

# **IMPLEMENTATION OF VALAUE ADDED TAX IN NEPALESE CONTEXT**

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## VIVA-VOCE SHEET

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

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## **DECLARATION**

I hereby declare that the work reported in this thesis entitled **Implementation of Value Added Tax in Nepalese Context** submitted to the Mechi Multiple Campus, Bhadrapur, jhapa is my original work. It is done in the format of partial fulfillment of the requirements for the Master of Business Studies (MBS) under the supervision and guidance of Dr. Prithvi Bikram Rai (Associate Professor) and Mr. Nirmal K. Khatriwada (Lecturer) of Mechi Multiple Campus.

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## **ABBREVIATION**

CBS	Central Bureau of Statistics
DANIDA	Danish International Development Agency
EC	European Committee
EU	European Union
F/Y	Fiscal Year
FNCCI	Federation of Nepal Chamber of Commerce and Industry
GDP	Gross Domestic Product
GI	Gross Investment
Govt.	Government
Govt./N	Government of Nepal
GST	Goods and Service Tax
HIID	Harvard Institute for International Development
HMG/N	His Majesty's Government of Nepal
IRA	Inland Revenue Administration
IRD	Internal Revenue Department
IROs	Inland Revenue Offices
MBS	Masters of Business Studies
MODVAT	Modify of VAT
MOF	Ministry of Finance
NC	Nepalese Currency
NCC	Nepal Chamber of Commerce
NCCI	Nepal Chamber of Commerce and Industry
NLR	Nepal Law Review

No.	Number
Nov.	November
NRB	Nepal Rastra Bank
PAN	Permanent Account Number
RATC	Revenue Administration Training Center
RM	Raw Material
SAFTA	South Asian Free Trade Association (Area)
SP	Selling Price
T.U.	Tribhuvan University
USAID	United State Agency for international Department
VAT	Value Added Tax
WST	Wholesale Level Sales Tax
WTO	World Trade Organization

## CHAPTER - I

### INTRODUCTION

#### 1.1 Background of the Study

Beginning of 21st century and new millennium, economic development has been one of the emerging challenges for the developing countries like Nepal. Nepal is predominately, an agriculture based developing country as it contributes 40% (*Source: National Planning Commission*) to the gross domestic production. Due to the inadequate agricultural income, it contributes very negligible portion in the national economy in comparison to other countries. Therefore, it is necessary for the government to explore the other sectors for revenue. Economic growth is mainly related with the development and development is depend on the taxation.

Taxation, as an integral part in the national economy, plays a vital role in generating revenue in the nation. In the context of current global economic scenario, no government can run smoothly without sufficient revenue. Current economic world is very dynamic and complex. The changes in any part of the world affect other parts of the global economic policy. Therefore, the reforms of economic policy not only direct by the respective country but it is emerged as a global economy revitalization procedure. Obviously, the reforms are mainly focus on to reduce the rapid population growth, poverty, unemployment and to increase the productive investment. Nepalese economy also can't remain far from the global economic impact.

The main objective of the taxation is to make fund available for the economic development and for the stability of the country. But, the government of Nepal, as it has been striving on to fulfill the basic daily necessity of the people, to develop the basic infrastructure, to keep peace and security in the country, to continue the social welfare activities, etc., sufficient fund is required to the

nation. Thus, to maintain above all these, the government of Nepal has to collect more fund and revenue.

It is said that as the blood is needed for body and money is needed to operate the state. The sources of revenue of Government are tax, fines, fees, grants & assistance. Tax is a main source of revenue collection. The public revenue has two segments; taxable and non taxable.

Tax is a liability to pay an amount to the government. It is correct that nothing is certain in this world but death and taxes. Death and taxes are certain but death is not annual i.e. death means stopping the tax.

The main problem of Nepal is to depend upon the foreign aid (i.e. external and other fund of source) to economic development to cope with globalized challenges. Economic development is impossible without sufficient fund. To develop it needs revenue from internal sources i.e. taxation which contribute 80% (*Source: National Planning Commission*) to the Government. External source is unhealthy and dangerous for nation, which has 20%. So, taxation is a major instrument of social and economic policy and to promote economic growth, stability and efficiency.

Prof. Seligman defined tax as “a compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit conferred.” (Bhattarai and Koirala, 2004; 1.3)

Direct taxes (property tax, income, expenditure) and indirect taxes (VAT, exercise duty and custom duty etc) are modern taxation in the Nepal can be designed in such a way that it can play a major role in the economic and social development of the country. As a part of taxation, indirect tax is a major source of tax revenue in Nepal. Among Indirect taxes, which have got the lion shares in total tax revenue, VAT is probably the best tax which is broad based, transparent and economically neutral.

VAT is the most recent innovation in the field of taxation. VAT was introduced first in the world by Dr. Wislom V. Sieves in 1919 in German. Then, entered into France in 1954. Nepal adopted it through the enactment in the VAT Act, in 2052 B.S. and rules 2053 B.S. But it was implemented from the 1st Marg, 2054 B.S. The basic objective of the Act is to strengthen and broaden the sources of revenue. The following are the primary objective for the applying this act in Nepal: 1. To increase the tax base for the growth of the revenue. 2. To strengthen the tax system. 3. Establishment of healthy and transparent tax system. (Dr. Wislom V. Sieves in 1919 in German)

VAT is modified and improved form of sales tax. It has replaced sales tax, hotel tax, contract tax and entertainment tax. It is a new tax system of Nepal. It is an indirect tax. It is levied on value added on goods and services at each stage in the process of production and distribution. Value added for the firms is sales minus expenditure on goods and services purchase from other firm. It is adding payment to factor of production wages, salary, rent, interest and profit. It is based on VAT and is collected at each stage of production and distribution chain.

VAT is a broad based tax, self motivated tax. Proper implementation of VAT, it needs skilled administration and customer awareness. It is needed to flow information of VAT to the final consumer for their consciousness. VAT has been adapted by more than 120 countries in the world. Developed countries have no extra difficulties for implementation. But in developing countries, as it has poorly designed, it is unable to increase productivity, form the capital for meeting public expenditure. The rate of VAT in Nepal had 10% in the implementation of the initial year and increased up to 13% from the 1st Magh 2061 B.S.

Value Added Tax (VAT) is the most recent innovation in the field of taxation. It is levied on the values added of goods and services. (VAT in the Asia and the pacific region: 1989)

"VAT is levied on all goods and services, unless specifically exempt by the law and collected at different stages in the process of production and distribution."  
(Dr. Khadka, The Nepalese Tax System: 2000)

VAT shall be imposed on the goods and services supplied and imported in Nepal or exported from Nepal. However, VAT shall not be imposed on the goods and services mentioned in Annexure.1 of the act. Similarly tax on transaction of goods and services mentioned in Schedule 2 of the Act shall be levied at the rate of Zero percent (i.e. Zero rates). The list of goods and services mentioned in schedule 1(not subject to VAT) or schedule 2(subject to VAT at Zero percent) may be revised by Government by publishing notification in the Gazette.

## **1.2 Statement of the Problem**

Nepal is the least developed land locked country which has adopted the system of mixed economy for achieving development goals. About 5 decade of planned development system the Nepalese economy is still suffering from poverty and stagnation. More than 80% people are living in rural area and depending in agriculture. Nepal is facing on various problems like political, economic, social, technology and others dependency of foreign aid and loan from developed country.

Nepal has low income rate, fluctuation of the economy instability, high population growth, unemployment. And also problems of deficit budget of government due to the lack of proper used of resources. The deficit financing increases share for external as well as internal and foreign aid. For the payment of external as well as internal loan and financing the government expenditure internal revenue is the main source. Tax revenue is the main source of government revenue. VAT is a strong component of tax revenue. But lack of proper implementation of tax policies, lack of knowledge, lack of public awareness, lack of support from business community and lack of efficient management are problems of revenue collection. Still government has not been

able to implement full fledged VAT system in Nepal. Under invoicing by sellers, not issuing Tax invoice by registered sellers, ineffective tax administration, consumers misconception about VAT that it increases price of goods and services etc. are major problematic issues about VAT.

This study is focused to implementation system of VAT in Nepalese context shows the major problems are directed towards:

- What were the major problems faced by the government while implementing the VAT in initial period and also problems facing at present?
- To what extent are the businessmen being oriented about VAT?
- How far is the current billing system effective to increase the revenue?
- What is the level of success of VAT implementation in Nepal?

### **1.3 Objectives of the Study**

The basic objective of this study is to examine the implementation system of VAT in Nepalese context and the specific objectives of this study are listed below-

- To identify the problems faced by the government and business sectors after implementation of the VAT system in Nepal.
- To analyze the existing problems of VAT which are facing by the government in Nepal.
- To find out the contribute of VAT to Total Tax Revenue.

### **1.4 Significance of the Study**

This study examines the present scenario of VAT in Nepal along with problems faced by the government during initial phase of implementation and tries to

examine the most important issues and strategies for future. This study mainly focus existing practical problems of VAT in Nepal where many more business community people are unknown about various aspects of VAT .This research is useful for government, business sector, policy maker, stake holders, tax officials, auditors, accountants, students, consumer, managers, teachers, and the readers who are interested in the field of taxation. They all can obtain a clear idea and knowledge about various aspects of VAT who are interested in this field. This research has multi -dimensional and special significant. It also clears the role of VAT in total revenue collection, the probability of VAT implementation in future, VAT impact in Nepalese economy and other important information.

### **1.5 Limitation of the Study**

To keep the research work feasible, to keep study in track, to go according to plan the researcher has to barricade the research from some limitations. The following are the limitations of this study:

- This study covers and depend only limited data available during research period (2007 A.D. to 2012 A.D.).
- This study focus only on implementation system of VAT in Nepalese context.
- The extend of this study is based on the available data and the relevant literature.
- Limited business organizations and tax offices, situated at Jhapa are consulted to collect primary data.
- The methodology followed in this study is not designed by the advanced and sophisticated techniques.
- This study covers around the five years data.

- Statistical tools used to analysis the data have their own limitations.
- This study is done only to fulfill the requirement of master degree in business studies so that it can't cover all the dimension of the subject matter.

## **1.6 Research Methodology**

The research design is based on descriptive and analysis tools and techniques. In this study both primary and secondary data are used for investigation. Primary source of information has been collected through personal contact with concerned people by administering some questionnaire and through personal interviewers and informal chats related to VAT implementation system.

Secondary source of information has been collected from published reports, booklets, and other articles, facts and figures derived from department of VAT. Reports of ministry of finance and report of VAT also collected for investigation.

Statistical tools such as mean, median, mode, standard deviation etc. are used for analysis of data. The presentation of the data shall be done through diagrams, charts, figures etc. and interpretation of the result.

## **1.7 Organization of the Study**

This study has been divided into five chapters which are as below:

- Introduction is in the first chapter which includes background of the study, statement of the problem, objectives of study, significance of the study, and limitation of the study, research methodology and organization of the study.
- The second chapter presents the review of literature dealing with theoretical review of the study along with related studies like relevant

books, journals, research as well as thesis, published and unpublished study and so on.

- The third chapter presents research methodology dealing with research design, nature and sources of data and its collecting and gathering of data along with the method of its presentation, description and analysis tools and technique.
- The fourth chapter concern with presentation and analysis of data which deals with the presentation of related data collection in figure or table or diagram and its analysis using statistical tools and interpretation the result.
- The fifth chapter is related to summary, conclusion and recommendation of the study.
- At the end the extensive bibliography, appendixes are also included of the study.

## **CHAPTER - II**

### **CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE**

Many researchers have conducted study in the field of Taxation of Nepalese context. Only limited numbers of studies have been conducted in the field of VAT in Nepal. In this chapter attempts have been made to present the review of literature regarding implementation scenario of VAT in Nepal. Previous studies related with this field are reviewed as valuable foundation for current study. This chapter is divided into two section; conceptual and review of literature.

#### **2.1 Conceptual Framework**

##### **2.1.1 Introduction**

Value Added Tax (VAT) is most recent innovation in field of taxation. It is one of the most powerful tool of the revenue collection of government. VAT is the best in indirect tax. It has gained huge popularity within a short span of time.

VAT is modern and scientific form of sales tax. It is an improved version of sales tax. It is levied on value added of goods and services at each stage in the process of production and distribution /sales and purchase of both domestically produced and imported goods and services.

VAT is a broad base tax. It is eventually borne by the final consumers who consume goods and enjoy the services, as goods and services are shifted, in the process of production a distribution.

Although VAT is similar to the retail sales tax VAT is a multistage tax, which is levied at different stage of production and distribution, where as retail sales tax is levied at only at the final stage. A sales tax will give automatically tax exemption to most exports, where as VAT involves collecting tax at earlier and refunding it at the final stage.

Sales tax is commonly divided into three types; turnover tax, single stage tax and multiple stage tax. Turnover tax is imposed at all stages of the production and distribution process. On the contrary, the single stage tax is levied at only one stage of the production and distribution process. It may be imposed at either manufacturing level or at the wholesale level or retail level.

Tait (1998) emphasizes the key trend of introducing VAT as "The rise of VAT is an unparalleled tax phenomenon. The history of taxation reveals no other tax that has swept the world in some thirty years, from theory to practice, and carried along with it academic who were once dismissive and countries that once rejected it." (Tait: 1988).

Multiple taxes, as turnover tax are also levied at different stages of production and distribution process. VAT falls in the category of multiple stage tax. So, VAT and retail tax. VAT is also called as goods services tax (GST) in some countries.

VAT is a newly tax system of Nepal. Whatever name we call, VAT is a newly entrant family member of indirect tax. It is imposed on the value added. Value added is the value that a producer or firm (whatever Manufacturer, distributors, advertising agencies etc.) add to raw material or purchase before selling the new or imported products or services. That is, input (the raw materials, transport, rent, advertising and so on ) are bought, people are sold some profit is left. So value added can be levied at from the additive side (wage + profit + rent + interest) or from subtraction side (output-inputs). Therefore, value added =wage + profit + rent + interest= output-input

### **2.1.2 Origin of VAT**

VAT was introduced in attempt to improve the existing shortcoming of the sales tax. In history, the VAT has emerged as an alternative to defective multi-stage turnover tax. In the 21st century nothing has become popular as VAT in the field of taxation.

Emergence of VAT dates back to 1919 as an improved turnover tax. German industrialist Dr. Wilhelm Von Siemens proposed the tax to replace multistage turnover taxes in Germany. In 1994, Prof. Carl S. Shoup recommended VAT for Japan, but such proposal never came into effect. The modern VAT first appeared in France in 1954. It covered industrial sector that extended to the whole-sale level.

Following France, several other countries such as Senegal, Algeria and Morocco (1960) introduced VAT that was limited to import and manufacturing stage only. Thereafter, Brazil (1967) Uruguay (1968), Ecuador (1970), Bolivia (1973) and Argentina (1975) introduced VAT in their countries. Subsequently, many European countries such as Denmark, Sweden and Norway also adopted VAT. During 70s and 80s, VAT spread to Asian countries such as Vietnam (1985), Korea (1977), China (1984), Indonesia (1985), Taiwan (1986), Philippines (1988), Japan (1989). Thailand (1992), Singapore (1994) and Mongolia (1989).

In South Asia, Pakistan introduced VAT in 1990, followed by Bangladesh (1991) and Sri Lanka (1995). In India, the tax reform committee led by Raja J. Chelliah recommended full-fledged VAT for India in 1992 and implemented MODVAT in place of VAT.

In Nepal, the tax system review Task Force constituted by Nepalese government in 1995 under the chairmanship of Prof. Madan Kumar Dahal proposed and recommended to implement VAT in lieu of sales tax, hotel tax, contract tax and entertainment tax. In this way, VAT came into full operation in Nepal in Feb. 1998. At present, around 130 countries have adopted it in their respective countries.

### **2.1.3 VAT in Nepal**

As the adoption of VAT program was at the heart of worldwide policies, Nepal was also no exception. So in Nepal VAT system is adopted quite late then

others countries because in was new concept and most recent innovation in the field of taxation. The Nepalese government adopted it to convert the sales tax into VAT and to promote the oriented economy in the eight five years plan (1992-1997). After restoration of democracy in 1990s, the government adopt to liberties the trade, investment and financial system. Then state 1992/1993 budget speech that VAT on domestic production would be applied as an experimental basis. A two tiger sales tax system was in function at that period (1992/1993).

As a parts of its liberal economy policy, HMG asked donors study the VAT system. VAT tasked force committee was formed in 1993. United State Agency for International Development (USAID). Harvard Instituted for international Development (HIID) was agreed to provide financial and technical assistance. The government of Nepal was request the Danish International Development Agency (DANIDA) as a donor to continuity the VAT. The DANIDA supported the VAT project and it is continuously supporting till now. The two-tiger sales tax was declared to remove in its 1994/95 budget.

The parliament of Nepal enacted Value Added tax Act 2052 from 1995 and regulation in 1996 from the budget speech 1992/93 and then government tried to implement the VAT system in Nepal. From this Budget speech announced the principles and rate of VAT and tried to levy from domestic productions. (Expect some listed items). At that period VAT rate was 10% but now it has changed into 13% from 1st Magh 2061, under this system manufactures, deludes, distributors were required to register in this system. Actually, VAT was introduce on 16 Nov. 1997 (1st Marg, 2054) in Nepal.

After enacted the Act 2052, VAT was fully responsible by the VAT administer. Trading program of VAT organized by Federation of Nepal Chamber of Commerce and Industry (FNCCI), Nepal chamber of commerce (NCC) Charters Accountants Association and others professional groups.

VAT was levied in the replacement of existing sales tax act 2023, Hotel Tax Act-2018, contracted Tax Act 2023 and Entertainment Tax Act 2017 were reputed along with implementation of VAT. After implementation of VAT it has create many problem and could not be implemented fully until the fiscal year 2062/063 due to the political instability and full incorporation of business community. The main problems whereas trading group was against the VAT. But industrialist was favor several new provisions relating to VAT were introduced through the finance Bill 1998. After then the situation becomes so bad that the several of VAT were put on stake. Ultimately, both sides agreed in 39 points on September 1998 and become favor. Then VAT replaced the old taxing System. It is a broad-based tax and covers the value added in good and service and at every stage of production and distributions. It is a modern and improving tax system of collective revenue. So it is called the backbone of revenue collection of the government. Dr. Rup Bahadur Khadka, published an article in 1984 "VAT in Asia and pacific Region" After analyzing the VAT system in this region, shows that the adaptability of VAT system in Nepal has greater scope. May be, he is the one who firstly proposed VAT system for Nepal, by observed the experience of VAT system in nation and aboard. Nepal has been considering VAT system since 1992. A commitment to implement the VAT system in Nepal was in 1995/1996 budget and scheduled from April 1997. But it was postponed till November 1997 due to some reasons. After implemented the VAT in Nepal, the obstacles were created in private sector.

At last HMG/N implemented VAT since 16th Nov. 1997. The budget speech of FY 2008/09 government has emphasized the implementation the VAT in Nepal. For good implementation, it would have increased the area and decreased the rate. But government increased the rate of 3% (i.e. 10%-13%), By this cause, the government increased is not apply good road -map to implementation of VAT in Nepal till now.

#### **2.1.4 Types of VAT**

The types of VAT can be determined on several bases. The most important thing is to be considered for the classification of VAT on the basis of treatment of capital goods. The precious treatment of deductibility of tax on durable capital goods is of great concern in distinguishing VAT of various types Shoup: 1962). From these angles, types of VAT can be classified as follows:

##### **2.1.4.1 Income or Net National Income**

Under the income type, VAT does not exclude capital goods purchased from other firms from the tax base in the year of purchase whereas depreciation is excluded from the tax base in the subsequent year. It is not the output of the consumption goods only which is taxed but also capital goods from which depreciation is deductible. Thus, it becomes a tax on net national product and the tax base is the same as that of the personal income tax without exemptions. So, the tax income under this type is regarded as national income.

The base of the tax in income types

$GNP - \text{Depreciation} = \text{Net National Income (NNI)}$

Under this, tax base equals to private personal income. Most of countries do not prefer practice of this type because that it faces the same problem as we face in calculating income for a certain period.

##### **2.1.4.2 Gross National Product**

Under this type, the purchase of capital goods are neither deductible from the tax base in the year of purchase nor the depreciation is allowed to deduct from the tax base in the subsequent years. Tax is levied both on consumption and gross investment when the firms are not permitted to deduct even the amount of depreciation on capital goods tax is imposed on the base of tax is total consumption goods plus all final product capital goods.

The base of tax in GNP types = Gross investment + consumption = GNP

This type of VAT is very difficult to calculate the tax base. "This tax against some of the equity criteria that it is unlikely to be used. (Shoup: 1969)

#### **2.1.4.3 Consumption Type**

Under consumption type of VAT, all capital goods purchased from other firms in the year of purchases are excluded from the tax base while depreciation is not deducted from the tax base in subsequent year. This type is considered as neutral because in this type no discrimination is done with respect to capital and consumable goods. The producers are free from the liability of paying tax to concern the tax office in the purchasing years. Since investment is not received from the taxation under this variant, the base of tax is consumption. It is really superior of VAT system. It would help the trader is investment of capital goods for production.

"The consumption variant is attractive from the point of view of that tax administration as there is needed to distinguish between the purchase of the intermediate goods and the capital goods under this variant as is necessary under the other two variants." (Khadka: 2000)

The base of tax in consumption types = Gross national production - Gross investment = GNP - GI = total consumption

This consumption type is also called full-fledged VAT because the coverage is very wide. This type is also known as comprehensive VAT.

Among these three types of VAT's, consumption type has been widely used in several countries in Europe and elsewhere. The consumption type of VAT is most popular and widely recognized because it is attractive from the point of view of tax administration as well as from the consideration of foreign trade. The GNP type of VAT can be taken as best-one from the point of view of government but from the point of view of tax payers it will make double affect

to the tax payer so it is not good in comparison to income and consumption type. Both income and GNP types of VAT are theoretically defective and practically difficult to implement. So, in comparison to others consumption type of VAT has been accepted and successfully implemented. It is also compatible with the destination principle of taxation.

### **2.1.5 Methods of Computation of VAT:**

VAT can be computed by following three methods:

#### **2.1.5.1 Addition Method:**

In this method, value added is computed by adding up all income generated or factor income like wages, Interest, rent, profit etc. during the production and distribution process. Then value added tax rate is applied to the value added to get VAT payable. This method is very close to income type of VAT that includes the rewards to all the factor of production in its base. In this method for the tax purpose both income and expenditure is taken. This method is also known as the direct value added computation method. The following table shows that the collection of revenue by the additional method.

**Table No. 2.1.5.1 Method of calculating VAT through the addition method**

Payments	Manufacturer	Wholesaler	Retailer	Total
a) Salaries	Rs. 2000	-	-	Rs. 2000
b) Rent	Rs. 1000	Rs. 800	Rs. 500	Rs. 2300
c) Wages	Rs. 500	Rs. 300	Rs. 200	Rs. 1000
d) Interest	Rs. 300	Rs. 200	Rs. 0	Rs. 500
e) Profit	Rs. 200	Rs. 100	Rs. 50	Rs. 350
f) Value added (a+b+c+d+e)	Rs. 4000	Rs. 1400	Rs. 750	Rs. 6150
g) Value added tax@13% of (f)	Rs. 520	Rs, 182	97.5	799.5

Source: Estimated arbitrary figures during the study

From the above table shows that the manufacture pays for the factor of production as salaries Rs. 2000, rent, Rs. 1000. wages Rs. 500, interest in 300 and profit Rs. 200 then the total value added is Rs. 4000 and he has to pay VAT @ 13% on 4000= Rs. 520 as a value added tax. Similarly, the wholesaler and retailer have to pay tax @ 13% on their value added amount i.e.. Rs. 182 and Rs. 97.5 as a value added. The government gets Rs. 520+182+97.5=Rs. 799.5.

In this method, all the payment made for the factors of production has to be added so it seems easy but it creates complexities in calculating of its practice.

### 2.1.5.2 Subtraction Method

Under this method, value added determine in net turnover that is obtained by subtracting the cost of material form sales proceeds. The cost of production is deducted from the sales. This method is very close to consumption type of VAT. This method is also called direct method because adding the payment made by the firms to the subtracting the cost of production from sales directly.

**Table No. 2.1.5.2 Method of calculating VAT through subtraction method**

Sales proceed	Amount (Rs.)	purchasing Cost	Amount (Rs.)	Value added A-b
200 piece of T-shirts @ Rs. 50sss	10000	Transporta tion	5000	
100 pieces of @ Rs. 30	3000	Phone & Electricity	500	
5 Pieces of Jacket @ Rs. 1000	5000	Salary	8000	
50 Pieces of Bag @ Rs. 100	5000	Others	1500	
Total	23000		15000	8000

Source: Estimated arbitrary figures during the study

Value added amount can be obtained by following proceeds:

$$\text{Value added} = \text{Total sales proceed} - \text{total purchasing cost} = (2300 - 1500) = \text{Rs. 8000}$$

$$\text{Value added tax} = 13\% \text{ of } 8000 = \text{Rs. 1040}$$

Theoretically, it looks simple and easy but very difficult to compute where multiple rates of VAT exist.

### **2.1.5.3. Tax Credit Method**

Under this method input tax is credited from output tax and passed into next stage up to consumption level. A goods tax is levied on sales in the period and from this is subtracted the sum of VAT on purchase invoice for the same period. So the firm only pays the tax for the value added it creates. In Summary, VAT payable is the tax paid on sales (outputs) minus the tax paid on purchases (inputs). This method is also known as invoice or indirect subtraction method.

It is considered as a tool for self-enforcing (cross-checking) measure due to the tax carried under a VAT system. While "the addition method provides no means of cross checking at all and the subtraction method provides much less clear-cut guidance for cross auditing." (Due: 1976)

Among the three methods the tax credit method is almost widely used in Europe including the European Union and elsewhere. Under tax credit method tax evasion and undervaluation of tax is not possible due to its catch up effect" which could not achieved under addition and subtraction method. The tax credit method for calculating VAT liability is technically and legally superior in controlling tax evasion as well as reducing affects with efficient administration system and creates a well audit. So, Nepal has also adopted this tax credit method to calculate VAT payable.

From the above three method it is clear that if the rate is same throughout the production and distribution method all the three method, the VAT amount to be paid same in all and should give same result so, tax credit method is widely accepted by many developed as well as developing countries.

**Table No. 2.1.5.3 Following table shows the computation of VAT under tax credit method**

Stages	Cost price	Added value	SP before VAT	VAT @13%	SP including VAT	VAT to Govt.
1. Imported RM by importer	1000	-	-	130	-	130
2. Importer to manufacturer	1000	200	1200	156	1356	26
3. Manufacturer to wholesaler	1200	240	1440	187.2	1627.2	31.2
4. Wholesaler to retailer	1440	288	1728	224.6	1352.6	74.4
	1728	345.6	2073.6	269.5	2343.1	44.9

Source: Estimated arbitrary figures during the study

In above table, important, imported raw materials by an importer for Rs.1000 and 20% added value on cost price. Where VAT collected=269.5

Cost price to consumer = Rs.2343.1

## **2.1.6 Structure of VAT**

The structure means the construction of VAT. So, the structures which are elements of VAT are as followings:

### **2.1.6.1 Coverage**

VAT is scientific, modern, and progressive as compared to sales tax. It is improved form of sales tax. The coverage of VAT should be as broad as

possible. "A VAT is regarded as comprehensive on since its covers all economic activities through to retail level"(Shoup: 1988).

Under the VAT system the consumers know the amount of tax contributed by them and it should be levied on the value added at each stage from production and distribution. Larger the coverage of VAT, greater will be the revenue collected. Therefore the coverage of VAT should be made as broad as possible.

#### **2.1.6.2 Zero Rating**

In this system, goods and services are taxed with zero rates. Under the zero rating, levied on goods is service on value added with zero-rating. Such a zero rated trader is wholly a part of VAT system. A trader liable to zero rates is liable to an actual rate of VAT, which just happens to be zero. The zero rated goods are not required to pay tax and allowed to claim back the tax if any on purchases. Zero rated transaction does not bear any VAT rate. It does not reduce the competitive power in domestic products and attracts the exports. Therefore such a zero rated makes a full rerun for VAT in the normal way.

Now, in Nepal, it is limited to the export only.

#### **2.1.6.3 Exemptions**

Exemption means goods and service is free from tax control and tax jurisdiction. Actually, that exempt trader has to pay VAT on his input without being able to claim any credit for the tax paid his inputs. The exempt pays VAT on his purchases, but is unable to claim this input tax liability as a credit against his tax liability. Such trader is out of the VAT system and treated as a final purchaser of that goods and services.

In Nepal, Trader with less than 20 lakhs annual turnovers exempted from VAT. The exemption are provided on various goods and service like agricultures products, certain services basic necessities of life such as food, educational, health, religious and cultural groups and those with annual sales less than the a

specific limit are basically exempted from VAT. But mainly there types of goods and services purposed for exemption,

Basic life necessities products

Social welfare products

Cultural and others basic need items.

#### **2.1.6.4 Rate of Tax**

In order to make a VAT system simpler, it is better to levy VAT with the single positive rate because multiple rates make tax administration more completed under multiple rated VAT. There is need to classify commodities into different groups according to their rate. Multiple rates make tax system inefficient and businessman has to keep separate record. So, it is complex and credit scope for the tax evasion. On the other, a single rate makes VAT less costly and easy to administer.

Now, in Nepal, according to Value Added Tax Act 2052, VAT rate is levied with single positive rate 10% but now increased to 13% from Ist Magh, 2061.

#### **2.1.6.5 Registration and Threshold**

Every business firm or supplier who does transaction of taxable goods and services is required to register under VAT system and collect tax. The register firm or vender obtains a registration certificate and register number from the tax office. Failure to register is an offence and charged a fine. However, it is not necessary to register which the firms only does transaction of tax exempted goods and service. The PAN (Permanent Account Number) is compulsory to all Nepalese business neither it is small vender nor firms. The threshold for VAT registration is now Rs, 20 lakhs but it may be change time to time. If the transaction is less than threshold it is not necessary to registered for VAT purpose. But the more than Rs. 20 lakhs taxable transaction must be registered in IRO and should collect value added tax.

## **2.1.7 Operation of VAT**

### **2.1.7.1 Registration**

All the firms or vendors carrying on taxable transaction must be registered for VAT. However, registration must not be made mandatory for small vendors having an annual return below the thresholds. In Nepal, vendors below 20 lakhs NC annual turnover are no made mandatory for registration on VAT office.

### **2.1.7.2 Tax Invoice**

The tax invoice is a important document the invoice is to be prepared in triplicate. It establishes the seller's liability for tax and producer's entitlement to credit. Every registrant is required to issue a tax invoice the recipient in supplying goods and services. The specimen of an invoice has been prescribed in schedule five and six of VAT regulation 2053. It should be able to provide necessary information required by the VAT act and regulation.

### **2.1.7.3 VAT Collection**

Businessmen are responsible to collect VAT on the taxable supply made on the day on which payment for the supply is made and payment for the supply becomes due.

### **2.1.7.4 Book of Account**

The tax payer has to keep books of account in order to complete his VAT return. This book will provide; the amount of VAT paid on purchases,. collected on sales, taxable and exempt sales, the time of goods and services were supplied VAT registered vendor should be kept clean and transparent amount of his purchase and sales which are subject to positive, zero and exemption. All the registered taxpayers are required to maintain following account as referred to schedule 7, 8 and 9 of VAT regulation 2053.

Purchase Account

Sales Account

Value Added Tax Account

### **2.1.7.5 Tax Credit and Refund**

The tax payer allowed deducting their collected tax from paid tax which is known as tax credit. A VAT refund is a statement of amount of VAT they have charged, paid and differ of both amount. Tax paid in purchase is more than tax collected by sales; the taxpayer can adjust in next month's tax amount. If not adjust can be done up to next six month then it can be refunded according to the section 24(3) of value added tax act 2052 B.S.

### **2.1.7.6 Submission of Return**

Everyone who is required to collect VAT must file VAT return for each reporting period .The return period pointed within 25 days of next month in internal revenue office.

### **2.1.7.7 Auditing**

The purpose of VAT audit is to find out the actual VAT liability of the tax payers, according to the law and regulation. So, auditing is the method for the control and prevention of tax evasion.

## **2.1.8 VAT Administration System in Nepal**

Administration refers to the management of VAT implementation, planning and controlling. For this motto implementation network should be skilled and strong between lower levels to top level i.e. up to decision making level.

For this motto of the implementation government simplified the tax administration into two functional heads:

1.Inland Revenue Department

Inland Revenue Affairs.

The structure of Inland revenue Department divided into various division and section like policy making division, operation division, internal monitoring division, expert division.

#### **2.1.8.1 Policy Making Division**

The policy making division consist the excise section, information technology section, non tax revenue section and the policy and international affairs section.

**2.1.8.2 Operation Division** The operation division consists of large no. of tax-payers section, refund section, investigation section, tax-payers service section and tax auditing section.

#### **2.1.8.3 Internal Monitoring Section**

The section is responsible for reviewing the function of the inland revenue of center level and districts level.

#### **2.1.8.4 Export Section**

This group consists of lawyer, specialist, economist, liquidators and other related exports. This section provides the specialists services in the IRD department.

#### **2.1.8.5 Inland Revenue Department Offices**

HMG/N merged the tax offices and VAT offices into one office from Shrawan 2059. These merged offices are called internal revenue Department.

### **2.2. Review of Related Studies**

#### **2.2.1. Review from Books, Articles and Journals Related**

**Khadka, Rup Bahadur** (1989), an expert of Nepalese tax system, in his book entitled “VAT in Asia Pacific region” writes VAT is the most recent innovation in the field of taxation. It is levied on the value added of goods and services.

The tax as a broad based 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 of VAT, reasons for the growing popularity of VAT, development of VAT etc. This apart, the report examines the structure and operation of VAT in the Asian Pacific countries, which also explores the possibility of introducing VAT in Nepal. Probably he is the person of observer of VAT abroad and the firstly proposed VAT for Nepal with micro study of Nepalese economy and system.

**Khadka**, in his latest book “The Nepalese Tax System” point out the need to introduce VAT in Nepal. In this book, there are several reasons to introduce VAT in Nepal one of the important reasons was to develop a stable source of revenue by broadening the tax base. Moreover, Nepal will help to become less dependent on international trade taxes for revenue in the future. Since it will not be in position to levy import duties on trade that take place within the South Asian Association for Regional Co-operation (SAARC) region after the South Asian Free Trade Organization (WTO), which will also have to be considered in this context (Khadka, 2000).

**Shoup, Carl S.** in his famous book “Public Finance” considers value added tax as the latest and probably the final stage in a historical development of general sales tax, which is impose on the value added by the business firms. VAT is the difference between sales proceeds and the cost of materials etc, purchased from other firms, which is the tax base of VAT. A firm adds value added by processing or handling these purchased items with its labor force and its own machinery, building or other capital goods. (Shoup: 1999, p. 250-269)

**Silwal, Narayan Prasad** (1999), in his book “Value Added Tax: A Nepalese Experience” had expressed his practical experience about VAT. The book covers all aspects of VAT. In writer’s word “VAT is an all-non-cascading tax system. It extends to all levels of production and distribution. Similarly it covers stages and services. Any discrimination taxing goods or services or

exempting any of them renders VAT ineffective” (Silwal: 1999). The book mostly concentrates on Nepalese tax system. The book clearly analyze why the government of Nepal introduced VAT. HMG announced retail level sales tax at the rate of ten percent covering a whole range of goods and services. There was no procedural law to administer it. When RST introduce in Nepal, literacy level was just meager and billing and record keeping was fanciful. In this situation, required revenue could not take place which in turn into the development expenditures. So that a modern, efficient and neutral tax like VAT was, therefore, preferred to get rid of past anomalies.

The writer expressed a version by borrowing HMG declaration that “The government of Nepal does not have the option of doing nothing. Major changes have to be made in order to make tax administration fair, efficient and effective. The hostility, harassment and corruption that currently exist between the tax office and the business community must end if Nepal is to have a modern tax system. The business wants the system transparent and fair.”

Effective taxpayer service will include such programme as developing clear forms and instructions, providing points of contact to the public so that people can request and secure information about their tax obligations, and developing educational programme to inform existing and potential taxpayers. A primary objective of taxpayer services is to inform the public of their duties that easily comprehensible by even the less educated taxpayers. A primary objective of taxpayer services is to inform the public of their duties that easily comprehensible by even the less educated taxpayers. Thus, it is essential that tax administrators conduct types of information campaigns for different types of taxpayers (e. g. accountants, special trade associations, and the public) to disseminate information on judicial decisions, rulings, regulations, and other notifications to faster a high level of compliance and minimize misunderstandings of the tax laws and regulations. (Le and etal, 1992)

A high-level task force headed by Prof. Madan Kumar Dahal (GON, 1995) to review Nepal's tax system has made some recommendations for a VAT in Nepal. In its report, the task force recommends for a VAT in the place of existing sales tax and small service based taxes as a long-term tax reform measure. The report has emphasized the introduction of VAT in Nepal to (a) broaden tax base and increase the tax revenue (b) make the tax system transparent and elastic (c) prevent tax evasion (d) make the tax system efficient and (e) encourage exports. The report has also emphasized that there are some other factors to be considered seriously before implementing a VAT. They are: (a) price level (b) equity (c) nature of the taxpayers (d) small taxpayers etc. The report recommends some necessary preparation to be undertaken before implementing a VAT such as drafting a law, developing an efficient and capable administration. A functional organization pattern is recommended. The other recommendations to the task force are: development of an effective tax refund system, measures to increase self-compliance, taxpayer's services, computerization of the administration, research and development, a different type of personnel system, extensive taxpayers education programme etc.

Good taxpayer services and well-designed and targeted publicity campaign are crucial elements in encouraging taxpayers to comply voluntarily with the tax legislation. To facilitate voluntary compliance, the tax administration should provide taxpayers with consistent, impartial, courteous and prompt service. In many developing countries and countries with economies in transition, relatively simple measures, such as providing taxpayers with tax return forms, eliminating fees for receipt of tax payment by the banks, a common practice in some Eastern European countries and establishing taxpayer assistance counters in easily accessible locations in the tax administration would significantly improve taxpayer services. (Silvani and Catherine, 1997)

**Shrestha, Sudeep** (1999), in an article on "Consumers' awareness necessary for success of VAT" focuses on need of awareness regarding VAT among consumers. According to him, though VAT is paid by the consumers the no

clarity of its effects on their purchase and sales of commodities have led to confusion. Moreover, the government has been accused of not taking any positive steps towards educating them. Due to their ignorance, as opposed to the government policy, consumers are forced to pay VAT in all purchases they make, common people are still ignorant of VAT. Since consumers pay VAT, it is necessary for the government to educate them. It is necessary on the part of consumers to know about the goods and services that are VAT exempted not to be cheated by businessmen. Consumers also need to know the businessmen who are entitled to collect VAT and who are not.

**Pandey, Mukti** (1999), in an article “Value Added Tax: ON a New Path” also focuses on VAT awareness for the success of VAT system. According to him, the success of VAT system is not only the success of the VAT department but also the success of the VAT nation as a whole. The role of general media, radio, and national daily/weekly newspapers play is important in this context. Emphases should be given to mass public media instead of distributing booklets and return forms to taxpayer. Therefore, an environment of VAT awareness should be created covering the public, non-government and government organization.

### **2.2.2. Review of Related Dissertation**

**Sharma, Chintamani** (1998), has examined several aspects of VAT administration such as its problems, constructions, possibilities, operation and other aspects. In his dissertation, he has found the following findings:

- Most of the traders and businessman are lacked with the minimum concept of VAT. They are mainly facing pricing, billing and accounting problems.
- An adequate VAT education programs are not conducted and VAT administration has also facing lack of administrative personnel.

- The relation between government and business community is broken, which has been barrier to implement VAT successfully.
- His suggestions to the government to implement VAT successfully in Nepal are as follows:
- The government should pay attention of design the strong administration.
- The government should try to produce gazette manpower and to train them well. The government should launch comprehensive education program.

At last, he concludes that VAT requires the strengthened administration for effective and efficient implementation. (Sharma, 1998)

**Ghimire, Lalmani** (1998), in his dissertation “Value Added Tax: Key Issue in Nepal” explains great importance for the effective implementation of VAT administrative capability in Nepal. Organizational structure, audit and inspection system, reward and punishment, political intervention, selection of skilled and experienced manpower are needed to improve for effective implementation of VAT. VAT is considered as a broad based tax and potential advantages of it can be attained fully if the tax is extended through retail level. For the period time, he suggested to improve following aspects: i) administrative power and creditability ii) identification of taxpayers iii) registration iv) education programs v) incentives for small traders (Ghimire, 1998).

**Bista, Raghu Bir** (1999), in his research, focused the need of VAT for several reasons. They are effective revenue mobilization, industrial development, strong administration, transparency and avoiding all tax loopholes. VAT helps to reduce the resource gap by broadening the tax base and mobilizing additional resource by controlling tax leakage, smuggling, unofficial trade and corruption through transparency and account based cross checking. Positive and favorable effects of VAT on all sectors can be aliened only of government can operate the administration with effectively and efficiently.

In his research, the following findings can be gained:

- The sales tax system is failure to several cases: narrow tax base, inelasticity of tax rate, incapable and weak administration tax leakage, corruption and political intervention. So, the entire tax reform is needed.
- A VAT is account based, invoice based and record based; it checks the tax loopholes.
- For implementation of VAT the public awareness level relating VAT and VAT administration should be good and it is a pre-requisite in the preparation of VAT (Bista, 1999).

**Dhakal, Arjun** (2000), in his dissertation analyzed the Nepalese tax structure along with the basic emphasis and historical background and potential revenue of VAT in Nepal. The increasing trend of resource gap of Nepal is forcing the country to debt trap situation. Domestic resource mobilization through the properly designed tax system is the best way to uplift the situation. In this process, Nepal is adopted the destination based, consumption type VAT operated by tax credit method. VAT encourages investment, supports economic growth and keeps price stable. Exemption and zero rating reduced the regressive of VAT, however, it makes the administration complex. The study found that VAT is unable to compete the existing sales tax mainly due to the minimum use of invoice by sellers and as well as having no interest to obtain invoices by purchasers. Elasticity and buoyancy of Nepalese tax system are very low. Further, they are decreasing in recent years. VAT, more attractive from the theoretical as well as empirical aspects, is being, hot milk in mouth from practical viewpoint mainly due to the inefficient tax administration. Hence, the introduction of the VAT is not fulfillment of the requirement and VAT system itself has a great need of reforming in the Nepalese context. (Dhakal, 2000)

**Subedi, Khusi Ram** (2005), in his dissertation “Implementation and Effectiveness of VAT in Nepal” explains monitoring system of the VAT administration is not effective, because of this; taxpayers are still encouraged for tax evading practice. Many businessmen do not issue invoice for their

selling and even to follow the other importer invoice so an effective and efficient auditing, investigation and monitoring system should be developed.

He further explains that the VAT administration should be kept free from any sort of intervention or influences from the outside. Honest and capable person should be selected for key position. Training of the tax personal should be kept at the top most priority. A good working environment should be created inside the administration, reward and punishment system should be strictly followed as a major guideline of conducting administration. Tax officials should closely be monitored for any kind of misdeeds.

Gautam (2010), in this dissertation “revenue collection from VAT and it’s problems” explain great importance in total revenue. From his view, VAT is found to the best alternative for revenue collection. The share of VAT revenue is increasing trend in every fiscal year from 2011/12. VAT is a essential choice for revenue collection. VAT become in power point of attraction of many countries and gained popularly day by day, the structure of VAT administration is till weak, traditional, corrupted and incomplete, most of the taxpayers are not conscious about the VAT system, smuggling business activates are increased due to the tax administration are major finding of his study. He indicates the major problems in revenue collection from VAT that are VAT billing, narrow tax base, smuggling under valuation and unauthorized trade, weak tax administration, weak public consciousness level and geographical barriers.

### **2.3. Research Gap**

As to the research gap is concerned there are many changes taken place in the implementation of VAT. About 10 years have already been passed since it came into implementation but less study had undertaken on the topic of VAT in Nepalese context and most of the studies were related with theoretical aspects. So, this fresh study related to implementation system of VAT in Nepalese context, has been done in this research. The researcher has tried to analyze the existing problems which are facing by the government and problems faced by the business sectors in major market area of Kathmandu city by conducting field survey, in order to know the practical experience of VAT. Data are both

primary and secondary. But finding suggestion and recommendations given in this report are based on current primary data analysis and annual report of the IRD.

## **CHAPTER -III**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

The research methodology is procedure of relating the solution of the problem through a systematic and planned way with the collection analysis and interpretation of the facts and figures.

In this research, the main motto of this study is to examine the implementation system of VAT in Nepal. Every research needs a good methodology to show better performance of the true result. For this purpose the different methods are used to acquire adequate methods and true information about subjective matter. In order to achieve this objective the following research methodology has been purposed under the following headings:

##### **3.1.1 Field Work Procedure**

In this method, the researcher collects the data as primary source on the related field by visiting the various people.

While conducting the fieldwork, the researcher has visited with various persons like experts, economists, businessman, officers of the IRD, in matters with implementation system of VAT in Nepal.

For the examination of internal resource mobilization through VAT in Nepal, secondary sources of data are collected from various years related to tax revenue value added tax and total revenue effects from domestic trade, foreign trade, revenue activities of the revenue collecting procedure of manufacturing. By the same way, the study is made on the basis of relevant factors like rules, structure of VAT, influence of regular and development expenditure to rising of VAT and collecting revenue of collection of data have arranged in appendices.

### **3.1.2 Research Design**

Research design is the research method and technique used during the entire study. Planning Structuring and making strategy for investigating of the information in order to reach a conclusion is research design. The design is to make descriptive way for the historical study of VAT and regarding the analysis of revenue collection through VAT is made on the available of collected data. Here the study is concerned with, implementation system of VAT in Nepalese context and its effect on economy after implementation of VAT in Nepal like consumer's behavior, business organization, price difference after applying the business firm and facing problem by government and related field. So, this study is divided into five chapters by inserting variable tables, figures and diagrams.

### **3.1.3 Nature and Sources of Data**

Information is relevant in research. Data can be collected from primary source and secondary source. Data are collected in order to fulfill the objective of the study. As regards with the historical study of VAT can not found the numerical data to analyze the concerned subject matters. Descriptive abstracts are taken form books, booklet articles, news papers, magazine, reports etc.

The sources of data can be dividend into two parts

#### **3.1.3.1 Primary Sources**

Unpublished data form field by questionnaire, mail, direct visit etc are primary sources. They are fresh and original data which are collected and recorded by the investigator or researcher.

The major tools used for collection of primary data are administration of questionnaire to a responsive person.

A set of 70 questioners were developed and distributed to the respondents in order to make accurate and actualization of the format. Besides, telephone

interviews, mobile contact, mail and SMS conducted to collect more information on the related matters.

### **3.1.3.2 Secondary Sources**

Published data like articles, news, thesis, books are secondary data.

The major sources of secondary data for the study are:

- Published journals from Nepal Rastra Bank.
- Published reports of Internal Revenue Department and its web site ([www.ird.gov.np](http://www.ird.gov.np))
- Published document of World Bank's reports, National Planning Commission and Central Bureau of Statistic's report.
- Published documents of Ministry of Finance like Budget Speech, Economy Survey etc.
- Published documents of different trade institution like Nepal Chamber of Commerce (NCC). Federation of Nepal Chamber of Commerce and Industries (FNCCI) etc.
- Other related data records like economic journal, tax journal, business age, new business age, VAT Act 2052 & rules 2053, Kantipur daily, Kathmandu Post, the Himalayan Times, the Rising Nepal, Gorkhapatra, website etc.

### **3.1.4 Sampling Theory**

The research is designed to examine the implementation system of VAT in Nepal. So, for getting true fact result researcher forwarded the questionnaires in the various business firms, industries, exports people as well as respondents are selected randomly within Kathmandu valley.

The researcher had visited the office of Internal Revenue Department to collect necessary information.

### **3.1.5 Presentation and Analysis of Data /Techniques and Tools**

The data are collected according to the subject matters. In this study the bibliography cards have been prepared first on the basis of available literature, journals, reports and data. Then the accumulated literature, reports and data were reviewed and tabulated accordingly with the objectives. To analyze the collected facts and figures various tools are used wherever necessary. The techniques included are statistical tools, tables, bar diagrams, trend bar and others tools as needed to manage the data for getting the result.

## **CHAPTER IV**

### **PRESENTATION & ANALYSIS OF DATA**

The main objective of this study is to examine the present practice of implementation system of VAT in Nepalese context. To achieve the stipulated objective, collected data are analyzed and interpreted. Collected primary and secondary data are analyzed with the help of statistical tools and techniques.

On the basis of primary data which related with field research, annual report of IRD, Economic Survey of current passed year and the budget speech of current year, the researcher has tried to explore deeply the existing problem of VAT and its implementation. And the researcher has analyzed and diagnosed the collected data to come up with the favour of conclusion.

#### **4.1 Implementation System of VAT in Nepalese Context**

In accordance with the policy of 8th plan, VAT came after enacted the law of VAT Act. 2052 and regulation 2053, It was implemented as the replacement of existing sales tax, hotel tax, contract tax and entertainment tax only but not as an others tax.

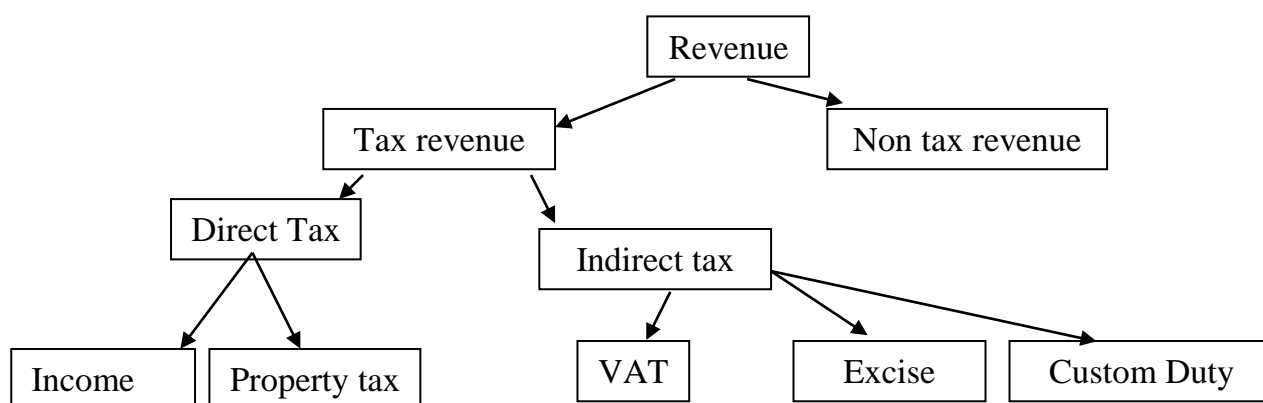
The most significant point of its implementation is to increasing the revenue and to develop the sustainable development of economy in Nepal. It can be seen and analysis the implementation system of VAT in Nepalese context as following.

### 4.1.1 Analysis of Secondary Data

Analysis of secondary data is as following heads:

### 4.1.2 Total Revenue Structure

Figure 4.1



Source: RAJASWA (2062)

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

- a. Tax revenue
- b. Non-tax-revenue

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

## 4.2. Composition of Total Revenue

**Table 4.1 Composition of Total Revenue**

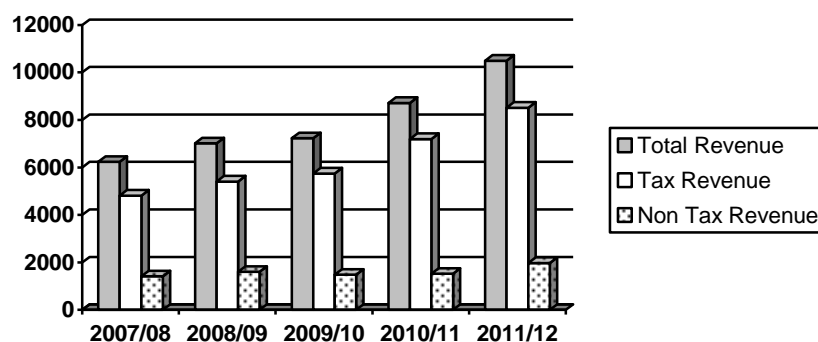
(Rs. in crore)

S. n.	FY	Total Revenue	Tax-revenue		Non tax- revenue	
			Amount	As% on TR	Amount	As% on TR
1	2007/08	6233.10	4817.30	77.29	1415.80	22.71
2	2008/09	7012.27	5410.47	77.16	1601.80	22.84
3	2009/10	7228.20	5743.04	79.45	1485.16	20.55
4	2010/11	8719.97	7197.34	82.54	1522.63	17.46
5	2011/12	10493.93	8515.55	81.15	1978.38	18.85

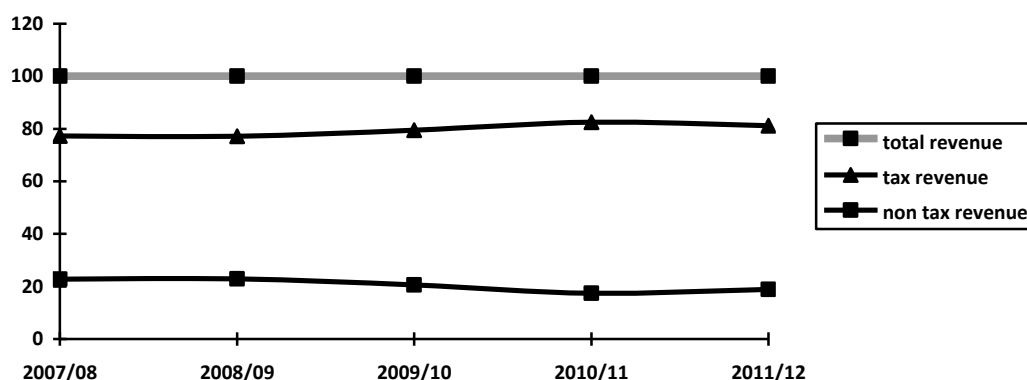
Source: Economic Survey 2012, Various Budget Speech Issues, MOF, Annual Report IRD, RAJASHOW, 2012

Nepalese economy is characterized by a low revenue performance in contrast to the growing public expenditure. The contribution of tax revenue total revenue is higher than non-tax-revenue. The above table shows the composition of tax revenue and non- tax revenue and their share in total revenue. In the fiscal year 2007/08, the share of tax revenue was 77.29 percent and the share of non tax revenue was 22.71percent. Of the total revenue collection, in the fiscal year 2008/09, the share of tax revenue was 77.16 percent and the share of non tax revenue was 22.84 percent. In this way, in the fiscal year 2009/10, 2010/11, 2011/12, the share of tax revenue were 79.45, 82.54 and 81.15 percent and the share of non tax revenue were 20.55, 17.46 and 18.85 percent respectively. On an overall contribution of tax revenue to total tax revenue seems as increasing trends where as non tax revenue seems as slightly decreasing trend from fiscal year 2007/08 to fiscal year 2011/12.

**Graph 4.2 Composition of Total Revenue (In Crore Rs.)**



**Graph 4.3 Trend of Tax Revenue & Non Tax Revenue as % on Total Revenue**



### 4.3. Contribution of VAT Revenue to Tax Revenue

**Table 4.2 Contribution of VAT Revenue to Tax Revenue**

(Rs. in Thousands)

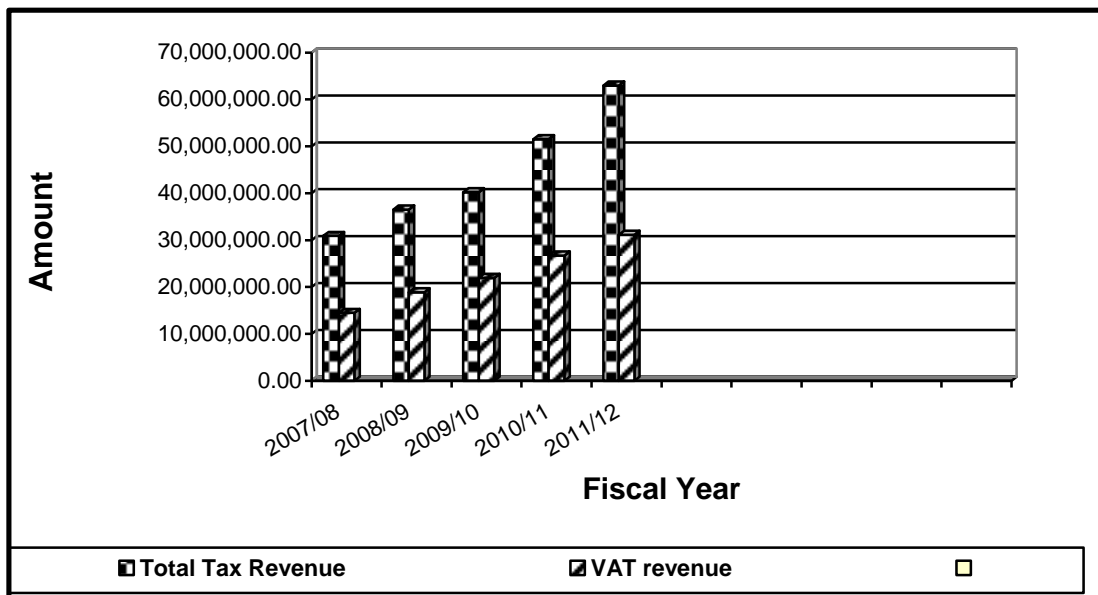
S.N.	FY	Total Tax Revenue	VAT revenue	VAT revenue as % TR	Increase/ (Decrease)
1	2007/08	30,920,989	14,478,896	46.83	
2	2008/09	36,552,762	18,894,627	51.69	4.87
3	2009/10	40,202,336	21,946,014	54.59	2.90
4	2010/11	51,541,450	26,704,180	51.81	(2.78)
5	2011/12	62,979,367	31,154,633	49.47	(2.34)

Source: Economic Survey, MOF 2012. Ktm.

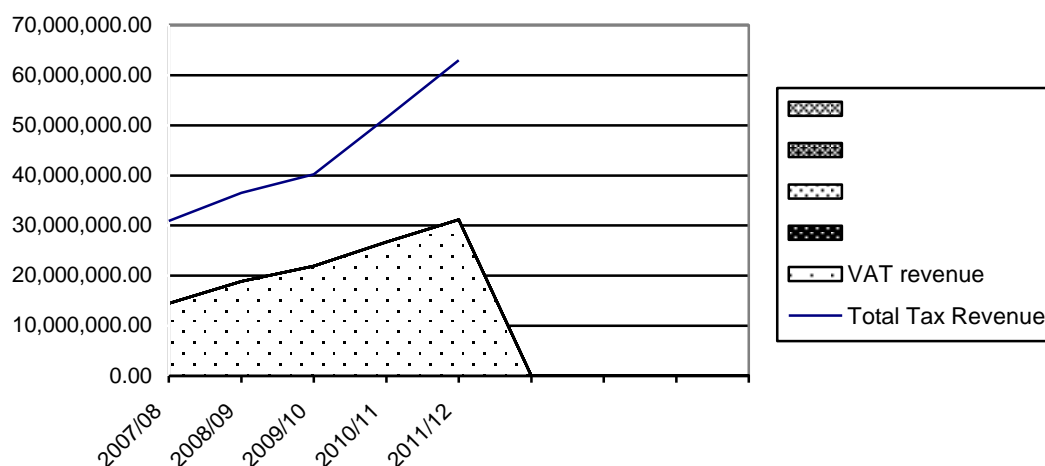
In the FY 2007/08, the tax revenue amount was Rs.30,920,989.00 thousands out of which Rs.14,478,896.00 thousands was VAT revenue. In F/Y 2008/09 the contribution of VAT revenue to total tax revenue was 46.83 percent and which was increased by 4.87 percent as compared to F/Y 2007/08. In 2009/10 the contribution of VAT revenue was increased by 2.90 percent as compared to previous year but in year 2010/11 contribution of VAT revenue in total revenue was decreased by 2.78 percent. Similarly in F/Y 2011/12, the contribution of vat revenue on total tax revenue is 49.47 percent but vat revenue was decreased by 2.34 percent.

**Graph 4.4 Graph Showing Tax Revenue & VAT Revenue**

(in Thousand Rs)



**Graph 4.5 Trend of Tax Revenue & VAT Revenue as % on Total Revenue**



#### 4.4. Status of VAT Registration

**Table 4.3 Status of VAT Registration**

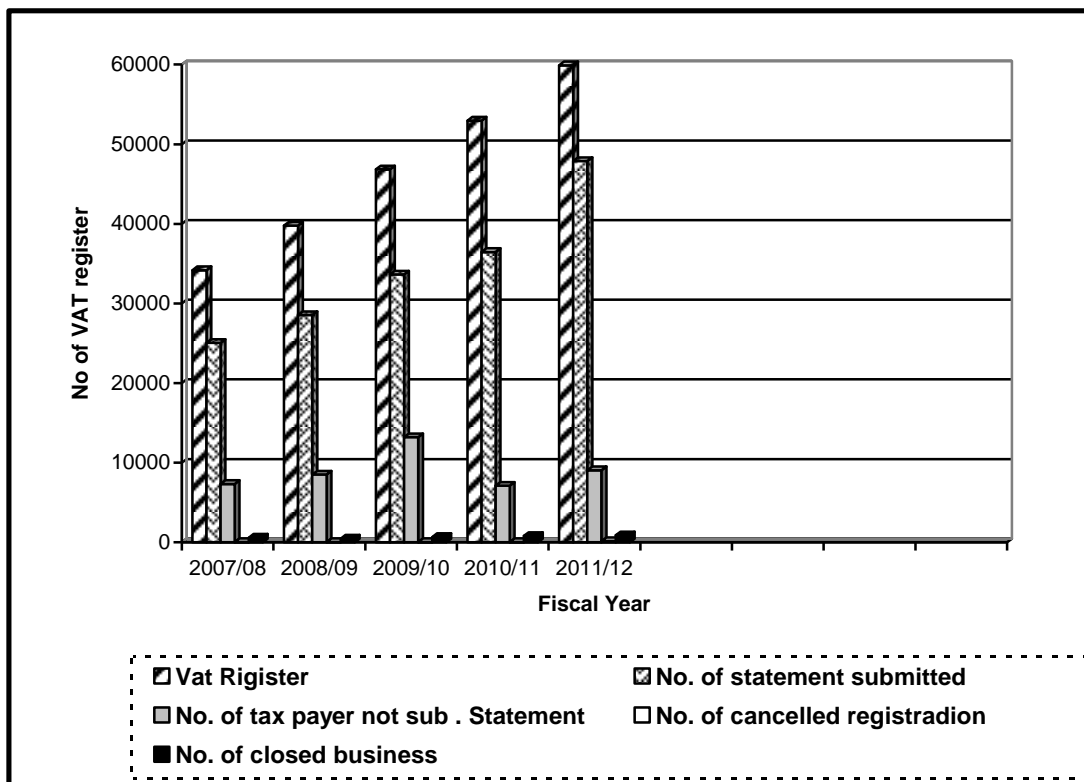
FY	Vat registration (a)	No. of statement submitted (b)	Percentage (b)/(a)	No. of tax payer not submitting return (c)	% (c)/(a)	No. of cancelled registration (d)	% (d)/(a)	No. of closed business (e)	%(e)/(a)
2007/08	34174	25049	73.30	7,322	21.43	30	0.09	570	1.67
2008/09	39776	28525	71.71	8,492	21.35	30	0.08	445	1.12
2009/10	46831	33633	71.82	13,198	28.18	36	0.08	647	1.38
2010/11	52965	36457	68.83	7,098	13.40	31	0.06	793	1.50
2011/12	59850	47880	80.00	9,050	15.11	150	0.25	810	1.35

Source: Annual Report, Internal Revenue Department, 2011

The above table shows the no of VAT registered business divided into categories of statement submitted, statement not submitted, cancelled registration and closed business and their respective share during last 5 year starting form fiscal year 2007/08 to 2011/12. In the FY 2007/08, the total number of registered taxpayer was 34,174 out of which 25,049 had submitted the tax statement. It meant 73.30 percent tax payer had submitted the tax

statement in the Inland Revenue Department. In the same FY, the number of taxpayers who had not submitted the tax statement was 7,322 which come to 21.43 percent of the total registers. There was 30 cancelled registration and 570 business were closed during the year. In fiscal year 2008/09, the total number of VAT registrants were 39,776 out of which 71.71 percent submitted the statement where as 21.35 percent did not submitted the return. Similarly, the number of tax payers who had cancelled their registration was 30 and the number of registrant who closed their business was 445 which come to 1.12 percent of the total no of VAT registrants. From the above table we can conclude that year by year vat registration are increasing and number of statement submission are also increasing. Number of taxpayer not submitting their return are 28.18, 13.40 and 15.11 in the fiscal year 2009/10, 2010/11 and 2011/12 respectively. Besides that, number of cancelled registration and closed business are also increasing.

**Graph 4.6 Graph Showing Tax Registrants and Return Filing**



## 4.5 Status of Return Filers

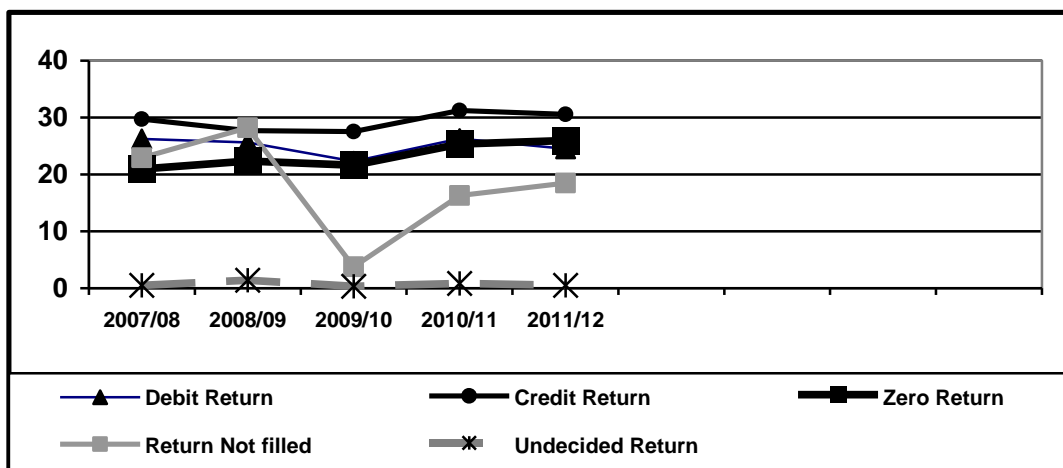
F/y	Debit Return		Credit Return		Zero Return		Return Not filled		Undecided Return		Total Return
	Total	%	Total	%	Total	%	Total	%	Total	%	Total
2007/08	8483	26.21	9625	29.73	6783	20.95	7322	22.62	158	0.49	32371
2008/09	9478	25.60	10260	27.72	8271	22.34	8494	22.94	516	1.39	37017
2009/10	10449	22.31	12883	27.51	10139	21.65	13198	28.18	163	0.35	46831
2010/11	11457	26.30	13594	31.21	11044	25.36	7098	16.30	362	0.83	43555
2011/12	12052	24.48	15050	30.57	12779	25.96	9095	18.47	258	0.52	49234

**Table 4.4 Status of Return Filers**

Source: Annual Report, Internal Revenue Department, 2008, page no. 43

The above table shows that the total taxpayer divided into Debit Return Filers, Credit Return Filers, Zero Return Filers, Non Filers and Undecided Tax Returns during the last 5 years starting from 2007/08 to 2011/12. The number of Debit Return filers starting from 2007/08 to 2011/12 was 8483, 9478, 10449, 11457 and 12052 which come to 26.21, 25.6, 22.31, 26.30 and 24.48 percent respectively of the total registrants which is in increasing trend. The number of credit return filers during the same period was 9625, 10260, 12883, 13594 and 15050, which come to 29.73, 27.72, 27.51, 31.21 and 30.57 percent respectively of the total registrants which is also increasing in decreasing trend. The number of Zero return filers had also increased during the same period which is 6783, 8271, 10139, 11044 and 12779 which come to 20.95, 22.34, 21.65, 25.36 and 25.96 percent respectively of the total registrants. Likewise, the number of undecided return had also increased during the same period. The undecided return was 158, 516, 163, 362 and 258 which come to 0.49, 1.39, 0.35, 0.83 and 0.52 percent respectively of the total registrants during the reported period which seems oscillating in trend.

**Graph 4.7 Graph Showing Trend of Return Filing**



#### 4.6 Trend of VAT Registrants

The status of VAT registered business is depicted in the following table. On an average the no of VAT registered business has increased at the rate of 13% p.a.

**Table 4.5 Trend of VAT Registrants**

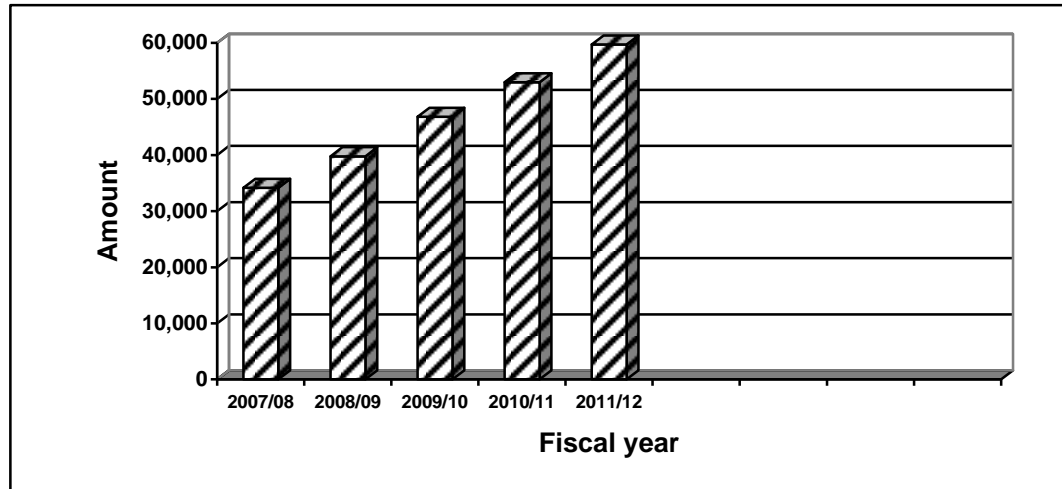
SN.	FY	VAT Registration	Increase%
1	2007/08	34,174	-
2	2008/09	39,776	16.39
3	2009/10	46,831	17.74
4	2010/11	52,965	13.10
5	2011/12	59,850	13.00

Source: Annual Report, Internal Revenue Department, 2011

In FY 2007/08, the number of VAT Registrants was 34174. During the fiscal Year 2008/09 the number of registrants has increased by 16.39 and reached to 39776. The average no of increase in VAT registrants during the fiscal year 2007/08 to 2011/12 is 15.05 percent. The number of VAT registrant was

increased in increasing trend from 2007/08 to 2009/10 and the number of VAT registrants increased in decreasing trend from 2010/11 to 2011/12.

**Graph 4.8 Graph Showing Trend of VAT Registration**



#### 4.7 Trends of VAT Revenue

**Table 4.6 Trends of VAT Revenue**

(In thousands Rs.)

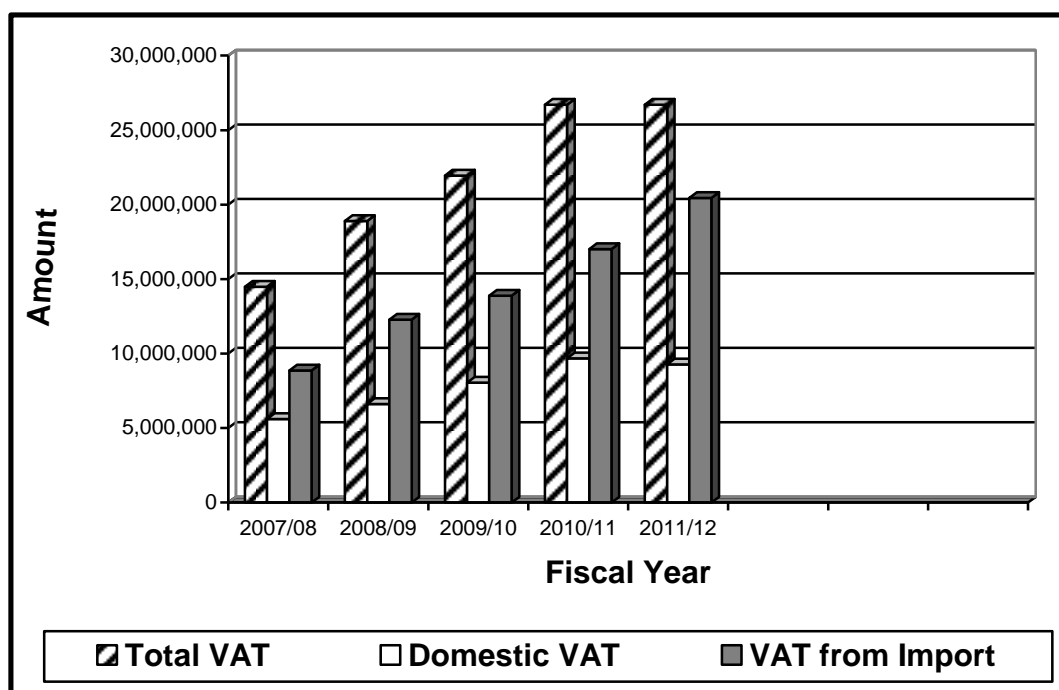
S.N	FY	Total VAT	Domestic VAT	Percentage	VAT from import	Percentage
1	2007/08	14,478,896	5,604,123	38.71	8,874,773	61.29
2	2008/09	18,894,627	6,624,333	35.06	12,270,294	64.94
3	2009/10	21,946,014	8,057,438	36.71	13,888,576	63.29
4	2010/11	26,704,180	9,689,979	36.29	17,014,201	63.71
5	2011/12	29,703,211	9,264,711	31.19	20,438,500	68.81

Source: Annual Report, IRD.2011

VAT Revenue was divided into two parts i.e. Import VAT and Domestic VAT. In the FY 2007/08 and 2008/09 VAT collection from import were Rs.8874773.00 thousands & Rs.12270294.00 thousands which was 61.29 and 64.94 percent of total VAT collection. During the 5 years started from 2007/08

to 2011/12 VAT collected from domestic transactions was less in comparison to VAT collected from import transactions. VAT revenue collection was in increasing trends in each FY. Therefore, VAT revenue collection was also satisfactory as it was in terms of increasing trends.

**Graph 4.9 Showing the Trends of VAT Revenue**



#### 4.8 Analysis of Primary Data

Primary data has been collected by putting forward questionnaires to respondents and analyzed and presented as below:

##### 4.8.1 Views on Implementation System of VAT in Nepalese Context

**Table 4.7 Implementation Aspect of VAT in Nepal**

Respondents	Sound		Unsound		Medium		Total
	No.	%	No.	%	No.	%	No.
Businessman	9	26	0	0	26	74	35
Consumers	3	9	3	9	29	82	35
<b>Total</b>	<b>12</b>	<b>17</b>	<b>3</b>	<b>4</b>	<b>55</b>	<b>79</b>	<b>70</b>

Source: Opinion Survey

From the above table it is clear that 74% businessmen and 82% consumers argued that implementation system of VAT in Nepal is medium. Similarly 9% consumers viewed it as unsound whereas 26% businessmen and 9% consumers expressed it as sound. In conclusion, we can say that the implementation system of VAT in Nepal is medium.

#### 4.8.2 Views on the Best Way to Increase Base of VAT in Nepal

**Table 4.8 Best Way to Increase the Base of VAT**

Respondents	Reducing threshold		Including service sectors		Incorporating agricultural sectors		Other	Total	
	No	%	No	%	No	%	No		%
Businessman	22	63	10	26	3	11	0	0	35
Consumer	18	51	9	26	7	20	1	3	35
Total	40	57	19	27	10	14	1	2	70

*Source: Opinion Survey*

On analysis of above table, 63% businessmen and 51% consumers opined that reducing threshold is the best way to increase the base of VAT 26% of businessmen and consumers are in favor of including service sectors whereas 11% businessmen and 20% consumers are in favor of incorporating agricultural sectors. One of the respondents expressed that the base of VAT can be increased by educating consumers and businessmen about VAT. Hence it is concluded that the base of VAT can be increased by reducing threshold.

### 4.8.3 Views on Superiority of VAT Over Sales Tax

**Table 4.9 Superiority of VAT Over Sales Tax**

Respondents	Yes		No		I don't know		Total
	No.	%	No.	%	No.	%	
Businessman	35	100	0	0	0	0	35
Consumers	31	88	2	6	2	6	35
Total	66	94	2	3	2	3	70

*Source: Opinion Survey*

The above table shows that all businessmen are in favor of VAT while 88% consumers supported VAT is superior to sales tax but 6% consumers are against this statement. In conclusion we can say that VAT is superior to sales tax.

### 4.8.4 Views on Reason of Problem in Effective Implementation of VAT in Nepal

**Table 4.10 Problem in Effective Implementation of VAT in Nepal is Due to**

Response	Businessmen		Consumers		Total	
	No.	%	No.	%	No.	%
Administrative incapability	20	57	4	11	24	34
Under invoicing	10	29	24	68	34	49
Frequent change in Act/Rules	0	0	2	6	2	3
Lack of Public awareness	1	3	2	6	3	4
Lack of long term policy and strategy	1	3	1	3	2	3
Lack of knowledge and information to taxpayers about VAT	3	8	2	6	5	7
Others	0	0	0	0	0	0
<b>Total</b>	<b>35</b>	<b>100</b>	<b>35</b>	<b>100</b>	<b>70</b>	<b>100</b>

*Source: Opinion Survey*

Above table shows that 57% businessmen and 11% consumers viewed that administrative incapability is the main problem in effective implementation of VAT in Nepal where as 29% businessmen and 68% consumers are in favor of under invoicing. Thus, businessmen and consumers have different view regarding problem in effective implementation of VAT in Nepal.

#### 4.8.5 Views on Improvement & Effective Implementation of VAT in Nepal

**Table 4.11 Suggestions for Improvement and to Make More Effective Implementation of VAT in Nepal**

Response	Businessmen		Consumers		Total	
	No.	%	No.	%	No.	%
Strengthen and improve VAT administration	11	31	14	40	25	36
Improve VAT laws and regulation	3	9	3	9	6	9
VAT education to the businessmen	1	3	2	6	3	4
Develop information technology	5	14	3	9	8	11
Develop skill manpower	1	3	0	0	1	1
Political commitment	5	14	1	3	6	9
Change in threshold	0	0	1	3	1	1
Improve in auditing	6	17	6	17	12	17
Reward and Punishment	0	0	1	3	1	1
Need of training Program	2	6	3	9	5	8
Need of training Program	2	6	3	9	5	8
Others	1	3	1	1	2	3
<b>Total</b>	<b>35</b>	<b>100</b>	<b>35</b>	<b>100</b>	<b>70</b>	<b>100</b>

*Source: Opinion Survey*

Among 35 businessmen, 31% of them suggested that VAT can be improved and made more effective through strengthening and improving VAT administration, 17% of them suggested that VAT can be improved through improving auditing and 14% of them are in favor of developing information technology and political commitment. Majority 36% of the total respondents are in favor of strengthening and improving VAT administration. Among 35 consumers, majority(36%) suggested that VAT can be improved and made more effective through strengthening and improving VAT administration.

#### 4.8.6 Views on Awareness of Price Effect Due to VAT

**Table 4.12 Price Rises Due to VAT**

Respondents	Yes		No		I don't know		Total
	No.	%	No.	%	No.	%	No.
Businessman	0	0	35	100	0	0	35
Consumers	2	6	30	86	3	8	35
Total	2	3	65	93	3	4	70

*Source: Opinion Survey*

Among 70 respondents, the total businessmen opined that price does not rise due to VAT where as only 86% of consumers are aware that price does not rise due to VAT.

#### 4.8.7 Views on rate of VAT in Nepal

**Table 4.13 Acceptability of Single VAT rate (13%) in all Types of Products**

Respondents	Yes		No		I don't know		Total
	No.	%	No.	%	No.	%	No.
Businessman	9	26	24	69	2	5	35
Consumers	10	29	15	43	10	28	35
Total	19	27	39	56	12	17	70

*Source: Opinion Survey*

The above table shows that only 26 % of businessmen and 29 % of consumers have positive view regarding the single VAT rate (13%) in all types of products where as 69% businessmen and 43% consumers are against the single rate of VAT.

#### 4.8.8 Views on Effect of VAT in the Economic Development

**Table 4.14 Effect of VAT in the Economic Development**

Respondents	Positive		Negative		Moderate		Total
	No.	%	No.	%	No.	%	No.
Businessman	28	80	0	0	7	20	35
Consumers	25	71	0	0	10	29	35
Total	53	76	0	0	17	24	70

*Source: Opinion Survey*

Among 70 respondents, 80% businessmen and 71% consumers expressed that the effect of VAT in the economic development is positive where as 20% businessmen and 29% consumers viewed it as moderate.

#### 4.8.9 Views on Attitudes of Tax Payers on VAT Implementation

**Table 4.15 Reasons for not Showing Positive Attitudes Towards VAT Implementation by the Tax Payers**

Respondents	Businessman		Consumers		Total	
	No.	%	No.	%	No.	%
Lack of Value added Tax education	12	34	11	31	23	33
To hide transaction/ tax	3	9	7	20	10	14
Increase the working capital	20	57	15	43	35	50
Others	0	0	2	6	2	3
Total	35	100	35	100	70	100

*Source: Opinion Survey*

On this question, 57% businessmen and 43% consumers expressed that tax payers are not showing positive attitudes toward VAT implementation to increase the working capital, 34% businessmen and 31% consumers gave its reason as lack of value added tax education and 9% businessmen and 20% consumers expressed their opinion on it as to hide transaction/tax.

#### 4.8.10 Views on VAT leakage in Nepal

**Table 4.16 Existence of VAT Leakage in Nepal**

Respondents	Yes		No		I don't know		Total
	No.	%	No.	%	No.	%	No.
Businessman	35	100	0	0	0	0	35
Consumers	35	100	0	0	0	0	35
Total	70	100	0	0	0	0	70

*Source: Opinion Survey*

Total businessmen and consumers expressed that there is VAT leakage in Nepal.

#### 4.8.11 Views on Taking Bill on Purchase

**Table 4.17 Frequency of bill taking on purchase**

Respondents	Businessman	Consumers		Total			
	No.	%	No.	%	No.	%	
Yes, on all purchase	1		3	4	12	5	7
Yes, but not regular	18		51	25	71	43	62
No, I don't get any bill	0		0	0	0	0	0
Total	35		100	35	100	70	100

*Source: Opinion Survey*

Among 70 respondents, 51% businessmen and 71% consumers used to take bill on purchase but not regular, 46% businessmen and 17% consumers used to

take bill on most of their purchase and only 3% businessmen and 12% consumers used to take bill on all purchase.

#### 4.8.12 Views on Present Threshold Limit

**Table 4.18 Present Threshold Limit for Effective Implementation of VAT in Nepal**

Respondents	Low		Moderate		High		Very High		Total
	No.	%	No.	%	No.	%	No.	%	No.
Businessmen	0	0	28	80	5	14	2	6	35
Consumers	3	9	25	71	5	14	2	6	35
Total	3	4	53	76	10	14	4	6	70

*Source: Opinion Survey*

About present threshold limit for effective implementation of VAT in Nepal, 80% businessmen and 71% consumers viewed it as moderate, each 14% businessmen and consumers expressed it as high, each 6% businessmen and consumers expressed it as very high and 9% consumers viewed it as low.

#### 4.8.13 Views on Role of Billing System

**Table 4.19 Role of Billing System in Implementation of VAT in Nepal**

Respondents	Yes		No		I don't know		Total
	No.	%	No.	%	No.	%	
Businessmen	35	100	0	0	0	0	35
Consumers	31	88	0	0	4	12	35
Total	66	94	0	0	4	6	70

*Source: Opinion Survey*

Among 70 respondents, total businessmen and 88% consumers expressed their view that billing system plays vital role in the implementation of VAT in Nepal.

#### 4.8.14 Views on Open Border System

**Table 4.20 Opinion on Open Boarder System as a Main Hindrance for the Successful Implementation of VAT in Nepal**

Respondents	Yes		No		I don't know		Total
	No.	%	No.	%	No	%	
Businessmen	27	77	2	6	6	17	35
Consumers	22	63	5	14	8	23	35
Total	49	70	7	10	14	20	70

*Source: Opinion Survey*

Here, 77% businessmen and 63% consumers accepted that open boarder is a main hindrance for the successful implementation of VAT in Nepal where as 6% businessmen and 14% consumers are against it.

#### 4.8.15 Views on Reason for Need of VAT in Nepal

**Table 4.21 Main Reasons for Need of VAT in Nepal**

Respondents	Businessman		Consumers		Total	
	No.	%	No.	%	No	%
Effective revenue	3	9	3	9	6	9
Transparency	2	6	2	6	4	6
Avoid leakage	0	0	2	6	2	3
Increase tax base	0	0	2	6	2	3
All	30	85	26	73	56	79
I don't know	0	0	0	0	0	0
Others	0	0	0	0	0	0
Total	35	100	35	100	70	100

*Source: Opinion Survey*

Among 70 respondents, 85% businessmen and 73% consumers expressed their view that VAT is needed in Nepal for effective revenue, transparency, to avoid leakage and increase tax base.

#### 4.8.16 Views on Problem in the Process of Collecting VAT in Nepal

**Table 4.22 Problem in the Process of Collecting VAT**

Response	Businessman		Consumers		Total	
	No	%	No	%	No	%
Registration	2	6	2	6	4	6
Account Keeping	3	9	4	11	7	10
Billing	27	77	24	69	51	73
Tax refunding	3	8	4	11	7	10
Others	0	0	1	3	1	1
Total	35	100	35	100	70	100

*Source: Opinion Survey*

On this question, 77% businessmen and 69% consumers viewed billing system as problem in the process of collecting VAT. Similarly, 9% businessmen and 11% consumers indicated account keeping, 8% businessmen and 11% consumers argued on tax refunding and 6% businessmen and consumers viewed registration as the problem in the process of collecting VAT.

### 4.9 Major Findings of the Study

#### 4.9.1 General Findings

- VAT is most scientific, modern and new innovation in the field of taxation.
- VAT has been most essential alternative of different tax reform programs for developing countries like Nepal. It leads to revenue enhancement, transparent and scientific tax system. There will be vital scopes for increasing the revenue from VAT in coming days.

- Most of the customers, traders/businessmen are lacked with the concept of VAT. They are facing billing, accounting problems. .
- Due to different reasons the operating of VAT is extremely geographical structure, open boarder, traditional business system, and low public consciousness level, under valuation of pricing, corruption and accountability.
- VAT is more efficient tax to avoid the cascading and pyramiding effects.

#### **4.9.2 Findings from Secondary Data**

- There is greater share of tax revenue in total revenue than non tax revenue which is on average 80 percent contribution in total revenue. Similarly, VAT revenue has also great contribution in tax revenue.
- The contribution of VAT revenue to direct tax revenue was in increasing trend in each F/Y.
- The number of VAT registrant business shows in increasing trend every year during the past five years and reached a height of 59,850 during the fiscal year 2011/12. The number of cancelled registration and no of closed business shows oscillating trend.
- The number of debit return, credit return filer and zero return filer all shows increasing trend. The number of debit return filers exceeds credit return filers in number.
- The collection of VAT from import exceeds the domestic VAT collection and is in increasing trend in overall.
- VAT is a great revenue raiser than all other alternatives because the share of indirect tax has increased during the study period and there is great contribution of VAT in Tax Revenue.

#### 4.9.3 Findings from the Primary Data

- The opinion survey shows that the implementation system of VAT in Nepalese context is medium. Among 70 respondents, majority (74% businessmen and 82% consumers) argued that implementation system of VAT in Nepal is medium.
- According to survey, the base of VAT can be increased by reducing the threshold. 63% businessmen and 51% consumers opined that reducing threshold is the best way to increase the base of VAT. 26% of businessmen and consumers are in favor of including service sectors whereas 11% businessmen and 20% consumers are in favor of incorporating agricultural sectors.
- Most of the respondents are in favor on the view of superiority of VAT to sales tax. All businessmen are in favor of VAT while 88% consumers supported that VAT is superior to sales tax but 6% consumers are against the superiority of VAT over sales tax.
- The VAT implementation process is not satisfactory in Nepal. Opinion survey shows that the main problems in the effective implementation is administrative incapability and under invoicing. Opinion survey shows that 57% businessmen and 11% consumers viewed that administrative incapability is the main problem in effective implementation of VAT in Nepal where as 29% businessmen and 68% consumers are in favor of under invoicing. Thus, businessmen and consumers have different view regarding problem in effective implementation of VAT in Nepal
- From the study it has been found that VAT can be effectively implemented through strengthening and improving VAT administration. Out of the total respondents (31% businessmen & 36% consumers) suggested that VAT can be improved and made more effective through strengthening and improving VAT administration. Opinion survey

shows that single rate of VAT is not acceptable. 26 % of businessmen and 29 % of consumers have positive view regarding the single VAT rate (13%) in all types of products where as 69% businessmen and 43% consumers are against the single rate of VAT.

- VAT has positive effective on the economic development of the country. Among 70 respondents, 80% businessmen and 71% consumers expressed that the effect of VAT in the economic development is positive where as 20% businessmen and 29% consumers viewed it as moderate.
- Tax payers are not showing positive attitude towards VAT implementation. The given reasons are to increase working capital, due to lack of VAT education and to hide tax and transaction. Out of the total respondents, 57% businessmen and 43% consumers expressed that tax payers are not showing positive attitudes toward VAT implementation to increase the working capital, 34% businessmen and 31% consumers gave its reason as lack of value added tax education and 9% businessmen and 20% consumers expressed their opinion on it as to hide transaction/tax.
- There is VAT leakage in Nepal. Total business men and consumers expressed that there is VAT leakage in Nepal.
- Most of the businessmen and consumers take bills on purchase but not regularly Among 70 respondents, 51% businessmen and 71% consumers used to take bill on purchase but not regularly, 46% businessmen and 17% consumers used to take bill on most of their purchase and only 3% businessmen and 12% consumers used to take bill on all purchase.
- The present threshold limit is moderate for the effective implementation of VAT. 80% businessmen and 71% consumers viewed it as moderate, each 14% businessmen and consumers expressed it as high, each 6%

businessmen and consumers expressed it as very high and 9% consumers viewed it as low.

- Billing system plays vital role in the effective implementation of VAT in Nepal. Among 70 respondents, total businessmen and 88% consumers expressed their view that billing system plays vital role in the implementation of VAT in Nepal.
- Open boarder is a main hindrance for the successful implementation of VAT in Nepal. 77% businessmen and 63% consumers accepted that open boarder is a main hindrance for the successful implementation of VAT in Nepal where as 6% businessmen and 14% consumers are against it.
- Effective revenue, transparency, to avoid leakage and increase tax base are main reasons for which VAT is needed in Nepal. Among 70 respondents, 85% businessmen and 73% consumers expressed this view.
- Finally, billing system has been found as the main problem in the process of collecting VAT in Nepal. 77% businessmen and 69% consumers viewed billing system as problem in the process of collecting VAT. Similarly, 9% businessmen and 11% consumers indicated account keeping, 8% businessmen and 11% consumers argued on tax refunding and each 6% businessmen and consumers viewed registration as the problem in the process of collecting VAT.



## **CHAPTER -V**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Summary**

VAT is the most recent innovation in the field of taxation. VAT was introduced first in the world by Dr. Wislom V. Simens in 1919 in German. Then, it was introduced in France in 1954. Then after, it has been spread all over the world with in a short span of time. It became effective in Nepal since 16th November, 1997. Nepal has adopted a consumption type, tax credit method, principle of destination with international standard, provision of exemption and zero rate goods and service, tax refund facility with single rate ( currently 13%) of VAT. VAT is modified and improved form of sales tax. It is an indirect tax and new tax system. It is a scientific taxing system. It is a progressive and best source of collecting revenue on taxation in Nepal. VAT is levied on value added goods and services at each stage in the process of production and distribution chain. VAT is one of the most important tools, element and component of indirect tax. It is broad base tax system. The government of Nepal has been charging 13% VAT rate at present. The level of threshold of is Rs 20 lakhs. That means, only the business having turnover exceeding the stipulated limit has to be registered compulsory, but less than the limit can also get registered voluntarily.

Around ten years have already been passed since VAT has come into implementation in Nepal but it has not brought satisfactory result. There were a lot of problems when VAT was implemented. Among those problems some were reduced and some of them are exist up to now. The existing problems of government and problems faced by the business sector are still hindrance for the successful implementation of VAT in Nepal.

Due to lack of proper billing, scientific data resources, transparency, unresponsive behavior by business sector, knowledge about VAT of consumer, investigation trained and skilled manpower, information of network and soon made unable to implement VAT effectively in Nepal.

## **5.2 Conclusion**

Being a better economic developed country is the objective of every country of this world. To meet the objective it is essential to have sufficient revenue generation. Generally tax revenue plays the great role for development of nation's economy. Tax revenue consists of direct tax and indirect tax. Value added Tax (VAT) is a type of indirect tax. It is the most recent innovation in the field of the taxation. It is levied on the value added of the goods and the services. It is theoretically, the tax is broad based as it covers the value added to each commodity by a firm during all stages of production and distribution. Value Added Tax (VAT) is tax based on goods and services. This tax is levied on the sale, exchange, transfer, import etc. of all goods and services apart from those specified by the law as tax-exempt. VAT is most scientific, modern and new innovation in the field of taxation. VAT has been most essential alternative of different tax reform programs for developing countries like Nepal. It leads to revenue enhancement, transparent and scientific tax system. There will be vital scopes for increasing the revenue from VAT in coming days. Most of the customers, traders/businessmen are lacking with the concept of VAT. They are facing billing, accounting problems. Due to different reasons the operating of VAT is extremely geographical structure, open border, traditional business system, and low public consciousness level, undervaluation of pricing, corruption and accountability. VAT is more efficient tax to avoid the cascading and pyramiding effects. On reviewing registration trend, people are becoming more conscious toward the advantages of registering in VAT and the implementation scenario of VAT is going on soundly. The revenue collection from import is very much higher than from internal source.

### **5.3 Recommendations**

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

- Billing system plays vital role in implementation of VAT in Nepal. So efforts should be made for actual billing system by adopting following measures:
- Conduct monitoring and follow up of the market to check whether or not invoices are being issued properly as stipulated in the Act and regulation.
- Expand audit and investigation programme.
- Government of Nepal should launch consumer education campaign regarding the importance of issuing and receiving invoices.
- There should be made billing software and entered in computer, there by tax payers would not be able to delete the transaction file.
- Government should create an environment of strong and full political commitment for successful implementation of VAT.
- Open boarder is also a main hindrance for a successful implementation of VAT.

So, it should effectively be controlled to prevent the illegal trade and checking should be in practiced.

- The VAT administration training centre should be made well with modern net of VAT.
- The tax refund procedure should be simplified and provided in time.
- The training should be given to the registered businessman in order to make them able to maintain the books records and accounts as per the legal provisions.
- The VAT should be implemented to make the corporate sector transparent.
- Current fine and penalty is strong so keep it same.
- Training program must be provided to tax officers to develop skilled manpower and improve administration with current information technology.
- The existing threshold limit is high for considering registration. So it should be reduced to submit the potential registrants tax payers within VAT net.
- There are large number of exempted goods and services. So it should be reduced.
- VAT system of Nepal is not standing on real ground. It is challenges to create the environment in which tax system. So it should be stand on real ground.
- There must be the management of reward and punishment who may be either it may be employee of tax payee who pay tax sincerely, they must be rewarded otherwise they must be strongly fined.

- The IRD should conduct regular seminars, meetings and interaction with good co-ordination business sector to create position attitudes towards VAT.
- It should make the provision of temporary registration of the transaction concerning fair circus shows and tax refund to the tourist.
- There is contradiction for current VAT rate. So it should be differentiated with higher rate of luxurious goods and lower rate of essential goods.
- Tax office should be coordinated with custom office, private sector and other related bodies for information of data and proper implementation of VAT.
- The technology is changing; it is the challenge of the 21st century. So in the record keeping, computer system and networking program must be developed and linked so as to make the VAT work simple which also helps to make data base system effective.
- Some of the staffs in the administrative sectors are corrupt. They do as per the businessmen in consideration of kinds and cash. So, the control over such corruption should be done strictly.

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

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## APPENDIX

### Questionnaire

Dear Sir/madam,

I am doing my Research on "Implementation System of VAT in Nepalese Context" in partial fulfillment of the requirement for Master of Business Studies from Tribhuban University. In this regards I have prepared a Questionnaire to seek the views. I shall be definitely obtained for your prompt and responsible response.

**Respondents Name:** .....

**Position:** .....

**Institution:** .....

1. What do you think about the implementation system of VAT in Nepalese context?

- A. Sound
- B. Unsound
- C. Medium

2. What can be the best way to increase the base of VAT in Nepal?

- A. Reducing threshold
- B. Including service sector
- C. In comportsing agricultural Sector
- D. Others

3. Do you think that the VAT is superior to Sales Tax?

- A. Yes
- B. No
- C. I Don't know

4. What is the problem in effective implementation of VAT in Nepal?

Please remark.....

- A. Administrative in capability

- B. Under invoicing
  - C. Lack of Public awareness
  - D. Frequent change in Act / Rules
  - E. Lack of long term policy and strategy
  - F. Lack of knowledge and information to tax payers about VAT
  - G. Others
5. How to effective implementation of VAT can be done? Please remark.....
- A. Strengthen and improve VAT administration
  - B. Develop information technology
  - C. Political commitment
  - D. Reward and punishment
  - E. Need of training program
  - F. Improve VAT law and regulation
  - G. VAT education to the businessman
  - H. Develop skill manpower
  - I. Change in threshold
  - J. Improve auditing
  - K. Others
6. Do you know about the price effect of VAT?
- A. Yes
  - B. No
  - C. I don't know
7. Is it accurate of single VAT Rate (13%) in all types of product?
- A. Yes
  - B. No
  - C. I don't know
8. What is the effect of VAT in Economic Development?
- A. Positive
  - B. Negative
  - C. Moderate

9. What can be the reason for not showing positive towards VAT implementation by the tax payer?

- A. Lack of Value Added Tax education
- B. To hide transaction/ tax
- C. increase the working Capital
- D. Others

10. Is true existence of VAT leakage in Nepal?

- A. Yes
- B. No
- C. I don't know

11. Do you get bill on every purchase?

- A. Yes, on all purchase
- B. Yes, most of my purchase
- C. Yes, but not regular
- D. No, I don't get any bill

12. What is the present threshold limit for effective implementation of VAT in Nepal?

- A. Low
- B. Moderate
- C. High
- D. Very high

13. Is there any Role of Billing system in implementation of VAT in Nepal?

- A. Yes
- B. No
- C. I don't know

14. Do you think that the open border system as a main hindrance for the successful implementation of VAT in Nepal?

- A. Yes
- B. No
- C. I don't know

15. What is the main reason for need of VAT in Nepal?

A. Effective Reason

B. Avoid Leakage

C. Transparency

D. Income Tax base

E. All

F. I don.t know

G. Others

16. What are the problems in the process of collecting Vat in Nepal?

A. Account Keeping

B. Registration

C. Tax refunding

D. Billing

E. Others

## Appendix II

### Schedule of Activities in the Implementation of VAT in Nepal

_____	Eighth five Year Plan (1992/93 to 1996/1997) adopted policy of introducing VAT.
11 July 1993	The 1993/94 budget stated that VAT would be introduced within a year or two
September 1993	Formation of VAT Steering Committee and VAT Task Force Harvard Institute for International Development under the USAID Financial Assistance. This assistance was suspended in 1995, resumed in February 1996 and continued until September 1997.
.....	DANIDA has been extending technical assistance since 1997
7-27 March 1994	First VAT training for tax officer was organized in Kathmandu and since then several courses on VAT have been organized in various places.
24 April	First VAT training program with FNCCL, Several programs have been organized since then.
15 May 1994	First VAT interaction programs the Nepal Chambers of Committee and various district chambers of Commerce and industry all over the Kingdom.
14-16 July 1994	First VAT training program for the representatives of FNCCL. Since several such program have been organized.
30 October 1995	VAT Steering Committee reconstituted.
3 December 1995	VAT Bill was presented to the Lower House of the Parliament
24-26 December 1995	VAT Bill was discussed in the Economic Committee of the Parliament

- 27 December 1995 Chairman of the Economic Committee of the Parliament submitted report on the VAT Bill to the Lower House of the Parliament.
- 30 December 1995 The Lower House of the Parliament passed VAT Bill
- 4 January 1996 VAT Bill was passed by the Upper House of the Parliament.
- 3 March 1996 VAT interaction program was organized with pharmaceutical association,. Since then may interaction programs where held with all most all commodity association.
- 11-12 March 1996 VAT training program for journalists.
- 20 March 1996 Royal Scet to VAT Bill
- 16 July 1996 Conversion of the Sales Tax and Excise Administration into VAT Administration
- 12-20 August 1996 VAT interaction program for parliamentarians.
- 17 September 1996 VAT interaction program for Chartered Accountant's Association, since them many VAT interaction programs were organized for several other professional groups.
- 14 November 1996 A VAT Task Force was set up with members from VAT administration FNCCL and consumer forum.
- 24 January 1997 Cabinet approved the VAT regulations.
- 24 March 1997 Formation of the National VAT Steering Committee consisting of representatives from HMG/N, FNCCL and Donor
- 1 August 1997 Formation of VAT Task Force with members from HMG/N and industry and commerce sectors.
- 21 September 1997 Approval of VAT Manual by HMG/N
- 16 November 1997 VAT went live
- 15 December 1997 Approval of VAT Technical Group in order to solve VAT implementation problems.
- 13 February 1997 Completion of 90 days period for compulsory VAT registration.

- April/May 1998 Series of discussion between the government and the private sector representatives on various tax issues, including VAT.
- 10 July 1998 Introduction of several new provisions relating to VAT through the Finance Bill 1998.
- 1 September 1998 Agreement between the government and the private sector representatives on various taxes issues, including VAT, which is known as 39 points Agreement.
- 11 July 1999 various measures were introduced through the Finance Bill 1999 in the customs duties, income tax VAT in order to ease VAT implementation.
- April 2000 Department of VAT merged into Department of Tax.
- 16 November 2000 Issuance of PAN forms the 'Taxpayer Service Center' to the taxpayers of the Valley of Kathmandu.
- 30 July 2001 Inland Revenue Department was established.
- 17 August 2001 PAN was issued form all the Inland Revenue officers.
- (1st Magh 2061) VAT rate increased 10% to 13%.

### Appendix-III

#### Office of Inland Revenue and It's Working Area

S.N.	Offices	Status	Working Area
01	Inland Tax Office Ktm-1	A	Tripureshwor from the linking bridge of Thapathali Kupandole, East of Kantipath from the statue of his Majesty Tribhuvan through the kesharmahal. Jaya Nepal Chitraghar, Naxal Bhawati, Sano Gauchar, Southern part of main road to Dhobikhola Kalopul and Eastern part of the Dhobikhola of remaining area of Kathmandu District
02	Inland Tax Office, KTM-2	A	Tripureswor form the linking bridge of Thapathali Kupandole, west of kantipath form the statue of his Majesty Tribhuvan through the Kesharmahal, Thamel, Saghumti, Kaldhara, south of the road to Bishnumati, East of the Bishnumati river and northern part of the Bagmati
03	Inland Tax Office Ktm-3	A	Dholbikhola, west part of Kalopul form the beginning through Jaya Nepal Chitraghar, Kesharmahal, Thamel, Satghumti, Kaldhara to noth of the read to Bisnumati, East of the Bishnumati, remaining part of the west of the Bishnumati river and Rasuwa, Nuwakot and Dhading District
04	Inland Tax Office, Biratnagar	A	Morang District
05	Inland Tax Office, Lalitpur	B	Lalitpur District
06	Inland Tax Office, Simara	B	Bara and Rautahat District
07	Inland Tax Office, Birgunj	C	Parsa District
08	Inland Tax Office, Bharatpur	C	Chitwan District and Nawarpur area, east oft the Daunne of

			Nawalparshi District
09	Inland Tax Office, Bhairahawa	C	Rupandehi, Palpa and Gulmi Distric and Parasi area, west of the Daunne of Nawalparasi District
10	Inland Tax Office, Pokhara	C	All the districts of Gandaki and Dhaulagiri Zone
11	Inland Tax Office, Nepalgunj	C	All the districts of Bheri and Karnali Zone
12	Inland Tax Office, Bhadrapur	D	All the districts of Mechi Zone
13	Inland Tax Office, Dharan	D	Sunsari, Dhankuta, Terathum, Bhojpur and Sankhuwasabha District
14	Inland Tax Office, Lahan	D	All the districts of Sagarmatha Zone
15	Inland Tax Office, Janakpur,	D	Dhanusha, Mahottari, Sindhuli, Ramechhap and Sarlahi District
16	Inland Tax Office,Hetauda	D	Makwanpur District
17	Inland Tax Office, Krishnanagar	E	Kapilvastu and Arghakhanchi District
18	Inland Tax Office, Tulsipur	E	All the districts of Rapti Zone
19	Inland Tax Office, Dhangadi	E	All the districts of Seti Zone
20	Inland Tax Office, Mahendranagar	E	All the districts of Mahakali Zone
21	Inland Tax Office	E	Bhaktapur, Kavre Palanchowk, Sindhu and Holkha District