

CHAPTER-I

INTRODUCTION

1.1 General Background

Economic development has been one of the most popular slogans in almost all the developing countries all over the world. Similarly, achievement of high rate of economic growth rate, reduction of income disparities and poverty and improvement of living standard of people are some development strategies towards which most of the government efforts have been directed in developing countries. It is known that government needs more revenue mobilization for overall economic development and state welfare. Besides this, for meeting day-today expenditure, the government also requires some sources of income which is called revenue. The role of revenue in the development of a country is not less important than the role of oxygen for the existence of human body. In this context, a government needs to mobilize a lot of internal resources to fulfill its responsibility towards its nation and people. In the developing country like Nepal, there is a necessity for raising a larger volume of funds for the development and administration expenses. The revenue collection is a challenging task in itself which demands increasing necessity of regular expenditure in general and development expenditure in particular. However, resource mobilization is very low compelling the government to rely heavily on foreign assistance. Development expenditure has been dependent almost entirely on the foreign aid. External assistance is uncertain, precarious, inconvenient and not conducive to the healthy and overall development should there be heavy dependence on it. The foreign aids are not bad for economic development of the nation per se. But the experience of the most of the developing countries shows that there are negative effects of increasing international grants and loans to finance the public development activities. Thus the government should depend on its own resources for generating revenue in order to finance these regular and development activities.

The government can collect revenue from taxable and non taxable sources. Tax is a key source for revenue generation and mobilization. Different persons have defined taxation in different ways. In this respect, it would be better to take the definition given by Prof. Seligman. In his words, "Tax is the compulsory contribution from a

person to the government to defray expenses incurred in the common interest of all without reference to special benefit conferred.” From the definition given above, it can be said that firstly, a tax is a compulsory levy and those who are taxed have to pay it without getting corresponding benefit of services or goods from the government. The taxpayer does not have any right to receive the direct benefit from the tax paid. Due to this compulsory nature, people have expressed different views in satirical way about the taxation. In this respect, some say “Nothing is certain in this world but death and taxes”, some say “Death and taxes are both certain... but death is not annual”; while others say “Death means stopping to pay tax”. Here, it should be noted that all compulsory payments are not taxes. For example, fines and fees are also compulsory payments without having direct benefit to the payer but they are not taxes because the objective is not to collect revenue but to curb certain types of offences. Secondly, the taxpayer cannot receive any quid pro quo for the payment of tax. The taxpayer does not receive equivalent benefit from the government. A tax is not a price paid by one for which he can claim for goods and services. The charge of price for goods and services by public authority is not a tax. Thirdly, the tax is paid to the government for running it. Fourthly, the amount is spent for common interest of the people. The tax is collected from haves and basically, spent for the interest of have-not in the society. Fifthly, a natural or an artificial person pays the tax. (Kandel, 2004:3) In conclusion, it can be said that a tax is a liability to pay an amount to the state on account of the fact that the assesses have income of a minimum amount from certain specified sources or that they own certain tangible or intangible property or that they carry on certain economic activities or they consume certain goods and services which have been chosen for taxation. (Kandel, 2004:3) Taxes are major fiscal policy instruments and important government policy tools have an important role in increasing the rate of capital formation and thereby a high rate of economic growth can be achieved. Increase in taxes may be directed to increase in saving through the postponement of consumption. The increase in saving means a higher volume of resource is available for making useful and productive investments. Taxation may also play a dual role. On the one hand, it may be used to make the maximum volume of resource available to public sector. On the other hand, taxation may be used to promote useful investment in the private sector and to prevent their source from being dissipated over speculative and unproductive investment as well as over lavish and luxurious

consumption. Thus, taxes in developing countries serve as the severe means of raising revenue. Therefore, Taxation may be utilized by the government as an effective tool for giving incentive to the proper growth of saving, investment, and gross domestic product.

In Nepal, the tax policy is mostly guided towards the revenue generation. It is the largest source of public revenue of today's governments. It is the internal source of national income. Tax is the legal duty of every citizen of a country to pay honestly. In the present day government has to spend a lot of money to play regular expenditure, maintain peace & security launch other public welfare activities, development work, government need to sufficient fund. The government has to manage its funds from internal as well as external sources. External sources of government revenue are foreign loans, grants, external borrowing etc. Mostly external sources are uncertain inconvenient and they are not good for healthy for development of nation because it should be paid after a certain time period and another source of government revenues is internal which constitute tax and non tax source revenue. The term Tax is defined as a liability to pay an amount to the government. It is a compulsory contribution to the national revenue from the tax payers according to law. It is used for common interest of the people however, the taxpayer do not get direct personal benefits. The tax can be classified in two types they are:

Direct Tax

Indirect Tax

1.1.1 Direct Tax

A Direct tax is tax paid by a person on whom it is legally impose. In direct tax, the person paying and bearing tax is same, the person can't shift his tax to others. Some examples of direct taxes are briefly described below individually.

i. Income Tax

Under income tax, taxable income, which is subject to a basic tax rate, is arrived at after allowing deductions depending on circumstances from chargeable incomes. For natural person, taxable income is derived by deducting allowable deductions depending on marital status and other personal circumstances from

admissible incomes and is subject to a basic rate with increasing rates above Rs. 115000.

ii. Corporate Tax

Tax imposed on income of corporate bodies is called corporate tax. All profits, whether distributed or not, are taxed. A part is transferred to shareholders and deducted in advance when the dividend is paid.

iii. Capital Gain Tax

A tax is levied on any capital gain when an asset is disposed of. These assets are land, buildings, long term investments, etc. Owner-occupied houses, cars, National Saving Certificates and goods and chattels worth less than a limit are excluded, and losses may be offset against gains.

iv. Capital Transfer Tax

Capital transfer tax applies to lifetime gifts as well as legacies.

v. Other Taxes

These consist of stamp duties (payable on financial contracts), vehicle tax, property tax, house and land tax etc. Direct taxes yield more than two-thirds of total revenue. Their great merit is that being progressive and assessed according to the individual's circumstances; they ensure that the heaviest burdens are placed on the broadest backs. Their progressive character also gives additional weight to their role as built-in-stabilizers.

1.1.2 Indirect Tax

On the other hand, indirect taxes are those which are imposed on one person but partly or wholly paid by another, in indirect tax, the person paying and bearing tax is different. In other words those types of taxes are ultimately paid by consumers, not by a businessman or firm. There are only mediators. Indirect taxes may be specific or ad valorem.

The Indirect taxes may be:

i. Customs Duty

As per Section 2 (c) of Custom Duty Act 2019, customs duty means the customs duty payable at rates prescribed by Nepal Law from time to time on exports or imports.

ii. Excise Duty

As per Section 3 of the Excise Duty Act 2058, excise duty is charged on import and production of those goods and services, which are specifically mentioned in the schedule forming part of the Act. Those goods or services not covered by the Schedule are free from the boundary of the Act.

iii. Value Added Tax (VAT)

Value Added Tax is one of the indirect taxes which constitute the main topic and focus of the present research as well. What is VAT and how it is levied forms the main concern of the subject. So, this section obviously does not need any description in that the introductory description follows in the next section below.

1.1.3 Value added tax (VAT)

A value added tax (VAT) is a form of consumption Tax. From the perspective of the buyer, it is a tax on the purchase price. From that of the seller, it is a tax only on the value added to a product, material, or service, from an accounting point of view, by this stage of its manufacture or distribution. The manufacturer remits to the government the difference between these two amounts, and retains the rest for themselves to offset the taxes they had previously paid on the inputs. The value added to a product by a business is the sale price charged to its customer, minus the cost of materials and other taxable inputs. A VAT is like a Sales tax in that ultimately only the end consumer is taxed. It differs from the sales tax in that, with the latter, the tax is collected and remitted to the government only once, at the point of purchase by the end consumer. With the VAT collections, remittances to the government, and credits for taxes already paid occur each time a business in the supply chain purchases products.

VAT is the main source of government revenue. In Nepal value added tax act was enacted by 1995 and started to implement only on 1997. This tax was levied in place of the manufacturing level sales tax, Hotel tax Contract Tax and Entertainment Tax. However it could not be implemented fully until the fiscal year 1998/99 due to the political instability and strong opposition from the business community VAT replaces the old sales tax the contract tax the hotel tax and Entertainment Tax. It has been designed to collect the same revenue as the four taxes it replaced. Since the collection of both custom duties and Income Tax depends to a great extent upon the effectiveness of VAT it is expected to help enhance revenue collection. The VAT is

broad based tax as it covers the value added to each commodity by a firm during all stages of production and distribution it is a modern tax system to improve the collection of taxes to increase efficiency and to lessen tax evasion.

1.2 Focus of the study

Basically, this study is focused on analyzing the contribution of value added tax to total tax revenue. Study is also focus on present condition of tax system on Nepalese context. It will focus on improvement and difficulties regarding implementation of value added tax.

1.3 Statement of the Problem

The Value Added Tax (VAT), which is considered as the back bone of the income tax in the country has been contributing remarkably to the government in its total revenue collection. It is imposed on the value added to goods and services consumed in Nepal or exported out of the country. Nepal is an underdeveloped and one of the poorest countries in the world it has low per capital income and more than one third people of the nation are living under the poverty line. The economic development and prosperity is very low. Foreign dependency and internal leakages has made government think for another option which is expected to increase the revenue. Moreover, fiscal deficit has been increasing due to the continuously growing expenditure and the low revenue performance in Nepal.

VAT is a new experiment in Nepalese tax system. So many problem and difficulties had to be faced in primary phase of implementation. There is no conducive environment for executing the concept of VAT. The tendency of unnecessarily troubling taxpayers must be stopped to ensure a friendly atmosphere at various tax collection offices. The major problem associated with VAT is lack of knowledge. In Nepal most of the taxpayers are unknown about the VAT although government uses e-governance system for Tax collection.

Thus this study concentrated on how to overcome resource gap problem and effective implementation of VAT in order to increase in its contribution to the Total Tax Revenue focusing following matters.

- i. What is the actual contribution of VAT in Total Tax Revenue collection?

- ii. Whether businessmen and consumer are in favors of VAT or not?
- iii. Difficulties in implementation of VAT.

1.4 Objective of study

The main objective of this study is examined the contribution of VAT to Total Tax Revenue and also effectiveness of VAT in the Nepalese context. The specific objectives of this study are:

- i. To study the historical background of VAT.
- ii. To evaluate the contribution of VAT to total Tax revenue.
- iii. To compare VAT with other majors sources of direct and indirect Tax.
- iv. To provide suggestions, recommend for making VAT more effective in Nepal.

1.5 Significance of the Study

VAT is the effective tool of tax system. Nepal as developing country and has not independent from external sources for revenue generation, therefore effective mobilization of internal sources is necessary an VAT can be an effective and successful tools to internal resources mobilization. The scope of the study is finds out the contribution of VAT to Total Tax Revenue in addition it also explore the practical scenario of VAT. Another objective of this research is to find out the problem of effective VAT implementation and its possible correction measures. So the research is significant in the sense that its thorough study may facilitate the government making policy and solving the implementation problems and VAT relate issues. It may be helpful for the businessmen and the consumers as well who are still lost amid the confusion about the proper implication of VAT. They will also keep themselves informed about the current condition of VAT implementation in Nepal. This study carries a great significance to mobilize additional resources through improved and successful implementation of VAT and hence make the country self-dependent to some extent instead of the rapidly persisting resource gap.

1.6 Limitation 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.

- i. Basically this study will be an academic study for partial fulfillment of MBS.

- ii. Most of the data will take form secondary sources so analytical data taken from secondary source will limit this study.
- iii. It will be difficult to complete this study within limited period of time. It will be under taken within the boundaries of limit area, subject and time.
- iv. The study is based on analytical and descriptive types of research.

1.7 Organization of the Study

The study will have been organized into five major chapters each devoted to some aspects of the study of contribution of value added tax to total tax revenue in Nepal, which are as follows:

Chapter I: “Introduction” which includes why the researcher choose this topic. This chapter includes Background of Study, Focus of the study, Statement of the Problem, Objective of study, Significance of the Study, Limitation of the study, and Organization of the Study

Chapter II: “Review of Literature” which includes reading materials of this chapter is books review, journals review and previous researches review.

Chapter III: “Research Methodology” expresses the way and use techniques while studying applied in research process. It includes research design, source of data, data collection techniques and data analysis tools.

Chapter IV: “Presentation and Analysis of Data” with presenting charts, figures and other statistical and financial tools.

Chapter V: “summary, concussion and recommendation” This chapter is concerned with output of thesis as summary, concussion and recommendation for improvements.

CHAPTER II

REVIEW OF LITERATURE

This chapter deals with the review of relating to the topic of the study in more details and descriptive manner. For this purpose various books, journal, and past thesis are reviewed. This study reviewed the available international literatures as well as national literatures. To reviewed the available international literatures as well as national literatures. To review study, different books, reports, journals and research studies published by various institutions unpublished dissertations submitted by master level students have been reviewed. It is divided into three headings; Conceptual review, Review of related research studies and Research gap.

2.1 Conceptual Review

2.1.1 Historical Background of VAT

Value Added Tax popularly known as "VAT" in short forms is conceived by Bilhelm Fon Simens 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 system in those days. In fact, the system is conceptualized with two objectives. First objective is to streamline a tax system, which ensures perennial and depended able 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 three economic activities. Though the system is conceptualized with

Such noble objectives, it remained virtually far from being implemented for decades in 1949 A.D. It's 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 after math of the great sum of 1930s and ravaging the second great world war. In those days, governments of the countries, so suffered, were totally disquiets to find a way to heal the unfathomable economic catastrophe of the 1930s 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 good governance and lead a nation to prosperity. A progressive and sustainable tax system in a country. Ideal tax system is a prerequisite for 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 Pandave requested their uncle Vidur, the Prime Minister of Hastinapur to tell them secrets of good governance on. This, Vidur said, "Your Majesty a king has to look always into how his people are taxed. If you tax your people beyond they can pay, they will be compelled to convert themselves into sophism, and this will lead a nation to retrogression". (Shrestha, 2062) For the first time in the world France introduced 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 is 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. Therefore 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, six 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 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, Tajikistan, Georgia, Lithuania, Latvia etc. Too who belonged to European region has 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 adopted 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 introduction VAAT 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 1 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.

Table2.1: countries and the year when they introduced VAT

Year	Countries that have started adopting VAT
1954	France
1960	Ivory Coast
1961	Senegal
1967	Brazil, Denmark
1968	Germany, Uruguay
1969	Netherlands, Sweden
1970	Ecuador, Luxemburg, Norway
1971	Belgium
1972	Ireland
1973	Austria, Bolivia, Italy, United Kingdom, Vietnam
1974	Argentina, Chile, Colombia, Costa Rica, Nicaragua
1976	Honduras, Israel, Peru
1977	South Korea, Panama

1980	Mexico
1982	Haiti
1983	Dominican Republic, Guatemala
1984	People Republic of China
1985	Indonesia, Turkey
1986	Morocco, New Zealand, Nigeria, Portugal, Spain, Taiwan
1987	Grenada, Greece
1988	Hungary, The Philippines, Tunisia
1989	Japan, Malawi
1990	Iceland, Kenya, Pakistan, Trinidad and Tobago
1991	Bangladesh, Benin, Canada, Jamaica, Mali, Algeria, South Africa,
1992	Tajikistan, Belorussia, Kyrgyzstan, Russia, Thailand,
1993	Burkina Faso, Czech Republic, Paraguay,
1994	Bulgaria, Finland, Lithuania,
1995	Gabon, Ghana, Switzerland,
1996	Albania, Belize, Guinea, Uganda
1997	Barbados, Congo, Nepal
1998	Croatia, Mongolia, Sri Lanka, Tanzania,
1999	Cambodia, Cameroon, Mozambique, Netherlands, Papua
2000	Australia, Chad, Macedonia, Namibia, Sudan
2001	Botswana, Rwanda
2002	Lebanon
2005	India*

*India has implemented Modified VAT since 1986. This system is not exactly a VAT system. The system was introduced to refund excise duty paid on inputs.

Table 2.2: Standard VAT rates throughout the world

S.N.	Country	Standard Rate
1	Albania	20%
2	Andorra	4.50%
3	Argentina	21%

4	Armenia	20%
5	Australia	10%
6	Azerbaijan	18%
7	Bangladesh	15%
8	Barbados	17.50%
9	Belarus	20%
10	Bolivia	13%
11	Bosnia and Herzegovina	17%
12	Brazil	12%
13	Bulgaria	20%
14	Canada	5%
15	Chile	19%
16	Colombia	16%
17	Croatia	25%
18	Cyprus	17%
19	Czech Republic	21%
20	Denmark	25%
21	Dominican Republic	16%
22	Ecuador	12%
23	Egypt	10% (15% on Communication Services)
24	El Salvador	13%
25	Estonia	20%
26	Ethiopia	15%
27	Faroe Islands	25%
28	Fiji	15%
29	Finland	24%
30	France	19.60%
31	Georgia	18%
32	Germany	19%
33	Ghana	13%
34	Greece	23%

35	Guatemala	12%
36	Guyana	16%
37	Hungary	27%
38	Iceland	25.50%
39	India ⁵	13.50%
40	Indonesia	10%
41	Iran	5%
42	Ireland	23%
43	Israel ⁶	17%
44	Italy	21%
45	Japan	5%
46	Jersey ⁸	5%
47	Jordan	16%
48	Kazakhstan	12%
49	Kosovo	16%
50	Latvia	21%
51	Lebanon	10%
52	Liechtenstein	8.00%
53	Lithuania	21%
54	Luxembourg	15%
55	Macedonia	18%
56	Malaysia ⁹	10%
57	Maldives	6%
58	Malta	18%
59	Mauritius	15%
60	Mexico	16%
61	Monaco ^[36]	19.60%
62	Montenegro	17%
63	Morocco	20%
64	Namibia	15%
65	Nepal	13%
66	Netherlands	21%

67	New Zealand	15%
68	Norway	25%
69	Pakistan	16%
70	Palestinian Territory	14.50%
71	Panama	7%
72	Paraguay	10%
73	People's Republic of China	17%
74	Peru	16%
75	Philippines	12%
76	Poland	23%
77	Portugal	23%
78	Republic of Moldova	20%
79	Romania	24%
80	Russia	18%
81	Saint Kitts and Nevis	17%
82	Serbia	20%
83	Singapore	7%
84	Slovakia	20%
85	Slovenia	20%
86	South Africa	14%
87	South Korea	10%
88	Spain	21%
89	Sri Lanka	12%
90	Sweden	25%
91	Switzerland	8%
92	Taiwan	5%
93	Thailand	7%
94	Trinidad and Tobago	15%
95	Tunisia	18%
96	Turkey	18%
97	Ukraine	20%

98	United Kingdom	20%
99	Uruguay	22%
100	Uzbekistan	20 %
101	Venezuela	12%
102	Vietnam	10%
103	Austria	20%
104	Belgium	21%

Source: Wikipedia

2. 1.2 History and Development of VAT in Nepal

In the eighties, various countries, to maintain a sound macroeconomic policy, adopted various takes of reform programs. This program was in swing in 1990's. As the adoption of reform program was at the heart of worldwide policies. Nepal was no exception. The Nepalese government revealed its intention for the adoption of various reform programs to promote market oriented economy in the Eighth Plan (1990-1995) document. In a process to reform task policy, it has mentioned that some time in the med-plan period a VAT will be introduced in the country. Before that VAT was completely unknown word to the general people of Nepal. After a restoration of democracy in 1992/93, a two-tier sales tax system was in function at that period. Under this system dealers and distribution of nine-selected items were required to register for sales tax purpose and collect tax on their sales. It was extended further to five more items in 1993/94. Only the amount of tax paid to manufactures was allowed to credit. Further, sole distribution or agents of the foreign firm or companies and their wholesalers were also required to register for the purpose of collection of sales tax.

As a part of its liberal economic policy, the government of Nepal asked donors to study the VAT system. Finally a VAT task force was created in the Sales Tax and Excise Department in 1993. United States Agency for International Development (USAID) and Consultancy Assistance for Economic Reform for International Development (HIID) started the study in order to makes the necessary preparation for the introduction of VAT. The task force was fully devoted to accomplishing preparatory work. It prepared the draft for VAT legislation, organization, staffing, and

exemptions. Due to political instability and frequent changes in the priority for the implementation of VAT, the task force could not continue its job. At the time of creation of task force, the Nepali congress was in absolute majority in the parliament. A mid-term poll changed the political scenario. The United Marxist-Leninist (UML) party created a minority government whereas the Nepali congress became the opposition party. The government led by UML could not reveal its positive attitude towards the implementation of VAT. In the contrary, the two-tier sales tax was declared to be removed in its 1994/95 budget. This negative step hurt the donor agencies and consequently the USAID suspended its support and Harvard Institute for International Development's experts returned. The VAT task force was dismantled. Soon after the verdict of the Supreme Court to re-install the dissolved parliament, a coalition government led by Nepali congress, formed and it showed as earlier, a firm commitment to introduce VAT in its F/Y 1996/97 budget. The USAID resumed its support but the amount allocated for the study of VAT had already been transferred to other projects. Again, scarcity of fund is realized by the government and search of the donor who can provide the necessary fund and technical assistance for the implementation of VAT. After all, the DANIDA supported the VAT project. It is continuously supporting till now. As a part of preparatory work, the VAT Act was passed in 1996 by the parliament. The government in 1997 approved VAT Regulations. In the same year, the department of Sales Tax and Excise were renamed as the Department of Value Added Tax (VAT). After a year, the Ministry of Finance approved nine volumes of manuals. Furthermore, VAT Taskforce organized a various discussion and interaction program related to VAT in different parts of the country. Various introductory brochures were published and distributed to the potential taxpayers, businessmen and the administrative staffs. The VAT was initially scheduled to be effective from July 1997. The government was planned to register the potential taxpayer in VAT from this period. In support of VAT, the government decided to rationalize the tax structure by educating the rate of income tax, sales tax, and custom duties in advance. The VAT was to replace the Hotel Tax, the entertainment Tax and the Contract Tax. For this purpose the VAT task force was preparing its work in accordance with the schedule. Meanwhile the private sector of business field opposed the government policy on adoption of VAT. Nepal Chamber of Commerce held a nationwide discussion program among traders, businessmen,

industrialists and their representative association in March 1997 to collect the attitude towards the introduction of VAT in Nepal. Most of the business community showed their dislike to the VAT which was scheduled to be operated from two months later. Business persons protested the decision of the adopting of VAT with the slogan “NOVAT” issue of VAT resulting in a conflict between the government and the private sector. Confrontation continued for a long time. Accepting the increasing pressure of business sector, finally the government decided to postpone the date of application for four months. The government also announced the date for the VAT to be effective from November 16, 1997. With a view to facilitating the functioning of VAT the government made an arrangement in the budget for F/Y 1997/98 to convert the Hotel tax into the Sales tax. The rate of the sales tax reduced from 15 percent to 10 percent. Further the rate and the slab of income tax and customs duty were also lowered. The government took a heavy revenue risk by curtailing the rate and structures of various taxes without prior demand of the taxpayers.

Whatever reasons were laid for the postponement of the effective date of VAT, the preparatory team got a very valuable time for the preparation of VAT. The government and its associated body tried to convince the business community in favor of VAT. It was really a very hard work to implant VAT without the dull cooperation of business community. The VAT project, Ministry of Finance as well as Department of VAT devoted the extended period of making friendly relations by providing more training, information campaign meetings, talk program and interaction program between different groups of people. In the mean time the business group was also divided into two groups. Industrialist was in favor of VAT whereas the trading group was against it. Despite heavy protest by the trading group, the government implemented the VAT from the scheduled date of November 16, 1997.

Even after the adoption of VAT the days were not as easy as expected. Trading businessmen were completely against the VAT whereas industrialists were in favor of it with heavy concession on various taxes. The government announced all the concessions without prior plan in budget speech four months before the date of VAT implementation, which could not motivate the businessmen. On the one hand the businessmen enjoyed the privilege provided by the government for the successful enforcement of VAT, on the other they continued to protest against VAT.

Political situation was also volatile. The government was in a pressure to quit. As usual, the businessmen were against VAT. Industrialists were in favor of further concession in tax regime that was against the principle of VAT. VAT administrators were not fully aware of its system. Due to various reasons VAT could not function as expected. The business community demanded the continuation of all exemptions and incentives granted under the sales tax system.

Businessmen were also very angry at the function of octroi a local tax. FNCCI, a apex body of private sector, decided on February 4, 1998 that they would not sit for negotiations with the government regarding the implementation of VAT unless the government scrapped out octroi.

On March 1998, the government and the private sector reached agreement regarding the modalities of the implementation of VAT. Exemption of industrial machinery and tractors, soft behave towards the retailer, acceptance of the bill value in import point, setup a committee in order to review the VAT law and establishment of permanent revenue board where the main agreement. Since most of the agreed points were not activated the businessmen again began to oppose VAT. A series of discussion took place before the presentation for the F/Y 1998/99 budget. The demands of Businessmen were increasing considering the volatile situation of the political party. The government requested for the agreement but the businessmen rejected the proposal and did not sign in agreement. Even though the government addressed few issues that were asked by the businessmen, Finance Bill 1998 incorporated following changes.

- i. The threshold was increased from Rs. 1 million to Rs. 2 million.
- ii. Cottage industry got relief from the registration in VAT.
- iii. A special arrangement to be provided to settle the old stock of businessmen.
- iv. The rate of interest was reduced to 15 percent from 18 percent.
- v. The ate of penalty of the late filing of return fixed at 0.1 percent per day instead of 100 percent
- vi. Tax offices were empowered to issue a tax assessment if tax prayer cannot justify the reason for under invoicing.
- vii. Firms, companies and industries are required to issue serially numbered invoice with their names and addresses. The VAT administration may inspect, with prior approval of the DG of the VAT Department, the books of

accounts of unregistered vendors in connection with VAT, and may penalize if the books of accounts are not maintained properly.

- viii. A list of exempted items increased.
- ix. Despite above mentioned provision, the government also announced the several measures in the field of income tax, customs duty and revenue investigation with a view to rationalize the tax in accordance with VAT principle. Provision of some curative measures provided for the simplification of tax collection irritated businessmen more than were attracted towards it. They continue to oppose the VAT system vigorously.

Finally both parties agreed not to implement the provisions provided by the Finance Act until they reached an agreement. Ultimately, both parties agreed on 39 points on September 1998. Most of the agreement was in connection with the further exemptions and concessions in various fields VAT as well as to the taxes. Few of them were in adverse direction of VAT principle.

VAT administration had allocated a TPIN (taxpayer identification Number) consisting of nine digits to registered taxpayer with a view to process data in computer. It was developed as per international standard. Last ninth digit was for checking the accuracy of the number, which is called check number. All the records of taxpayer are stored in the computer in database format. As the computer processed all the data of taxpayer, it has become an integral part of VAT administration. Before that all the records were kept manually.

In accordance with the purpose of integrating VAT and Tax department into one department from coming year a provision was made in Finance Act, 1999 that “A PAN (Permanent Account Number) was allocated to the registrant of income tax from the next fiscal year”. For this purpose a Taxpayer service center established under the department of Tax. PAN was also similar to TPIN. Those tax payers who have already received the TPIN were converted to PAN with same number. The service of this center was only confined to nine offices of Kathmandu valley. Issuance of PAN was accessed to all tax payers of the country from December 16, 1999 after the establishment of Inland Revenue Department (IRD). For the simplification of management of date, a database computer system has been developed since the inception of VAT in Nepal. With a view to provide all the services from the same window and to make effective mobilization of internal resource, the government

decided to integrate the Department of VAT and department of Tax. The department of VAT merged into department of Tax on April, 2000. Through the budget speech for F/Y 2001/02, the government announced to establish “Inland Revenue Department” from July 2000. Before the merger, there were 17 offices under the VAT Department and 41 offices under the Tax Department. To over the whole kingdom of Nepal, all those offices merged together and established 21 offices on the basis of including geographical region, number of taxpayer, taxpayer services and potentially of tax collection. Out of them, four offices were classified into “A” class, tow into “B” lass, five into “C” class, five into “D” class and Five into “E” class. Officials and staffs wee reorganized according to its work load. The newly established department will administer the following taxes from the same window.

- i. Income tax (individual and corporate income tax, Remuneration income tax, interest tax, house rent tax.)
- ii. Value added tax.
- iii. Non-tax (dividend, principal, and interest payment, royalty, charges and fees)
- iv. Other related charges and fees related to excisable goods.
- v. VAT has been justified in the light of government fiscal imbalances and need for extra revenue mobilization through an efficient tax system. The Government of Nepal has increased VAT to 13% effective from Magh 1, 2061.

2.1.3 Types of VAT

There are three types of VAT that 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 subsequence years.

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

Income type VAT

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

Income type VAT = Gross Receipt (GR) - Cost of Intermediate Goods (CIG) - Depreciation (D)

GDP Type VAT

It excludes neither the purchase of capital goods nor the depreciation form the tax base. It means the tax is levied on bath consumption and goods investment.

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

2.1.4 Methods of computing VAT

Value -added tax can be collected by using the different methods of computation however; the choice of the appropriate method depends on the type of VAT employed and the principle under which VAT is adopted. The VAT can be computed by employing any of the three methods,

- i. Addition method,
- ii. Subtraction method, and
- iii. Tax-credit method,

Among the above "the last method has never been utilize"(Due,1976:71)

Addition Method

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

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

If the firm constructs its own capital good rather than purchasing it, this addition method captures the value added by the firm. The capital method is readily applicable to the income type but clumsy for the consumption type of value added tax (Musgrave and Musgrave, 1976:401). Virtually, no country uses the addition method, although Argentina and Israel have applied it to selected economic activities, such as banking and finance, where value of inputs and outputs is difficult to measure. From the practical point of view; this method is more complex to compute.

It would be awkward to use the addition method to compute the base of the consumption type of value-added tax since to the net profit figure there would have to be added depreciation and the excess of opening inventory net profits), with subtraction of capital goods purchased or produced within the firm and subtraction of an excess of closing inventory over opening inventory (Shoup, 1969:259)

Subtraction Method

Under this method, value added is determined as net turnover, which is obtained by subtracting the cost of materials from sales proceeds (Khadka, 1989:5), and the procedure was used in the Michigan VAT (Due, 1976:7d1). Value added is obtained by subtracting purchases of produced goods from the figure of sales during the period, as given in functional form by,

$$VAT = f(S_v - P_v)$$

Where, f=function of, S_v = Sale value; P_v = Purchase value

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

Tax Credit Method

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

$$\text{VAT} = f(\text{Outputs} - \text{inputs}) = (\text{Tax paid on sales} - \text{Tax paid on purchases})$$

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

be the rate at various earlier stages, the process of calculation VAT liability under different methods are shown in the table below:

Table2.3 Methods of Computing VAT

S.N	Methods	Stage of Production and Distribution			Total
		Manufacturer	Wholesaler	Retailer	
1	Addition Method				
	a. Wages	10000	5500	7500	23000
	b. Rent	3000	1500	1500	6000
	c. Interest	1500	1000	500	3000
	d. Profit	3500	2000	2500	8000
	e. Value added(a+b+c+d)	18000	13000	12000	40000
	f. VAT liability(13% of e)	2340	1300	1560	5200
2	Subtraction Method				
	a. Sales	86000	96000	108000	290000
	b. purchase	68000	86000	96000	250000
	c. Value added(a-B)	18000	10000	12000	40000
	d. VAT liability(13% of c)	2340	1300	1560	5200
3	Tax Credit Method				
	a. Sales	86000	96000	108000	290000
	b. Tax on Sales	11180	12480	14040	37700
	c. Purchase	68000	86000	96000	250000
	d. Tax on Purchase	8840	11180	12480	32500
	e. Net VAT Liabilities(b-d)	2340	1300	1560	5200

Note: All the sales and purchase are exclusive of Tax and figure are arbitrarily assumed

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

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

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

From the above table, it is clear that VAT liability calculated by any of the three methods is same that Rs. 5200. In the table, VAT rate is same that is 13% for all methods. However, if there is rate differentiation in different stage VAT liability will differ for different method. Although, the change in the VAT liability will be same under both the addition and subtraction method, as there is same amount of value added at each stage of production and distribution. Assuming that the transactions (Figure) presented in the table are for economy as a whole in a specific period of time, a VAT of 13% rate gives Rs. 5200 as tax under the first two methods having the amount of value added Rs. 40000. In tax credit method, value added, as such is never calculated however VAT liability exactly equals to that by other methods. Thus, VAT is levied on the basis of value added but not directly.

2.2 Value- Added Tax and Other Sales Taxes

2.2.1. VAT versus Turnover TAX

The turnover tax, the earliest form of the sales tax, offers the advantage of simplicity- all transaction are taxed, typically at a uniform rate, and the yields the maximum revenue for given tax rate. As the tax is imposed on the gross monetary value of a product at multiple stages of business activity, it is multistage and broad based in nature. The turnover tax or cascade tax is levied as a percentage of sales, regardless of value added, at each stage of sale right from the initial production of materials to the final sales to the a consumers. Thus, the burden of tax as percentage of consumer expenditures vary widely on different goods because of the varying number of transactions involved in different commodities between initial production and final sale to the consumer. since, turnover is proportional to a firm's turnover, gives an incentive to vertical integration, as the tax may-make it cheaper to produce and intermediate product within a firm than to buy a similar input produced more efficiently by an outside supplier, in contrast, value added tax do not provide this artificial adjustment to vertical integration so have been very widely adopted in preference to turnover tax. Under the system of turnover tax, taxable value of any commodity depends on the number of stages it passes through the production and distribution process. This makes the larger base for the cascade tax so the revenue productivity is high. Instead, value added tax is less productive since the base is only value -added.

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

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

In Europe, the turnover tax was used after World War I, from Germany, France, Italy, Belgium, the Netherlands, and Austria but has been superseded by the VAT. Similar, in many developing countries, the turnover taxes have been replaced by other forms of sales tax. However, the turnover tax will do less harm where there is little manufacturing and exports consist of primary products or the output of integrated enterprises than in countries with more diversified economies (Goode, 1984; 1540).

2.2.2. VAT versus Manufacturers' Sales Tax

Manufactures' sales tax is levied on the sales value of manufacturing in case of the domestic product and on the import value in case of the imported product. Basically, the tax is not levied on the sale to other sales tax registered vendors, in such cases the sellers had to note on the invoices the buyers sales tax registration number and particular of the goods. Thus, sales tax registered manufactures could purchase their raw materials, auxiliary raw materials and chemical becoming physical ingredients of

taxable products free of tax. So, the tax base of a manufactures' sales tax narrows too much as compared to VAT which covers value added in each stages. The broader base of VAT is not only due to the inclusion of value added of each stage but also due to the coverage of services as well. If the make-up system is introduced in the tax, it will cover the various costs including transportation and profit margin of the importers in the sales tax base. MST, however, being a single stage sales tax, will avoid the worst evils of the cascade tax, if it is properly designed. Under the MST, the exclusion of unprocessed foods and many artisans' products-either legally or because of noncompliance-mitigates the burden on the lowest income classes. Unlike the cascade tax, MST creates as incentive to the firms to push various functions beyond the point of impact of the tax in order to reduce the amount of the tax due. Thus, forward integration of the manufacturer is discouraged and helps for specialization. However, when the manufactures transfer their own activities to dealers and wholesalers, establish artificial sales depots, undervalue sales etc, it brings inefficiency in the production and distribution channel.

The distribution of the tax burden under the MST is no t uniform to various consumer goods. And to the domestically produced and imported goods because of variation in magnitude of wholesale and retail level margin. The variation is haphazard, if anything, the burden will be greater on the basic necessities, which tend to have low margins than on the most luxurious goods on which the margins tend to be high. There is a particular danger of favoring imports, since advertising and other distributive activities with respect to these goods may be performed after the point of importation, whereas the costs of these activities will be reflected in the manufacturers' prices of domestically produced goods, if they are performed by manufactures. VAT would put as equal burden on both imports and domestic products since the burden of this tax depends upon the final price irrespective of the proportion of the value added at different stages in the process of imports, production, and distributions. It would improve the efficiency and competitiveness of domestic products in the international market by relieving exports from taxation.

Under MST, one serious defect, cascading becomes inevitable when goods and services are purchased from registered firms by nom-registered firms and supplied again to registered firms. In practice, it is possible in many developing countries, where importers directly sell their imports to non-registered firms or persons, which

may be raw materials for manufacturing industries. Even the purchase of raw materials from registered firms or primary producers are also taxed, which further extended the cascading effect and hence strikes a growing economic sector. Further, the refund system is not perfect in MST. In contrast, VAT does not suffer from cascading or pyramiding effects and it does not affect economic growth negatively. Under a VAT, the taxable price always equals to the final sales price of the goods so that the net tax liability cannot be reduced by altering the methods of doing business .so, there will not be incentive neither for vertical integration nor for disintegration. This makes the tax system neutral. Which helps VAT to stand superior to the MST? However, VAT is difficult to administer than the MST. Basically, the difficulties arise due to the provisions like tax credit, refund, exemption, zero-rating, cross-checking etc and further, the taxpayer are in large number than the MST. However, the VAT can be made simple and effective by some measures, which are carried by the tax itself. They are; i) actual invoice based self-assessment mechanism, ii)VAT serves catch-up effects, which make tax evasion likely impossible; iii) VAT has a self policing features; iv) cross- checking of tax liability and credit is possible; v) net tax liability is distributed to all production and distribution stages rather than concentrating only in a single stage. Lastly, to conclude, more advantages of VAT over the MST can be attained when the tax is extended to the retail level.

2.2.3 VAT versus Wholesalers' Sales TAX

Wholesalers' sales tax, as such, is a tax on the sales value of the wholesalers, and hence it has a broader base than the MST since it covers the margins of the wholesalers into the tax base as well. Although, the significant difference between WST and MST depends on the extent to which wholesaler's sales tax is applied to the sales to retailers. Since the wholesaling is not carried on exclusively by separated enterprises and is done also by importers and manufactures, it is necessary to register all three kinds of enterprises (manufacturers, importers and wholesalers) and collect tax on their sales to unregistered buyers including retailers and consumers. It has been recommended for developing countries by some well-known experts but in practice has been only in Portugal and a few developed countries, including the United Territory, Australia, and New Zealand, An administrative advantage of the

wholesalers' sales tax that is relevant for equal treatment is that manufactures who sell direct to retailers do not need to be taxed on a hypothetical price that is less than the actual price, to be able to compete with manufactures selling it independent wholesalers (Shoup, 1969:242)

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

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

2.2.4 VAT versus Retailers' Sales Tax

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

There is no incentive to alter distribution system, most import and domestic goods can be treated equally pyramiding is avoided, and the desired pattern the distribution can be

attained. Thus, RST avoids virtually all the problem associated with the MST because of the imposition at the Final sale to consumer.

The actual amount of tax under RST is not affected by the number of stage through which a commodity passes but depends on the tax rate and the for price of the commodity. In the similar manner, under a VAT system the net liability remains unchanged regardless the choice of production and distribution system, since tax is levied only on the value added at each stage. In addition some aspects like reliving producers' goods from taxation, free export from and broader tax adjustment are possible feasible in both the taxes VAT and RST is less than VAT. The problem of cascading does not appear in both VAT and RST because there is no possibility for tax being levied on tax, since important is relived from taxation through the suspension technique under the RS while the same objective is achieved through the tax credit method. Both a similar while considering the treatment of imported and domestically produce goods. Further, similarity appears on the avoidance of the pyramiding problem since vendors need not be apply a mark up on the tax amount levied on earlier stages, under both the taxes. In this regard, RST may be considered a seriously competitor of the VAT. Beyond the similarities between VAT and RST, there are also some basic differences between them. The collection of a retail sales tax places the entire impact of the sales tax upon retailers while much of VAT is collected at pre-retail levels. Under the RST, if t he manufacturers, wholesalers, or importers directly sell to the consumers, the whole tax amount from that community is lost, while under a VAT, it will reduce only a part of total tax liability that is amount of VAT liable at that stage. In developing countries, most of the retail traders are small entrepreneurs with relatively inadequate records and a high prosperity to evade tax. Thus, particularly in a developing country, the danger of complete evasion is far less with VAT, since any sales can be collected more effectively form typical manufacturers and wholesalers than form retailers.

The only one advantage of RST over VAT is that the number of taxpayers is small; however a significant problem is created because of the large number of small retailers having only limited records. If such very small retailers are kept beyond the tax net from the administrative difficulty, resulting decrease in the tax base is much larger under a RST than VAT. It is because RST loses entire amount of tax on the sale of exempted seller while such exemption causes a loss of tax only in a small

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

2.3 Superiority of VAT

From the above comparison, VAT is definitely non-distortion and desirable than sales tax and other single-stage levies, however, the RST is the nearest competitor, VAT is a perfectly neutral tax, which does not discriminate regarding the producers and consumers' choice. Due to the broader coverage of VAT, it is more productive, and does not carry any undesirable evils in the economy like others. The provision of VAT like exemption, threshold, zero-rating, refund etc makes the tax system more equitable. It also induces investment and export trade by eliminating capital goods and exports from the tax base. Avoidance of pyramiding and cascading effects is the basic feature of VAT. Cross-auditing and self-policing are other important features associated with VAT. In addition, VAT based on origin serves a special benefit to the countries of Common Market Area since neither boarder checking nor import or export verification of control is needed.

2.4 Principle governing VAT

There are following principles, which are governing VAT.

1) 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.

2) Removing cascading effect:

Cascading in tax system means tax on tax. Within sales tax system, tax paid at one stage becomes the cost for another stage. Therefore, there is tax on tax especially on multi stage tax system. However, 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.

3) Increasing the tax base:

Nepalese economy is small. The tax evasion in Nepalese tax system is 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 taxpayers 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.

4) Maintaining Neutrality:

The guiding principle of current tax system is neutrality. Neutrality concept in relation to taxation says system should not discriminate one economic activity against other. It should not disturb production, distribution & consumption pattern of the economy. VAT is a tax system, which is neutral.

5) 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 taxpayer 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.

Netting off under 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 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 businessman 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 government revenue or 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 in nature.

2.5 Importance of VAT

Now a day's 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 programmers 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 i.e. govt. policies & programmers alone cannot achieve such a massive task unless they are properly backed by businessman of the country. This never means 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:-

1) VAT is and efficient Tax system:

VAT system is considered as a efficient tax system than test other product base tax system. Its application is found to be beneficial from many angles. The system is advantageous to me tax authorities, because it ensures collection of more & more revenue to the govt. in a perennial way. It is beneficial to the 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 and market price. Ti is good from the businessmen's point of view as well because if 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.

2) 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 helps 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 eliminated inefficiency of product base tax systems & thus, restrict unbridled price rise in the market.

3) VAT discourages business firms to under state 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 in allowed for balancing with the tax collected on sales & thus business firms will not be tempted to understate their income statement incase, 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.

4) VAT helps to controls 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 good costlier than the same products of other registered competitors in addition, govt. organization, 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 conduction unauthorized trade.

5) 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 encourage export & helps to earn foreign convertible currency. It helps to increase employment opportunities in the country. It attempts to decrease financial in efficiency 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.

6) 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 at custom point; tax authority will be deprived of collecting tax on transaction of the product. It is true in case of sales of manufactured goods. But under VAT system, applicable tax cannot 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.

2.6 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 main reason for implementing the system is 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.

1) 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 making 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 number of businessmen. In order to remove this, VAT regulation is introduced in our country, which requires transactions performed at retail stage too pay tax. This will broaden the existing tax net of our country to an extraordinary level.

2) 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 a viable solution in the hand of govt.

3) 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 and 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 height beyond imagination.

4) Fairer tax system:

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

5) Reduce foreign dependencies:

Our economy is in a disgraceful state we are heavily dependent to run our economy and day to day administration of the country upon foreign loans, aids, grants etc. we have been loitered in foreign debts and 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 it 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 and to bring timely reforms in administration of the govt. revenue and they are assisting us technically and financially in these areas. 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 and loans.

6) Justification for tax payment:

Vibrant social system and equitable and peaceful society are dreams of and 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 and spend the money for keeping the society live and peaceful so that the people who pay tax can earn more and more money by doing business in the society. Maintain peace and security in the society so that wealth earned by doing business is secured there. Check all sorts of malpractices in business so that irregularity and gap between rich and 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.

7) Others:

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

2.7. Basic features of Nepalese VAT system:

While Nepal has adopted a conventional VAT similar to that implemented over 130 countries around 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 communication of VAT is tax credit method.
- iii. Followed the principle of destination.
- iv. There is provision of exemption and zero rate goods and 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.

2.8. Structure of VAT

2.8.1. 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 person's 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 through to the retail level. So, value added at each stage by each firm 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.

2.8.2 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 the 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 and no credit is allowed for tax paid on inputs. Exemption thus implies the exclusion of certain goods and services from the tax jurisdiction. For example, if exports are exempt, exporters are not 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 in to 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.

- i. Basic agriculture products.
- ii. Goods of basic needs.
- iii. Live animals and animal products agriculture inputs.
- iv. Medicine, Medical and similar health services.
- v. Education.
- vi. Books, Newspapers etc.
- vii. Artistic and cultural goods and services, carving services.
- viii. Personal or professional services.
- ix. Other goods and services.
- x. Land and building.
- xi. Betting, Casinos, Lotteries.

2.8.3 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 rat 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.

- i. Goods and services purchased or imported
- ii. Exports of goods
- iii. Exports of services
- iv. Imports goods and services by accredited diplomats.

2.8.4 Threshold

Small vendors having an annual turnover up to 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 taxpayers.

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 there, 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 millions. 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.

2.8.5. 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 permission there constant therefore a consideration. To be a taxable supply the consideration can be in money or money's worth.

2.8.6. Place of Supply

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

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

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

2.8.7 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:

- i. The time of issue of an invoice by the supplier.
- ii. The time, when the supplier receives the payment for goods and services.
- iii. In case of the goods, the time when the receiver receive or take away, the goods from the transaction place of t he supplier.
- iv. 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:
- v. 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.
- vi. If UK payment for goods and services is partially made, the earliest day on which the payment is made.

- vii. In case of the goods or services having not 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.

2.8.8 Taxable Value

Taxable value is an object 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 adjustment such as discounts or rebates at the time of the sale 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 supplier and recipient are independent of each other. The supplier should include all the expenditures bear 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, taxable value is calculated by subtracting purchase value from the sales value. If a tax officer is not satisfied that the declared value is significantly below than the market value, he may determine the value of the disputed transaction to the best of his ability.

2.9 Operation of VAT

2.9.1 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. However, 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 collect 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 is calculated along with the head. Nepalese VAT follows the following registration procedures:

- i. Fill in VAT registration application form.
- ii. In case of partnership, fill also next form designed for partnership firms.
- iii. Attach it with the copies of business and income tax registration certificates.
- iv. 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.
- v. By processing the information, VAT department prepares a VAT certificate with TPIN and provides it to the concerned taxpayer through the corresponding VAT office.
- vi. 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.
- vii. In the process, taxpayer has to furnish information within 15 day in case of changes in the information mentioned in the VAT application form.
- viii. Every taxpayer is required to mention the TPIN in the following documents:
- ix. Tax invoice/abbreviated invoice 0 Purchase and sales book.
- x. Documents for the correspondence to the VAT office.
- xi. Documents relating to income tax.

- xii. Documents relating to customs duties, and Documents relating to obtain a loan from a bank or any financial institution exceeding Rs.1,00,000.
- xiii. The taxpayer has to furnish information within 15 days, in case of change in the information maintained in the VAT application form.
- xiv. A VAT registered firm can apply for de-registration under the following conditions:
- xv. 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.
- xvi. In case of the personal ownership, if the owner dies.
- xvii. In case of partnership firm if it is dissolved.
- xviii. If a registered person ceases to be engaged in the taxable transaction.
- xix. If registration is done in error.
- xx. 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.

2.9.2 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:

- i. A sequential identifying number.
- ii. The date of the transaction.
- iii. The date of issue of the invoice, if it is different from the date of the transaction.
- iv. The name, address, and TPIN of the vendor.
- v. The name, address, and TPIN of the buyer, if registered. The type of transaction (eg. Sale, hire, render)

- vi. A description sufficient to identify the goods and services supplied.
- vii. The quality of the goods or the extent of services for corresponding description.
- viii. The rate of VAT and the amount of payable, excluding VAT for each description of goods and services.
- ix. The value of any goods or services provided in part exchange.
- x. The total amount payable excluding VAT.
- xi. The rate and amount, if any discount offered.
- xii. The total amount of tax charged.
- xiii. 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."

- i. The abbreviated invoice shall not be used for transactions exceeding Rs.5,000 including VAT.
- ii. The registered person must keep a daily record of sales.
- iii. Any bill rolls or cash rolls used by the retailer must be totaled daily and retained for inspection at any reasonable time.
- iv. The following information must be recorded on the abbreviated invoice.
- v. An identifying number issued in sequential order.
- vi. The name, address and registration number of the vendor.
- vii. The data of transaction.

- viii. A sufficient description to identify the goods or services supplied.
- ix. 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.

2.9.3 Books of Account

Every VAT registrant requires keeping records of all the invoices either received or issued, including the serial number and date of issue. In general, VAT liability is determined based on 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 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 based on 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 of VAT purposes. Sales book is also an invoice based account. At the end of each accounting period, VAT registrant's 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 may change 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 using 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:

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

2.9.4 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 credit clearly. Further, such debit or credit note must include the following:

- i. Serial number.
- ii. Date of issue.
- iii. Name, address and registration number of supplier.
- iv. Name, address and registration number of the recipient, if registered.
- v. Number and date of tax invoice related to the transactions.

- vi. Description of goods or services and reason for credit and debit.
- vii. The amount of debit or credit.

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

2.9.5 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 return 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 sub branches if any. There is no special rule, 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 the input tax is higher than output tax. This situation may arise when taxpayers' build-up their inventory or when outputs are zero-rated, such as exports. It is not unnatural to expect some credit return 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 taxpayer 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.

2.9.6 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 trimester basis.

Some circumstances are beyond the control of a taxpayer. 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 acts as late payment penalties. The rate of such penalty is 10% of the VAT payable in the first month, an additional 10% 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%. Interest on overdue is charged on a calendar month basis. However, such interest will not be less than 12% of the average interest charged by Commercial Bank of the period.

2.9.7 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 form, 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 taxpayer produce their own assessment applying die tax rule 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 is as follows:

- i. Tax return is not filed,
- ii. Tax return is late,
- iii. Tax return is incomplete, or
- iv. 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 trimester assessment, depending upon the state of a particular taxpayer. The process regarding computer assessment is designed in the following way:

- i. Find out the highest amount declared by the taxpayer in his tax returns during the pervious 12 months from the VAT payable.
- ii. 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 filing periods in the year then multiply by the VAT rate.
- iii. Pick the highest figure in a or b.
- iv. Add the amount found in (c) to the 20 percent or 30 percent of it self to get the assessment amount.

Management Assessment

The tax officers do management assessment when a taxpayer receives updated information after submitting his return 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:

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

2.9.8 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.

- i. Tax officers can also issue to 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.
- ii. Tax officers can also authorize to suspend the transaction of a VAT debtor.
- iii. Tax officers can also withhold the export/import of a VAT debtor.
- iv. Tax dues can also be realized by seizing and selling the property of the VAT debtor.
- v. 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.

2.9.9 Tax Credit

Tax credits is an important element/characteristic of VAT system is a 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 paying VAT on their purchases

nor can claim an input tax credit. Input tax credit is allowed only when the following requirements are fulfilled:

- i. The goods and services supplied to the VAT registrants must be solely for use in his business of making taxable sales.
- ii. The registrant must hold and be able to produce a valid tax invoice for the goods and services for which credit is desired.
- iii. 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 credit⁵ in on the purchases related to tax exempted sales, but not to purchases related to his exempt sales. Only the purchases, for which 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. This includes such items as computers and cars. In these cases only partial input tax credit can be taken. For example, 40% of input tax credit may be claimed on aero planes and automobiles and 60% 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 alcohol mixed beverages such as liquor and beer and light petroleum fuel for vehicles. In this case no input tax credit can be taken.

2.9.10 Tax Refund

Under the Nepalese VAT system, there is a provision for the refund of VAT. Such situation generally arises 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-porter. 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 proceeded, 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 providing 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 a multilateral agreements also enjoy this facility.

Other Refunds

Refunds are also provided on some situations where VAT may be collected y 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.

2.9.11 Penal Provisions

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

2.9.12 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 relation to the suspension of his place transaction. However, before filing an appeal, the tax payers most deposit the disputed amount of the assessed tax due, the rest of the amount of lax due plus the win amount of the fine shall have to be deposited or a bank guarantee of the same has to be provided.

2.9.13 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 program can be functioned to the people. The present VAT administration may lie simplified into two functional heads as department and VAT offices. The VAT department and field offices under this department are responsible for administrating 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 with 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:

Table 2.4: VAT offices under VAT department

S.N.	Name of office	Place of office
1.	IRO Bhadrapur	Bhadrapur
2.	IRO Biratnagar	Biratnagar
3.	IRO Dharan	Dharan
4.	IRO Lahan	Lahan
5.	IRO Janakpur	Janakpur
6.	Big tax payer office	Harihar Bhawan
7.	IRO Kathmandu 1	Babarmanal
8.	IRO Kathamandu 2	Babarmahal
9.	IRO Kathmandu 3	Laximpat
10.	IRO Lalitpur	Lalitpur
11.	IRO Bhgaktapur	Bhaktapur
12.	IRO Hetauda	Hetauda
13.	IRO Brigunj	Birgunj
14.	IRO Simara	Simara
15.	IRO Bharatpur	Bharatpur

16.	IRO Krishnanagar	Krishnanagar
17.	IRO Pokhara	Pokhara
18.	IRD Dang	Dang
19.	IRO Bhairawaha	Bhairawaha
20.	IRO Dhangadi	Dhangadi
21.	IRO Mahendranagar	Mahendranagar
22.	IRO Nepalgunj	Nepalgunj

2.10 Review of Literature

Tax reforms to strengthen the country's system which becomes one of the seriously raised concerns in many developing countries in modern times. Most of the developing countries have undertaken many tax reform programs as an integral part of their development efforts in last three four decades. A distinguished and essential feature of tax in almost all developing countries around the world is the adoption of a VAT in their tax system.

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

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

He lastly developed a VAT proposal for Nepal showing some successful VAT implemented Asian countries-China, Indonesia, Korea, New Zealand, Philippines, and Taiwan. A study of VAT " in developing countries was undertaken by IMF staffs (1973) at the time when the introduction of VAT was gaining a pace in developed as well as in developing countries. The study examined the applicability of a VAT in seven developing countries have adopted the VAT considering the fact that many uncertainties arises in the introduction phase of new tax system because developing countries have limited experience. According to the study, "the most important feature of VAT in developing countries is its conceptual basis such as taxable base exemptions, treatment of small traders etc. Implementing VAT in the developing countries is also a big issue in present time. In fact, the feasibility of VAT in developing countries depends largely upon the ability and willingness of these countries to administer it. The administrative efficiency is also influenced by the structure of VAT employed and the social and economic environment of the country." Although the study shows that the VAT as a revenue raiser, the key problems should also be viewed from the angle of taxpayers compliance, as the cost of doing business tend to increase with VAT because of the various compulsory compliance procedure such as billing system, maintaining books of accounting and other accounting treatment.

Finally, the study that VAT produces between 10 to 30 percent of government revenues of the seven developing countries by the study and the VAT revenue in these countries is expected at faster rate than the rate of the growth of the economy.

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

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

VAT Revenue: VAT would generate more with less cost than taxes it replaces. "Traditional income and sales taxes have meeting public resistance and the VAT provides a new, buoyant revenue base, typically yielding more than initial estimates

as the case of Indonesia, Korea New Zealand, Portugal and Tunisia how". Because of broad coverage, this tax offers much greater revenue potentiality as compares to other types of taxes. According to the study the VAT contributes form 12% to 30% of revenue in most countries.

Neutrality: "The VAT is non distortion provided there are few exemptions and little Zero-rating on investment should be fully credited and this frequently is an improvement over the taxes replaced that often taxed capital goods."

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

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

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

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

Professor John F. Due and Ann F. Friedlander (1994) in their famous book "Government Finance" evaluates the VAT that in addition to avoiding the adverse consequences of turn over tax and greater revenue raise, a proper cross audit is possible. The possibility of cross checking is considered as a beauty of the VAT. In their view, tax reported as paid by one form to its suppliers for which it takes credited against it own tax liability, should appears as tax paid to the Government by the

suppliers. This cross check is not automatic but it can be made by auditors or ultimately by computers. So VAT is the most meritorious one, whose uses have extended rapidly.

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

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

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

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

Gautam, (2002) submitted the thesis on value added tax: problem and prospective.

-) The main objective of this study were:
-) To examine the possible effects of VAT in the Economy.

-) To observe the potential revenue of VAT in Nepal.
-) To analyze the existing challenges in VAT implementation.
-) To examine the Nepalese tax structure.

Requires data and information were collected from the secondary as well as primary source.

Gautem cited the following findings:

-) There is trend of persisting resource gap along with the huge amount of saving investment and import-export gaps in analyzing the revenue & expenditure structure of Nepal.
-) An efficient, strong & fair administration is the most crucial for proper implementation of VAT but VAT administration is weak.
-) There is a crisis of confidence between the private sector and the Government bodies i.e. VAT payers & self VAT collectors.
-) VAT being a self-assessed, involve based and account based tax the role of business community along with the general consumer is more important for its successful operation.

Acharya (2003) submitted the thesis on –A comparative study of sales and VAT in Nepal.

The major objectives of the study were:

-) To compare and evaluate VAT and sales tax from the view point of theoretical and revenue generation prospective.
-) To access the feasibility of VAT as an alternative to sales tax in Nepal.
-) To examine the impact of VAT on different economic issues like investment, threshold, price level, punishment and administration.
-) To provide valuable suggestion and recommendation for the effective implementation of VAT in Nepal.

Acharya used secondary as well as primary source of the study purpose.

Acharya pointed out the core finding which are as follows:

"In order to mobilize more tax revenue the tax system should be efficient, sales tax during mid 1990. The main weakness of VAT administration were lack of sound physical environment, weak financial resources, lack simple and transparent. It was

urgent to think the alternative of expert and lack of statistics. To study briefly about past 5 years VAT revenue collected at largest amount in fiscal year 2057/058."

Bhatta (2005) submitted the thesis on "Value Added Tax System in Nepal".

The major objectives of the study were:

-) To review background, trend of VAT collection and its contribution in Government revenue.
-) To analyze the problem faced by the Governments to collect VAT.
-) To study the efforts made by Government to collect VAT.
-) To evaluate the performance of VAT & find out the status & prospects of VAT in Nepal.

Bhatta cited out the following findings:

-) Administrative capability is great importance for the effective implementation of VAT in Nepal.
-) There is problem in billing system.
-) The VAT revenue collection is not satisfactory.
-) Various publicity programmers should be initiated.
-) Others.

Kakshapati (2005) submitted the thesis on "Revenue collection from VAT with its problems prospects".

The major objectives of the study were:

-) To revise about theoretical aspect of VAT.
-) To examine the importance of VAT in revenue collection.
-) To identify current problem & analyze future prospect of VAT.
-) To recommend for making VAT effective & efficient in coming days.

Kakshapati demonstrated the following findings:

-) Tax leakages have badly eroded Nepalese tax base.
-) Majority of the taxpayers are not conscious about VAT system of Nepal.
-) Due to weak administration system, the smuggling business activities have increased.

) Billing system is one of the major aspects of effective implementation of VAT.

Nepal (2008) submitted the thesis on "Revenue generated from VAT in Nepal".

The major objectives of the study were:

-) To analyze the status of VAT registrants.
-) To analyze the composition of VAT revenue.
-) To analyze the composition of VAT revenue.
-) To analyses the applicability of VAT.
-) To examine the helpfulness of VAT on economic growth.

Nepal cited the following findings:

-) Compulsory registrant is more than voluntary registrant in Nepal.
-) VAT revenue from import dominates VAT revenue form Domestic VAT revenue.
-) Among the source of revenue VAT has dominant all other sources of revenue collection i.e. income tax, excise duty and other.
-) People show positive response towards applicability of VAT.
-) VAT increases inflation.
-) VAT helps in economic growth.
-) VAT discourages illegal trade.

Ghimire (2008) submitted the thesis on "Contribution of VAT to National Income.

The major objectives of the study were:

-) To evaluate trend of VAT collection in IRO of Kathmandu and Nepal.
-) To assess the contribution of VAT from IRO, Kathmandu to national revenue, total tax revenue, indirect tax revenue and total VAT revenue.
-) To study about effectiveness and problems of implementation of VAT.
-) To provide suggestions for effective implementation of VAT in Kathmandu.

Ghimire cited the following findings:

-) The trend of VAT registrants in IRO of Kathmandu is in increasing trend which shows that people are being quite aware regarding VAT system and its advantage.

-) Revenue is in increasing trend so it is expected to generate more VAT revenue in future and in the long run VAT will be an integral part of Nepalese tax structure but the revenue resources have not increased to meet in increasing Government expenditure as expected.
-) The share of tax revenue is greater than the share of non-tax revenue and the share of VAT is very low in national GDP as compared to other developed countries.
-) VAT system will help government to curb illegal activities.
-) Difficulties in business registration procedure, accounting keeping system and cost of record keeping are the major problems in business sectors.

Shrestha (2008) submitted the thesis on "A study on VAT: implementation, problems & its effectiveness in the Nepalese economy."

The major objectives of the study were:

-) To examine the implementation of the VAT in general.
-) To analyze the problems faced by the Governments to collect VAT.
-) To conduct an empirical investigation regarding to effectiveness and problems of VAT in Nepal.
-) To provide suggestion on the basis of the study to the concerned authorities.

Shrestha cited the following findings:

-) Despite the best effort, large numbers of potential tax payers are outside the boundaries VAT net due to which honest taxpayers have to face unfair competition.
-) There is no proper system of valuation of goods in custom and control mechanism is also not good. Beside this open boarder is one of the main problem for successful implementation of VAT.
-) Businesspersons are not happy with the present increased VAT rate although t he present VAT act is very good for implementation.
-) There is lack of education among customers and business sector.
-) Fine and penalty system is very strong rather than facilitative one.
-) There is need of modern tools regarding registration of tax payer, investigation system, tam audit and systemic database.

2.11 Research Gap

About 15 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 contribution of VAT in Revenue collection in Nepal by identifying existing problems. This study is focus only on contribution of VAT to total tax revenue and this study is basic on secondary data. Only 11 years data has been taken for analysis and current price system is use for analysis of data. There are lots of researches on VAT in abroad but very few of these are concerned about countries like Nepal. SO, the study will mainly focus on the contribution of VAT to total tax revenue in Nepal. Besides this, the study will beneficial to the policy makers, revenue department, and students of tax, private sectors and researchers. It will provide the clear data, concept and ideas as well as knowledge to those persons who are interested and want to gain knowledge of VAT system. Similarly, it will be equally helpful to the researchers who carry out their research work. It will lead a step ahead about VAT by this research work. The focus of the research work is on the contribution of VAT and implementation in Nepalese perspectives.

CHAPTER III

RESEARCH METHODOLOGY

This chapter describes the research methodology used for achieving the basic objective of the study. Thus, it presents research design, population and sample, data collection procedure, tools for analysis and methods of presentation and analysis.

3.1 Research Design

A research design is a plan or blue print of investigation for the collection and analysis of data .It helps the researcher in the right direction in order to achieve the goal.

This is a descriptive, diagnostic and development research. Descriptive research is essentially a fact finding approach relative largely to present and abstracting generalizations by cross sectional study of the current situation and diagnostic research design relates to problem and to find out that solution. The research can also be taken as a development approach as it takes the developmental approach in finding out the solution. The research can also be taken as a contribution and Effectiveness of value added tax in Nepal.

3.2 Data collection procedure

Data and information used in this study is collected from secondary sours. To get accurate send actual information data will collected from economic survey published by ministry of finance, internal revenue department. In this study mainly secondary data are used more for analysis.

3.3 Population and sample

All the data Tax revenue, Non tax revenue VAT revenue, GDP contribution in Nepal are considered as total population. Sample size has been selected from 2000/01, 2001/02, 2002/03, 2003/04, 2004/05, 2005/06, 2006/07, 2007/08, 2008/09, 2009/10 and 2010/11 year data which will show the share of VAT to Revenue collection.

3.4 Sources of Data

Each field work has its own data needs and data sources. Data for this study has been collected from secondary source data.

Secondary Data

The secondary data of this research were collected from the following sources:

- a) Published and unpublished reports, articles and dissertations on the concerned subject.
- b) Published documents of National planning commission.
- c) Publication and annual report of Inland Revenue Department (IRD).
- d) Different publication of Central Bureau of statistics.
- e) Publications of Nepal Rastra Bank.
- f) Various books Written by tax officers and scholars.
- g) Publications Budget Speeches and Economic Survey of Various fiscal year of ministry of Finance, the Government of Nepal.
- h) Critical analysis published in National newspaper and magazine.
- i) Publications related to VAT and Total tax income.
- j) Website,

3.5 Methods of Data Presentation and Analysis

In the process of presentation and analysis of the data, various statistical tools were used in order to get the meaningful result. Collected data from primary and secondary sources were first processed for tabulation and analysis. For the purpose of analysis, following simple statistical tools were used:

- a) Simple Average,
- b) Simple Percentage,
- c) Graphs, charts and Diagrams,
- d) Trend analysis

CHAPTER IV

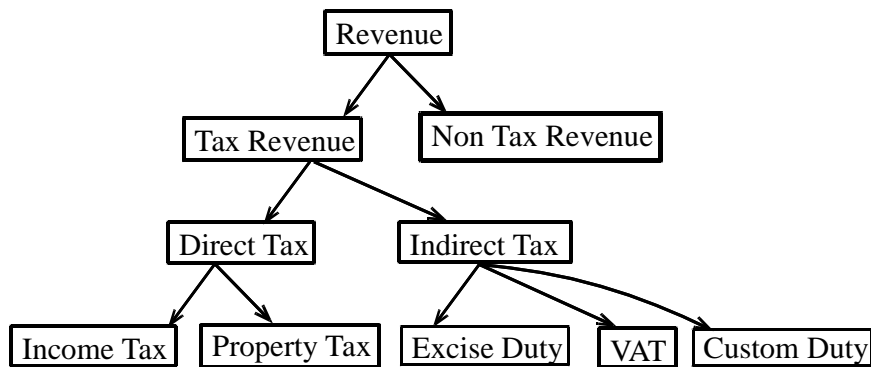
PRESENTATION AND ANALYSIS OF DATA

This chapter is devoted to the presentation and analysis of the Contribution of VAT to total tax revenue 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 international resources.

Revenue structure of Nepal is given below:



Revenue structure of Nepal

Contribution of tax revenue, non-tax revenue and percentage description is presented below in the form of table and diagram.

Table No. 4.1: Contribution of tax revenue, non-tax revenue in total revenue.

Fiscal Year	Total Revenue(Rs in millions)	Tax Revenue		Non Tax Revenue	
		Amount(Rs in millions)	% as Total	Amount(Rs in millions)	% as Total
2000/01	48893.8	38865.0	79.49	10028.8	20.51
2001/02	50446.6	39330.6	77.96	11116.0	22.04
2002/03	54538.9	40896.0	74.99	13642.9	25.01
2003/04	62331.0	48173.0	77.29	14158.0	22.71
2004/05	70122.7	54104.7	77.16	16018.0	22.84
2005/06	72281.9	57430.4	79.45	14851.5	20.55
2006/07	87712.1	71126.7	81.09	16585.4	18.91
2007/08	107622.5	85155.5	79.12	22467.0	20.88
2008/09	143474.5	117051.9	81.58	26422.6	18.42
2009/10	179945.8	156294.9	86.86	23650.9	13.14
2010/11	199818.7	172777.6	86.47	27041.1	13.53

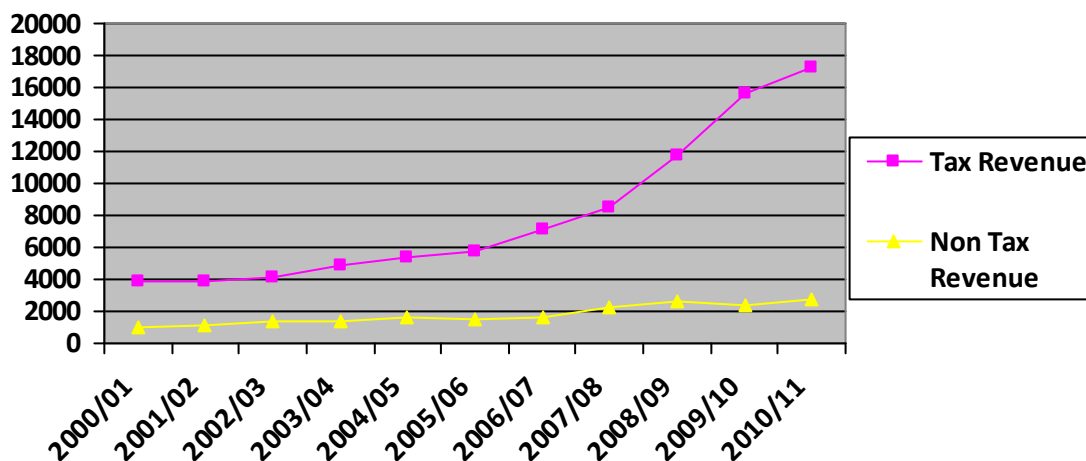
Source: Economic survey of various years, MOF

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 2000/01 to the fiscal year 2010/11 the revenue has increased from Rs. 48893.8 million to Rs. 199818.7 million.

Similarly tax revenue as well as non tax revenue is also increasing trend. Total tax revenue has increased from Rs. 38865.0 million to Rs. 172777.6 million in fiscal year 2000/01 to 2010/11. It is the main source of revenue collection. It has also contributed very much in national revenue. Similarly, Tax revenue as well as nontax revenue has also increased from 10028.8 million to 16018.0 million in fiscal year 2000/01 to 2010/11. But it decreased in the fiscal year 2005/06 to Rs. 14851.5 million. In the fiscal year 2006/07 to 2010/11 has also increased the non-tax from Rs.16585.4 million to Rs.27041.1 million. It has contributed less to national revenue.

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

Figure No.4.1: Contribution of tax revenue, non-tax revenue in total revenue.



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.

4.1.1 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 Value added 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

Fiscal Year	Total Tax Revenue(Rs in millions)	Direct Tax Revenue		Indirect Tax Revenue	
		Amount(Rs in millions)	%	Amount(Rs in millions)	%
2000/01	38865.0	10159.4	26.14	28705.7	73.86
2001/02	39330.6	10597.5	26.94	28733.1	73.06
2002/03	40896.0	10881.9	26.61	30014.1	73.39
2003/04	48173.0	11912.6	24.73	36260.4	75.27
2004/05	54104.7	13071.8	24.16	41032.9	75.84
2005/06	57430.4	13968.1	24.32	43462.3	75.68
2006/07	71126.7	18980.3	26.69	52146.4	73.31
2007/08	85155.5	23087.7	27.11	62067.7	72.89
2008/09	117051.9	34320.7	29.32	82731.2	70.68
2009/10	156294.9	41750.0	26.71	114545.0	73.29
2010/11	172777.6	48655.1	28.16	124122.5	71.84

Source: Economic survey of various years, MOF

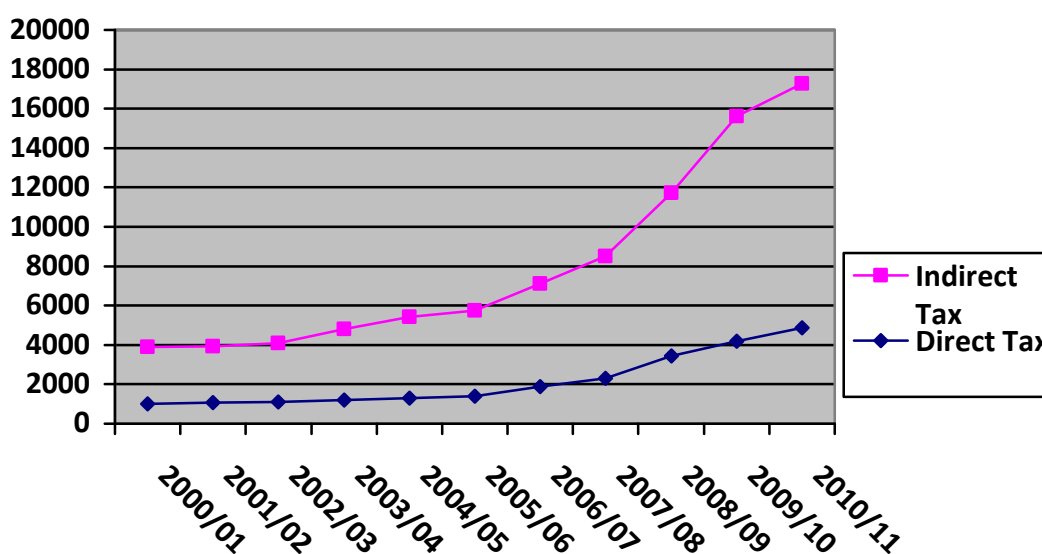
The table shows increasing trend of total tax revenue as well as its component i.e. direct and indirect tax. Direct tax has increased from 1015.94 million to Rs. 4865.51 million from the fiscal year 2000/01 to fiscal year 2010/11.

Similarly, Indirect tax has also increased from Rs. 2870.57 million to Rs. 124122.5 from the fiscal year 2000/01 to fiscal year 2010/11. The contribution made by direct tax on total tax, revenue is 26.14%, 26.94%, 26.61%, 24.73%, 24.16%, 24.32%,

26.69%, 27.11%, 29.32%, 26.71% and 28.16% in the fiscal year 2000/01, 2001/02, 2002/03, 2003/04, 2004/05, 2005/06, 2006/07, 2007/08, 2008/09, 2009/10, and 2010/11 respectively and indirect tax is 73.86%, 73.06%, 73.39%, 75.27%, 75.84%, 75.68%, 73.31%, 72.89%, 70.68%, 73.29% and 71.84% in the fiscal year 2000/01, 2001/02, 2002/03, 2003/04, 2004/05, 2005/06, 2006/07, 2007/08, 2008/09, 2009/10 and 2010/11 respectively. 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.

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

Figure No. 4.2: Tax revenue structure of Nepal



Above figure shows that Direct Tax and Indirect Tax is increasing since 2000/01 to the year 2010/11. Indirect tax has maximum contribution to the total tax revenue of country.

In this ways, 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.

4.1.2 Revenue collection from VAT

As VAT is Indirect tax, it contributes some portion in total revenues. 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

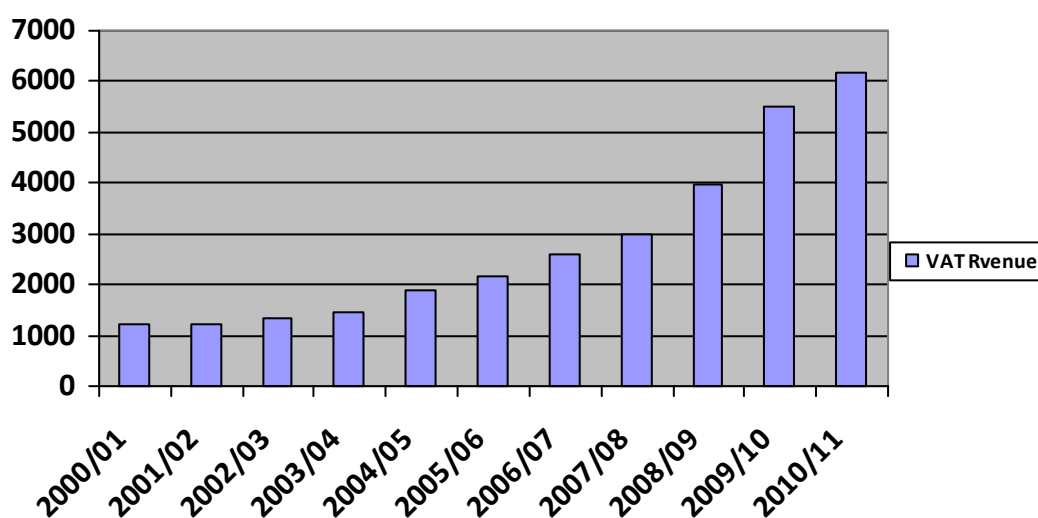
Fiscal Year	Revenue Collection From VAT (Rs in millions)	Percentage Change(%)
2000/01	12382.4	-
2001/02	12267.3	-0.93
2002/03	13459.7	9.72
2003/04	14478.9	7.57
2004/05	18885.4	30.43
2005/06	21610.7	14.43
2006/07	26095.6	20.75
2007/08	29815.7	14.26
2008/09	39700.9	33.15
2009/10	54920.9	38.34
2010/11	61663.6	12.28

Source: Economic survey of various years, MOF.

Above Table shows, that amount of VAT has Rs.12382.4 million in the fiscal year 2000/01 and in the fiscal year 2001/02 its collection decreased to Rs. 12267.3 million. Again after the fiscal year 2002/03 is continuously increasing. In fiscal year 2010/11 total VAT, Rs. 61663.6 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 2009/10 i.e. 38.34% and in some year it has negative incensement in also like in year 2001/02 i.e. 0.93%.

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

Figure No.4.3: Revenue collection from VAT



Above figure also shows that except in the year 2001/02 the revenue collection trend from VAT is in increasing trend. In the year 2009/10 there is maximum increased in revenue collection by VAT. This shows that VAT is getting popularity in our country.

4.1.3 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 4.4: Contribution of VAT to total tax revenue

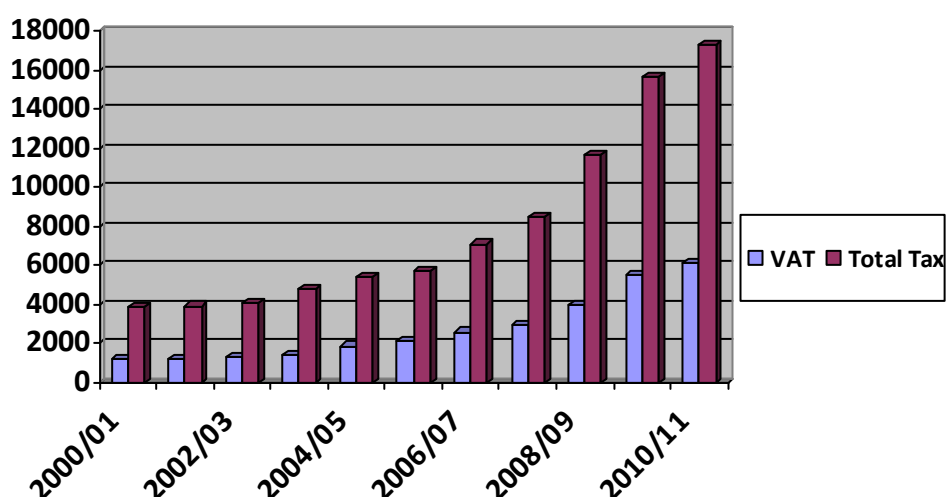
Fiscal Year	VAT Revenue (Rs in millions)	Tax Revenue (Rs in millions)	% of VAT
2000/01	12382.4	38865.0	31.86
2001/02	12267.3	39330.6	31.19
2002/03	13459.7	40896.0	32.91
2003/04	14478.9	48173.0	30.06
2004/05	18885.4	54104.7	34.91
2005/06	21610.7	57430.4	37.63
2006/07	26095.6	71126.7	36.69
2007/08	29815.7	85155.5	35.01
2008/09	39700.9	117051.9	33.92
2009/10	54920.9	156294.9	35.14
2010/11	61663.6	172777.6	35.69

Source: Economic survey of various years, MOF.

Above table shows that there contribution of VAT revenue on tax revenue in the fiscal year 2000/01, 2001/02, 2002/03, 2003/04, 2004/05, 2005/06, 2006/07, 2007/08, 2008/09, 2009/10, and 2010/11 are 31.86%, 31.19%, 32.91%, 30.06%, 34.91%, 37.63%, 36.69%, 35.01%, 33.92%, 35.14% and 35.69% . Maximum contribution is 37.63% in fiscal year 2005/06 and minimum is 31.19% in the year fiscal year 2001/02. According to above data an average contribution of VAT on national revenue is about is about 34.09%.

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

Figure No. 4.4: Contribution of VAT to total tax revenue



Above diagram shows that with the increase in tax revenue, VAT revenue is also increasing. The percentage of share of VAT on tax revenue has not satisfactory condition comparison to the previous fiscal years. There is the maximum contribution of VAT on tax revenue in the fiscal year 2005/06.

4.1.4 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.

Tale 4.5: Contribution of VAT to indirect tax revenue.

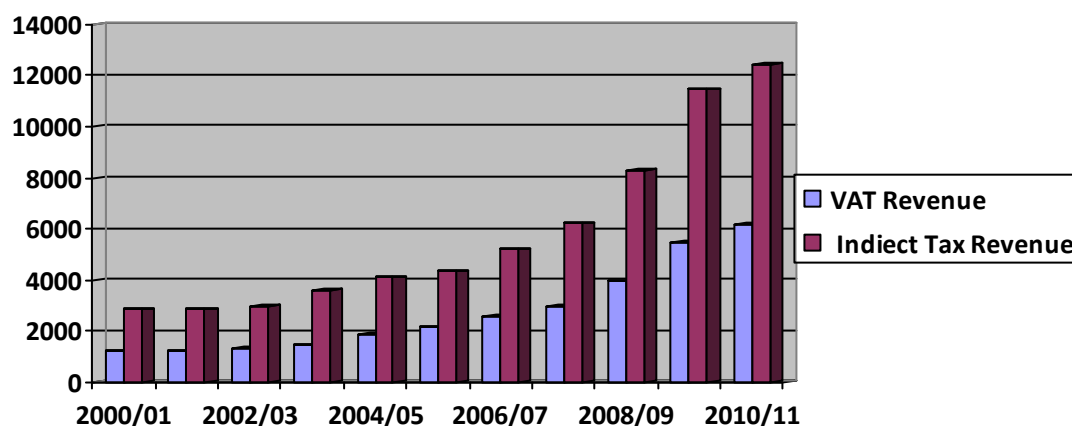
Fiscal Year	VAT Revenue (Rs in millions)	Indirect Tax Revenue (Rs in millions)	% of VAT
2000/01	12382.4	28705.7	43.14
2001/02	12267.3	28733.1	42.71
2002/03	13459.7	30014.1	44.84
2003/04	14478.9	36260.4	39.93
2004/05	18885.4	41032.9	46.02
2005/06	21610.7	43462.3	49.72
2006/07	26095.6	52146.4	50.04
2007/08	29815.7	62067.7	48.04
2008/09	39700.9	82731.2	47.99
2009/10	54920.9	114545.0	47.95
2010/11	61663.6	124122.5	49.68

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 2006/07 to 50.04% and minimum in the fiscal year 2003/04 is 39.93%. It shows that the contribution of VAT on indirect tax revenue is an average 46.37%. VAT has contributed to indirect tax 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. 4.5: Contribution of VAT to indirect tax revenue.



Above diagram shows the contribution of VAT on indirect tax revenue in different on different fiscal year. It shows that there is maximum contribution of VAT on indirect tax revenue in the fiscal year 2006/07, with the increase in indirect tax.

4.1.5 Contribution of VAT to total revenue.

Government revenue is collected mainly tax and non-tax revenue. VAT is main source of revenue collection. The contribution of VAT to total Revenue is shown in below table.

The following table shows the contribution of VAT in total revenue.

Table 4.6: Contribution VAT to total revenue

Fiscal Year	VAT Revenue (Rs in millions)	Total Revenue (Rs in millions)	% of VAT To Total Revenue
2000/01	12382.4	48893.8	25.33
2001/02	12267.3	50446.6	24.32
2002/03	13459.7	54538.9	24.68

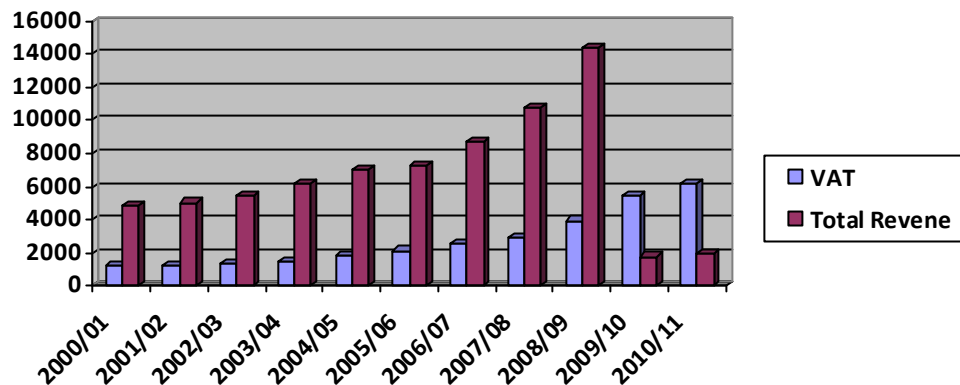
2003/04	14478.9	62331.0	23.23
2004/05	18885.4	70122.7	26.93
2005/06	21610.7	72281.9	29.90
2006/07	26095.6	87712.1	29.75
2007/08	29815.7	107622.5	27.70
2008/09	39700.9	143474.5	27.67
2009/10	54920.9	179945.8	30.52
2010/11	61663.6	199818.7	30.86

Source: Economic survey of various years, MOF.

Above data shows that VAT contribution in the year 2000/01, 2001/02, 2002/03, 2003/04, 2004/05, 2005/06, 2006/07, 2007/08, 2008/09, 2009/10 and 2010/11 are 25.33% ,24.32% ,24.68% ,23.23% ,26.93% ,29.90% ,29.75% ,27.70% ,27.67% ,30.52% and 30.86% respectively. In which is about 30.86% maximum contribution in the fiscal year 2010/11 and minimum contribution 23.23% in fiscal year 2003/04. Average contribution to total revenue is 27.35% in last two years contribution of VAT is increasing.

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

Figure No. 4.6: 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 2010/11 there is maximum contribution of VAT revenue on total revenue in comparison to other fiscal year.

4.1.6 Contribution of VAT to GDP

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

Table No. 4.7: Contribution of VAT to GDP

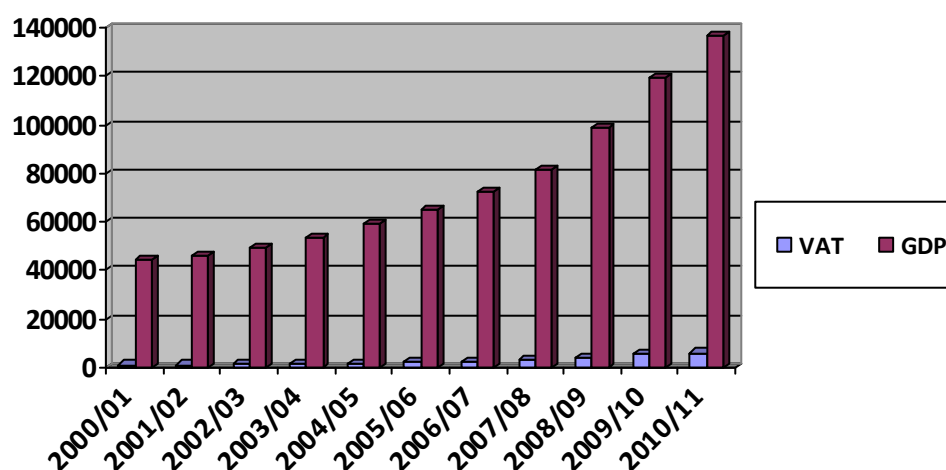
Fiscal Year	VAT Revenue (Rs in millions)	GDP (Rs in millions)	% of VAT
2000/01	12382.4	441519	2.80
2001/02	12267.3	459443	2.67
2002/03	13459.7	492231	2.73
2003/04	14478.9	536749	2.70
2004/05	18885.4	589412	3.20
2005/06	21610.7	654084	3.30
2006/07	26095.6	727827	3.59
2007/08	29815.7	815658	3.66
2008/09	39700.9	988272	4.02
2009/10	54920.9	1193679	4.60
2010/11	61663.6	1369430	4.50

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 contribution on GDP was 2.80% , 2.67%, 2.73%, 2.70%, 3.20%, 3.30%, 3.59%, 3.66%, 4.02%, 4.60% and 4.50% in fiscal year 2000/01, 2001/02, 2002/03, 2003/04, 2004/05, 2005/06, 2006/07, 2007/08, 2008/09, 2009/10 and 2010/11 respectively. Such contribution never crosses 5% during 11 years.

On showing the about data on multiple bar diagram, it seems as follows.

Figure No. 4.7: Contribution of VAT to GDP



From the above diagram, It looks nominal contribution of VAT to GDP but in nearly years its contribution to GDP is increasing trend and its looks satisfactory onwards years.

4.1.7 Revenue collection before VAT

VAT includes sales tax. Entertainment tax, hotel tax, air flight tax and contact tax etc. The revenue collection before implementation of VAT in different fiscal year is presented in the table below.

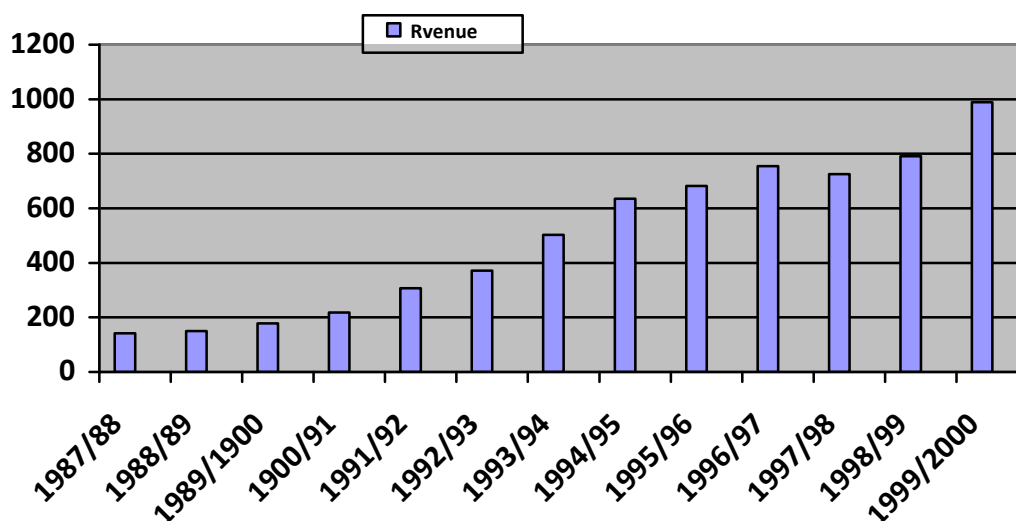
Table No.4.8: Revenue collection before VAT

Fiscal Year	Revenue Collection From (Sales Tax, Hotel Tax, Entertainment Tax, etc)	Percentage Change(%)
1987/88	Rs.1,41.34	-
1988/89	Rs.1,50.57	6.53
1989/1900	Rs.1,78.33	18.44
1900/91	Rs.2,18.13	22.32
1991/92	Rs.3,07.02	40.75
1992/93	Rs.3,71.47	20.99
1993/94	Rs.5,02.44	26.07
1994/95	Rs.6,35.19	26.42
1995/96	Rs.6,81.58	7.30
1996/97	Rs.7,54.16	10.65
1997/98	Rs.7,25.91	(3.75)
1998/99*	Rs.7,90.72	8.93
1999/2000	Rs.9,88.52	25.02

Above Table shows, that amount of tax has Rs. 1, 41.34 million in the fiscal year 1987/88 and it was 725.91 million in the fiscal year 1997/98. VAT was fully implemented from fiscal year 1998/99 its collection was Rs. 7, 90.72 million and Rs 988.52 in fiscal year 1999/2000. Revenue was continuously increasing 6.53%, 18.44%, 22.32%, 40.75%, 20.99%, 26.07%, 26.42%, 7.30%, 10.65% from fiscal year 1987/88 to 1996/97 respectively and in fiscal year 1997/98 it decrease by 3.75%. Again it increases by 8.93, 25.02% in fiscal year 1998/99 and 1999/2000. Regarding percentage change in amount it is not same ratio in some year it has increased in

higher percentage like in the year 1991/92 i.e. 40.75% and in some year it has negative incensement in also like in year 1997/98i.e. 3.75%.

Figure No. 4.8: Revenue collection before VAT



Above figure also shows that the revenue collection trend form Sales Tax, Hotel Tax , Entertainment Tax is in increasing trend except fiscal year1997/98. From fiscal year 1998/99 VAT was fully implemented in Nepal.

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 mechanism of VAT system is 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 2000/01 to fiscal year 2010/11the total revenue is absolutely increasing. From the analysis of the trend of revenue of past 11 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.

1) 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 11 years period from fiscal 2000/01 to fiscal year 2010/11 except in fiscal year 2001/02 the amount of tax in the form of VAT has been increasing. During the study period contribution of VAT to total tax revenue is Maximum contribution is

37.63% maximum contribution in fiscal year 2005/06 and minimum is 31.19 in the year fiscal year 2001/02. According to data an average contribution of VAT on total tax revenue is about is about 34.09%.

2) The tax revenue is one of the major sources revenue of government. The contribution of VAT on indirect tax revenue is an average 46.37% and there is maximum contribution of VAT in indirect tax revenue in the fiscal year 2006/07 to 50.04% and minimum in the fiscal year 2003/04 is 39.93%.

3) Government revenue is collected mainly tax and non-tax revenue. VAT is main source of revenue collection. The contribution of VAT In which is about 30.86% maximum contribution in the fiscal year 2010/11 and minimum contribution 23.23% in fiscal year 2003/04 and average contribution is of study period is 27.35%.

4) 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 2.80 %, 2.67 %, 2.73 %, 2.70%, 3.20%, 3.30%, 3.59%, 3.66%, 4.02%, 4.60% and 4.50% in fiscal year 2000/01, 2001/02, 2002/03, 2003/04, 2004/05, 2005/06, 2006/07, 2007/08, 2008/09, 2009/10 and 2010/11 respectively

5) The revenue collection before implementation of VAT from Sales Tax, Hotel Tax, Entertainment Tax was Rs.1,41.34, Rs.1,50.57, Rs.178.33, Rs.2,18.13, Rs.3,07.02, Rs.3,71.47, Rs.5,02.44, Rs.6,35.19, Rs.6,81.58, Rs.7,54.16, and Rs.7,25.91 from fiscal year 1987/88 to 1997/98. It was Rs. 7, 90.72 in fiscal year 1998/99 and Rs. 9, 88.52 in fiscal year 1999/2000. Revenue was continuously increasing 6.53%, 18.44%, 22.32%, 40.75%, 20.99%, 26.07%, 26.42%, 7.30%, 10.65% from fiscal year 1987/88 to 1996/97 respectively and in fiscal year 1997/98 it decrease by 3.75%. Again it increases by 8.93, 25.02% in fiscal year 1998/99 and 1999/2000. Regarding percentage change in amount it is not same ratio in some year it has increased in higher percentage like in the year 1991/92 i.e. 40.75% and in some year it has negative incensement in also like in year 1997/98 i.e. 3.75%.

CHAPTER V

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

Tax is contribution from a person to government. It is a liability to pay and 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 is raised through taxation. Broadly, it can be classified into categories i.e. direct tax and indirect tax. VAT is a good example of indirect tax, which is newly discovered in the field of taxation in comparison to other taxes. VAT is the latest innovation which is a multi-stage, commodity and service-based tax levied on the added value of business enterprise at different stages of production and distribution. It affects only 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 the threshold limit should be registered in VAT office. Those below the threshold unit are compulsory not to register but if they want they can register 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 an 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 the best alternative 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 a very popular tax system throughout the world.

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

USAID. 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 there was strong opposition from the Business community about the implementation of VAT. Nepal introduced VAT with single rate of 10% from 16 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 HIP 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 as export 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 registered vendor should receive and give 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. Taxpayers determine their tax liability themselves and pay tax. If a taxpayer 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 non-compliance of taxpayer. The taxpayers may not always agree with the assessment made by tax officers. In that case tax payers may file and appeal the revenue tribunal within 35 days against a tax assessment or penalty.

From the review of Nepalese tax structure it is found that average tax contribution 80.13% of total revenue. The share of indirect tax is 73.56% on total tax. The amount of tax revenue increasing continuously like total VAT revenue has been increasing but it is unable to achieve its potential. In a fiscal year 2010/11 VAT increase by 12.28% then the previous year. The average contribution of VAT on national revenue is about 34.09% of study period and its contribution is contently increasing mood.

Like that the contribution of VAT on indirect tax revenue is an average 46.37% and it also increasing mood. VAT to total revenue about 30.86% maximum contribution in the fiscal year 2010/11 and minimum contribution 23.23% in fiscal year 2003/04. Average contribution to total revenue is 27.35%. In last two years contribution of VAT is increasing and Contribution of VAT to GDP is in increasing mood but its contribution is nominal.

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 a best alternative of tax reform. Nepalese government was adopted VAT by replacing 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 liberation policy. Excise duty in Nepal is severely limited due to the contraction of industrial activities throughout the taxation in recent year under such condition we cannot collect more revenue from income tax, custom duty and exercise 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 fluctuation, 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 form 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 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 contribution of VAT depend 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. Likewise the culture of doing business without maintain 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 contribution 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 more contribution 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 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.

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 revenue collection in Nepal.

-) Most of taxpayers 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 taxpayers 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 and effective and efficient auditing investigation and monitoring system should be developed.
-) The time consuming process in registration and other activities should be changed and punctuality with time 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 hones taxpayers. The government has started some incentive mechanism for the taxpayers 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, which honesty takes 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 based on 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 may not be far from tax office like door-to door collection method.
-) In the resent 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 modem net of VAT for its progress with the close coordination to the concerned share holders.

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