagar	96	143	203	269	97	180	287	383
3	Dharan	74	76	113	165	112	131	151	192
4	Janakpur	75	137	129	203	149	240	370	513
5	Lahan	99	93	142	168	174	236	243	409
6	Simara	45	97	82	106	69	137	140	212
7	Birgunj	230	280	392	538	193	325	418	597
8	Hetauda	14	39	499	90	74	77	114	194
9	Bharatpur	48	83	45	80	62	142	213	325
10	Dhangadhi	52	56	94	140	114	261	205	277
11	Mahendranagar	65	52	88	118	77	88	94	116
12	Pokhara	108	201	242	400	245	323	307	487
13	Lalitpur	131	244	380	581	267	325	434	535
14	Bhairahawa	55	118	181	224	162	302	350	468
15	Kath-3	673	1034	1561	1627	772	1239	1767	2632
16	Nepalgunj	89	133	165	226	154	158	237	373
17	Kath-2	1012	725	821	966	1483	1888	2289	1054

18	Kath-1	562	1410	1668	1910	300	454	688	3265
19	Bhaktapur	178	206	262	314	134	271	296	465
20	Krishnagar	31	28	29	44	22	36	40	102
21	Dang	19	36	77	158	155	179	177	240
22	Large tax office	-	-	19	9	0	0	0	0
Total		3680	5255	7322	8492	4879	4879	9050	13040

Source: Annual Report 2008/2009, IRD

Appendix 4a

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

Fiscal	Estimated			Actual			
Year	(X)	$x=X-\bar{X}$	x^2	(Y)	$y=Y-\bar{Y}$	y^2	xy
2000/01	1350	-819	670761	1204	-895	801025	733005
2001/02	1475	-694	481636	1194	-905	819025	628070
2002/03	1373	-796	633616	1344	-755	570025	600980
2004/04	1550	-619	383161	1447	-652	425104	403588
2004/05	1695	-474	224676	1889	-210	44100	99540
2005/06	2365	196	38416	2194	95	9025	18620
2006/07	2646	477	227529	2670	571	326041	272367
2007/08	2965	796	633616	2981	882	777924	702072
2008/09	4100	1931	3728761	3970	1871	3500641	3612901
	ΣX		Σx^2	ΣY		Σy^2	Σxy
	19519		7022172	18893		7272910	7071143

Estimated Revenue

$$\text{Mean } \bar{X} = \frac{19519}{9} = 2169$$

$$\text{Standard Deviation } (\dagger) = \sqrt{\frac{(\Sigma x^2)}{N}} = \sqrt{\frac{7022172}{9}} = 883.31$$

$$\text{Coefficient of Variance (C.V.)} = \frac{\dagger}{\bar{X}} = \frac{883.31}{2169} \times 100 = 40.72\%$$

Actual Revenue

$$\text{Mean } \bar{Y} = \frac{18893}{9} = 2099$$

$$\text{Standard Deviation (} \dagger \text{)} = \sqrt{\frac{(Y - \bar{Y})^2}{N}} = \sqrt{\frac{7272910}{9}} = 898.9$$

$$\text{Coefficient of Variance (C.V.)} = \frac{\dagger}{\bar{Y}} = \frac{898.9}{2099} \times 100 = 42.82\%$$

Correlation Coefficient (r_{xy}) =

$$\frac{\sum xy}{\sqrt{\sum x^2} \sqrt{\sum y^2}} = \frac{7071143}{\sqrt{7022172} \times \sqrt{7272910}} = \frac{7071143}{2649.9 \times 2696.83} = 0.989$$

The result shows that there was positive relation

$$\text{Calculation of P. E} = 0.6745 \frac{1 - Zr^2}{\sqrt{\rho}} = 0.6745 \frac{1 - Z(0.989)^2}{\sqrt{9}} = 0.02187 \times 0.007$$

Again,

6 x P.E

$$= 6 \times 0.007$$

$$= 0.042$$

$r > 6P.E$

$$0.989 > 0.042$$

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

Appendix 4b

Calculation of Estimated VAT Revenue for 2009/10

Fiscal Year (X)	Actual (Y)	X- \bar{X} X2004/05 (X)	X^2	XY
2000/01	1204	-4	16	-4816
2001/02	1194	-3	9	-3582
2002/03	1344	-2	4	-2688
2003/04	1447	-1	1	-1447
2004/05	1889	0	0	0
2005/06	2194	1	1	2194
2006/07	2670	2	4	5340
2007/08	2981	3	9	8943
2008/09	3970	4	16	15880
	ψ X18893		ϵ^2 X60	$\epsilon \psi$ X19824

$$a = \frac{\psi}{\rho} \times \frac{18893}{9} \times 2099$$

$$b = \frac{\epsilon \psi}{\epsilon^2} \times \frac{19824}{60} \times 330.4$$

The estimated revenue for 2009/10

$$y = a + bx = 2099 + 330.4 \times 5 = 3751$$

...The estimated VAT revenue for 2009/10 will be Rs. 37510000thousand

APPENDIX 5

List of VAT exempt goods and service

1. Basic Agricultural Products

- a. Paddy, rice, wheat, maize, barley, millet, pulses, flour, and similar unprocessed food materials.
- b. Green and fresh vegetable, fresh fruits, fresh eggs and similar products (except used in hotels, restaurants, bars, guest house, cafeteria and other similar organization.
- c. Unprocessed cereals,(such as sugarcane, tea leaf, tobacco, cotton, cardamom, jute, oil, seeds, soyabean)
- d. Herbs.

2. Goods of Basic Needs

- a. Unprocessed edible oil,
- b. Piped water, including water supplied by tankers.
- c. Fuel wood and coal.
- d. Salt.

3. Live Animals and animal products:

- a. He goat, sheep, yak, he buffalo, bore, pigs, rabbit, and similar other animals, their fresh milk and uncooked/ unprocessed varieties.
- b. Cows, she buffalo, and she goat.
- c. Ducks, hens, cocks, turkey and similar other birds and other fresh meat, eggs, and similar uncooked varieties.
- d. Fresh or dried fish(other than packed)

4. Agriculture input

- a. seeds of any plants listed in Group I
- b. Manure, fertilizer and oil conditioners.

- c. Agriculture hand implements.
- d. Pesticides made mainly for use of crops.
- e. Agriculture equipment, including tractors.
- f. Birds and animal feed.

5. Medicine, Medical and Similar Health service.

- a. Medical or surgical services provided by Government Institutions.
- b. Human blood and products derived from human blood.
- c. Human or animal organs or tissue for medical research.
- d. The supply of services by persons on the register of veterinary surgeons and veterinary doctors.
- e. The supply of goods made for, and suitable only for the use of disabled persons.
- f. X-rays films and oxygen gas to be used for treatment.
- g. Raw materials purchased or imported by the drug industries to the extent approved by the department of drugs management.

6. Education

- a. The provision of research in a school or university.
- b. The provision, otherwise than for profit, of professional or vocational training or refresher training.
- c. The provision of education in a school or university and supply of goods made in connection with such service.

7. Books, Newspaper etc

- a. Books, newspaper, newsletters and periodicals.
- b. Newsprint.

8. Artistic and Cultural goods and services, carving services

- a. Paintings, handicraft, carving and related services.

- b. Cultural program.
- c. Admission to libraries, archaeology, museum, zoos and botanical gardens.

9. Personal or Professional services

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

10. Personal or Professional services

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

11. Other goods or services

- a. Postal Service (provided by Nepal Government only)
 - i. The service conveyance of letter, money and packets by the post office.
 - ii. The supply by the post office of any service in connection with the conveyance of letter, money and postal packets.
- b. Postage stamps.
- c. Financial and insurance services.
- d. Bank notes and cheque books.
 - i. The printing and issue of bank notes.
 - ii. The supply of bank notes from outside the kingdom of Nepal to the kingdom of Nepal.
 - iii. Cheque book.
- e. Gold and silver.
 - i. Gold, gold coins and gold ornaments.
 - ii. Silver and silver cons(other than ornaments and goods made or silver)
- f. Electricity
- g. Raw wool

- h. Battery operated tempo, their chassis and battery,
- i. Bio-gas, solar power and wind power operated power generation plant and their main parts on the recommendation of the alternative energy centre.
- j. Aero plane, Helicopter, fire Bridge and Ambulance.
- k. Jute goods.
- l. Industrial machinery included in section 84 of custom tariff and subject to 5% TRAIF.
- m. Woolen carpet & woolen carpet weaving, dying, washing, knitting.
- n. Aluminum, copper, scrape, circle, plate and utensils.
- o. Cotton yarn.
- p. Woolen yarn to be used in hand knitting sweater (except artificial & acrylic) domestically.
- q. Donated goods received for calamities or Phil and tropic purpose approved by ministry of finance.

12. Land & Building:

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

13. Betting, Casinos, Lotteries

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

Zero Rates

Goods or service payable at zero rates

1. Export of goods.

- a. Goods exported outside the kingdom of Nepal ;
- b. Goods shipped for the use as stores on a aircraft to an eventual destination outside the kingdom of Nepal

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

2. Export of service

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

3. Import of goods and service by accredited diplomats.

Source: Inland Revenue