

**CONTRIBUTION OF VAT TO GOVERNMENT REVENUE**

**A**

**THESIS**

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**T.U. Regd No: 7-3-28-61-2006**

*Submitted to:*

**Office of the Dean**

**Faculty of Management**

**Tribhuvan University**

**In partial fulfillment of the requirements for the Degree of**

**Master of Business Studies (M.B.S.)**

**R.R.M. Campus, Janakpurdham**

**JULY, 2011**

# RECOMMENDATION

This is to certify that the thesis:

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## **DECLARATION**

I hereby declare that the work reported in this thesis entitled “**CONTRIBUTION OF VAT TO GOVERNMENT REVENUE**” submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirements for the Master of Business Studies under the supervision **Mr. Gopal Prasad Shah**, R.R.M. Campus, Janakpurdham.

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## ACKNOWLEDGEMENTS

This is really an appreciable curriculum of T.U. because it helps the students to express their theoretical concept gained during the study period into the practical field. So, being concerned to thesis, I have also got a chance to express my theoretical concept gained from class and library study into this practical field. The present study “**CONTRIBUTION OF VAT TO GOVERNMENT REVENUE**” has been prepared for the partial fulfillment of the requirement for Master Degree in Business Studies.

At first, I would like to pay thanks to my father and mother as well as my brother who headed me towards the light of education and path of truth. Due to their non-stopping effort for guidance, today I come in this position. So I would like to share the credit of my success with them. I'm really indebted by them.

After this, I would like to express my cordial gratitude to my all teachers. For this dissertation, I would like to pay my sincere thanks to my thesis Supervisor – **Mr. Gopal Prasad Shah**, R.R.M. Campus. His incessant suggestion and guidance from the beginning to the end is really an appreciable effort.

I would also like to express my gratitude to all other members of R.R.M. Campus, Janakpurdham, especially, staffs from MBS department, libraries staffs as well as all known and unknown people who supported as well as inspired me to complete this thesis. Similarly, I am very grateful to my respective Big Brother Mr. Bhabish Chandra Jha and Mr. Satish Chandra Jha.

Last but not least I am greatly indebted by my all friends and family members. In this regard, I'm grateful to my friend's Mr. Rajesh Agrawal and other friends for their motivational effort and support even though they have very busy hour.

Advices, Recommendations and suggestions are whole-heartedly welcome. Thanks,

**Shree Chandra Jha**

(Researcher)

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## **ABBREVIATIONS**

- FY: Fiscal year
- AFO: Assistant Finance Officer
- Co: Company
- GDP: Gross Domestic Product
- HMG/N: His Majesty's Government/Nepal (Now Government of Nepal)
- IRD: Inland Revenue Department
- IRO: Inland Revenue Office
- ITA: Income Tax Act
- NPEDC: National Productivity and Economic Development Center
- PEs: Public Enterprises
- Rs.: Rupees
- SAARC: South Asian Association for Regional Cooperation
- T.U.: Tribhuvan University
- TDS: Tax Deduction at Source
- VAT: Value Added Tax
- VDIS: Voluntary Disclosure of Income Scheme

## CHAPTER I

### INTRODUCTION

#### 1.1 General Background

Taxation should be justifiable to achieve maximum social and economic objective. It helps in re-distribution of economic means by the transformation of wealth from persons with higher economic level to economic level. It should minimize gap between rich and poor. Regional economic imbalances may also be reduced by providing incentives and concessions in income tax for starting new industries in backward areas. It has become an effective instrument to ensure balanced socio-economic growth. Nepal is an agricultural country. The pr-dominant position occupied by the agriculture sector in the Nepalese economy is borne out by the fact that more than 81 percent population of the country is dependent upon agriculture which contributes about 39 percent to the total GDP.(IRD, Ktm/ Economic Survey) Agriculture is the major supplier of raw materials to industries.

The Constitution of the Kingdom of Nepal has clearly directed Nepalese government for a self-reliant economic system encouragement to national enterprises, preventing of economic system encouragement to national enterprises, preventing of economic exploitation as well as upgrading the standard of the people. In self-reliant economic system and sound infrastructure for the development, the government should generate revenues.

Taxation is the most effective and powerful tool reserved in the hands and government. The major objective of taxation is to make fund available for the economic development and economic stability. Tax means compulsory contribution from a person to the government to defray expense incurred in the common interest of all without reference to special benefit conferred. Next it can say tax is compulsory contribution imposed by public authority using the rights given by the law. The main objective of taxation has been shifted from security perception to the economic development. The modern objective of taxation is not only to maintain peace and security but also to conduct that the tax has been objective of raising revenue to have resource mobilization, equal distribution of wealth and income in the society, encouragement in production of certain products encouragement in

employment saving and investment removal of regional imbalances and enforcement of government policy. (*Bhattarai, & Koirala, 2007*).

The source of government revenue can be broadly classified into two categories tax revenue and non tax revenue. The government receives the tax revenue as a compulsory payment where as non tax revenue is conditional one. Taxes are broadly classified into two groups: Direct tax and Indirect tax. Direct tax is a personal tax, if the same person to whom the tax is legally imposed and there is no possibility of shifting pays it, and then it is called direct tax. Examples include income tax; property tax etc. On the other hand, indirect tax is a commodity and service tax. If any tax is legally imposed for one person but the incidence of the tax is borne another person through backward and forward shifting process. Then it is called indirect tax. Value added tax (VAT), Hotel tax, customs duty etc are example of indirect taxes.

It was Wilhem Von Siemens who first recommended Value Added Tax (VAT) for the Germany in 1919 in order to avoid the adverse effects of multistage sales tax. In that time Germany did not apply Value Added Tax, (VAT) but it reduce the rate of multi stage sales tax. The concept of value added tax (VAT) was developed further in 1949 by a tax mission to Japan lead by Professor Carls S. Shoup. This mission recommended the Euka-Kachi-Zei (VAT) for Japan in order to avoid the undesirable-and unintended effects of Japanese enterprises and turn over taxes in place at that time. That issue was considered seriously but the Japanese government decided not to implement it. No countries applied value added tax (VAT) till 1953 but in 1954 it was adopted in France in restricted scale. Since that time value added tax (VAT) is becoming topic of debate and discussion all over the world and now more than 132 countries have implement this system and trend of adopting value added tax (VAT) is increasing throughout world (Khadka. 2001), Nepal has implemented it since 16 November 1997. From the experience of the various countries, VAT is known as best form of sales tax which leads to revenue enhancement and economic efficiency. It may be adopted by developing countries without extra burden and may work as important instrument for resource mobilization internally. There is high scope of increasing resource from VAT if implemented effectively and all the participants of VAT system keep their records truly and honestly.

### **Tax is defined in different ways:**

In simple terminology, tax is a liability to pay an amount to the government. It is compulsory contribution to the national revenue from the tax payers according to law.

According to Professor Seligman, "A compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit conferred." (Quoted from Dhakal, Income Tax & House-Land Tax: Law & Accounting, 2001 page: 1)

According to Plehn, "Taxes are general contributions of wealth levied upon persons, natural or corporate to defray expenses incurred in conferring common benefits upon the residents of the states." (Ibid, page 2)

Value added tax (VAT) is a part of indirect tax and it is considered as one form of sales tax. VAT is collected in every stage of production and distribution of goods and service. Value added tax has been taking as developed form of sales tax and it is the most recent innovation in the field of taxation. It is a tax imposed on value added by business firms on goods and services at the successive stages of production and distribution. It is easy to operate and transparent. Value added tax is imposed only in the value added at particular stage in production and distribution. Value added tax is similar to turnover tax in the service because both taxed are imposed on each stage in the production and distribution process. Value Added Tax (VAT) however is different from the turnover tax as the later is impose on total value at each stage, while former is imposed only on Value added at that stage. Value Added Tax (VAT) is important instrument for the internal resource mobilization.

There is wide scope for increasing revenue from Value Added Tax (VAT). The sound implementation of Value Added Tax (VAT) surely contributes for big part of revenue collection. It is however recent innovation in the field of taxation. It is the tax imposed on value added by business firms on goods and services at the successive stages of production and distribution. Value addition on commodity or service is simply the excess of sale value over business purchase by business entity in successive stage of production and distribution processes. Business-enterprises add value to their purchase either processing them by their equipments or directly.

Hence Value Added Tax (VAT) is multistage tax and "Which is imposed on every stage of production and distribution of goods and services.

In conclusion VAT has been the most essential ingredient of tax reform of developing countries because it is the most improved form of sale tax which leads to revenue enhancement and economic efficiency. It is an important instrument for the internal resource mobilization. There is tremendous scope for increasing the revenue from VAT. The proper implementation of VAT will obviously increase its contribution to contributing days. The tax reform with an adopting VAT is one of the major elements of tax revenue to achieve the goal of rapid economic development for any under developing countries. Most of the people do agree with the suitable name of tax as KAR in Nepali that means as "most to pay." (*Kandel, 2001*)

## **1.2 Statement of Problem**

Nepal is an underdeveloped country having poor economic growth rate. It has been facing serious gap and fiscal gap problem. Total expenditure has exceeded total revenue in each subsequent year. The government expenditure is continuously rising due to weakness and large investment in selecting development projects and regular expenditure is increasing due to result increasing burden of debt servicing and salary as well as allowances of government personnel. Thus, there is growing difference between expenditure and resource plus foreign aids. In other words, financial resources gap is the major constraint of the Nepalese economy.

To raise the government revenue, it is necessary to raise the sources of revenue which helps to relieve from serious bottleneck of resource gap in the proceeds of economic development programme.

The government has to spend a lot of money to fulfill its responsibility towards its people the responsibility may be for either security & special services and economic development or other development activities. Because of the instability and stagnant economic condition of deficit in the country the pace of revenue collection is slowing down and financing and external loan the economy is facing resource gap. Share of external loan is always increasing to finance the government expenditure. For the payment of external loan and to finance the

government expenditure, internal source of revenue is the main source. Tax revenue is one of the internal sources of government revenue. But there exist lack of proper implementation of different tax policies. Besides this because of the lack of knowledge about tax, the public always take paying tax as burden for them. Another problem on revenue collection is the instability in the country. All these problems are creating obstacle on the revenue collection which also minimize the country economic development.

The nation whether is to conduct day to day operation or development activities revenue plays a vital role. In such reality, the main sources of collecting the national revenue from VAT can be regarded as the backbone of the income tax system. Without proper implementation of VAT in every part of the country it is not possible to collect required revenue for the country. Thus the country should be well focused. This study concentrated on the finding out of the contribution of VAT in National revenue.

The contribution VAT to the national budget must be increased to achieve the goal of national development and equal economic distribution. The collection of VAT can be increased only if the government of Nepal takes effective steps for making the tax payers and implementing the tax laws effectively. So as to discourage the tax evasion practice. Loopholes must be traced out and monitored effectively.

### **1.3 Objective of the study**

The general objective of the study is to analyze the contribution of VAT in revenue collection in Nepal. However the specific objectives are given below:

- a) To study the historical background of VAT.
- b) To examine the contribution of VAT in Revenue collection in Nepal.
- c) To analyze the effectiveness and problems of VAT in Nepal.
- d) To provide suggestions, recommend for making VAT more effective in Nepal.

#### **1.4 Significance of the study**

Value added tax (VAT) is part of taxation and taxation is powerful tools of mobilizing the internal resources of any country. About eleven years have been passed since VAT came into operations. But many Nepalese people are unknown about various aspects of it. VAT being itself a complicated and modern tax system, more effects should be made on actual circumstances. Theoretical and practical knowledge are required to implement VAT properly. So this study analyzes Nepal's VAT system with its effectiveness in revenue collection. The major significance of the study are as follows.

- ) The study in some extent is beneficial to policy maker, private sector researcher and other general people.
- ) This study also provides an idea and knowledge to these persons who are interested about VAT system.
- ) This study explores contribution of VAT in revenue collection in Nepal.
- ) This study tried to provide knowledge another VAT is effectively implemented or not.

#### **1.5 Limitations of the study**

There are different causes due to which a researcher has to conduct the research from some limitation. The major limitation of the study is as follows.

- ) The study is concentrated only on VAT.
- ) The study is based mainly on secondary data but primary data is also included.
- ) Primary data are collected through opinion, survey of tax experts available in Janakpurdham- Dhanusha and other cities of Nepal.
- ) The study is based on laws, rules & regulations and implementation of Nepalese income tax.
- ) The study has covered the period only from FY 2057/058 to 2066/067

- ) Due to limited time, it made difficulty to get further information about the subject of the study.

## **1.6 Plan of the Study**

The study has been organized into six chapters. They are as follows:

**Chapter I** : Introduction

**Chapter II** : Review of Literature

**Chapter III** : Research Methodology

**Chapter IV** : Presentation study and Analysis of Data

**Chapter V** : Summary, Conclusion and Recommendations

The foremost chapter is about introduction that includes the general background, statement of the problem, objectives of the study, scope of the study, significance of the study and limitation of the study.

The second part of the study has contained the review of literature. This part has been studied by dividing into two units as Review of Act and Review of Thesis reports, Books and Articles. Many published and unpublished related materials were studied, presented and interpreted as per the requirement.

The third part of the study is about resource methodology and includes research design, population and samples, nature & source of data, data collection procedures, methods of presentation and analysis, tools and techniques of analysis, research variables, weight of choice, selection of respondent and respondent's profiles.

Presentation and Analysis of Data has been presented in the fourth chapter. This is one of the most important chapters and includes the data related to the topic extracted from economic survey and annual reports published by Ministry of Finance. The analysis has been presented accordingly with suitable methods of presentation. Similarly, presentation and analysis of opinion survey has been placed under this chapter. It is the main body of the chapter where descriptive and analytical analysis of the primary information collected through sampling method from various respondents has been studied, analyzed and presented accordingly.

The final chapter of the study, summary, conclusions and possible recommendations regarding improvement employment income and related issues.

## **CHAPTER II**

### **REVIEW OF LITERATURE**

#### **2. Introduction**

A literature review is an essential part of all studies. It is a way to discover what other researchers have covered and left in the area. A critical review of the literature helps the researcher to develop a thorough understanding and insight into previous research works that relates to the present study. It is also a way to avoid investigation problems that have already been definitely answered. Thus a literature review is the process of locating, obtaining, reading and evaluating the research literature in the area of the student's interest. The purpose of literature review is to find out what research studies have been conducted in one's chosen field of study and what remains to do. The primary purpose of literature review is to learn not to accumulate.

#### **2.1 Historical Background of VAT**

Value Added Tax popularly known as "VAT" in short forms is conceived by Wilhelm von Siemens of town any for the first time in 1919 A.D. (Pandit: 2056) advised the German authorities to implement the system in order to solve the problem of short government revenue they are facing in those days. In fact, the system is conceptualized with two objectives. First objective is to streamline a tax system which ensures perennial and dependable source of more and more funds, to government. Second objectives is to adopt a system under which business community be taxed on actual turnover of their economic activities. Though the system is conceptualized with such noble objectives, it remained virtually far from being implemented for decades in 1949 A.D. Its extensive or detours form is envisaged in order to introduce reform in tax system of Japan. 1950s is the decade when the post developed and prosperous nations of the world were badly suffering from aftermath of the great sum of 1930s and ravaging the second great world war. In those days, governments of the countries, so suffered, were totally disquieted to find a way to heal the unfathomable economic catastrophe of the 1930's great depression and great war.

In fact, a scientific and a feasible tax system is a must to any government of any country at any time in order to establish a good governance and lead a nation to prosperity. A progressive and sustainable tax system in a country. Ideal tax system is a prerequisite for a good governance is a state since prehistoric period. Below is cited an important incident of Mahabharat period. "After Pandavs transformed Khandavprastra into Indrasprastha, the prosperous state, they invited their predecessors from Hastinapur on a certain Yodhisthir, the eldest of the Pandavs requested their uncle Vidur, the prime minister of Hastinapur to tell them secrets of good governance on. This, Vidur said "Your Majesty a kind has to look always into how his people are taxed. If state taxes her people beyond they can pay, they will be compelled to convert themselves into sophism and this will lead a nations to retrogression". (Shrestha, 2062)

For the first time in the world France introduce VAT system in 1954 A.D. limiting it to transaction of wholesale stage only in industrial sector. Later the country extended the system in 1968 A.D. Ivory Coast and Senegal of continent of Africa are second and third countries who introduced the system in 1960 and 1961 A.D. respectively. Establishment of European Economic Community i.e. European Union, required all its members countries to adopt the system. So the system spread there comparatively very quickly. Among the members countries of OECD, all countries Except USA have adopted the system. All major SAARC and ASEAN countries of continent of Asia are found cool towards introduction of the system.

Meanwhile the system spread gradually in South American countries as well Brazil is first South American country, who introduced the system. In 1967 A.D. by the end of Seventy's decade 6 more countries of the continent introduced the system and by 1998 A.D. 11 countries of the continent in total have implemented the system.

By eighty's decade all major European Countries both EC and non EC, have adopted VAT system. Ninety's decade is the period when the largest number of countries introduced the system. During this decade Russia and other Federal State of USSR such as Estonia, Ukraine, Tajikastan, Georgia, Lithunia, Latuia etc too who belong to European region have introduced the system. By the end of 2000 A.D. 47 EC have implemented the system. Europe is the continent where the largest number of countries has excited the system.

Costa Rica and Nicaragua are two North American countries who introduced VAT system in 1975 A.D. by 2000 A.D. almost all major countries of continent have adopted the system except USA. In USA too, allot of preparation have been made to introduce two system.

In Asia, Vietnam is the first country who introduced the VAT system on July 1973. The country withdraw the system soon and again implemented the system on January 1, 1999. The third largest countries of the world in area and the first largest country of the world in population China and one of the smallest country of world, Singapore have introduced VAT on October, 1, 1984 and April, 1994 respectively. Among one of most densely populated countries. The biggest democracy of the world, India introduced VAT on 1st April, 2005, Japan on April 1, 1989. Altogether 17 countries of Asia have implemented the system by 2000 A.D. countries of Oceanic too have implemented VAT in their region New Zealand, Papua New Guinea, Australia are major countries of Oceanic who have implemented VAT system by 2000 A.D.

List of countries of different continents and the year when they introduced VAT system in their countries are given below which is based on information available from VAT project office Inland Revenue Department and IR office Lazimpat, Kathmandu.

**Name of the Country with Year**

1. France 1954 A.D.
2. Ivory Coast 1960 A.D.
3. Senegal 1961 A.D.
4. Brazil & Denmark 1967 A.D.
5. Germany 1968 A.D.
6. Nether land & Sweden 1969 A.D.
7. Ecuador, Luxembourg & Norway 1970 A.D.
8. Belgium 1971 A.D.

9. Ireland & Uruguay 1972 A.D.
10. Australia, Bolivia, Italy, Vietnam & UK 1973 A.D.
11. Costa Rica, Nicaragua, Chile, Argentina & Colombia 1975 A.D.
12. Honduras, Israel & Peru 1976 A.D.
13. South Korea & Panama 1977 A.D.
14. Mexico 1980 A.D.
15. Haiti 1982 A.D.
16. Guatemala 1983 A.D.
17. China 1984 A.D.
18. Indonesia & Turkey 1985 A.D.
19. Morocco, New Zealand, Niger, Portugal, Spain & Taiwan 1986 A.D.
20. Grenada & Greece 1987 A.D.
21. Hungary, Philippines & Tunisia 1988 A.D.
22. Japan and Malawi 1989 A.D.
23. Iceland, Kenya, Pakistan, Trinidad & Tobago 1990 A.D.
24. Bangladesh, Benin, Canada, Jamaica, Mali, South, Africa & Estonia 1991 A.D.
25. Tajikistan, Paraguay, Belorussia, Algeria, Fiji, Thailand, Ukraine, Cyprus, El-Salvador, Moldova, Kazakhstan, Kyrgyzstan, Russia, Dominican Republic, Uzbekistan 1992 A.D.
26. Burkina Faso, Poland, Romania, Czech Republic, Slovakia, Venezuela, Turkmenistan, Azerbaijan, Armenia Georgia 1993 A.D.
27. Bulgaria, Finland, Lithuania, Singapore, West Samoa, Congo Niger & Madagascar 1994 A.D.

28. Gabon, Ghana, Switzerland, Malta, Latvia, Liechtenstein Mauritania, Togo & Zambia 1995 A.D.
29. Albania, Belize, Uganda & Guinea 1996 A.D.
30. Barbados & Nepal 1997 A.D.
31. Croatia, Surinam, Mauritius, Tanzania, French, Polynesia Vanuatu, Sri Lanka, Mongolia 1998 A.D.
32. Slovenia, Namibia, Mozambique, Papua New Guinea 1999 A.D.
33. Macedonia, Dominica Botswana, Rwanda, Australia 2000 A.D.
34. India 2005 A.D.

## **2.2 Adoption of VAT in Nepal**

The implementation of VAT system in Nepal is being quite late than other countries of the world because VAT was the new concept in the field of taxation. After the transition of democracy in 1990, the government launched a reform program to promote modern market oriented economy, while maintaining sound macro economic policies. A major structural reform initiated then was to introduce VAT system in the country. The govt. adopted a policy of adopting VAT in eighth year plan (1992-1997). Similarly, the 1993/94 budget stated that VAT would be introduced within a year or two.

VAT steering committee and VAT tax force were formed in 1993. As a part of its liberal economic policy, GN accepted forms to study VAT system. The technical assistance of HIID under the USAID financial assistance took up the study. This assistance was suspended in 1995, resumed in 1996 and continued till 1997. GN started exploring donors for the continuation of VAT program. The DANIDA accepted the govt. required and pledge to support VAT project. The DANIDA has been extending technique assistance since 1997. VAT act was passed in 1995 by the parliament meanwhile the department of VAT in 1996. It had the full responsibility to administer VAT system, VAT interacts and training programmers were organized by the representative of FNCCI, NCC, journalists, Chartered Accountant Association businessmen and several other professional groups.

As VAT law was designed to handle a single standard rate, the multiple rates of sales tax were unified in ingrate is percent from the rate of 10 to 20 percent. Again, some more trainings, instruction programs in form companies, meetings etc. were having to convince people about the introduction of VAT system. VAT task force was set up with members from VAT administration. FNCCI, NCC and Consumer Forum. The cabinet approved vat regulation in 1997. The National VAT steering committee consisting of representatives from GN, FNCCI, NCC and Donors was formed. Another VAT task force was formed with member from GN, industry and commerce sector. Besides VAT Act and Regulations, the ministry of Finance approved nine volume of manual in 1997. In a run up the budget for the fiscal year 1997/98, the govt. decided to convert hotel tax into the sale tax and the rate of tax was also reduced to 10 percent. There was a significant revenue risk associated with the rate reduction, GN went ahead with, it agenda. The HIID had made a study, mean while, about appropriate rate of VAT. The study recommended is percent as a revenue neutral rate. At the time of announcing its budget of the fiscal year 1997/98, the govt. did not need the recommendation. Similarly, exemptions of the sell tax were not brought in line with what was listed in Act, 1995.

The final date for the introduction of VAT was set for November 16,1997 and game into practice. The existing sale tax act 2023, Hotel Tax Act 2018, Contract Tax Act 2023 and Entertainment Act 2017 were repealed along with the implementation of VAT later Nepal govt. has increased rate of VAT to 13% with affect from Magh 1, 2061. In the introduction phase, it faced many problems. There was protest against it through business community. Several rounds Negotiation were held to reach in an amicable settlement.

Infect, the implement of VAT was not easy in the beginning years. It was a matter of great debate. A large number of traders were against VAT. Now, the situation has charged. Despite some short comings, the overall functioning of VAT, so far is satisfactory.

### **2.3 Types of VAT**

There are three types of VAT which are as follow.

- i. Consumption type VAT

ii. Income type VAT

iii. GDP type VAT

### **Consumption Types of VAT**

It includes all capital goods purchased from other firms while depreciation is not deducted from the tax base, in the subsequent years.

Consumption type VAT = Gross domestic product - cost of intermediate goods - Cost of Capital goods.

### **Income Type VAT**

Purchased from other firms in the year of purchase while depreciation is excluded from the tax base. The tax falls both on consumption and asset investment.

Income Type VAT = Gross receipt - Cost intermediate goods - Depreciation

**GDP Type VAT:** It neither excludes the purchase of capital goods nor the depreciation from the tax base. It means the tax is levied both on consumption and goods investment.

GDP Type VAT = Gross receipts - Cost of intermediate goods.

## **2.4 Revenue collection method of VAT**

In an economy we find that goods and services are either manufactured or imported and then pass to and from many vendors either for resale or for use. They then produce some other product until they are put for personal use. While on the transfer of a product in the manner value added essentially takes place on the cost of the product. Under VAT procedure, Tax is levied on such added value.

Tax under VAT system can be calculated in three methods which are,

i) Subtraction method

ii) Credit method

iii) Addition method

### **Subtraction method**

Under this method, tax liability is calculated levying applicable tax rate on the value that comes after deduction of purchase value from the sales value. It can be made clear by following calculation.

**Table 2.1**

#### **Calculation of VAT under subtraction method**

Particular	Manufacturer	Wholesaler	Retailer	Total Economy
Sales	350	850	1050	2250
Purchase	150	350	850	1350
Value Add (Sales - purchase)	200	500	200	900
VAT (13 % on value added)	26%	65%	26%	117%

### **Credit Method**

Under this method VAT is reckoned separately on purchase and sales value and tax liability is determined after offsetting the part on purchase & implement from tax collected on sales. It can be made clear by founding calculations.

**Table 2.2**

#### **Calculation of VAT under Creation method**

Particular	Manufacturer	Wholesaler	Retailer	Total Economy
Sales	350	850	1050	2250
Tax on sale	45.5	110.5	136.5	292.5
Purchase	150	350	850	1350
Tax in purchase	19.5	45.5	110.5	175.5
VAT ( Tax on sales - Tax on purchase)	26	65	26	117

### **Addition method**

Under this method, VAT is calculated on the total components of value added. Similar to factory production incase of manufacturing enterprises. It can be make clear by following calculation.

**Table 2.3**

#### **Calculation of VAT under addition method**

Particular	Manufacturer	Wholesaler	Retailer	Total Economy
Rent	50	100	20	170
Salary/Wage	100	250	110	468
Interest	25	90	30	145
Profit (etc)	25	60	40	125
Total	200	500	200	900
VAT 13 %	26	65	26	117

Among these three methods of calculating vat credit method is most widely used in the world because of following advantage. It is easy to find out the amount of VAT collected amount of VAT deposited and the amount of VAT to be refunded. In can be used for any time, i.e. one month, six months etc. which is less than on financial period. It is easy to catch up the under statement of value at the earlier stage and to correct on subsequent sales.

## **2.5. Principle governing VAT**

There are following principles which are governing VAT.

### **i) Making tax system more transparent:**

Since Nepalese economy is not based on proper accounting system, the business persons used to keep double accounting i.e. one for tax purpose & another for its own purpose. Due to which there is no transparency and resulting pervasiveness of tax evasion. Since VAT is an account-based tax system, the objective of using this is to make the tax system more transparent.

### **ii) Removing cascading effect:**

Cascading in tax system means tax on tax. Within sales tax system, tax paid at on stage becomes the cost for another stage. So, there is tax on tax especially on multi stage tax system. But within VAT system, the tax on one stage does not become the part of the cost for another stage. The value added item & tax item are kept separate within this tax system. Due to this, this tax system is free of cascading.

### **iii) Increasing the tax base:**

Nepalese economy is small. The tax evasion in Nepalese tax system in very common. It is estimated that around 50% of the Nepalese tax is evaded or avoided. This situation has made the Nepalese tax net very small. Only a small part of the Nepalese supposed tax payers is within tax net. Tax GDP ratio in Nepal is only 12 % in comparison to up to 50% in some countries in the world.

That is why one of the objectives of VAT system in Nepal is to increase the tax base.

### **iv) Maintaining Neutrality:**

The guiding principle of current tax system is neutrality. Neutrality concept in relation to taxation says that tax system should not discriminate one economic

activity against other. It should not disturb production; distribution & consumption pattern of the economy. Thus VAT is a tax system which is neutral.

**v) Encouraging the export:**

Another reason of replacing tax by VAT is to encourage the export. Within VAT, under destination principle, the goods & services are taxed at consumption point. The goods & services are not taxed based on production. The goods & service that are exported are taxed under zero rates which is different from exemption. In case of zero rating, the tax payer can get refund of tax earlier paid, but under exemption such refund is not possible. That means under zero rating, the exporter should not pay tax on value added but he can get refund of that tax he pays in purchasing the raw materials & interrelated goods.

In such away, VAT can promote export. 2.1.6. Difference between VAT system & Sales tax system:

**Table 2.4**

**Principle Governing VAT**

S.N.	Value Added Tax System	S.N	Sales Tax System
1	Tax under the system is levied in each stage of a transaction. Thus tax collection under this system will be comparatively high.	1	Tax is levied one time only the source of a transaction of product. Thus tax collection will be notably under this system.
2	Tax paid by registered vendors is permitted for	2	Under the system, tax paid is not allowed for deduction.

Netting off under the system, thus tax shall not be treated as cost component of the concerned vendor. Concerned vendor needs to treat the tax as cost component in order to recover it. It is progressive tax system. Its application is beneficial to all concerned business enterprises general public & government.

It is a nondeductible tax system. Its application helps the government to raise some revenue that is all. Scope or extent of VAT is extensive, Its application will have a far reaching implication in economy of a country. The system greatly helps to mobilize domestic financial resources of a country. Though sales tax

system covers many fields, its extent is comparatively very limited and as a result its role in society will not be as pervasive as that of VAT

Under VAT system, tax is levied on pure cost. So, its application does not result price rise at the rate greater than tax amount. Thus profit to business man shall be lower than profit to them under sales tax system. Under sales tax system, tax is levied on tax included value. So, its application results price rise at the greater than VAT profit in a transaction under this system equals to profit & tax an profit under VAT system. Longer the channels of distribution higher the govt. revenue & vice versa. Length of channels of distribution doesn't have any impact on amount of govt. revenue. Tax under this system is both direct and indirect. Tax under this system is purely indirect in nature.

## **2.6 Importance of VAT:**

Now a days every politician and govt. vow for peace and economic development of general masses of their country. They may have policies to achieve this. Politicians many introduce their strategy and programmes for the purpose, if they reach to power. But, it can be taken for granted that they will not be able to achieve their objectives unless they have commercial activities of the country functioning in line with achieving their objectives ie govt. policies & programmes alone cannot achieve such a massive task unless they are properly backed by businessman of the country. This never mean to say that they need to be permitted to function the way they wish to. The govt. must persuade them to operate in a responsible manner under their watchful eyes.

One of the most effective ways to do so is to introduce value Added system in the country under their revenue generating mechanism. This system is regarded as comparatively more efficient than rest other systems developed so far due to followings:-

### **i) VAT is an efficient Tax system:**

VAT system is considered as a efficient tax system than rest other product base tax system. Its application is found to be beneficial from many angles. The system is advantageous to the tax authorities, because it ensures collection of more & more revenue to the govt. in a perennial way. It is beneficial to the general public

because it helps to restrict price rise in market by eliminating inefficiencies of product base tax system and helps to decrease burden of tax on market price. It is good from the businessmen's point of view as well because it requires them to invest comparatively lesser funds in their working capital in one hand & on the other hand their income tax matter will be streamlined.

**ii) VAT restricts price rise:**

Application of VAT system requires lesser investment in working capital of business firms than is required if other product base tax system are applied. This will help the firms to reduce their financing expenses to a notable extent if the firms manage their finance efficiently. Reduction in over head expenses of business firms greatly helps them to maintain market price of their product within sustainable limit. The system eliminates inefficiency of product base tax systems & thus, restrict unbridled price rise in the market.

**iii) VAT discourages business firms to understate their income statement:**

The most important attribute of the system is to introduce a procedure under which business community will be encouraged to declare their entire commercial transactions. It will greatly help to bring financial activities of business community under statistics of the concerned authorities. It is essential not only from public revenue point of view but from many others. Under VAT system input tax is allowed for balancing with the tax collected on sales & thus business firms will not be tempted to understate their income statement in case, if some firms try to do so they need to be ready to sacrifice the facilities of deducting tax they pay on their purchase or import of taxable products.

**iv) VAT helps to control unauthorized trade:**

Application of the system allows registered vendors to offset tax pay on their purchase or import of taxable goods & services. But people involved in unauthorized trade will be required to treat the tax they pay as cost of their product since they are not permitted to offset the tax they pay on their purchase or import. This will make their goods costlier than the same products of other registered competitors. In addition, govt. organizations, entities under govt. authority, corporate bodies etc all by their requirements from registered vendor

only. So vendors who conduct their commercial activities without being registered under VAT regulations need to be deprived from opportunity to sell their products to such a huge market. So application of VAT system encourages businessmen to be registered with the concerned authority & conduct their commercial activities in an authorized way, people involved in unauthorized trade cannot produce authentic documents of their commercial transaction which are required under VAT arrangement. So vendors involved in unauthorized trade shall find themselves in an advantageous position if they quit from conducting unauthorized trade.

**v) VAT improves Mobilization of internal resources:**

It helps to augment collection of govt. revenue, check revenue leakage. Increased revenue means increased development activities in the country. It encourages export & helps to earn foreign convertible currency. It helps to increase employment opportunities in the country. It attempts to decrease financial inefficiency of application of tax system by removing cascading & pyramiding effects. Application of the system can help business community to decrease their selling price as decreased tax rattail pose lighter burden of tax on cost of their product. It does not increase inflation in economy of the country. It can assist to streamline income tax acts & remove away practice of guess work in tax assessment.

**VI) Superb System:**

In a product base tax system, applicable taxes shall be collected at source of transaction of a product. Transactions of the product carried out afterwards do not require levying tax. For example importers of taxable goods are required to deposit sales tax at boarder custom office. The importers or wholesalers of the good are not required to impose sales tax on their sales. So, if some importer manages to escape from paying tax at custom point, tax authority will be deprived of collecting tax on transaction of the product. Same is true incase of sales of manufactured goods. But under VAT system, applicable tax can not be evaded in such way because each stage of commercial transaction of a taxable product will be taxed subject to regulation. Due to this, the system is called the most efficient tax system developed so far.

## **2.7. Reasons for introduction of the VAT system:**

VAT is the most advance tax system in the world. Around 130 countries have introduced this system. The man reasons for implementing the system are that the system is less distortable &-more revenue generating. So Nepal also introduced this system since 16th November 1997. Some important reasons for implementing the system are as follow.

### **i) Widening tax net:**

One of the main problems in our economy is narrow tax net; Means to say only limited number of businessmen are required to pay tax. Rest huge number of businessman is not make required to pay tax under the existing tax system. Reason of such biasness is system of imposing tax on transactions conducted in production & import stages only so, govt. as compelled to realize required revenue from limited numbers of businessmen. In order to remove this, VAT regulation is introduced in out country which requires transactions performed at retail stage too pay tax. This will broaden the existing tax net of out country to an extraordinary level.

**ii) Development of the country:**

Speed of development of other countries of world is very fast. The govt. of Nepal too, needs to keep pace with them. For this government had to increase her activities in various field in massive scale. In addition, the govt. needs to outlay massive funds for infrastructure development of the country. In one hand prevailing circumstances is such on the other hand internal resources of the country is so limited that it is hardly sufficient to meet even regular expenses of the country. So, it is utmost important that the government recomposes existing structure of taxation of the country in order to realize more & more revenue to the govt. & control tax evasion. In such situation, introduction of VAT system is only one viable solutions in the hand of govt.

**iii) Economic growth of the country:**

It is the most important objective of govt. of Nepal. Increased tax net enables govt. to reduce rate of taxes including import duty which will ultimately increase competitiveness of economy of the country as the lower tax rates decrease burden of tax on goods & services. Domestic products will substitute goods imported from foreign countries in one hand on the other hand export to align countries too can be increased. Such phenomenon pushes economy of the country to a height beyond imagination.

**iv) Fairer tax system:**

Existing product base tax system tempts businessmen to initial all sorts of malpractice in their business transactions leading to various problem is society. It is because that people who indulge in such practice will be in delusion that that they are in advantageous position in many ways than the other who can not do us they do, VAT system helps to eliminate all such condemnable things. The system requires all concerned to function on the basis of actual accounts of their economic activities in a transparent manner. And ultimately whole economy of the country will be based on the true & actual accounts of business transactions. The system initiate businessmen & concerned official for face play in the economy.

**v) Reduce foreign dependencies:**

Our economy is in a disgraceful state we are heavily dependent to run our economy & day to day administration of the country upon foreign loans, aids, grants etc. we have been loitered in foreign debts & aids previously because we found it easier than to trace out solution of our problems from our own. But after reestablishment of democracy, things have changed much in many ways.

Now a days we prefer to live on our own as far as possible / practical, though is not easy than to spread palms before foreign friends. Our Friendly nations are also advising to mobilize our internal resources in a better way & to bring timely reforms in administration of the govt. revenue and they are also assisting us technically & financially in these area. Replacement of earlier base tax systems by VAT system is a very good decision of govt. This system will help us to decrease gradually our dependency to foreign aids & loans.

**vi) Justification for tax payment:**

Vibrant social systems & equitable and peaceful society are dreams of an democratic govt. in today's world In order to fulfill that some of ways is to levy tax on addition of wealth of any person in the country in an efficient manner & spend the money for keeping the society live & peaceful so that the people who pay tax can earn more & more money by doing business in the society.

Maintain peace & security in the society so that wealth earned by doing business is secured there. Check all sorts of malpractices in business so that irregularity & gap between rich & poor is thin in society. Since traditional tax system are not effective enough for that VAT system can be great help in this regard. So it is implemented in our country.

**vii) Others:**

Govt. revenue of Nepal is heavily dependent on import duty. Liberalized economy of neighboring country costs negative impact on duty. Besides, complications & inefficiencies of existing tax systems necessitates the govt. implement VAT. In fact, implementation of the system is the sustainable source of the govt. revenue.

## **2.8. Basic features of Nepalese VAT system:**

While Nepal has adopted a conventional VAT similar to that implemented over 130 countries ground the world, it has injected some special features into VAT system to make it uniquely Nepalese. Some of them are as follow.

- i) It has adopted consumption type of VAT
- ii) The commutation of VAT is tax credit method.
- iii) Followed the principle of destination.
- iv) There is provision of exemption & Zero rate goods & services.
- v) There is the application of VAT to all business through the retail stages i.e. broad base,
- vi) "There is allowance of tax credit for taxable supplies including the Zero rate supply.
- vii) There is facility of tax refund. viii) Tax rate is 13 percent. ix) The level of threshold is Rs, 2 million.

## **2.9 Structure of VAT**

### **❖ Rate and Coverage**

Coverage of VAT is major issue while designing a VAT structure. The coverage of VAT includes both forward and backward coverage-the coverage of retail traders at one extreme, and of farmers, fishermen and the like at the other. Thus, the coverage of VAT may be defined with reference to both taxable transactions and taxable persons taxable transactions are defined broadly as suppliers made by the persons engaged in business activities. Taxable persons are those who independently engage in supplying the taxable goods and services including imports.

In Nepal, VAT is levied on all types of goods and services, both imported and domestically produced, except those specifically exempted by law and it is extended right thorough to the retail level. So, value added at each stage by each firms in the

process of production and distribution is subject to the taxable amount. However, small vendors whose annual transaction is below the registration threshold irrespective of their place in the production and distribution chain-are not required to register for VAT and hence the tax will not be levied to goods and services sold by the corresponding vendor.

Nepalese VAT is subjected to a standard rate of 13 percent, however a few transactions or goods and services are zero-rated and some are exemption from VAT.

### ❖ **Exemption**

Exemption simply suggests to an exclusion of a certain kinds of business transaction or a person from the tax net. If the objective of the government is to make me vendor free from the responsibility for registering and paying tax, but to keep some tax on the final purchaser, exemption is a suitable measure. If it is desirable to keep certain goods or services or transactions outside the tax net, then they should be exempt from VAT, exempt transactions are not subject to tax out no credit is allowed for tax paid on inputs. Exemption, thus, implies tile exclusion of certain goods and services from the tax jurisdiction. For example, if exports are exempt, exporters are not required to register under VAT. They do not need to collect VAT on their output and cannot claim for input tax credit.

Exemption of goods and services are granted on different grounds. Goods and services of basic needs are exempted on the ground of social welfare to maintain the equity norms. Similarly, some goods and services are exempted with the view of administrative simplicity. It is better not to bring the unorganized small vendors and scattered business firms into VAT. Again, the exemption technique is applied for selected goods and services to encourage their investment and hence production.

In Nepal, several goods and services are exempt from VAT. Exemptions are granted particularly on administrative and social ground. The list of exempted goods and services from VAT is presented below:

- Basic agriculture products

- Goods of basic needs
- Live animals and animal products agriculture inputs
- Medicine, Medical and similar health services
- Education
- Books, New papers etc.
- Artistic and cultural goods and services, carving services
- Personal or professional services
- Other goods and services
- Land and building
- Betting, Casinos. Lotteries (Detailed in Appendix II)

#### ❖ **Zero Rating**

Nepalese VAT is subjected to a Standard rate of 13 percent, however a few transactions or goods and services are zero-rated. Zero-rating simply means that some selected items are subject to tax but at a zero percent rate. If the objective is to free certain goods and services or transactions completely from the burden of VAT, it is desirable to zero -rate them. For example, if exports are zero-rated, exporters are required to register and comply with VAT. They collect VAT on exports at the rate of zero-percent, meaning that they do not collect any *tax* on exports but can claim for input tax. thus further means that exports do not bear any element of VAT. That's why zero-rating applies only to exports and certain export-related activities. This technique has been used commonly in European Union (EU) and other developing countries.

Nepal has taken care to relieve exports from the burden of taxation. Since the common worldwide method to relieve exports from the burden of VAT is to apply a zero-rate to them, Nepal has also zero rate the exports goods and services.

- Goods and services purchased or imported

- Exports of goods
- Exports of services
- Imports of goods and services by accredited diplomats-detailed in (Appendix II)

#### ❖ **Threshold**

Small vendors having an annual turnover upto certain amount are not required to register under VAT. The amount fixed for this purpose is known as threshold. Relating to simplification of VAT administration, Nepal has provided a threshold level even for taxable supply. A threshold would keep off traders from VAT who sell below the prescribed level. A threshold applies to taxable supply and there is an option to register voluntarily in VAT. Anyone selling below a level of threshold, it gets into VAT voluntarily, he/she would be getting a treatment equal to other registered tax payers.

A threshold is provided because the compliance costs of the small business as a percentage of sales are proportionately much higher than the compliance cost of large business. Similarly, the administrative cost of collecting VAT from small traders is relatively high in relation to the additional revenue raised from them. Besides these, the level of threshold is fixed taking into account such factors like revenue requirements, administrative capacity and so on.

In Nepal, the existing level of threshold is Rs. 2 million. Also, importers having commercial imports less than Rs. 2,00,000 annually or less than Rs. 10,000 at a time are not required to register.

#### ❖ **Taxable Supply**

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

### ❖ **Place of Supply**

Under the Nepalese VAT system, the following place are considered as the place of supply:

For movable goods, the place where the goods were sold or transferred

- For immovable goods, the place where the goods are located.
- For the imported goods, the customs points of Nepal where the goods first enter into Nepal.
- For the goods supplied by producer or vendor to himself, the place where
- The producer or vendor of the goods resides. " For services, the place where the benefit from service is received.

### ❖ **Time of Supply**

The time of supply is also important under VAT in order to establish the VAT liability. For most of the practical purposes, the time of supply will be the date of invoice. However under the Nepalese VAT, the time of supply will be that one, which happens earlier among the followings:

- The time of issue of an invoice by the supplier.
- The time, when the supplier receives the payment for goods and services
- In case of the goods, the time when the receiver receive or take away, the goods from the transaction place of the supplier.
- In case of the services, the time when the services are performed. However, for the certain good and services, the following special provision are made:
- The time of supply for regularly provided services such as telephone and similar other public service is that time when an invoice is issued for the service provided.
- If UK payment for goods and services is partially made, the earliest day on which the payment is made.

- In case of the goods or services having no tax credit facility, the time when the goods or services are used.

Among the above two conditions, if two or more occur at the same time, the time of supply is objectively determined by the director.

#### ❖ **Taxable Value**

Taxable value is a subject in which VAT is levied. A taxable value of any transaction is the total price charged by the seller, but it does not include the VAT itself. If there are any price adjustments such as discounts or rebates at the time of the sale, they are taken into account while calculating the taxable value. If the adjustment is essential after the sale, it needs to be made in subsequent determination of the tax or credits. The taxable value of a transaction is the price paid by the recipient to the supplier, provided that the supplier and recipient are independent of each other. The supplier should include all the expenditures borne by him while supplying the goods or services in the price.

If the goods are imported, the taxable value is the sum of import value, freight, transport costs, insurance, commission, import duties plus any other charges paid by the importer. If the transaction is between associated persons, or goods being exchanged or bartered, or at any time when the value declared is lower than the prevailing market value, the taxable value of the transaction shall be the market value of the goods or services. Such market value shall be taken as the consideration in money agreed between independent sellers and buyers for the supply of goods or services. In case of the goods, which have already been used, the taxable value is calculated by subtracting the purchase value from the sales value. If a tax officer is not satisfied that the declared value is significantly below the market value, he may determine the value of the disputed transaction to the best of his ability.

## **2.10 Operation of VAT**

#### ❖ **Registration**

The first step towards VAT operation is registration of vendors who are legal taxpayers. Suppliers of taxable goods and services are required to register under the VAT act to collect this tax. In other words, all vendors carrying on taxable business

must be required to register for VAT. However, the vendors having the transaction of only exempted goods and services, or falling below the registration threshold are not required to register in VAT system. But, vendors falling below the registration threshold can register voluntarily. Like other registered vendors, small vendors, who are registered voluntarily, will be able to claim back input tax paid on their purchase to collect on their sales and to hold the collected tax until its payment to the concerned tax offices.

The existing threshold limit of Nepalese VAT is Rs. 2 million. The importers having the annual volume of imports below 2 million remain beyond the tax net and so are not required to register. If any vendor is supplying mixed goods and services i.e. taxable as well as non taxable goods and services, he will have to register only when the transaction of taxable supply exceeds Rs. 2 million.

However, vendors having annual turnover below the registration threshold can register voluntarily. Group registration is not allowed under Nepalese VAT. Similarly, there is not necessary to register the branch or division of any producer or distributor. VAT liability collected by such branches or divisions are calculated along with the head. Nepalese VAT follows the following registration procedures:

- ) Fill in VAT registration application form.
- ) In case of partnership, fill also next form designed for partnership firms.
- ) Attach it with the copies of business and income tax registration certificates,
- ) Submit it to the concerned VAT office so that office gives a temporary certificate and allocates Taxpayer Identification Number (TPIN) and forwards the details to the VAT department.
- ) By processing the information, VAT department prepares a VAT certificate with TPIN and provides it to the concerned taxpayer through the corresponding VAT office.
- ) Taxpayer has to display the original certificate at main place of his transaction and certified copies at other places so that intended person can see easily.

- ) In the process, taxpayer has to furnish information within 15 day in case of changes in the information mentioned in the VAT application form.
- ) Every taxpayers is required to mention the TPIN is the following documents;
  - ) Tax invoice/ abbreviated invoice o Purchase and sales book
  - ) Documents for the correspondence to the VAT office. o Documents relating to income tax o Documents relating to customs duties, and o Documents relating to obtain a loan from a bank or any financial institution exceeding Rs. 1,00,000.
- ) The tax payer has to furnish information within 15 days, in case of change in the information maintained in the VAT application form.
- ) De-registration

A VAT registered firm can apply for de-registration under the following Conditions:

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

However, if the firms have already been taken the tax credit facility, tax would be determined on the stock including capital equipment and demanded to pay the VAT office.

## ❖ Invoicing

Invoices are the initial documents for VAT control and are most essential under VAT system. Every registered producer or vendor is required to issue an invoice for each taxable sale. There are two types of invoices: tax invoices and abbreviated invoices.

### **Tax invoice**

Tax invoice establishes both the liability of the supplier and the amount of the deduction allowed to the registered purchaser- A VAT registrant is required to issue a tax invoice in the prescribed form whenever a transaction takes place. A tax invoice should be issued by VAT taxpayers and contains the following information:

- ) A sequential identifying number
- ) The data of the transaction
- ) The data of issue of the invoice, if it is different from the date of the transaction.
- ) The name, address and TPIN of the vender.
- ) The name, address and TPIN of the buyer, if registered
- ) The type of transaction (e.g. sale. hire. render)
- ) A description sufficient to identify the goods and services supplied-
- ) The quality of the goods or the extent of services for corresponding description.
- ) The rate of VAT and the amount of payable, excluding VAT, for each description of goods and services.
- ) The value of any goods or services provided in part exchange.
- ) The total amount payable, excluding VAT.
- ) The rate and amount, if any discount offered.

- ) The total amount of tax charged.
- ) The total amount charged including VAT.

A minimum of three copies of each invoice is essential. The original copy must be given to the buyers and remains two copies must retain by the vendor. These copies must be available at any reasonable times for inspection by a tax officer. The invoices must be issued in a sequential numerical order. However, invoices can be prepared with different serial numbers for branches or different sections with prior approval of the VAT office. (Such as restaurants, bars, laundry etc. in case of Hotel).

### **Abbreviated Invoice**

This is simple type of invoice for registered sales to unregistered persons, who should be considered final consumer under the VAT system. VAT registrants may make an application to use an abbreviated invoice and the tax office may allow its use subject to the following conditions:

"The recipient of goods or services for which an abbreviated invoice is used shall not be entitled to input tax credit on that purchase.

- ) The abbreviated invoice shall not be used for transactions exceeding Rs. 5,000, including VAT.
- ) The registered person must keep a daily record of sales.
- ) Any bill rolls or cash rolls used by the retailer must be totaled daily and retained for inspection at any reasonable time.
- ) The following information must be recorded on the abbreviated invoice:
  - ) An identifying number issued in sequential order.
  - ) The name, address and registration number of the vendor.
  - ) The data of transaction
  - ) A sufficient description to identify the goods or services supplied.
  - ) The total amount of money paid, including VAT.

- ) In case of sales made under the abbreviated invoice, VAT is calculated by multiplying the sales by the VAT quotient.
- ) The VAT quotient is found by dividing the rate of VAT by 100 plus the rate of VAT.

#### ❖ **Books of Account**

Every VAT registrant requires to keep records of all the invoices either received or issued, including the serial number and date of issue. In general, VAT liability is determined on the basis of the accounts kept by the taxpayer himself. The records should be kept in such a way that VAT authorities are able to check the accuracy of the VAT returns. Such records are kept for fairly long time generally 4 to 6 years. In general, accounts must be maintained on the accrual basis. VAT liability should be calculated accordingly. This is because if it is levied only on the cash basis, taxpayers might delay payment. VAT registrants are required to maintain purchase and sales books and its list of all the sales and purchases in the corresponding book. They are also required to prepare for a VAT account.

#### **Purchase book**

VAT registrants are required to maintain an account of their business purchases for VAT purpose. Purchase book refers to the account of the VAT registrant/which includes all the transaction for business purchases. The record must be kept on the basis of invoices. At the end of each accounting period, the VAT registrant must total the amount of taxable purchases/imports, tax-exempt purchases/ imports and tax paid on purchases/ imports.

#### **Sales Book**

Similarly, VAT registrants are also required to maintain an account of their sales for VAT purposes. Sales book is also an invoice-based account. At the end of each accounting period, VAT registrants needs to total the taxable amount (standard and zero-rated) and tax exempt sales they have made in that period and tax collected on sales. If they make both taxable and tax exempt purchases and sales, they are then required to calculate the proportion of input tax they are entitled to the tax period.

## **VAT Account**

VAT registrants are also required to maintain the VAT account. It is a monthly summary of taxable purchases and sales and VAT paid on purchases and changed on sales.

## **Others**

VAT registrants can maintain their business accounts on computer with a prior approval of the VAT administration. VAT registrants must take their accounts available to the VAT officer for inspection at all reasonable times. In most instances, they will be produced at the VAT registrant's premises, but their production can be demanded at any place. The VAT officer may take possession of accounts at any reasonable time and they may be removed, copied or taken possession of, as necessary. VAT registrants are required to retain all the documents and accounts to their business for a period of six years. The VAT registrants require to use the purchase and sales books verified by the tax officers. However, the VAT officers need to verify purchase and sales books in the following cases:

- When the tax payer apply to verify the purchase and sales book in the office.
- In the period of tax auditing or checking.
- In the period of supervision.

## **Debit Note and Credit Note**

If a registered person needs to issue credit or debit note because of the change in price of the supplied goods and services, the note must be prepared by writing debit or credit clearly. Further, such debit or credit note must include the following:

- Serial number.
- Date of issue.
- Name, address and registration number of supplier.
- Name, address and registration number of the recipient, if registered

- Number and date of tax invoice related to the transaction
- Description of goods or services and reason for credit and debit
- The amount of debit or credit

Thus, prepared debit or credit notice must be totaled monthly by tax payers.

### ❖ **Submission of Return**

In the Nepalese VAT system, taxpayers must complete a VAT return and submit their returns to the concerned VAT office within 25 days following the end of the accounting period. This is for the use of compulsory registrants; and four months for voluntary registrants. This means compulsory registrants are required to submit returns every month while voluntary registrants have to submit a return for a period of four months. The head office is required to submit tax returns for the transaction carried out by its branches and subbranches, if any. There is no special rules, for example for seasonal business or others. Even if there is no transaction, it is necessary to submit a zero-return.

On receipt of VAT return, the tax officer is required to examine, the return and check for arithmetical accuracy. If this confirms that the amount shown as payable and other particulars on the return are correct, the return is to be accepted. Returns could show a debit, credit or zero. There is no need to attach purchase and sales invoices or any other documents relating to the tax with the returns. Debit returns are those returns where tax payers have to pay tax to the government. Such a situation occurs when the tax collected by a taxpayer on his sales (output tax) is higher than the tax paid by a taxpayer on his purchases (input tax). Since generally, sales are higher than purchases, most returns are expected to show debit. Credit returns are those where taxpayers have a negative tax liability i.e. where the government owes money to the taxpayers.

Such a situation may arise when the input tax is higher than output tax. This situation may arise when taxpayers build-up their inventory or when output are

zero-rated, such as exports. It is not unnatural to expect some credit returns under the VAT system. Zero returns are also possible. This happens when a taxpayer's input taxes and output taxes are equal- Taxpayers are required to submit zero return even if there were no transactions in a tax period. If a taxpayers does not submit a return within the stipulated time, he will be subject to penalty of 0.05% of payable tax per day or Rs. 500, whichever is higher.

#### ❖ **Payment of Tax**

In the Nepalese VAT system. Every VAT registrant having output tax liability greater than the input tax credit, is required to remit the difference to the government within 25 days from the close of the month in which the tax liability occurred. Compulsory registrants have to pay tax every month while voluntary registrant will have to pay on trimestral basis. There are some circumstances that are beyond the control of a taxpayers which can prevent paying tax due within the prescribed time. These include natural disaster such as floods and other unfortunate circumstances such as fire or death in the family. Under such circumstances, the law grants the authority to the Director General to .waive the payment of the penalty. On the other hand, if the input tax credit exceeds the output tax liability, the balance of credit is to be carried forward for the next month. However, a VAT registrant who have more than 50% of his sales as exports, can apply for refund instead of carry forward of the excess credit.

The provision for the additional charges has been made under the VAT Act as late payment penalties. The rate of such penalty is 10 percent of the VAT payable in the first month, an additional 10 percent in the second month and then no further action. There is also a provision for interest on nonpayment, the current rate of interest is 15 percent. Interest on overdue is charged on a calendar month basis. However, such interest will not be less than 120 percent of the average interest changed by Banijya bank of the period.

#### ❖ **Tax Assessment**

VAT is self-assessed tax. Taxpayers determine their tax liability themselves and pay tax. Tax assessment is a process of determining the amount of tax, any individual or company is liable to pay. This may be done by either two ways. One is that the taxpayers make tax returns, listing their income from various sources and any

facts affecting their entitlement to tax allowances and then tax authorities make the actual assessment. The alternative method is self assessment: besides supplying information on their income and entertainment to allowances, a taxpayers produce their own assessments applying die tax rules to their own figures. Then assessments are checked by the tax authorities. However, not all the VAT registrants many file their return and pay the tax within the specific time. Similarly, not all the taxpayers many file the correct returns and pay the correct amount of tax. There could be different situation regarding the improper tax assessment which are as follows.

- Tax return is not filed,
- Tax return is late,
- Tax *return* is incomplete; or
- Tax administration has significant reason to believe the tax liability is otherwise than as declared.

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

### **Computer Assessment:**

If a taxpayer does not assess his income himself and does not file his return within the specified time, he is termed as non-filer. The computer prints out the list of non-filers after 45 days of the expiry of the tax period and then VAT office gives notice to each non-filer. If they do not file return within the specified period even after the issue of the notice of non-filer, the computer makes a monthly or trimestral assessment, depending upon the state of a particular taxpayer. 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 12 months from the VAT payable.
- b. If a taxpayer has not filed any return, find the turnover amount stated on the registration application. Divide this by the number of filling periods or filling periods in the year then multiply by the VAT rate.
- c. Pick the highest figure in a or b.

d. Add the amount found in (c) to the 20 percent or 30 percent of itself to get the assessment amount.

### **Management Assessment:**

The tax officers do management assessment when a taxpayer receives updated information after submitting his returns and informs it to the tax officers or in the case of those taxpayers where tax officers find errors during the tax audit. The management assessment is done through the following procedures:

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

### **❖ Collection of VAT**

The VAT administration collects tax dues through the following methods:

- ) Tax officers are empowered to recover tax dues from the credit in a VAT debtor's account.
- ) Tax officers can also issue to a third party who is indebted to the VAT debtors, a demand for the payment of the money owing by third party to the VAT debtor.
- ) Tax officers can also authorize to suspend the transaction of a VAT debtor.
- ) Tax officers can also withhold the export/import of a VAT debtor.
- ) Tax dues can also be realized by seizing and selling the property of the VAT debtor.
- ) Tax officers can collect tax arrears within 6 years of their establishment but due cannot be collected after that period of the tax due determination.

### ❖ **Tax Credit**

Tax credits is an important element/characteristic of VAT system, is given differently on various situations:

#### Tax credit on Taxable supply

Under this system, VAT registrants having taxable supplies including the zero rated supplies are entitled to claim input tax credit. It is allowed to those purchase goods and services sold in taxable transactions. Small vendors falling below the registration threshold and not registered for VAT neither requires to pay VAT on their purchases nor can claim an input tax credit. Input tax credit is allowed only when the following requirements are fulfilled;

- ) The goods and services supplied to the VAT registrants must be solely for use in his business of making taxable sales.
- ) The registrant must hold and be able to produce a valid tax invoice for the goods and services for which credit is desired.
- ) The claim for deduction must be made within one year of date invoice

#### **Tax credit on mixed supply**

A person involved in mixed transaction i.e. both taxable and tax exempt transaction is entitled to claim input tax credit in on the purchases related to tax exempted sales, but not to purchases related to his exempt sales. Only the purchases, for which VAT registrant can identify as being for taxable sales, will be subject to the tax credit. The purchases of basic requirements such as diesel, telephone charge, stationary, etc may be used jointly for both taxable and exempted sales. In such purchases, a registrant can claim a proportion of his input tax based on the proportion of the taxable sales to the total sales.

#### **Partial Credit**

Some goods are used for both the purpose of the business and personal use. In such cases, it is very difficult to ascertain the proportion used in the taxable and tax exempt transactions. These includes such items as computers and cars. In these cases, only partial input tax credit can be taken. For example, 40 percent of

input tax credit may be claimed on aero planes and automobiles and 60 percent may be claimed on computers.

### **No Credit**

With certain goods and services, it is very difficult to ascertain whether they have been used for the purpose of the business or for personal use. These include such items as business entertainment, beverages, alcohol or alcoholmixed beverages such as liquor and beer and light petroleum fuel for vehicles. In this cases no input tax credit can be taken.

### **❖ Tax Refund**

Under the Nepalese VAT system, there is a provision for the refund of VAT. Such situation generally arise in the case of zero-rated supplies such as exports. This is because exporters of taxable goods do not have to collect tax on their exports but are entitled to claim tax paid on the inputs of exports. Refund may arise in other situation/cases also.

### **Refund to Exporters**

A VAT act provides 'immediate refund for exports. Since exports sales are zero rated, there is no tax due on such sales. This means that exporters are most likely to have large excess credit. A person is defined as an exporter for any month if his export sales for that month are more than 60% of total sales. An exporter may make an application for refund of VAT to the concerned VAT office. This office will process the refund of VAT to the concerned VAT office. This office will process the refund claim and forward it to the VAT refund section of the VAT department for the final approval and issuance of cheques.

### **Refund to Non-exporters**

There is also situation where it will be necessary to refund in the case of registrant who is non-exporter. A registrant may have excess credit even if he is not an exporter. In this case, he can carry forward his excess credit. He can claim for a refund if he has excess credits for a continuous period of 6 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 offices. After being processed, refund applications are to be forwarded to the VAT refund section of the VAT department that is fund section of the VAT department that is responsible for approval and issuance of cheques.

### **Refund to Diplomats etc.**

Refund is also provided to the accredited diplomats on reciprocal basis. In the case of importation, they do not have to pay tax since their imports are zero-rated. In the case of domestic products, they have to pay VAT first and claim for refund. Similarly, other officials of international organizations that are accredited by the Ministry of Finance also are entitled to claim for refund. Similarly, the projects which run under bilateral or multilateral agreements also enjoy this facility.

### **Other refunds**

Refunds are also provided on some situations where VAT may be collected by mistake, for example on a product that is either zero-rated or exempted. However, refund will not be provided if there is not an application attached with the necessary documents within a period of three years after the date of final account of the concerned transaction.

#### **❖ Penal Provisions**

Penal provisions have been made for any non-compliance, for example, a vendor will be required to pay liable tax plus upto Rs. 10,000 or 10 percent of payable tax, whichever is higher, if he fails to register before the commencement of his business. Penalty for non-issuance of invoice is Rs. 500 each time whereas the similar amount for the failure to keep the required information in account is upto Rs, 10,000 each time. Similarly, a taxpayer that has committed fraud or tax evasion will be charged with a penalty not exceeding 100 percent of the amount of tax, or six months jail or both.

#### **❖ Appeals**

A taxpayer may not always agree with the assessment made by the tax officer. In that case, he may appeal against such assessment. Such a provision has been made under various taxes. In the case of VAT, tax payer may file an appeal to the

revenue tribunal within 35 days against a tax assessment or a penalty order by a tax office or an order by the Director General relating to the suspension of his place transaction. However, before filing an appeal, the tax payers must deposit the disputed amount of the assessed tax due, the rest of the amount of tax due plus the win amount of the fine shall have to be deposited or a bank guarantee of the same has to be provided.

❖ **VAT Administration**

Administration means the management of affairs. Its organization should be strong and reached to the grass roots level so that the government policy and programme can be functioned to the people. The present VAT administration may be simplified into two functional heads as department and VAT offices. The VAT department and field offices under this department are responsible for administering VAT and excise. The VAT department is responsible for setting operational guidelines, program development and evaluation, design of forms and instructions, statistical analysis, budget development and resource allocation. The organizational structure of VAT administration is based on functional line. Sections and sub-sections have been created within each function. Large taxpayers, tax refund, services, tax audit and investigation, internal monitoring, collection and registration are important sections of VAT administration.

There are 22 VAT offices under VAT department, which are as follow:

**VAT offices under VAT department**

S.N.	Name of office	Place of office
1	IRO Bhadrapur	Bhadrapur
2	IRO Biratnagar	Biratnagar
3	IRO Dharana	Dharana
4	IRO Lahan	Lahan

5	IRO Janakpur	Janakpur
6	Big tax payer office	Harihar Bhawan
7	IRO Kathmandu 1	Bhabar Mahal
8	IRO Kathmandu 2	Babar Mahal
9	IRO Kathmandu 3	Lazimpat
10	IRO Lalitpur	Lalitpur
11	IRO Bhaktpur	Bhaktpur
12	IRO Hetauda	Hetauda
13	IRO Birgung	Birgunj
14	IRO Simara	Simara
15	IRO Bharatpur	Bharatpur
16	IRO Krishnanagar	Krishnanagar
17	IRO Pokhara	Pokhara
18	IRD Dang	Dang
19	IRO Nepalgunj	Nepalgunj
20	IRO Bhariahawa	Bhairahawa
21	IRO Dhangadi	Dhangadi
22	IRO Mahendra nagar	Mahendranagar

### 2.11 Review of related research works:

**Dahal (1995):** A high level task force headed by Dahal reviewed the Nepal's tax system in 1995. The report outlined the following reason to adopt VAT in Nepal.

- ) To broaden the tax base & to increase the tax revenue.
- ) To make the tax system transparent & elastic.
- ) To prevent tax evasion
- ) To encourage exports.

After Anahang the various aspects of tax structure & the position of me economy, *the* report finally recommended the following aspects to be incorporated before implementation of VAT is Nepal.

- ) A functional organization pattern.
- ) Development of effective tax refunds system.

- ) Measure to increase self compliance, tax payer services & tax education  
Computerization of the administration.

**Subedi (1997):** In studies concludes that VAT is applicable in Nepal on the sense of tax performance. In Nepal, VAT is desired to achieve the goals of neutrality, revenue productivity, fairness & transparency. From his view, VAT is found to be the best alternative to eliminate the existing inefficiencies of tax system. VAT would general more revenue with less distortion & will unify member of taxes producing very low amount of revenue because of its broad coverage. VAT being member of indirect taxes is regressive in nature utilizing income tax, special consumption tax & some exemption for equality goals, the focus of VAT should be on revenue generation in Nepal.

**Ghimire (1998):** In studies value added tax key issues in Nepal explain great importance *for* the effective implementation of VAT administrative capability in Nepal. Organizational structure, audit & inspection system, reward & punishment, political intervention, selection of skilled & experienced manpower are needed to improve for effective implementation of VAT. VAT is considered as a board based tax & potential advantages of it can be attained fully if the tax is extended through retail level. For the period of time, he suggested to improve following aspects

i) Administrative power & creditability ii) Identification of tax payer iii)

Registration iv) Educational programme v) Incentives for small traders:

He also finds some difficulties in implementation of VAT in Nepal such as rate structure, small traders in large proportion, lack of accounting records, illiteracy & high compliance cost etc. strong administration & educational programme, technical data base system, Combination of various revenue offices, high level of VAT implementation team etc are essential prerequisites of the successful implementation of VAT in Nepal.

**Paudel (1998),** did a research on the topic of "Value added tax in Nepalese context: its effectiveness in implementation 1998. In study, he focused the reform of the tax structure of Nepal was essential at that time. So, the new concept of value added system applied. The study say that the previous tax system was insufficient & loss productive which creates the problem of pyramiding & cascading as well as lack of transparency & neutrality. VAT is the best alternative for reducing such problems mentioned above. VAT also facilitate for income tax. This is the positive aspects of

VAT which are maintained in his research but there are many negative aspects of VAT according to him like weak administration bureaucracy & lack of cooperation, bad political environment, lack of education etc. In his research, the following findings are found:

- i. Nepali VAT administration is poor to design. That means there are lacks of trained & qualified manpower,
- ii. The tax payers are not conscious about VAT.
- iii. The business community are hesitating to come out on VAT net.
- iv. There are lots of misunderstanding between the govt. & the business community.
- v. The VAT rule is essential to change i.e. high rate in luxurious goods & low rate in essential goods.

**Dhakal (2000):** In this study, he analyses the different aspects of Nepalese VAT system being focused on revenue potentiality. The main objective of this research was to examine the historical background of the VAT, analyze Nepalese tax structure & estimate the potential of revenue yield from VAT. The major findings of the study are.

- a) Nepal has adopted the destination based consumption type VAT operated through the tax credit method.
- b) Nepal has followed the destination principle to adjust the international trade.
- c) The primary reason for growing popularity of VAT is its broad coverage without distorting economic efficiency.
- d) The stepwise collection of VAT discourages the evasion of VAT.
- e) VAT has somehow equity nature as compared to other kinds of sales tax.
- f) Due to administrative complexity as well as maintain the equity norms exemption & zero rating are principally purpose out such provision makes the tax base limited the recommendation of the study was.
- g) VAT should be extended through retails level as a bulk of tax performance to generate more revenue.

- h) The important sectors of VAT offices like tax refund, tax audit, tax payer's service investigation, return processing & registration should be separated for successful operation,
- i) Consumer should be make aware for taking invoice for every taxable
- j) purchase by comprehensive advertisement program.

**Upadhyay (2002):** In this study "Performance of VAT in Nepal" focuses on legal aspects of VAT and its development in Himalayan kingdom. He discussed about the general terminologies about the VAT and its functioning. The objective of the study to find out key issues regarding VAT in Nepal. VAT could be proved beneficial if certain key issues like invoicing, valuation, threshold, exemption & administration were taken into consideration. Unless these factors are considered, there will be no fruitful result.

**Pathak's (2004)** In this study, VAT system has a lot of challenges for the successful implementation of the VAT. There should be correction on traditional accounting system behavior of tax authority etc. He had recommended the following points for successful implementation of VAT in Nepal.

- a) Public awareness & publicity is very necessary.
- b) Department of VAT should be reorganized with the effective structure. Information network should be linked to every tax payer.
- c) Prize system should be given more priority to tax payers & consumers also.
- d) Open border must be controlled by strict security,
- e) VAT survey is needed for dragging the potential tax payers.

**Neupane (2005):** In this study, VAT as an internal source of resource mobilization in Nepal. He believes that VAT is the effective means to collect revenue. The basic objective of the study was to find out the actual collection of VAT & factors affecting collection of VAT. His study focuses on role & status of VAT in the total tax structure of Nepal estimation of potential revenue yield from VAT & examination of the growing resource gap in Nepalese economy. How VAT could be beneficial & helpful in solving out the growing need of revenue.

**Gautam (2006)** According to this study, VAT is a kind of indirect tax, which is found to be the best tax system for collecting the internal revenue for government.

But there are many problems in collecting the VAT amount like weak administration & its cross checking power, poor business transaction etc. For successful implementation to bring positive attitude towards VAT, following recommendations are given by him.

- i) Govt. has to improve administrative capabilities,
- ii) Govt. Should keep cooperative relationship with tax payers.
- iii) Special facilities & method of collecting revenue by VAT system should be changed according to changing environment.
- iv) The concept & method of collecting revenue by VAT system should be changed according to changing environment.
- v) Rules must be developed to quote price by the manufacturer inclusive of VAT on the product.

**Nepal (2007):** In this study "Revenue Generation from VAT in Nepal" he focused the VAT system on revenue generation. The main objective of this study to analyze the status of VAT registrants, analyze the composition of VAT revenue, analyze the applicability of VAT. The major findings of the study are:

- (a) Human resource that is needed in the tax system does not seem adequate in Nepalese context. This is main problem of tax authorities. IRD should give thrust for manpower development.
- (b) It is a crisis of confidence between the government and private sector. Without the close co-operation between two sectors VAT cannot be implemented effectively. It is necessary to cooperate the private sector with the government through the civil society, FNCCI and other different associations.
- (c) Good government should flow from top to bottom; inefficient and unproductive staff in the various tax offices should be replaced by highly qualified, professional staffs that have adequate training in revenue system.
- (d) Refund system should be made simple and effective and the period of such refund should be minimized.
- (e) VAT would be successful only if there is a perfect computerized system.
- (f) Open borders should be systematized to a greater extent.

**Shrestha (2008):** In this study "VAT implementation problems and its

Effectiveness in Nepalese Economy" focused on analyzed the implementation VAT in Nepalese tax structure and analyzed the problem faced by the government to collect VAT. She found that lack of clarities in the tax laws and regulation, unsatisfaction with VAT administration by tax payer, lack of awareness of VAT etc. She has recommended on the manpower of IRD and VAT office should be trained, efficient management effective monitoring system, publicity and taxpayer related Education should be organized should be made more easy and effective in order to refund the tax amount etc.

### **2.12 Research Gap**

About 11 years have already been passed since VAT came into operation but very few studies had undertaken on the topic of VAT in Nepalese context and most of the studies were related with theoretical aspect. In this study effort is made to evaluate effectiveness of VAT in Revenue collection in Nepal by identifying existing problems in Kathmandu city by conducting field survey.

## **CHAPTER III**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter is devoted to the research methodology applied in the study for the achievement of desired objective. Both primary as well as secondary sources of data are used to conduct this study. Opinion survey technique was adopted while collecting the primary data to find out the views of respondents representing different groups related to value adds tax. The empirical investigation was inducted to find out the practical aspect of VAT. While conducting the opinion survey, questionnaires were distributed to different group of people i.e. tax experts, tax administrations, businessman/traders and consumers.

#### **3.2 Research Design**

To achieve the specific objective of the study descriptive and analytical research has been carried in terms of effectiveness of VAT revenue collection in Nepal. For an empirical investigation, an opinion survey has been conducted. The opinions of the various 60 respondents associated with distinct groups. i.e. tax experts tax administrators, businessmen and consumers were collected through structured questionnaire.

Most of the materials of this study were concerned with past phenomena of the performance in numerical or theoretical terms. The study was oriented to:

##### **i. Analytical Research:**

In analytical research, the researcher used the facts and the information already available and analyses to make a critical evaluation of the materials. Analytical research had been carried out in terms of role of total tax revenue, income tax revenue and employment tax in the public revenue of Nepal.

##### **ii. Descriptive Research:**

Descriptive research includes survey and fact-finding enquiry of different kinds. It is concerned with finding of facts relating to the subject matter, obtaining important data and getting new areas of knowledge by describing them. Descriptive research has been carried out in the study of income tax and employment income.

### iii. Empirical Investigation:

Empirical investigation was conducted in respect of income tax collection, employment income's contribution to income tax revenue and effectiveness of income tax collection from employment income and other practical aspects of employment income.

To achieve the stated objectives of the study, opinions of 50 respondents were collected. Respondents are classified into tax-experts and employees. Questionnaires were sent to the respondents. The study was attempted to collect information regarding the share of employment tax to total income tax revenue, suggestions to increase its shares and aspects of employment income

### 3.3 Population and Sample

All the tax experts and employees in Nepal were considered as total population. Out of them, the experts and employees in Janakpurdham and other cities of Nepal considered as target sample. In order to benefit this study, 80 questionnaires were distributed but 60 responded to it so 60 sample size from Janakpur and Birgunj is selected by consulting with the experts, professors and judgment of researcher. The respondents have been divided into four groups. The following table shows the groups of respondent and the size of the samples.

**Table No. 3.1**

**Groups of Respondents and Size of Samples from each group**

<b>S.N.</b>	<b>Group of Repondents</b>	<b>Sample Size</b>
1	Tax Experts	15
2	Tax administrators	15
3	Business/Trades	15
4	Consumers	15
Total		60

### **3.4 Sources of Data**

According to the nature of study, the study requires primary as well as secondary data. Primary data has collected through a schedule of self-structured questions and interviews with concerned persons. Separate sets of questionnaires were used have options/information from four sample population. A set of questionnaire was developed and distributed to the selected respondents to get accurate and actual information. Secondary data were collected through annual report of IRD of different years, Economic survey of various years published by MOF, Nepal Rastra Bank's Economic Bulletin of Various time and Central Bureau of Statistics etc.

### **3.5 Method of Analysis**

Data obtained from the various sources can not be directly used in their original form. Further they need to be verified and simplified for the purpose of analysis. Data, information, figures and facts related to the study are checked rechecked, edited and tabulated for computation. According to the nature of data, they inserted in meaningful tables, which have shown in annexes, Homogeneous data are sorted in on table and various table have prepared in under stand able manner. Data were analyzed and interpreter using different types of analytical tools.

## **CHAPTER IV**

### **DATA PRESENTATION AND ANALYSIS**

This chapter is devoted to the presentation and analysis of the effectiveness of VAT in revenue collection in Nepal. To achieve the stated objective of the study and also to make easier to understand the findings, qualitative as well as quantitative data and information has been analyzed.

#### **4.1 Revenue structure of Nepal**

Modern economic planning of Nepal had started with the installation of first economic planning in 1956. Since then the taxes have been used the achievement of national economic goals. So, taxes play vital role to the economic development of Nepal. The money needed by the government can be collected from two sources i.e. debt and revenue. The debt can be external or internal debt. The revenue of government also comes from two sources i.e. non tax and tax. Non tax revenue includes grants, gifts, administration incomes, service charge, business incomes etc. and tax revenue includes customs, services, VAT, corporate and personal incomes taxes. The revenue of a country is the important internal resources. Contribution of tax revenue, non-tax revenue and the percentage description is presented below in the form of table and diagram.

**Table 4.1**  
**Revenue structure of Nepal**

*(Rs. in million)*

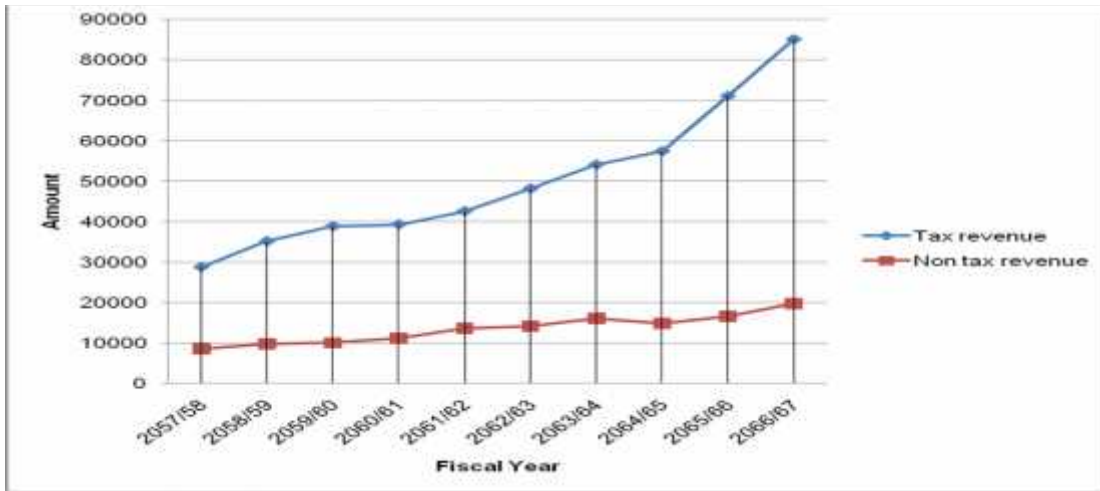
Fiscal year	Total revenue	Tax revenue		Non tax revenue	
		Amount	% as total	Amount	% as total
2057/58	37251.0	28752.9	77.19	8498.1	22.81
2058/59	42893.7	35152.2	77.29	9741.6	22.71
2059/60	48893.6	38865.0	79.24	10028.8	20.51
2060/61	50445.5	39330.6	77.97	11114.9	22.03
2061/62	56230.0	42587	75.74	13642.9	24.26
2062/63	62331.0	48173.0	77.29	14158.0	22.71
2063/64	70122.7	54104.7	77.16	16018.0	22.84
2064/65	72282.1	57430.4	79.45	14851.7	20.53
2065/66	87717.0	71127.0	81.09	16590.0	18.91
2066/67	107622.4	85155.4	79.12	19783.8	20.88

*Source: Economic survey of various years, MOF*

The composition of tax revenue and non tax revenue in total revenue structure has been shown in above table. It can be seen that revenue collection trend in increasing trend. Since the fiscal year 2057/58 to the fiscal year 2066/67 the revenue has increased from Rs. 37251 million to Rs. 107622.4 million. Similarly tax revenue as well as non tax revenue is also increasing trend. Total tax revenue has increased from Rs. 28752.9 million to Rs. 85155.4 million in fiscal year 2057/58 to 2066/67. It is the main source of revenue collection. It has contributed very much in national revenue. Similarly non tax revenue has also increased from 8498.41 million to 16018.0 million in two fiscal year 2057/2058 to 2063/2064. But decreased the fiscal year 2063/2064 to Rs. 14851.7 million. In the fiscal year 2065/2066 to 2066/2067 has also increased the non tax from 16890 to 19783.8 it has contributed less to national revenue.

**Figure No....1**

**Revenue structure of Nepal**



Above figure shows the increasing trend of total revenue as well as tax revenue. The contribution of tax revenue seems satisfactory but non tax revenue is not in increasing trend also. So in inclusion, tax revenue and non tax revenue of Nepal is not increased rapidly.

**❖ Tax revenue structure of Nepal**

Tax revenue is the main source of government revenue. Total tax revenue is divided broadly into direct tax revenue and indirect tax revenue. Direct tax revenue includes income tax, property tax, interest tax, gift tax, vehicle tax, expenditure tax, contract tax etc. whereas indirect tax revenue is composed of taxes like sales tax (VAT), entertainment tax, passenger tax, hotel tax , import tax, export tax, excise duty etc. The tax revenue composition and its collection are as below:

**Table No. 4.2****Tax revenue structure of Nepal***(Rs. in million)*

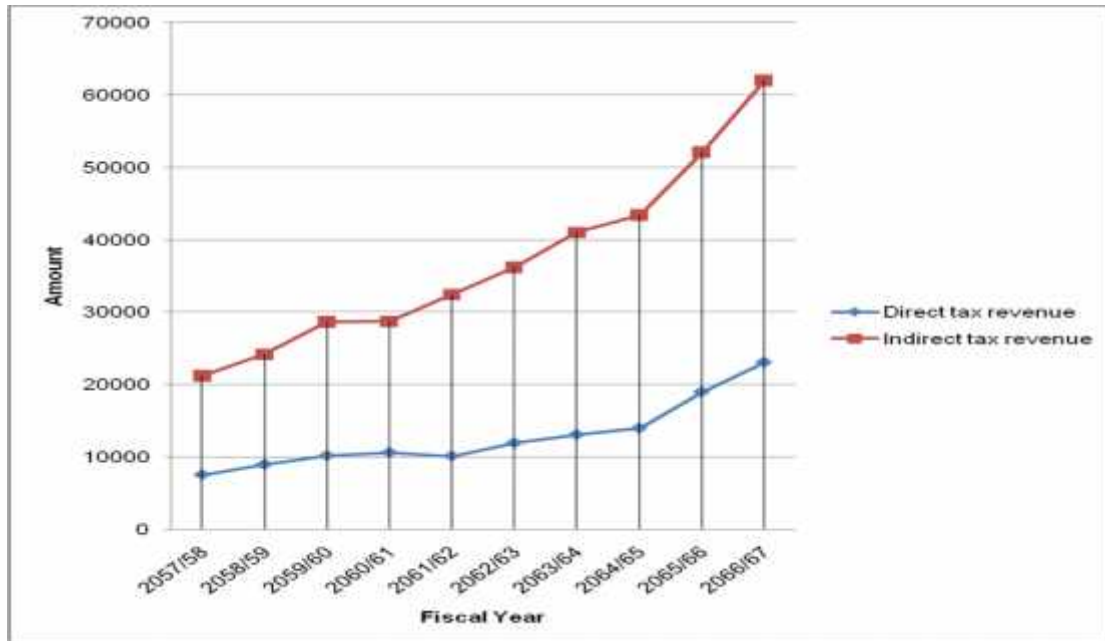
Fiscal year	Direct tax revenue		Indirect tax revenue		Total Revenue
	Amount	% as total	Amount	% as total	
2057/58	7516.1	26.14	21236.8	73.86	28752.9
2058/59	8951.5	27.00	24200.7	73.00	33152.20
2059/60	10159.4	26.14	28705.7	73.86	38865.10
2060/61	10597.5	26.94	28733.1	73.06	39330.06
2061/62	10105.7	23.73	32481.2	76.27	42586.9
2062/63	11912.6	24.73	36260.4	75.27	48173.0
2063/64	13071.8	24.16	41032.9	75.84	54104.7
2064/65	13968.1	24.32	43462.3	75.68	57430.4
2065/66	18980.5	26.69	52146.5	73.31	71127.0
2066/67	23087.7	27.11	62067.7	72.79	85155.4

Source: Economic survey of various years, MOF.

The table shows increasing trend of total tax revenue as well as its component i.e. direct and indirect tax. Direct tax has increased from 7516.1 million to Rs. 23087.7 million from the fiscal year 2057/2058 to fiscal year 2066/2067. Similarly indirect tax has also increased from Rs. 62067.7 million from the fiscal year 2057/2058 to the fiscal year 2066/2067. The maximum contribution made by direct tax on total tax, revenue is 27.11 in the fiscal year 2066/2067 and indirect tax is 72.79 in the fiscal year 2061/2062. The increasing trend of direct tax revenue is constraint then indirect tax revenue. Indirect tax revenue increasing trend is much fluctuated then direct tax revenue.

Figure No.....2

**Tax revenue structure of Nepal**



The above data can be shown is trend diagram which is as follows.

Above figure shows that indirect tax is increasing since 2057/2058 to the year 2066/2067. But direct tax has increased till year 2060/2061 and decreased in the fiscal year 2061/2062 and is in increasing trend. Indirect tax has maximum contribution to the total tax revenue of country.

In this way, Nepalese tax structure has heavily dominated by indirect tax. Direct tax has plays an important role in revenue collection and its best tax for revenue collection. Indirect tax has not generated in developed and underdeveloped countries. It is regarded as regressive in nature. So attention should be given in mobilizing additional financial resources through the direct tax.

**❖ Revenue collection from VAT**

As VAT is indirect tax, it contributes some portion in total revenue. The revenue from VAT is collected under the headings of tax on consumption and product of goods and services. VAT includes sales tax, entertainment tax, hotel tax, air flight tax and contact tax etc. The revenue collection from VAT in different fiscal year is presented in the table below.

**Table No. 4.3**  
**Revenue collection from VAT**

*(Rs. in million)*

Fiscal Year	Revenue Collection From VAT	Percentage Change %
2057/58	8765.9	-
2058/59	10259.7	17.04
2059/60	12382.4	20.69
2060/61	12267.3	-0.93
2061/62	13459.7	9.72
2062/63	14478.9	7.57
2063/64	18885.4	30.43
2064/65	21610.7	14.43
2065/66	26095.6	20.75
2066/67	31154.6	19.39

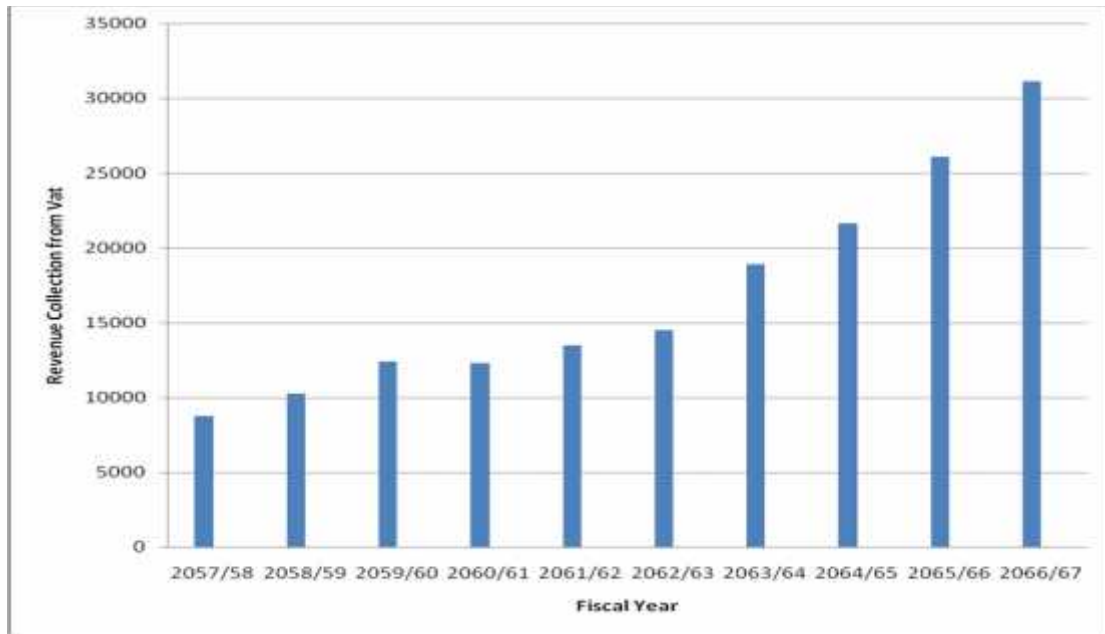
Source: Economic survey of various years, MOF.

Above table shows that amount of VAT has increased up to the fiscal year 2059/2060 and in the fiscal year 2060/2061 its collection decreased to Rs. 12267.3 million. Again after the fiscal year 2061/2062 is continuously increasing. In fiscal year 2066/2067 total tax Rs. 31154.6 million was collected. Regarding percentage change in amount, it is not same ratio in some year it has increased in higher percentage like in the year 2063/2064 i.e. 30.43% and in some year it has negative incensement in also like in year 2060/2061 i.e. 0.93%.

The data can be shown in trend diagram which are as follows:

**Figure No. ....3**

**Revenue collection from VAT**



Above figure also shows that except in the year 2059/2060 the revenue collection trend from VAT is in increasing trend. In the year 2063/2064 there is maximum increased in revenue collection by VAT.

This shows that VAT is getting popularity in our country.

**❖ Contribution of VAT to total revenue.**

Government revenue is collected mainly tax and non tax revenue, the direct tax and indirect tax revenues. The following table shows the contribution of VAT in total revenue.

**Table 4.4****Contribution of VAT to total revenue***(Rs. in million)*

Fiscal Year	Total Revenue	Revenue Collection From VAT	% of VAT revenue to total revenue
2057/58	37251	8765.9	23.53
2058/59	42893.7	10259.7	23.92
2059/60	48893.6	12382.4	25.32
2060/61	50445.5	12267.3	24.32
2061/62	56230.0	13459.7	23.94
2062/63	62331.0	14478.9	23.23
2063/64	70122.7	18885.4	26.93
2064/65	72282.1	21610.7	29.90
2065/66	87717.0	26095.6	29.75
2066/67	107622.4	31154.6	28.95

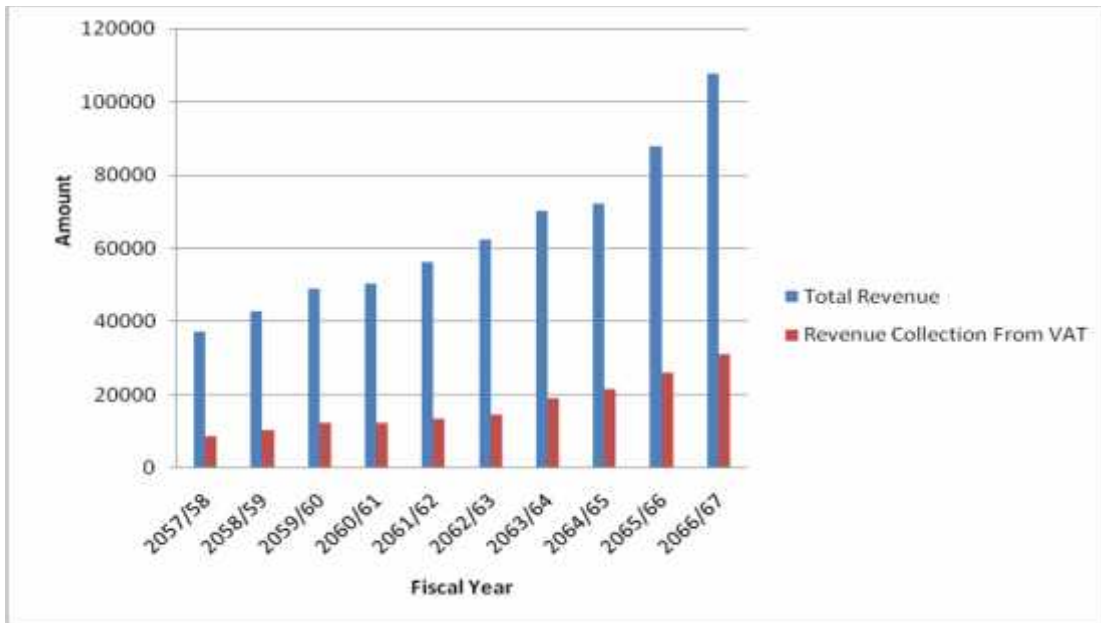
Source: Economic survey of various years, MOF

Above data shows that VAT has maximum contribution in the year 2064/2065 which is about 29.90 and maximum in the fiscal year 23.23%. So we can say that VAT contribution in total revenue collection is very low than other countries.

Above data can be shown in multiple bar diagram which is as follow:

**Figure No. ....4**

**Contribution of VAT to total revenue**



Above diagram shows that with the increase in the national revenue. VAT revenue is increasing only on difference is that sometime it is more and sometime it is less. In the year 2064/2065 there is maximum contribution of VAT revenue on total revenue in comparison to other fiscal year.

**❖ Contribution of VAT to total tax revenue.**

Tax revenue includes direct tax and indirect tax. VAT on indirect tax revenue. So, VAT will automatically contribute in the tax revenue, how much VAT has contributed to tax revenue is shown below.

**Table 4.5****Contribution of VAT to total tax revenue***(Rs. in million)*

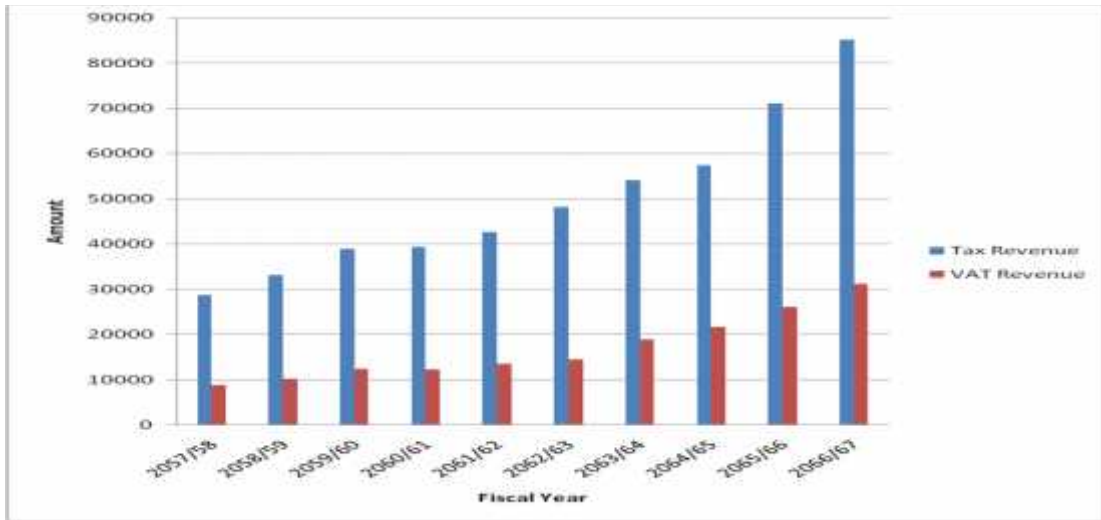
Fiscal Year	Tax Revenue	VAT Revenue	Percentage of VAT
2057/58	28752.9	8765.9	30.49
2058/59	33152.1	10259.7	30.95
2059/60	38865.1	12382.4	31.86
2060/61	39330.6	12267.3	31.19
2061/62	42587.0	13459.7	31.61
2062/63	48173.0	14478.9	30.06
2063/64	54104.7	18885.4	34.90
2064/65	57430.4	21610.7	37.63
2065/66	71127.0	26095.6	36.39
2066/67	85155.4	31154.6	36.58

Source: Economic survey of various years, MOF

Above table shows that there is maximum contribution of VAT revenue on tax revenue in the fiscal year 2064/2065 which is about 37.63% and minimum is the year 2062/2063. According to above data an average contribution of VAT on national revenue is about 33.20%. Above data can be shown in multiple bar diagram which is as follows:

**Figure No. ....5**

**Contribution of VAT to total tax revenue**



Above diagram shows that with the increase in tax revenue, VAT revenue is also increasing on except in the year 2060/2061, 2062/2063, 2065/2066, 2066/2067 where the percentage of share of VAT on tax revenue has not increased in comparison to previous fiscal years. There is the maximum contribution of VAT on tax revenue in the fiscal year 2064/2065.

**❖ Contribution of VAT to indirect tax revenue.**

Indirect tax includes customs, excise on industrial products and value added tax. So, VAT will automatically have certain percentage of share in indirect tax revenue. The percentage of contribution of VAT revenue to indirect tax revenue in different fiscal years of our country is as follows:

**Table No. 4.6****Contribution of VAT to indirect tax revenue.***(Rs. in million)*

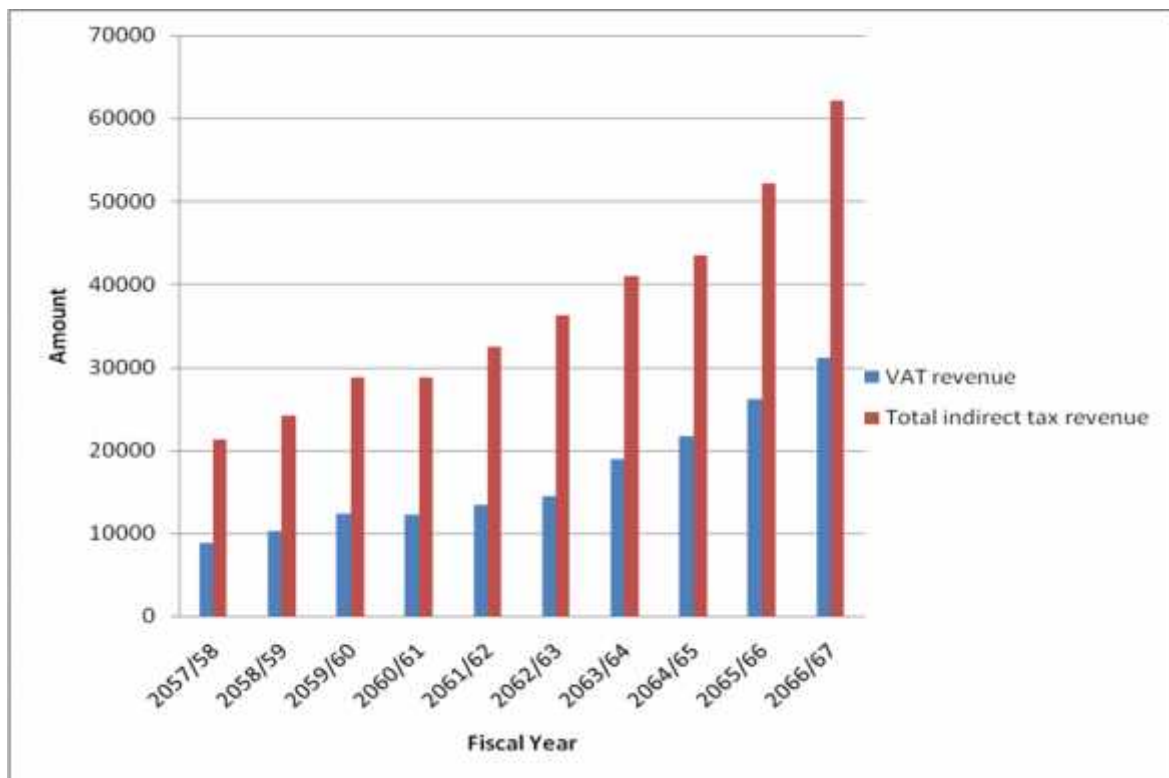
Fiscal Year	VAT revenue	Total indirect tax revenue	% of VAT
2057/58	8765.9	21236.8	41.28
2058/59	10259.7	24200.6	42.39
2059/60	12382.4	28705.7	43.14
2060/61	12267.3	28733.1	42.69
2061/62	13459.7	32481.2	41.44
2062/63	14478.9	36260.4	39.33
2063/64	18885.4	41032.9	46.02
2064/65	21610.7	43462.3	49.72
2065/66	26095.6	52146.5	50.04
2066/67	31154.6	62067.7	50.19

Source: Economic survey of various years, MOF

According to above table, there is maximum contribution of VAT in indirect tax revenue in the fiscal year 2065/2066 to 40% and minimum in the fiscal year 2062/2063 i.e. above 39.93. It shows that the contribution of VAT on indirect tax revenue is an average 44.68% i.e. VAT has contributed to indirect tax revenue by 44.68% even though VAT revenue is in increasing trend, its percentage of share on indirect tax revenue is not same. On showing the about data n multiple bar diagram, it seems as follows:

**Figure No.....6**

**Contribution of VAT to indirect tax revenue**



Above diagram shows the contribution of VAT on indirect tax revenue in different fiscal year. It shows that there is maximum contribution of VAT on indirect tax revenue in the fiscal year 2065/2066, with the increase in indirect tax.

### ❖ Contribution of VAT to GDP

The contribution of VAT in gross domestic production is presented in the following table:

**Table 4.7**  
**Contribution of VAT to GDP**

*(Rs. in million)*

Fiscal year	GDP	VAT revenue	% of VAT revenue
2057/58	330018	8765.9	2.65
2058/59	366251	10259.7	2.80
2059/60	413428.7	12382.4	2.99
2060/61	430396.6	12267.3	2.85
2061/62	460325.3	13459.7	2.92
2062/63	500699.1	14478.9	2.89
2063/64	548484.7	18885.4	3.44
2064/65	611088.5	21610.7	3.54
2065/66	675484.0	26095.6	3.86
2066/67	820814.0	31154.6	3.79

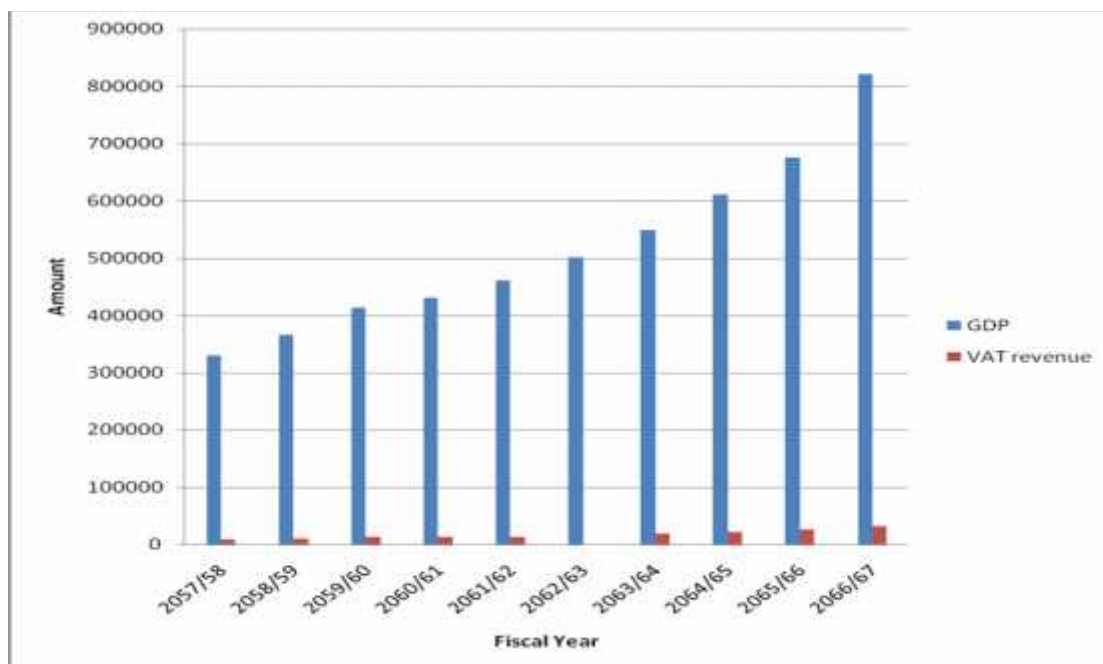
Source: Economic survey of various years, MOF.

From the above table it is clear that the percent of VAT revenue in GDP is nominal in Nepal. The VAT/GDP ratio was 2.65 in fiscal year 2057/2058 and such contribution never cross 3.86 during 10 years. In fiscal years 2060/2061, VAT contributed to GDP was only 2.85% and reached in 2.92% in fiscal year 2060/2061. After this year such contribution started to increased and reached 3.86% in fiscal year 2065/2066 but it was decreased in the fiscal year 2066/2067 VAT contribution to GDP only 3.79%.

On showing the about data n multiple bar diagram, it seems as follows:

**Figure No.....7**

**Contribution of VAT to GDP**



**4.2. Major findings from Secondary data**

VAT is the most advanced from indirect tax system; it is based upon same fact as like registration of firms, proper account keeping and billing system and so on. So it is very transparent in nature. The tax evasion is almost impossible if the proper mechanisms of VAT system are followed. After the presentation and analysis of secondary data collected as per the objective of this study; the following major findings are extracted.

- ) The revenue is collected as tax revenue and non tax revenue. From the fiscal year 2057/2058 to fiscal year 2066/2067 the total revenue is absolutely increasing. From the analysis of the trend of revenue of past 10 years, it can be conclude that the revenue is in increasing trend.
- ) The amount of tax revenue is also increasing throughout of the study period but the revenue from non tax revenue had decreased to Rs. 14851.7 million in the fiscal year 2064/2065. Besides this fiscal year the trend of non tax revenue is also increasing throughout the study period.
- ) The tax revenue includes direct tax revenue and indirect tax revenue. The portion of tax revenue is smaller than the portion of indirect tax revenue.

- ) During the study of ten years period i.e. from fiscal year 2057/2058 to 2066/2067, except in fiscal year 2060/2061 the amount of tax in the form of VAT has been increasing.
- ) During the study period in an average contribution of VAT revenue in total revenue is about 25.97%.
- ) The tax revenue is one of the major sources revenue of government. The average percentage of contribution in total tax revenue during the study period is above 33.20%.
- ) The contribution of VAT on indirect tax revenue is an average 44.68.
- ) The relationship between tax and GDP is known as VAT/GDP ratio. This is an indication of the utilization of taxes i.e. capacity. The VAT/GDP ratio is 2.65%, 2.80, 2.99, 2.85, 2.92, 2.89, 3.44, 3.54, 3.86 and 3.79 in the fiscal year 2057/2058, 2058/2059, 2059/2060, 2060/2061, 2061/2062, 2062/2063, 2063/2064, 2064/2065, 2065/2066, 2066/2067 and 2066/2067 respectively.

#### **4.3 Empirical Evaluation.**

Various empirical studies conducted before and after implement of VAT in Nepal. Many experts views that this system has been implemented effectively as expected. In the earlier period of VAT implementation, there was lack of skilled and trained manpower; administration structure wasn't set up properly. But currently different informative programs, seminars and meetings were held in order to give knowledge about VAT. As a result, now business community seems to be in flavor of VAT. All the traders having taxable capacity and include into the tax net. In such situation empirical study is done to know the views of different fields on different aspects of VAT.

For the purpose of survey questionnaire was prepared to know the opinion of the various person. The questionnaire was distributed to 80 respondents but only 60 respondents gave their views about it. The data collection from questionnaire and analysis of them are presented below in following way:

##### **❖ Views on VAT as an appropriate mean of raising the government revenue**

In the concept of Nepal where government expenditure is always increase the revenue collection is not increasing as required to finance the government

expenditure. It is necessary to know whether VAT is as appropriate means of raising fund or not in the views of it's of raising fund or not in the views of its appropriateness regarding its revenue collection can be shown in the following table.

**Table No.4.8**

**Views on VAT as an appropriate means of raising government revenue**

Respondents	Yes		No		Total
	Number	%	Number	%	
Tax experts	15	100	-	-	15
Tax officers	15	100	-	-	15
Businessmen	14	93.33	1	6.67	15
Consumers	13	86.67	2	13.33	15
Others	57	95	3	5	60

Source: Opinion survey.

From the study it is clear that almost all the respondent i.e. 95% respondents agreed that VAT as an appropriate means of raising government revenue. 100% of each of tax experts and tax offices,

93.33% business and 86.67% consumers take VAT as an appropriate means of raising government revenue where as 6.67% businessmen and 13.33% consumer viewed against the issue.

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

VAT has replaced four taxes such as sales tax, entertainment tax, hotel tax and contract tax. VAT a latest development of sales tax system is a new innovation in the field of taxation. VAT is being preferred by many countries of world is superior over sales tax and others. Because of effective revenue mobilization ability to tackle the all tax evasion wide tax base, transparent, VAT is considered superior to the areas it has replaced. The survey result on this aspect is summarized in the table below.

**Table No. 4.9**

**Views on superiority of VAT**

Respondents	Yes		No		Total
	Number	%	Number	%	
Tax experts	15	100	-	-	15
Tax officers	15	100	-	-	15
Businessmen	12	80	3	20	15
Consumers	11	73.33	4	26.67	15
Others	53	88.33	7	11.67	60

Source: Opinion survey.

According to the field survey, 88.33% of respondents provided their view on superiority of VAT to the areas it has replaced. Out of which 100% experts, 100% officers, 80% businessmen and 75.33% consumer's views that the VAT is superior. But 11.67% of respondents are opposite of its

superiority of VAT to the area it has replaced. The outcome proves that VAT is superior the areas it has replaced.

❖ **Views on billing system.**

Billing system is the backbone of the VAT system. All the business has to receive the bills of actual transaction price while importing and buying of goods and services. The price of the goods and services with and without VAT has to be mentioned explicitly in the bill. The business has to pay the amount of differences between tax collected as sale and tax paid on purchase to the VAT office. He has to pay the income tax as well as profit of the transaction. Thus the billing system plays crucial role in the field of VAT system. But in Nepal the billing system has been one of the major problems. So the question is designed is to show the comments on billing system of VAT. The outcome of field survey is given below.

**Table 4.10**

**Views of billing system**

Respondents	Possible		Impossible		Costly		Total Number
	Number	%	Number	%	Number	%	
Tax experts	14	93.33	-	-	1	6.67	15
Tax officers	15	100	-	-	-	-	15
Businessmen	10	66.67	-	-	5	31.33	15
Consumers	10	66.67	2	13.33	3	20	15
Others	49	81.67	2	13.33	9	15	60

Sources: Opinion survey

From the empirical survey it is found that all the tax offices and most expert advocate for the possibility of billing system. Businessmen argue treat billing system is possible at the same time 66.67% consumers also claimed that possible. But 6.67% experts, 33.33% businessmen and 20% consumer viewed that billing system costly. Only 13.33% consumers argue that billing system is impossible.

**❖ Views on rising Price due to VAT system.**

In the stage of VAT implementation, there was a strong opposition from the business community regarding the possibility of rise in price of commodities due to VAT system. There was also voice from different people on price rising as commodities. Consumers also complain that act of VAT. Here an investigation has been made to get the information the respondents to find out whether there will rise in the price due to VAT system.

**Table No 4.11**

**Views on rising Price due to VAT system**

Respondents	Yes		No		I don't know		Total
	No	%	NO	%	No	%	
Tax experts	1	6.67	14	93.35	-	-	15
Tax officers	2	13.33	13	86.68	-	-	15
Businessmen	5	33.33	8	53.33	2	31.33	15
Consumers	3	20	10	66.67	2	13.33	15
Others	11	18.3	45	75	1	6.66	60

From the opinion survey, 75% respondents conclude against the views that there is rise in price due to VAT system, 18.33% respondents claim that there is a rise in price where as 6.67% respondents are unconcern about the fact 93.33% experts 86.67% tax officers, 53.33% businessmen and 66.67% consumers argue that there is no raise in price due to VAT system. According to the survey, 13.33% each of businessmen and consumers have no idea about this question.

**❖ Views on revenue collection from VAT are satisfactory as it had accepted.**

VAT was introduced in Nepal to get revenue mobilization and to avoid the problems of existence tax system. As VAT is the best system to get greater revenue productivity due to the many problems relating to the implementation of the revenue collection from VAT is not satisfying as it

had been expected. But it has generating refundable amount of revenue since it was implemented in the country.

Views on revenue collection from VAT are satisfactory as it had been expected.

**Table 4.12**

**Views on revenue collection from VAT are satisfactory as expected**

Respondents	Yes		No		I don't know		Total
	No	%	NO	%	No	%	
Tax experts	-	-	15	100	-	-	15
Tax officers	-	-	15	100	-	-	15
Businessmen	4	16.67	8	53.33	3	20	15
Consumers	3	20	7	46.67	5	33.33	15
Others	7	11.67	45	75	8	13.33	60

From the field survey, 75% respondents argue that revenue collection from VAT is not satisfactory as it has been expected 13.33% respondents are unknown about the facts. 100% of tax experts and tax offices say that VAT is not getting expected amount of revenue. 26.67% businessmen and 20% consumers say that VAT is achieving expected amount of revenue where as 53.33% businessmen and 46.67% consumers agree that VAT is not getting expected amount of revenue.

**❖ Problems in the process of VAT implementation.**

Tax payers and tax collector both have to be conscious because VAT is new and advanced tax system experienced but it is still a matter of challenge especially in the case of implementation. The respondents were asked for their views to explore the problems that the implementation aspect is facing. The view of the respondents about the problems in the process of VAT implementation is shown in the following table.

**Table 4.13**

**Problems in the process of VAT implementation**

Respondents	No	Percentage	Rank
Registration	17	28.33	II
Collection	13	21.67	III
Tax Refund	20	33.33	I
Miscellaneous	10	16.67	IV
Total	60	100	

The above table shows that 33.33% respondents focused on the problem of tax refund process, 28.33% respondents focused on the problem of registration process.

Likewise 21.67% respondents focused on the problems of collection process and 16.67% respondents focused on miscellaneous problems like dishonest in both sides (tax payers and tax collector), weak regulations, problems on issue of original bill inefficiency of VAT administration in tax auditing.

❖ **Most important factors for effectiveness of VAT in revenue collection.**

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

**Table 4.14**

**Most important factor for effectiveness of VAT in Nepal**

S.N.	Respondents	No	Percentage	Rank
1	Honest Tax Offices	13	12.67	II
2	Honest Tax Payers	9	15	V
3	Clear rules red	15	25	I
4	Effect ion VA Admissions		20	III
5	Tax education	12	18.33	IV
Total		60	100	

The above table shows that 25% represent focused on need of clear act, rules and regulation for effectiveness of VAT. There after 21.67% respondents focused on honest tax offices, 20% respondents focused on effective VAT administration, 28.33% respondents focused on honest payers. So it can be conclude that clear act, rules, regulation are the most important factors for effectiveness of VAT in revenue collection in Nepal.

❖ **Measure of established VAT as major sources of revenue.**

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

respondents were asked for their views toward the measure to established VAT as the major source of revenue which is shown in the following table.

**Table 4.15**

**Measure of established VAT as major sources of revenue**

S.N.	Respondents	No	Percentage	Rank
1	More trained and qualified	20	33.33	II
2	Minimize present contact with the tax payer	5	8.33	IV
3	Computerized system for payment VAT	28	46.67	I
4	Collection VAT through private sectors	7	11.67	III
Total			60	100

The above table shows that 46.67 respondents focused on need of computerized system for the payment of VAT to establish VAT as a major source of revenue. Likewise 33.33% respondents focused on the need of more trained and qualified manpower. 11.67% respondents focused on need of private sectors participation in collection of VAT. 8.33 respondents focused onto minimize personal contact with the tax payers.

**❖ Problems faced after introduction of VAT system.**

VAT system was introduced in 1997. However the concept of this tax in Nepal was introduced in early years of 1990s. But is the introduction of VAT, sales tax was in operation. The respondents were asked for their views towards the problem faced after introduction of VAT system, which is shown in following table.

**Table No. 4.16**

**Problems faced after introduction of VAT system**

S.N.	Respondents	No	Percentage	Rank
1	Problems in accounting system	5	8.33	VI
2	Increase in company cost	11	18.33	II
3	Problems in tax found	3	5	VII
4	Problems in competitive cash	15	25	I
5	Problems in Amounts	10	16.67	III
6	Problems in trade and	9	15	IV
7	Problems in	7	11.67	V
Total		60	100	

The table shows that 25% respondents focused on problems in administration after introduction of VAT system. Like wise 18.33% respondents focused on decreased in competitive capacity, 15% respondents focused on problems in trade and tariff, 11.67% respondents focused on problems in credit transaction, 8.33% respondents focused on problems of accounting system and 5% respondents focused in problems in tax refund process.

**❖ Future of VAT system.**

VAT is advantages to the revenue mobilization by observing the international experience, not only this experience, the VAT system is also different than others type of taxing system like an example of Vietnam. It is introduced in Asia in 1973 but it was replaced in short time .So Nepal has applying VAT system since in 1997 but cannot be say as to the possible results and effects until its effective implementation. So in this context a field survey was held as "Do you think VAT will effective in future?" The following table shows the outcome of survey.

**Table 4.17****Effectiveness of VAT in Future**

Respondents	Yes		No		I don't know		Total
	No	%	No	%	No	%	
Tax expert	11.4	93.33	1	6.67	-	-	15
Tax office	14	93.33	1	6.69	-	-	15
Businessmen	12	80	2	13.33	1	6.67	15
Consumers	8	53.33	2	13.33	5	33.33	15
Total	48	80	6	10	6	10	60

According to the survey almost 93.33% tax experts and offices are totally optimistic about the future of VAT.

**4.4 Major finding from primary data.**

This study has been address to the effectiveness of VAT in revenue collection in Nepal and to find out the existing problems facing by government and business sector. During this study has found both positive and negative impacts of VAT .The major outcome and finding of this research are listed as follows:

- ) The mobilization of revenue is very low at present VAT is also included. The large number of potential taxpayers, who must be included within the boundaries of VAT net, remains outside. As a result, the honest tax payers have to do unfair competition.
- ) Trend of revenue collection ratio through VAT is depending on import business.
- ) Survey shows 95% respondents agreed that VAT as an appropriate means of raising government revenue.
- ) 100% respondents (tax offices and tax experts) are supporting to collecting the more revenue.
- ) Survey shows that all the tax officers and most experts advocate for the possibility of billing system. 66.7% businessmen argue that billing system is possible at the same time 66.67% consumers also claimed that possible. 13.33% consumers argued that billing system is impossible.

- ) Almost 75% respondents conclude against the view that is a rise in price due to VAT system.
- ) Survey shows 75% respondents argue that revenue collection from VAT is not satisfactory as it has been expected.
- ) Survey shows that 33.33% respondents focused on problems of tax refund process, 28.33% respondents focused a problems registered in process.
- ) Survey shows that most of the respondents focused on the needs of clear act rules and regulation for effectiveness of VAT.
- ) The future of VAT is progressive.
- ) Consumers are unaware with the billing importance and don't demand valid bill from businessmen while purchasing goods and services.
- ) Open boarder is main problem for effectiveness of VAT on revenue collection.
- ) For improvement and more effectiveness of VAT, there should be develop skill manpower; make coordination with private sector; manage of reward and punishment systems improve in administration so on.
- ) The existing tax administration is not become so efficient service oriented and resulted oriented so as to suit the modern VAT system but current act is suitable for implemented on of VAT properly.
- ) Tax offices are bargaining with the business for their financial benefits. They demand the irrelevant information from business sector.

## **CHAPTER V**

### **SUMMARY, CONCLUSION AND RECOMMENDATION**

#### **5.1 Summary**

Tax is contribution from as person to government i.e. a liability to pay an amount to the state. In other words, tax is compulsory contribution imposed by public authority using the rights given by the law. Taxes are levied primarily to raise revenue for government expenditure. In modern age the purpose of tax has shifted from security to economic development. Tax is the main source of financing government activities. In every country the largest part of government revenue raised through taxation. Broadly it can be classified into categories i.e. direct tax and indirect tax. VAT is good example of indirect tax which is newly discovered in the field of taxation in comparison to other taxes.

VAT is latest innovation which is multistage, commodity and service based tax and levied in the added value of business enterprises at different stages of production and distribution. It affects only in the added portion of price purchasers pay VAT to the sellers and sellers transfer it to government deducting VAT paid on their business purchase from VAT from the consumers on their sales. The ultimate burden of VAT is shifted to the consumers. In this system, every person or business firm which is above threshold limit should be registered in VAT office. Those below threshold unit are compulsory not to register but if they want they can registered voluntarily. After registration they get credit facility on tax paid on purchase of raw materials semi-produced goods and overheads.

Although the concept of VAT was innovation in the year 1919 by Dr. V.SIEMENS of Germany but after three and half decades of the evaluation of the concept of VAT, France became the first country to put VAT on practice. France introduced VAT in 1954 A.D. Then after, almost all countries started to take VAT as best alternatives of tax reform process. Because of its special features such as input tax credit system, based on accounting system less chance of tax evasion avoidance of cascading and pyramid effect it becomes very popular tax system throughout the world.

In the context of Nepal VAT System is completely new system of taxation Nepalese government introduced VAT since November 16,1997. Before the implementation of VAT, task force was created in September 1993 with the

technical assistance from US AID. But due to the midterm election 1994, VAT was not implemented as it was suggested by the task force. Then after another task force was formed and it recommended that the VAT should be introduced. In the earlier stage of VAT implementation there was strong opposition from the Business community about the implementation of VAT. Nepal introduced VAT with single rate of 10% from 16th November 1997 replacing sales tax, contract tax, hotel tax, and entertainment tax. Later again from Magh 1, 2061, VAT rate was increased 10% to 13%. For introducing VAT Nepal government took technical assistance HIIP under US AID, DANIDA. Nepal introduced VAT in order to widen tax for the country, reduce foreign dependency, justify tax system; there is a provision for refund of VAT. Such situation will arise in the case of zero rate supplies such an expert the threshold for registering in VAT offices is 2 million.

The first step towards VAT operation is registration of vendor who is legal tax payers. Each and every registered vendor should received and given the bill while purchasing and selling the goods respectively. Each VAT registered should keep records of all tax invoices they issue and receive, including the serial number and the data of the invoice, the amount charged and the VAT charged if a registration put tax liability is greater than his input to the authority within specified time period. VAT is self assessed tax. Tax payers determine their tax liability themselves and pay tax. If a tax payer does not assess his income himself and does not file his returns within specified time, he is termed to be a non filer. In such case VAT officials may have to make tax assessments penalties are designed to punish tax payers for their VAT official and to recoup to revenue losses due to the meet function of taxpayer. The tax payers may not always agree with the assessment made by tax officers. In that case tax payers may file an appeal the revenue tribunal within 35 days against a tax assessment or penalty.

From the review of Nepalese tax structure if is found that tax contribution 78% of total revenue. The share of indirect tax is 74% on total tax. The amount of VAT revenue increasing continuously like total VAT revenue has been increasing but it is unable to achieve its potential. The reasons behind this are many problems relating its implementation. But another positive fact is that there is increment in the tax registration year by year. Billing system is the backbone of VAT system, the main problem lies on the proper invoicing system lack of requirements number of qualified and trend tax administration is another problem. Other problems relating

to the effectiveness of VAT are lack of awareness about VAT on different groups of people; existence of corrupt, smuggling and undervaluation, narrow tax compliance, open border and unauthorized trade, lack of coordination between tax payers and tax collectors and between different departments of government, lack of courage to take accountability by different groups etc. So implementation in such various areas are needed if we can tackle the challenge relating to VAT then there must be great improvement in revenue collection for VAT.

## **5.2 Conclusion**

Every country of this world wants to get better economic development it is essential to have sufficient revenue generation particularly tax revenue plays the great role for the development of nation economy to achieve higher growth of revenue every country needs reform some of its tax system. In the context of the present world VAT is an if the best alternatives of tax reform Nepalese government adopted VAT by replacing four other tax system i.e. sales tax, hotel tax and entertainment tax. As we have just getting the membership of WTO, we shall need to decrease our customs duties are being drastically customs duties are being curtailed if worldwide span in order to accept liberalization policy. Excise duty in Nepal is severely limited due to the contraction of industrial activities through out the taxation in recent year under such condition we can not collect more revenue from income tax, custom duty and excise duty. Consumption based tax is only as alternative to collect more revenue, which directly helps to increase domestic resources for the development work. Thus on the basis on consumption related indirect taxes do not maintain equity norms but they can be considered as one of the most source of revenue generation. Furthermore this will help to reduce the future generation.

In the Nepalese context the trend of revenue contribution is fluctuating, it is increasing reasonably. The revenue collection from VAT is also increasing it is only the eleventh year of VAT implementation. Theoretically VAT is the best alternatives to gain high revenue collection. But practically it depends in its environment where it exist to get the potential target from VAT, the environment target relating to VAT must be as required it is only primarily stage of VAT implementation in Nepal so the revenue contribution from VAT is not as high as expected . But in the future VAT will be more effective as it has expected Empirical Investigation shows that VAT is an appropriate in each of raising government revenue and VAT will be more effective in the future. After the establishment of strong tax structure and smooth

environment for the implementation of VAT. VAT will give the revenue as it has been expected.

The effectiveness of VAT depends its implementation there must be sound surrounding. But being a developing countries Nepal has too many difficulties to implement the VAT proper these problems are challenges are now limiting the effectiveness of VAT. To get positive effect from VAT implementation first of all problems relating to the implementation of VAT must be minimized or removed. VAT has been implemented in our country till now it has not secured expected result because of many challenges problems in implementation like open boarder, ignorance of people, lack of full support and commitments from the politicians and forces of government officials to the responsibilities tax authority for implementing VAT to make compromises on various aspects of VAT unsuitable political situation etc. Like wise the culture of doing business without maintaining multiple sets of books of accounts, lack of culture of issuing and receiving bills at the point of sale or purchase, negative behavior of tax officials and lack of sense of accountability in government and political parties has greatly affected to the successful implementation of VAT.

In near future VAT can be made more effective as it was expected. These are certain elements which increase the effectiveness of VAT in revenue collection. Availability of clear VAT laws and rules, effective and efficient administration honest tax payers, a good collection programmer, establishment of proper invoicing mechanism and extension of tax coverage are the most important factor which obviously increase the revenue mobilization trough VAT and effectiveness of VAT in revenue collection can achieved. The governments too need to have particular mechanism to control monitor the different practice as relation to VAT. Until each and every unit relating to VAT is not monitored properly, implementation will have always some sorts of problem. Thus it is time for action and improvement for effective and successful operation of VAT from unit level so that VAT can be the best means for the economic development of the country.

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### 5.3 Recommendations

After a long preparation, planning VAT was introduced in our country and has already become a decade. Even though it has made great jump by implementing of VAT. In such circumstances or the bases of major findings and conclusion; following recommendation has been made to make VAT more effective revenue collection in Nepal.

- ) Most of tax payers as well as public are still unknown about VAT and its effects on various aspects. They have developed a kind of misconception regarding VAT. They think VAT means extra charge. So proper publicity is very important through radio, television, newspaper and pamphlets etc. Similarly is the school levels curriculum too, there should be included tax education and social obligation of paying tax.
- ) For proper billing system consumers should be made will informed and strict warning should be given to business that issue false bills issuing bills for every taxable sees must be made compulsory.
- ) VAT administration should be strong and committed towards to effective implementation of VAT.
- ) Most of tax payers are not satisfied with the behavior of tax administration. Thus they should be trained properly to deal with tax payers properly so that sense of cooperation may arise.
- ) Monitory system of the VAT administration is not so effective which is encouraging tax payers to evade tax. So an effective and efficient auditing investigation and monitoring system should be developed.
- ) In the process of revenue collection, the focus should be a transparency farmers and timely and quality production in administration instead of simple collection.
- ) Effective incentive mechanism must be introduction to give benefit to the regular and honest tax payers. The government has started some incentive mechanism for the tax payers to boost the pace of revenue collection of VAT. But it must be extended to the different parts of the country and the continuity of this type of mechanism is the most important requirement.

- ) Effective incentive mechanism for the tax administration, who honestly take their responsibilities and work against the tax evasion must be promotion cease reward honoring etc
- ) VAT rule a luxurious goods should be increased and daily consuming goods should be reduced.
- ) Government should be able to ensure the people that the revenue from VAT is used in transparent manner to uplift the economy of country.
- ) Under valuation should be effectively implement timely revision should be made on unpractical acts, rules and regulation on the basis of experience gained.
- ) According to the change in time. VAT collection technique should be changed and due to which revenue will also be collected and taxpayers also may not be far from tax office like door to door collection method.
- ) In the present Nepalese environment there exists instability of political situation, so government should create an environment of strong political commitment for effective revenue collection on VAT.
- ) Open boarder is also a main hindrance for a successful implementation of VAT. So it should effectively control to prevent the illegal trade and checking should be practiced.
- ) Training programs must be provided tax offices for development of skill manpower administration with current information technology.

Finally for the effective and more revenue collection from VAT in Nepal is to make effective billing with commitment and understanding is government, tax administration, private sector and tax payer would be the prime condition for the government should apply suitable VAT policies and strategies considering globalization, liberalization WTO and modern net of VAT for its progress with the close coordination to the concerned share holders.

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[www.ird.gov.np](http://www.ird.gov.np)

[www.mh/w.go.jp](http://www.mh/w.go.jp)

## APPENDIX- 1

### VAT offices under VAT department

S.N.	Name of office	Place of office
1	IRO Bhadrapur	Bhadrapur
2	IRO Biratnagar	Biratnagar
3	IRO Dharana	Dharana
4	IRO Lahan	Lahan
5	IRO Janakpur	Janakpur
6	Big tax payer office	Harihar Bhawan
7	IRO Kathmandu 1	Bhabar Mahal
8	IRO Kathmandu 2	Babar Mahal
9	IRO Kathmandu 3	Lazimpat
10	IRO Lalitpur	Lalitpur
11	IRO Bhaktpur	Bhaktpur
12	IRO Hetauda	Hetauda
13	IRO Birgung	Birgunj
14	IRO Simara	Simara
15	IRO Bharatpur	Bharatpur
16	IRO Krishnanagar	Krishnanagar
17	IRO Pokhara	Pokhara
18	IRD Dang	Dang

19	IRO Nepalgunj	Nepalgunj
20	IRO Bhariahawa	Bhairahawa
21	IRO Dhangadi	Dhangadi
22	IRO Mahendra nagar	Mahendranagar

## APPENDIX-2

### Revenue structure of Nepal

(Rs. in million)

Fiscal year	Total revenue	Tax revenue		Non tax revenue	
		Amount	% as total	Amount	% as total
2057/58	37251.0	28752.9	77.19	8498.1	22.81
2058/59	42893.7	35152.2	77.29	9741.6	22.71
2059/60	48893.6	38865.0	79.24	10028.8	20.51
2060/61	50445.5	39330.6	77.97	11114.9	22.03
2061/62	56230.0	42587	75.74	13642.9	24.26
2062/63	62331.0	48173.0	77.29	14158.0	22.71
2063/64	70122.7	54104.7	77.16	16018.0	22.84
2064/65	72282.1	57430.4	79.45	14851.7	20.53
2065/66	87717.0	71127.0	81.09	16590.0	18.91
2066/67	107622.4	85155.4	79.12	19783.8	20.88

Source: Economic survey of various years, MOF

The composition of tax revenue and non tax revenue in total revenue structure has been shown in above table. It can be seen that revenue collection trend in increasing trend. Since the fiscal year 2057/58 to the fiscal year 2066/67 the revenue has increased from Rs. 37251 million to Rs. 107622.4 million. Similarly tax revenue as well as non tax revenue is also increasing trend. Total tax revenue has increased from Rs. 28752.9 million to Rs. 85155.4 million in fiscal year 2057/58 to 2066/67. It is the main source of revenue collection. It has contributed very much in national revenue. Similarly non tax revenue has also increased from 8498.41 million to 16018.0 million in two fiscal year 2057/2058 to 2063/2064. But decreased the fiscal year 2063/2064 to Rs. 14851.7 million. In the fiscal year 2065/2066 to 2066/2067 has also increased the non tax from 16890 to 19783.8 it has contributed less to national revenue.

### APPENDIX-3

#### Tax revenue structure of Nepal

(Rs. in million)

Fiscal year	Direct tax revenue		Indirect tax revenue		Total Revenue
	Amount	% as total	Amount	% as total	
2057/58	7516.1	26.14	21236.8	73.86	28752.9
2058/59	8951.5	27.00	24200.7	73.00	33152.20
2059/60	10159.4	26.14	28705.7	73.86	38865.10
2060/61	10597.5	26.94	28733.1	73.06	39330.06
2061/62	10105.7	23.73	32481.2	76.27	42586.9

2062/63	11912.6	24.73	36260.4	75.27	48173.0
2063/64	13071.8	24.16	41032.9	75.84	54104.7
2064/65	13968.1	24.32	43462.3	75.68	57430.4
2065/66	18980.5	26.69	52146.5	73.31	71127.0
2066/67	23087.7	27.11	62067.7	72.79	85155.4

Source: Economic survey of various years, MOF.

The table shows increasing trend of total tax revenue as well as its component i.e. direct and indirect tax. Direct tax has increased from 7516.1 million to Rs. 23087.7 million from the fiscal year 2057/2058 to fiscal year 2066/2067. Similarly indirect tax has also increased from Rs. 62067.7 million from the fiscal year 2057/2058 to the fiscal year 2066/2067. The maximum contribution made by direct tax on total tax, revenue is 27.11 in the fiscal year 2066/2067 and indirect tax is 72.79 in the fiscal year 2061/2062. The increasing trend of direct tax revenue is constraint then indirect tax revenue. Indirect tax revenue increasing trend is much fluctuated then direct tax revenue.

#### APPENDIX- 4

##### Revenue collection from VAT

(Rs. in million)

Fiscal Year	Revenue Collection From VAT	Percentage Charge %
2057/58	8765.9	-
2058/59	10259.7	17.04
2059/60	12382.4	20.69
2060/61	12267.3	-0.93
2061/62	13459.7	9.72

2062/63	14478.9	7.57
2063/64	18885.4	30.43
2064/65	21610.7	14.43
2065/66	26095.6	20.75
2066/67	31154.6	19.39

Source: Economic survey of various years, MOF.

Above table shows that amount of VAT has increased up to the fiscal year 2059/2060 and in the fiscal year 2060/2061 its collection decreased to Rs. 12267.3 million. Again after the fiscal year 2061/2062 is continuously increasing. In fiscal year 2066/2067 total tax Rs. 31154.6 million was collected. Regarding percentage change in amount, it is not same ratio in some year it has increased in higher percentage like in the year 2063/2064 i.e. 30.43% and in some year it has negative incensement in also like in year 2060/2061 i.e. 0.93%.

## APPENDIX-5

### Contribution of VAT to total revenue

(Rs. in million)

Fiscal Year	Total Revenue	Revenue Collection From VAT	% of VAT revenue to total revenue
2057/58	37251	8765.9	23.53
2058/59	42893.7	10259.7	23.92
2059/60	48893.6	12382.4	25.32
2060/61	50445.5	12267.3	24.32
2061/62	56230.0	13459.7	23.94
2062/63	62331.0	14478.9	23.23
2063/64	70122.7	18885.4	26.93
2064/65	72282.1	21610.7	29.90
2065/66	87717.0	26095.6	29.75
2066/67	107622.4	31154.6	28.95

Source: Economic survey of various years, MOF

Above data shows that VAT has maximum contribution in the year 2064/2065 which is about 29.90 and maximum in the fiscal year 23.23%. So we can say that VAT contribution in total revenue collection is very low than other countries.

## APPENDIX-6

### Contribution of VAT to total tax revenue

(Rs. in million)

Fiscal Year	Tax Revenue	VAT Revenue	Percentage of VAT
-------------	-------------	-------------	-------------------

2057/58	28752.9	8765.9	30.49
2058/59	33152.1	10259.7	30.95
2059/60	38865.1	12382.4	31.86
2060/61	39330.6	12267.3	31.19
2061/62	42587.0	13459.7	31.61
2062/63	48173.0	14478.9	30.06
2063/64	54104.7	18885.4	34.90
2064/65	57430.4	21610.7	37.63
2065/66	71127.0	26095.6	36.39
2066/67	85155.4	31154.6	36.58

Source: Economic survey of various years, MOF

Above table shows that there is maximum contribution of VAT revenue on tax revenue in the fiscal year 2064/2065 which is about 37.63% and minimum is the year 2062/2063. According to above data an average contribution of VAT on national revenue is about 33.20%. Above data can be

## APPENDIX-7

### Contribution of VAT to indirect tax revenue.

(Rs. in million)

Fiscal Year	VAT revenue	Total indirect tax revenue	% of VAT
2057/58	8765.9	21236.8	41.28
2058/59	10259.7	24200.6	42.39
2059/60	12382.4	28705.7	43.14
2060/61	12267.3	28733.1	42.69

2061/62	13459.7	32481.2	41.44
2062/63	14478.9	36260.4	39.33
2063/64	18885.4	41032.9	46.02
2064/65	21610.7	43462.3	49.72
2065/66	26095.6	52146.5	50.04
2066/67	31154.6	62067.7	50.19

Source: Economic survey of various years, MOF