

# CHAPTER- I

## INTRODUCTION

### 1.1 Background of the Study

The revenue of the government comes basically from two sources non-tax and tax. Non- tax revenue includes different sources like grants and gifts, administrative incomes, business incomes. Grants and Gifts mean the amounts given by the people of the country itself voluntarily or one country to other country. The examples of grants and gifts revenues are grants of foreign governments or agencies. The administrative income denotes the amount charged by the government for providing administrative services. The examples of such revenue are registration fees, fines and penalties. Business income means the return received by the government for providing various goods and services to the people. The examples of business incomes are charges for postage, electricity, water etc. The basic objective of non-tax revenue is not to collect revenue but to provide services to the people. The revenue from non-tax sources comes automatically while performing other works.

Another source of government revenue is tax revenue. Customs, excise duty, value added tax, corporate and personal income tax are the examples of these sources of tax revenue. The main objectives of taxation are to collect revenue. The government passes the act for getting tax revenue and collects the tax as per the act. The tax cannot be imposed without the act of the parliament. Nepal gets around eighty percent of the revenue from these source.

Although, the government collects the revenues from different sources such as tax, remittance from public enterprises, fees, fines, grants and deficit financing. However, across all these sources of collecting the public revenues, taxation is the main sources since it occupies the most important place in the government treasury. Because of the importance of these sources in revenue mobilization of a country, some person likes to say tax is the sinews of the state (Kandel; 2006).

Tax is the compulsory contribution by the people or organization to the government without any direct return. It is the compulsory payment by the people or organization to the government. In other words, tax is a compulsory contribution imposed by a public authority irrespective of the exact amount of services rendered to the taxpayers in return and imposed as a penalty for any legal offence. It is the compulsory contribution from the person to the government to defray the expenses using the means of planning, organizing, staffing, leading and controlling for achieving the goals.

Management aspect is most important in the VAT system. In fact, the success of VAT depends upon the capacity for its administrative management. This is because VAT would bring a large number of businessmen into tax net. This means that the number of persons who will have obligation to file return and pay tax will increase drastically. This will give rise to a voluminous paper works in dealing with large number of taxpayers under a rather complicated operation system, which demands large integrated and efficient management setup. All management aspects of VAT are designed to increase the “voluntary compliance.” by the tax payers. In addition, the collection activities such as checking and processing of returns, inspection, controlling, auditing fine and penalties are important aspects of management. A basic requirement of the successful management of VAT is the identification of appropriate taxpayers. A simple VAT return form, effective tax payers, assistance program, a reliable electronic data processing (EDP) system provide accurate and timely information. An effective penalty system is needed for non-compliance.

Generally, VAT management has three levels Viz-central office, regional office and district offices. The function of each office are clearly defined, coordinated and controlled offices are scattered to make the efficient and successful operation of VAT.

The need of different type of staff depends upon the factors such as the organizational structure and operation system. The number of staff in VAT management is determined by many factors. For example, a relatively more complex VAT structure demands more staff and vice-versa. In order to manage

the administrative process of VAT, it has divided into three levels Viz-director general, Director department head and other related sub-department to participatory activities.

## **1.2 Statement of the Problem**

A sound tax system is one of the essential requisites of an economic development. The taxation system should be such that it raises adequate revenue to the government without discouraging private sector. Through taxation, resources of the private sector are transferred to public sector for the economic development of the country sustainable economic development has been the prime concerned of every developing nation.

Nepal is a developing country facing serious problem of resource gap. Because of low production and low employment opportunity has directly affect to national economy so that, revenue collection rate could not achieved as targeted but government expenditures are increasing day by day. For maintaining the resource, the government has been trapped to take the loan from external or internal sources. Facing this problems government instrument has to be fully utilities especially for revenue collection bodies.

Tax revenue, non-tax revenue, grant and loans are various sources of government funds. Grants are based on several political considerations. In our experience grant, volume is decreasing and the amount of loan is increasing. In other hand, grant is not the permanent source. It can never be a substitute to domestic resource and can never be a remedy too.

Non-tax revenue is raised from private sector but it has low base and cannot mobile adequate fund.

Developing country has suffered the problem of repayment of loan on lumsun and installment basis as per required time period. Only taxation is the major and effective sources of revenue.

Keeping in view the necessity of adequate resources mobilization for meeting the increasing need of fund for development, Government of Nepal has

taken the based that “VAT on major part of tax reforms,” with in the territory of tax seems different problems, which are presented below.

Before the implementation of VAT, the empirical tax system was not scientific and it had poorly designed defective tax structure. The major defect can be taken as a narrow base, be not transparent and cannot cover the whole area. Huge share in GDP has placed from the agricultural sector remains cut of the tax net. The other but not minor defect of Nepalese tax systems are low elasticity of major taxes, plethora of exemption and tax concession granted to the industrial sector, low contribution of exemption and tax concession granted to the industrial sector, low contribution of direct taxes to the total tax revenue low voluntary tax compliance, cumbersome legal and administrative procedures, impractical rates, very week tax administration and wide spread tax evasion.

To get a concrete achievement by reforming the existing tax system, the government of Nepal has started value added tax (VAT) from November 1997. The VAT in Nepal replaced the existing sales tax and other small service based taxes (Hotel, Entertainment, and contract tax). Obviously, the VAT had broadened the tax base and increased the revenue elasticity in the fiscal year 1996/97. The total revenue generated from hotel tax, entertainment tax, contract tax and sales tax that were replaced by VAT.

However, the issue of VAT in Nepal is still a mater of discussion. Mainly the individual businessman are reluctant to pay VAT even the consumer are not aware of taking VAT invoice. Uneducated individuals are scared whether the VAT is raising price. Low voluntary tax compliance cumbersome legal and administration procedures weak tax administration and tax evasion are still prevailing. So in this situation identification of the main problems and future prospective of VAT and their detail analysis and evaluations is imperative and necessary for this study.

### **1.3 Research Question**

In the view of discussion of the problem, the research questions are as follows:

1. What are the problems regarding VAT implementation in Nepal?
2. Is the VAT management system of Nepal is effective?
3. What is the future prospect of VAT in Nepal?
4. How much contribute from VAT revenue to total government revenue?

#### **1.4 Objectives of the study**

VAT plays an important role in revenue mobilization. The main objectives of this study are to evaluate the problems regarding VAT, its management system and future prospective of VAT in Nepal and to evaluate the importance of VAT in the economic development of the nation. Besides this, the specific objectives of this study are as follows;

1. To identify the problems in the implementation of VAT in Nepal.
2. To evaluate the management system of VAT.
3. To identify the future prospective of VAT in Nepal.
4. To evaluate the contribution of VAT revenue in total government revenue.
5. To provide appropriate suggestion and recommendation to the concerned sector about VAT.

#### **1.5 Significance of the study**

There are many researches on VAT in abroad but few are available in our country and also most of the effort on VAT was held only on the theoretical background. There is no empirical study yet made on the revenue potential of VAT in Nepal. Nepal is a poor developing country. Therefore, the government has imposed various kinds of taxes upon the public. Among them, the VAT is the most important, effective, modern and scientific technique to collect revenue in the nation.

In Nepal, the government has introduced VAT on first Mangsir 2054. The VAT system has passed 13 years of its implementation period in Nepal. Although, it is not more popular among the people even though it has been

effective technique. So there are some hidden controversial opinions about VAT and then people it indifferently. Therefore, it is necessary to breakdown this controversial opinions between the government and people about VAT. VAT should be made simple, understandable, and no controversial and transperence among the people and then it should be more popular. If VAT is made popular then the government can easily collect more revenue without any difficult. Then people will feel their duty and responsibility to pay Vat to the government. Above all reasons it is necessary to make the people simple, easy understandable, transperence, uncontroversial and popular among the people. It helps to collect enough revenue for the development of nation. This study enables for better implementation of VAT administration. This analysis will be helpful for efficient VAT administration and implementation .This study also helpful for efficient VAT administration and implementation .This study also helpful to find out the existing problem in VAT collection, payment and administration. It will enable to carryout the existing problems regarding VAT collection, payment and administration and be enabling to find out the future perspectives regarding VAT.

## **1.6 Limitation of the Study**

Value added tax covers the broad and vast area. However, this study was covered Limited area due to various Limiting factors. This study covers only eight years actual and three years forecasted data mainly based on secondary sources. The non availability of data was the main factors of making the study limited. Lack of sufficient data and information about VAT also has limiting factors. This study has based on following limitation;

1. This study only covers with the partial fulfillment of requirements for the degree of masters of business studies (MBS), not for Generalization purpose .

2. There has been various areas of VAT for the study, but this study is only concerned with topic “Problems, Management and Prospective of VAT” in Nepal.
3. The reliability of the study depended to large extent on the reliability of the secondary data.
4. The time and constraints also limitation.
5. Respondents of the empirical study are only based on Bheri zone.

## **1.7 Organization of the Study**

This study is divided in to five major chapters. Chapter first is the introducing chapter, which shows light on the various aspect of study including the role of taxation in economic development. Chapter second covers review of literature. Chapter third is research Methodology. Chapter four is the main body of research. It gives evaluation, trends, comparison with other discipline and management of VAT. Chapter five tries to raise the major key issue of VAT after it’s introduce in Nepal. It also gives summary, conclusion and Recommendation. Mainly this study based on following format:

### **1. INTRODUCTION**

General Background

Statement of Problem

Research Question

Objective of the Study

Significance of the Study

Limitation of the Study

Organization of the Study

### **2. REVIEW OF LITERATURE**

Conceptual frameworks

Review of related studies

Review of Books

Review of journal & articles

Review of dissertation/thesis

Review of others.

**3. METHODOLOGY OF THE STUDY**

3.1 Research Design

3.2 Population and Sample

3.3 Nature & Sources of Data

3.4 Data collection procedures

3.5 Data Analysis procedures

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Analysis of Secondary Data

Analysis of Primary Data

VAT and it's problem in Nepal

VAT and its Management in Nepal

VAT and it's prospects in Nepal

Major finding of the study

**5. SUMMARY, CONCLUSION AND RECOMMENDATION**

Summary

Conclusion

Recommendation

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Appendixes

## **CHAPTER- II**

### **REVIEW OF LITERATURE**

#### **2.1 Conceptual Frameworks**

No Discipline can be developed without a strong theoretical base. Practice should be supported by theory. Theoretical underpinning provides logical reasoning in the form of broad principles. It provides a general frame of references by which the rules and regulation of value added tax can evaluate. It can also guide the development of practice and procedure of VAT. The theoretical base of VAT should introduce concept, principles, assumptions, and evolution, coverage and administration practices of VAT.

##### **2.1.1 History of Taxation in Nepal**

Nepal is one of the parts of eastern civilization. With in eastern civilization the tax used to be imposed as per shastrs in ancient time, Koultilya, Manustmrity, Yangnabalka smrity etc, were the sastras, which governed the taxation system at that time. The main principle of taxation at that time was to impose like the honey collection of honeybee or getting milk from the udder of the cow (kandel)

In ancient time, tax was manly imposed on land however, other various types of direct and indirect tax were also in practice. Ancient rulers of Nepal are Kirat and Lichhavi. Before Livhhavi regime, Kirat ruled Nepal. In the time of Lichhavi the ruler established the office of revenue collecting named Kuther. Some historical Documents present the information bout three types of tax. These were tax on agriculture, farming and commercial activities.

They also applied different tax reform measures. Tax was introduced in buff farming, but they exempted the tax in garlic and onion trading. At that period, customs duty was a major part of revenue. Markets were called Drarg in Lichhavi Regme. At that time, most of the people of Kathmandu walley were traders rather than farmers. The offices related to customs collection were established inside the Drag (Market). The king has the right to appoint the tax

collectors. Custom duty was collected for the both import and Export. In 1783 AD, the rates for import and Export from Tibet were defined. After Lichhavi the Malla Rulers ruled the country. They less or more continued the system of Lichhavi Regime. The Rana Rullar established the land Revenue office named “Mal Adda”. However, they were no laws and rules relating to collect revenue. This was Depending on Rana’s family, what ever they would like to do. The collected revenue was not deposited into consolidated national fund. The collected revenue was not deposited into consolidated national fund. The collected revenue was deposited in personal Account of the Rana’s family. (Kandel)

After the drawn of democracy in 2007 BS, the first Budget was introduced in 2008 BS. After that, so many reforms in tax system are carried out in Nepal. Different types of tax laws were introduced and abolished. The responsibility of revenue collection was shifted over the ministry of finance. Even after 2007 B.S land tax customs duties and exercise duties were bulks of tax revenue and only non-tax revenue was income from land and the contribution of sales tax. Indirect taxes increased considerably with the peace of development and the contribution of indirect tax to total revenue also increasing.

After the political revolution in February 1951 (2007 BS Falgun), the role of government has increased to developmental as well as philanthropic works. The government of Nepal has presented its first budget in 2008 BS Falgun 21. The first five-year plan was started in 2013BS. The planned activities of the government needed huge amount of source and means. Therefore, huge revenue was demanded and Nepalese government started to collect heavy tax on income as permanent source. As a result, it issued first finance ordinance in 2016 BS of imposed tax on Business profit and remuneration. In 2017 BS, the Income tax act named “Business profit and Remuneration Act 2017 B.S” was made it provision of finance ordinance 2016 B.S, That was first income tax act and it was replaced by income tax act 2019 Bs. That act was amended for eight times. This tax act was replaced by new income tax act 2058 BS. This is the current tax

act in Nepal. Before income tax act 2058, value added tax act and VAT rules was introduced in Nepal in 2052 BS and 2053 BS respectively.

### **2.1.2 Theoretical Studies of VAT**

Value added tax is an indirect tax, which is imposed on value added amount in different levels of production and distribution of goods and service. “Value Added” is the excess of sales value over cost by a manufacturing or trading firm during a period of time. In other words, value added is the amount added in the purchase price of a certain commodity or service. It is the total amount of expenses plus profit margin, which are included in the cost price of product (Khadka).

Selling price (SP) = Cost price + Value added (VA) (Expenses + Profit)

Value Added (VA) = Selling Price (SP) – Cost price (CP)

Value added tax is an indirect tax, which is paid and collected by the businessmen. It is a new, modern, scientific and transparenance tax. It is superior than sales tax. The tax rate differs from country to country. In Nepal, the VAT rate was 10% in the starting period, but now the prevailing tax rate of VAT is 13% VAT is imposed on the every stage of production, sales and distribution. It means, it is extended from production to distribution, sales and distribution. It means, it is extended from production to distribution stages of levels. The producers, importers, whole sellers, retailers and consumers have liable to pay VAT.

The value added of a business enterprise can be calculated by applying either of three methods; Addition method, subtraction method and tax credit method. In addition method VAT is calculated by adding the incomes produced by the firm. These incomes may include interest, profit, rent, wages etc. In opposite to addition method, subtraction method calculates VAT liability by subtraction the cost of materials from sales proceeds. Under tax credit of invoice

method, the tax liability is derived by deducting tax paid by the seller in purchasing from the total amount of tax collected from sales.

**Adding Method :**

Value Added (T) = t (wages + rent + interest + profit)

**Subtraction Method :**

Value added (T) = t (Sales value – Purchase value) or t (outputs – Inputs)

**Tax credit Method :**

Value added (T) = t(outputs) – t(inputs)

Where, T= VAT payable

t= VAT rates.

Within three methods of calculation VAT, input tax credit method is used by most of the countries in the world. The main reason of being so is the advantage that it possesses. The first advantage of input tax credit method of VAT is easiness in finding out amount of VAT collected, deposited and to be refunded easily. The second advantage is its nature that can be used for any time, i.e. one month, two months, six months etc, which is less than one financial period. The third advantage is its easiness in catching up the understatement of value at the earlier stage and correcting on subsequent sales. (Kandel)

There are three types of VAT a) consumption type b) Income type and c) Gross National product type. Under the consumption type VAT; all capital goods purchase from other firms in the year of purchase is excluded from the tax base while depreciation is not deducted from the tax base in the subsequent years. Since investment is received from taxation under this variant, the base of tax is consumption.

The income type VAT does not excluded capital goods from the tax base in the year of purchase. This variant, however does excluded depreciation from the tax base in the subsequent years. More over and excess of closing inventory over closing inventory is excluded.

### **2.1.3 History (origin and Development) of VAT in Nepal**

In the history of taxation, VAT is the latest and emerging tax. VAT has been regarded as one of the most important fiscal innovations. VAT is the most significant event in the history of commodity taxes and the speed with which the value added tax has spread around the world is unmatched by that of any other tax in modern tax (Khadka)

The concept of value added tax was first recommended by Dr. Wilhelm von Siemens in 1919 in Germany. Dr. Wilhelm had suggested applying the VAT in Germany in order to make strong economic power. However, it was not successful to apply at that period. Again, VAT was suggested by Professor Thomas S. Adams for United States of America who observed "Sales tax with a credit of refund for Taxes paid by the producer or dealer (as purchase) on goods bought for resale or for necessary use in the production of goods for sales". VAT was also recommended by Prof. Carl S. Shoup mission for reconstruction of the Japanese economy in 1949. However, the VAT was not introduced by any country till 1953 France introduced VAT at first in 1954. Then VAT is being developed and introduced in each country. France led the way in 1954 by adopting a VAT that covered the industrial sector along and the tax was limited up to the wholesale level. The tax was limited to the boundaries of France until the fifties.

However, VAT has been spreading rapidly since the 1960's. The Ivory Coast followed France by adopting VAT in 1960. Then VAT was introduced by Senegal in 1961 and by Brazil and Denmark in 1967. VAT gathered further momentum when it was made a standard form of sales tax required for the countries of the European Union (European Economic Community). In 1968, France extended VAT to the retail level while the Federal Republic of Germany introduced VAT in its tax system. The Netherlands and Sweden imposed this tax in 1969 while Luxembourg adopted it in 1970, Belgium in 1971, Ireland in 1972. Italy, the United Kingdom and Austria in 1973. The other members of the European Union, Portugal and Spain introduced VAT in 1986, Greece in 1987, while this tax was adopted by Finland in 1994, and many other European

countries have adopted VAT. Similarly, many countries in North and South America, and Oceania have introduced VAT. (Khadka)

Among the twenty-four members of the organization of Economic co-operation and Developed Countries except the United State of America. VAT has been considered in great depth even in the USA where there are many supporter of this tax.

VAT has been spreading in the Asia region as well. The Republic of Vietnam adopted VAT briefly in 1973. South Korea introduced VAT in 1977, China in 1984, Indonesia in 1985, Taiwan in 1986, Philippines in 1988, Japan in 1989, Thailand in 1992, Singapore in 1984 and Mongolia in 1998.

In SAARC region, VAT has been considered in great depth in India. This country introduced VAT in different way under the name of modified value added tax (MOD VAT) in 1980. Unlike the VAT system of other four countries, the Indian MOD VAT system design to correct the excise duty. This tax is adapted mainly to avoid the disadvantage of input taxation, such as the cascading. The scope of MOD VAT has been extended over three years. Further various attempts have been made to introduce a broad based VAT in place of Several Domestic trade taxes. There seems to be a broad VAT in place of several Domestic trade taxes. There seems to be a broad based agreement among the Indian states to convert the state sales tax into VAT.

Among the other members of SAARC, countries, Pakistan adopted VAT in 1990, Bangladesh in 1991 and Nepal in 1997 (i.e. 2054 B.S.) while Srilanka introduced VAT in 1998. Nepal was considering the preparation for VAT since 1992. The first intention to move towards VAT could be found in the 8<sup>th</sup> plan (1992-1997). VAT is experimental basis was announced in FY 1992/93 budget with a tow-tier sales tax system on some selected items. A commitment to implement VAT in Nepal was made in 1995/ 96 budget and it was scheduled to come into effect from April 1997. However, for some reason, the implementation was postponed until November 1997. Now VAT has passed Thirteen year of its implementation period.

As VAT is less distractive and more revenue productive, it has been spreading all over the world. The tax was adopted by eight countries by the end of the 1960's VAT was introduced by at least one country each year except 1974, 1978 and 1979. Now about 130 countries have adopted VAT and it is under consideration in many other countries. In fact, VAT has become a popular subject for tax reforms in recent years.

In the Nepalese context, VAT came into existence by replacing the sales tax, entertainment tax, contract tax and hotel tax. The eighth five year plan planned to implement the VAT in Nepal at the end of the plan period. The minister of finance in Nepal announced in July 1993 but got that the government focuses on gradually transforming the sales tax into a value added tax. Since then, subsequent government had to make a series of tax policies and set tax rates in order to ensure the new sales tax system in fair, simple and efficient form.

Value added Tax act 2052 and value added Tax Regulation 2053 was enacted. The sales tax and excise duty department was converted into VAT department. Finally, VAT was implemented on and from 1<sup>st</sup> Mangsir 2054. However, the process of registrations in the VAT department started since Baisakh 2054.

The business community was hostile to the idea of implemented VAT from the very outset. The implementation of VAT in Nepal caused of discussion from the business community from the opposition, political parties as well as the public. The majority of the business community strongly protested against VAT and they were negatively publishing VAT. So, the voices of the few honest ones could not make any difference. As per the business community the merits of VAT are limited to the any only and that VAT is inflationary, regressive, VAT will increase the costs of doing business, its early implementation without doing proper homework will bring disasters. According to them, VAT is complicated and it will be encourage corruption.

On the other hand while business man especially the whole sellers and retailers have raised their voice against VAT, the supporters of VAT emphasis

that VAT would not increase price in any term, as it would simply replace existing four categories of tax like sales tax, retail tax, entertainment tax and contract tax. Also there were global and internal compulsions to implement a transparent tax system before Nepal's entry into the world Trade organization (WTO). If we do not take membership of WTO by 2004, we will not be able to export any goods to any country thought the world.

A series of discussions were held between the government and the representatives of the business community. These representing bodies forwarded several issues like customs valuation system, VAT and income tax, treatment of stock, the time period for the declaration of the stock, a review of the exemption limit, the probability of the VAT being limited to imports / wholesale stage, refund of custom duties and income tax, penalty provision and creation of a permanent Revenue Board.

To encourage business to register in VAT, it was agreed to provide the facility of declaring old stocks. This provision allowed the taxpayers to claim for tax deduction by declaring the existing stock. As a result, the nearly registered and those who had already registered declared existing stock on the total value without any proof or invoice.

Thus, the business communities tried until the last moment to postpone the implementation of VAT, but the government went on with their schedule to implement VAT. However, it expanded the deadline for registration to three months. Certain amendments were made in the value added tax act 2052 and value added tax regulation 2053. Now VAT has completed more than Twelve years of its implementation.

The threshold of VAT is NRs twenty lack and the tax rate 10 % in earlier was increase to 13 % at present for VAT.

#### **2.1.4 Forms and Types of VAT**

There is no any hard and fast rule to classify the VAT. VAT may classify different way according to its nature, scope and method of collection. Basically, VAT has classified in to three types : - Consumption type, Income

type and the Gross National product type, which are briefly explain as follows (Kandel ; 2006)

**a) Consumption type of VAT**

If all capital goods (Investments) bought from other firms are excluded from the tax base (value added in the year of purchase but the depreciation is included in the tax base, it is known as consumption type VAT. It can e expressed in the following equation.

Value added=wage + Consumption types + Deprecation +profit-capital goods purchase from outside (in the year of purchase).

Value added=Sales –Purchase (Including purchase of capital goods from outside in the year of purchase).

The above equation clearly shows that the tax base is consumption because investments (capital goods purchased from outside for business use) are free from taxation. Under this type of VAT investment are encouraged because it excluded from tax base. Similarly, imports are taxed whereas export is relieved from tax. Thus, tax vase for the nation under this type is equal to the domestic consumption of the country. Nepal has adopted it with tax credit mechanism from beginning.

**b) Income type VAT**

Under the income type VAT, capital goods purchased from the outside suppliers are included in tax base in the year of purchase but depreciation is excluded from the tax base. The following equation may be presented to make clear idea about tax base.

Value added + wages + interest + rents + profits + Capital goods purchased from outside (in the year of purchase)

OR,

Value added = Sales – purchase (Excluding purchase of capital goods from outside in the years of purchase))-depreciation.

The above equation clearly shows that the value added is equal to the consumption on plus net investment.

It means the tax base for the nation is the net national income that comprises the consumption and net investment of all firms with in the country.

**c) Product type VAT**

The product type VATA includes capital goods purchased from the other firm in the tax base in the year of purchase and includes depreciation in the tax base. It can be expressed in the following equation.

Value added= wages + interest + rents + depreciation + profits + capital goods purchased from outside (in the year of purchase)

The aforementioned equation obviously shows that the tax is imposed on both consumption and gross investment. This means that value added by all firms with in the country constitutes the Gross National product (GNP). That is why: the tax base of this type to VATA is conceptually equal to the GNP. Thus, this type of VAAT is also termed as ' Gross National product type VAT'. (Amatya, Pokharel, Dahal 2004)

**2.1.5 Method of Computation of VAT**

The value added is the net tax base under the VAT system. How VAT is computed is an important aspect. The VAT payable can be computed by employing any of the three different methods (Khadka;2001)

**a) Addition Method**

This method is also known as the correct value added computation method. Under is method value added (a tax base) is directly ascertained by adding profit to the conversion costs incurred by the firm. The conversion costs may consist of the payment to the factors of production such as wages, interests, rents etc. That is used in converting purchased materials into saleable goods. Thus, is method is appropriate for the income type of value added tax that includes all payments for the factor of production in its tax base.

### Value Added Statement (Under Addition Method)

<u>Particulars</u>	<u>Amount</u>
Conversion costs (wages, interest, rent, depreciation)	xxx
<b>Add: profit</b>	xxx
<b>Value added</b>	xxx

#### b) Subtraction Method

This method also known as net turnover method. Under this method, the tax base is obtained by subtracting the cost of purchase from sales proceeds. It means value added is sales minus purchase. Thus, this method is appropriate for the consumption type VAT that is levied on value added derived by subtracting cost of materials from sales proceeds.

<u>Particulars</u>	<u>Amount</u>
Sales proceeds (+ or – stock of finished goods)	xxx
Less: Cost of goods or services Purchased from outside	xxx
Value added	xxx

#### C) Tax Credit Method

This method is also known as the invoice method. Under this method, value added is not directly computed. Value added tax is imposed on the total value of sales and the vendors (sellers of suppliers) are allowed to deduct the input taxes from their gross tax liability. This means that tax liability of a person is determined by subtracting tax, on purchases from the tax liability of a person is determined by subtracting tax on purchases from the tax on sales. Thus, it is known as ‘Invoice method’. Statement of net tax liability (under tax credit method)

<u>Particulars</u>	<u>Amount</u>
Tax collected through sales proceeds	xxx
Less: Tax paid in inputs	xxx
Net tax liability of a person	xxx

Among the three methods of computation of VAT, the tax credit method is widely used in the countries of the European Union the elsewhere. This is because this method possesses several advantages over the other methods. Thus, this method is suitable under the destination mechanism in which the tax credit chain is not broken. It is also especially useful, if it is designed to reduce the rate of VAT at some stage in the business process (say raw materials) or primary stages without reducing the total tax at later stages. This phenomenon is known as “Catch up effect”, which could not be achieved under the addition and subtraction method.

The tax credit method further provides the merit of handling exemptions and rate differentiation as well as reducing cascading effect. Therefore, the tax credit method for calculating VAT liability is superior in controlling the tax evasion with efficient administrative system.

### **Different Methods of calculating VAT**

**Table 2.1**

**Calculating the VAT liability under addition method VAT Rate @ 13%**

<b>Stages of production &amp; Distribution</b>					
	<b>Primary producer</b>	<b>Producer</b>	<b>Wholesaler</b>	<b>Retailer</b>	<b>Total</b>
Wages	880	160	240	260	1540
Rent	380	80	90	120	670
Interest	240	40	90	120	490
Profit	500	120	180	100	900
Value Added	2000	400	600	600	3600
VAT Liability @ 13%	260	52	78	78	468

*Source: - Estimated figure during the study.*

**Table 2.2****Calculating the VAT liability under Subtraction method (VAT Rate @13%)**

<b>Stages of production and Distribution</b>	<b>Sales price</b>	<b>Purchase price</b>	<b>Value added</b>	<b>VAT liability (13% of 3)</b>
Primary product	1500	-	1500	195
Producer	2000	1500	500	65
Wholesaler	2200	2000	200	26
Retailer	2600	2200	400	52
<b>Total</b>	<b>8300</b>	<b>5700</b>	<b>2600</b>	<b>338</b>

*Source: - Estimated figure during the study.*

**Table 2.3****Calculating the VAT liability under Tax credit method @ 13%**

<b>Stages of production &amp; Distribution</b>					
	<b>Primary producer</b>	<b>Producer</b>	<b>Wholesaler</b>	<b>Retailer</b>	<b>Total</b>
Purchase	-	1500	2000	2200	5700
Tax on Purchase	-	195	260	286	741
Sales	1500	2000	2200	2600	8300
Tax on sales	195	260	286	338	1079
Net VAT liability	195	65	26	52	338

*Source: - Estimated figure during the study.*

**2.1.6 Coverage of VAT**

VAT is a tax on goods and services consumed in Nepal. The tax is based on the principle that each producer or distributor adds value, in some way, to the materials they have purchased and it is this added value that is taxed at each stage of the production and distribution chain (Adhikari)

The coverage of VAT in Nepal is based on transfer, sales, supply, import and export of goods and services and except some special provisions. It is levied on the value added at each stage of the production and distribution. Every

persons, firms, or companies who are involved in such transaction liable to pay and collect tax. The actual coverage is structured by standard and zero rates as well as tax exempted provision (Adhikari)

**A) Standard Rated Areas**

Nepal has adopted “Inclusive basket system” which makes broad based tax coverage. Under this system all transactions regarding transfer, sales, supply, import and export of goods and services, where value added exists are taxable, except some special provisions. The value Added Tax Act has made provision of exempted goods and services under schedule one. Except this provision all value added economic transactions are taxable and tax collected at the rate of 13%. This is called standard rated area.

**B) Zero Rated Areas**

Under the VAT system some goods and services are may be taxed at zero rates. The objectives of this zero rate is to relieve some goods and services from taxation working under regular VAT system and net for the purpose of promote and encourage export and to maintain diplomatic behaviors. Under this, purchaser is allowed to credit the tax paid on inputs or purchase in concern. However, he has to maintain all records regarding VAT.

The VAT is meant to apply only to the consumption of goods and services in Nepal. Supplies made in Nepal that are exported are taxable at zero rates. Exports are allowed to claim input tax credits for VAT paid or payable on purchase of goods and services relating to their commercial activities. Exports are allowed to claim input tax credits for VAT paid or payable on purchase of goods and services relating to their commercial activities. Exports taxed at zero percent (0%) include exports of both goods and services.

Under zero rates, following goods and services are included 1) Exports of goods from kingdom of Nepal. (In the case where terms and conditions specified by VAT law are fulfilled)

- 1) Exported outside of kingdom of Nepal. (In the case where terms and conditions specified by VAT law are fulfilled.)
  - Exported outside of kingdom of Nepal or
  - Stores taken on board on and aircraft on flight to a destination outside the kingdom of Nepal or
  - Goods taken or kept inside the international flight to a destination outside the kingdom for a destination outside the kingdom for the purpose retails sales and supply.
- 2) Service to be supplied for the persons outside the kingdom of Nepal.
  - Service provided or supplies by a person, who resides in the kingdom of Nepal, to the person outside the kingdom of Nepal that who has not any business, business agent or any legal representative in Nepal.
  - Supply of goods or services by a person who resides in the kingdom of Nepal and a registrant, to the person who resides outside the kingdom of Nepal.
- 3) Imports of goods and services by accredited Diplomats.
- 4) Government may provide the facility of zero rate to pharmaceutical or medicine procedure.
- 5) Goods supplied to defined export house.

**C) Exempted Goods and Services.**

Under VAT system all goods and services are divided into two basic categories, taxable and tax-exempt. Goods and services are either taxed at the standard rate of 13% or they are total at zero present. Those taxed at the standard rate include all goods and services exempt those that are specified as taxed at zero percent or tax-exempted.

In the following transaction purchaser does not pay VAT. The latest list of tax-exempt goods and services is given.

**1. Basic agricultural products.**

- Paddy, rice, wheat, maize, Mullet, beans, cereals and other unprocessed of raw agriculture products and vegetables and products.
- And raw vegetables, fruits, flowers and other unprocessed agriculture products, except the supplies by restaurant, bars hotels, cafeteria, guest houses and others.
- Raw and unprocessed cash crops, such as cotton, sugarcane, ginger, jute, orthodox tea, tobacco and other agriculture products.
- Herbals and remaining.

**2. Goods related to basic needs.**

- Raw or unprocessed mustered oil.
- Drinking water, supplied through public pipelines and tankers.
- Wooden fuels and wooded in coals.
- Kerosene (Excluding Air oil)
- Salt

**3. Live animals and animal's product.**

- Unprocessed foods related to animal products such as mutton, buff, pork etc.
- Fresh milk (including pasteurized) and curd.
- Fresh and jry fish.
- Fresh chicken from cock, hen, duck etc.

**4. Agriculture inputs**

- Seeds related to basic agriculture products.
- Fertilizer, compost and inputs related soil treatment.
- Usual agriculture tools and hard implements.
- Pesticides related to agriculture.
- Tools and inputs related to poultry.
- Agriculture machinery and equipment fishnets, house pipe, pump set (not more than eight horsepower capacity) etc,
- Foods & livestock and ingredients related to feed supplement.

**5. Medicines, medical treatment and medical services.**

- Medical and surgical services provided by Government- owned institutions and non-profitable non-governmental and community based institutions.
- Human blood, blood related ingredients and vaccines.
- Human and animal organs and tissues used for medical research.
- Medicines related to human lives, livestock and products related to birth control.
- Tools, equipment and machinery for the use of disabled persons.
- X-ray films and treatment oxygen gas.
- Raw materials of medicines purchased or imported by industry itself under preserved. Quality of department of medical management.
- Equipment used for the treatment or heart used only for disabled persons.

**1) Education**

- University, collages and school research works.
- Vocational and professional training and refreshment training lunched under non-profit making business.
- Teaching services provided by schools, colleges and universities.

**2) Books, Newspaper and printing inputs.**

- Books, newspaper, Magazines and periodic publications.
- Newsprints

**3) Cultural, artistic and skillful services.**

- Arts and services related to handicrafts.
- Cultural programs.
- Entrance fees related to library, museum, art, gallery, botanies garden (wild live park)

**4) Public traveling, services and transportation**

- Air transport, non-tourist transport service (Excluding cable car service) and transport (Excluding cargo supply transport service)

**5) Vocational and professional services.**

- Individual or institutional professional services provided by artists, player, writer, model interpreter.
- Other Goods and service.

**2.1.7 Treatment of Different goods & services on VAT**

**1) Treatment of Negative value adds**

The value adds means creating of additional value of goods and services by imposing additional activities. It increase the cost price of certain goods or services. If the value of certain goods and services is increased. It is named as positive value adds. However, in market mechanism by different variables the value of goods. Similarly outdated and out fashioned are main factors that occurred the situation of negative value adds. In this situation, a seller may sell the goods and service in the price less than the cost paid. But the taxpayer is liable to prove the cause of negative value add or selling of goods and services less than purchase price. In the case of negative value and tax officer may assess the tax and may make the tax credit invalid (adhikari)

**2) Treatment of Capital goods**

For the implementation of full VAT, the tax paid on all capital purchase should be allowed as a tax credit at once. After providing tax credit, If over payment is establisher, this overpaid tax should be refunded immediately as for as possible. This provision ensures that the tax is on consumption and should encourage investment. However their was a debate regarding the treatment of capital goods. Since some countries, before introducing the VAT, were getting substantial amounts of revenue from taxing capital goods.

In Nepalese context except the stock-in-trades or trading goods the VAT act has made special provision for capital nature of goods. The tax paid on purchase of capital goods that goods are used in business works can be credited from collected tax. Since in this case tax paid on purchase should be treated as input tax. Regarding this, some capital goods that are used in business as well as

personal use the tax paid on the purchase of these goods are credited on proportionate basis. Most registrants are entitled to claim input tax credit for any VAT paid on capital goods for use primarily on business and commercial activities. Unlike the income tax, deduction rules the input tax credit for any VAT paid on capital goods is not amortized over the life of the asset. It can be claimed in full in the period in which it is acquired. If the capital goods are later put to non-commercial use, special charge of use rules will be applied.

### **3) Treatment of Financial Services**

Financial services fall under the tax-exempt area. Many Experiences and studies have proved tax on financial services is not practical work.. Since it is very difficult to identify the credit lines on invoices that the services provided by financial Institutions. The market price cannot be identified clearly regarding the VAT. The Taxing on financial services does not increase the tax base. Since actual VAT, payable on financial services is only possible on retail sales to the households. Financial Services Used by business that occupies the major share of services would be deductible as credit. However, it helps to increase equity. It does not give any meaning in the services of VAT. Financial service may be treated separately with separate VAT rate or with financial service tax. However, it will far from the concept and sprit of VAT in general. In the light of all these constraints, Nepal has excluded the financial services from VAT.

## **2.1.8 Other Terms and Provision of VAT Laws**

### **1) Taxable price**

VAT and Treatment of Regarding the taxable price discount commission and sales bonus are Exclusive for example, If a tax payers sells its product in cash and he provides the trade discount or cash discount deducting from price and he shows the same in tax invoice, the net price after deducting the discount or commission is taxable. However, if a supplier receives the return in kind or in other than cash instead of his sales, however the value in kind has not been mentioned on deducted from total price in tax invoice. In such case the supplier sold goods or services. The price will be according to market price. (Sec 12-3).

## **2) Hire Purchase Sales System and VAT Collection**

Hire purchase is a mode of business. Under this system purchaser will pay the price value of sold goods in various installments. The ownership of sold goods will be transferred to purchaser with final payment as mentioned in agreements. It can be celerity by instance. If a registrant enters under an written agreement to sell a motor vehicle on installment basis and agreed to supply the motor vehicle only on 40% payment. Both seller and buyer agreed to settle remaining 60% with various installments. In this case, tax should be collected at the time of payment according to sales scheme. In other words, supplier should collect VAT when buyer does pay the cash as agreed installments under agreed sales scheme.

Similarly after payment of some installment if buyers become unable to pay the remaining amounts and there are enough reasons of being unable to pay the remaining amounts and the seller exempts the remaining value of installments, in this case, if such conditions are maintained in the schemes and agreement, the remaining or unpaid value is not taxable. But if there is no any written agreement, tax should be collected at the time of issuing sales invoice of transfer of motor vehicle from sales depo whatever comes at first (sector 12, sub sector-3 and 7).

## **3) Partial use of goods and Tax Credit**

If a producer purchase some raw material and he uses the material to make both taxable and non-taxable goods. In this case, the proportion of use in both categories should be identified. If it is possible to identify the used proportions, the producer is entitled to claim tax credit in extent of proportion used for the production of taxable goods. For example, if a manufacture imports the raw steel plate worth Rs.5000 (including customs duty) and pays the VAT at customs points Rs.6500. He uses the raw material for making bicycle and wheel chair for disabled persons in the ratio of 50:50. Here the producer is entitled to

credit the tax paid on purchase only Rs.3250. Since he has used only 50% raw materials for the production of taxable goods (section 17, sub section 3)

#### **4) Partial use of Capital goods and payment of VAT**

If a trader purchases the two sets of computer for official use and credits the tax paid on purchase of computers in proceeding months. After two years he sells his trading firm to another person. In this case, the VAT on the value of sold computer should be collected assuming that the sale of computer should collect and deposit the VAT. Similarly in the case whether taxpayer sells only assets or goods except company on firm, tax should be charged and collected on all assets that for, which previously tax has paid on purchase and already has been taken the facility of tax credit. But in case of date expire and losses of taxable goods due to natural calamities, fire and robbery the taxpayer is not liable to pay tax for such assets (section 17 (4))

#### **5) Second hand Goods and Treatment of VAT**

Regarding the business of used goods, laws have made separate provision. A businessman who is involved in the second hand or reconditioned goods, he should register his business for VAT purpose according to limit and threshold and he should collect VAT on the sales of taxable goods. However, if he falls below the threshold he is not compelled to register for VAT the taxable value will be calculated by deducting the purchase from sales. However, the taxpayer is not entitled to credit the tax paid on purchase of those second hand goods purchased for resale.

With this regard for the business of second hand goods, the IRD has prescribed two types of account. One is general and another is global accounting. Purchasing in piece and dealing with separate piece falls under general accounting. Under this, the work of function of selling or buying of goods will be same and would be used for original purchase i.e. buying of car and selling if after making it reconditioned. In this case, if a businessman purchases a second hand car at Rs 40000 and sell it at Rs 150000 after recondition it he should

maintain the separate account. However, if he purchases the scrapes of cars motorbikes and generators at per kg rate, it is not necessary to have separate account. He should keep global account at the rate of per kg (section 17 (5) and rule 33)

### **2.1.9 Tax administration**

In general, the prime goals of VAT administration are to promote voluntary compliance and to promote the VAT revenue by effective, efficient and way of economy. Identification of taxpayers, tax registration, processing of returns, tax audit assessments, collection, credit refund and control of stop filers are main functional areas of tax administration.

Nepalese VAT administration also should be studied under this periphery. Ministry of finance is the main and responsible body for collecting financial resources and managing the public expenditure Department of customs, Revenue administration Training centre, Department of Revenue Investigation and Inland revenue Department are the wings of ministry of finance. Previously Department of value added tax administered by VAT. In FY 2001/02 the government merged, the Department. The IRD is currently responsible for the administration of the taxes like- Income taxes, corporate taxes, value added tax, excise, vehicle tax and certain fee and duties like entertainment fee (film development fee), tourism development fee liquor control, duty, smoking and liquor duty special fee etc. Like wise, the Department of IRD is located in Kathmandu valley.

Under IRD, there are Twenty-one Revenue offices throughout the kingdom including on large taxpayers office. There offices and Department jointly administer the VAT as well as income taxes.

Government of Nepal is the authority to appoint tax officers in necessary number to achieve purpose and objectives of collecting inland revenues. Similarly the Jurisdiction of a tax officer is also should be prescribed by Government. All tax officials are the civil servants under the revenue services.

The IRD has functional organizational structure from the operational point of view it has divided two parts. One is policy related and other is

operational related. The operational related part contains six functional works and these are taxpayer service, tax audit, Investigation collection, tax refund and others. Similarly, the policy related part contains the sections related to personal administration, Internal and financial administration, tax policy, International taxation, advance rulings, information technology, appeals, excise and Non-tax. Government of Nepal may appoint tax officers in required numbers. Government of Nepal may delegate tax administration related authority to other government officer. Similarly, the VAT act has provided the authority to other government to define the jurisdiction of tax officers. Thus, the Department carries out the functions such as tax administration, tax policy, tax treaty and international taxation, review and appeal related to tax matters, advance ruling, tax. Enforcement and investigation, tax audit, tax refund, excises and liquor administration, taxpayer's services.

#### **1) Registration**

For successful implementation of VAT, it is essential to have registration of all taxable producers and suppliers timely. According to VAT act and Vat related others laws of Nepal, the persons (the suppliers or producers of taxable goods and services) are required to register in concern Inland revenue office under the VAT act and rules and should obtain the TPIN. In other words a person who is involved in a commercial activities and the turnover exceeds the given threshold is required to register for VAT purpose. A person means an individual, firm, company, association, cooperative Institution, Joint business, partnership, trust, government body or religious organization. However, it is not necessary to register who deals only non-taxable goods and services similarly some persons who fall below than the defined threshold are not necessary to register. However, if they want they can register and take TPIN. A non-registrant is not entitled to collect VAT and utilize the facility of tax credit and refund.

The TPIN refers to the taxpayer Identification number that is be allocated to each registrant during the registration process. It consist nine digits with a cheque digit. It does not represents the such as geographical territory and nature

and form of business organization. For registration purpose, the taxpayer can get the prescribed form in Nepali from any Inland Revenue office. Major Information to be mentioned or to be filed in the form is name, types of business entity. The number of PAN and number of TPIN will be same.

The VAT Act has not mentioned any provision group registration and divisional registration. The documents required for registration are copy of citizenship certificate of proprietor and the registration documents of concerned department (i.e. Department of commerce for trading business, Department of Industry for industrial business etc.). The identification threshold for VAT purpose is Rs. Twenty lac. Registration is required for any business that with annual taxable sales of more than Rs.twenty lac. Regarding the calculation of turnover zero-rated sales is also included under turn over .VAT registrants are required to pay VAT on or before the 25<sup>th</sup> day following the end of each month. They must provide precede their customers with a tax invoice and should maintain records and keep their VAT records for a period of six years.

A VAT Registration may be cancelled by anyone whose total taxable sales for four consecutive calendar Quarters is not more than Rs twenty lac and who has been registered for a full fiscal year or by persons who no longer have a commercial category. The Act has mentioned other conditions regarding the cancellation of registration. The taxpayer may cancel the registration under following condition held: -

- ) If the organization is closed or transferred or collapsed in case of corporate body.
- ) If the business is running under proprietorship and owner is died.
- ) If the partnership is dissolved or dead of any partner, in case of partnership.
- ) If the distributor or producer stops to sale or produce taxable goods or services.
- ) If the business is registered by mistake.

## **2. Accounting**

The effectiveness of VAT depends on the VAT accounting system. The VAT accounting should be informed based as well as less costly. The accounting in VAT consist the process of maintaining purchase book, sales book and VAT account and stock. Thus, purchase and sales book are main part of VAT accounting. The purchase Book contains the information TPIN, the supplier's name and customer's name. Similarly in the sales book date, invoice number, name and number of the supplier, purchase price and taxable price of import, the taxable value and the amount of VAT should be recorded purchase book is a certified register. The registrants should maintain or record as the purchase by the registrants during the period all goods and services other taxable or non-taxable in separate columns.

The sales book is another main part of VAT accounting. It should be posted on the basis of sales invoice chronologically showing the amount of standers and zero-rated sales amount and tax amount. The VAT account is a monthly summary showing the source of the figures used in the VAT return. In order to complete, the VAT return a taxpayer should need to ensure that the book and records would provide the information related to the account of VAT paid on purchases, the amount of VAT collected on sales a method of distinguishing between taxable and exempt sales, the time the goods and services supplied, and proof that goods were exported.

The tax invoice is a major part of VAT account. It requires the name and address of the seller and the purchasers, the seller's VAT number and invoice number similarly it contains the date of the transaction and a description of the sale including the number of items purchased and the unit cost of each item and a mutation of any discounts. Invoice or tax bill is the base for whole VAT system.

Every taxpayer should maintain and update all VAT related accounting records and liable to produce such records while tax officer would like to observe. The taxpayers are liable to preserve such accounts for six years.

### **3. Return Filing**

For every month taxpayer should determine the tax himself and should file the return with in 25<sup>th</sup> day of next month to the related tax officer in concerned Inland Revenue Office. It is mandatory to file the return whether there is business transaction or not. If there is no any sales tax payer showed file return with zero return. The registrant who has the turnover more than Rs. Twenty lack and up to Rs. Ten lack may file the return in every two months. However, the voluntary registrants or who have the sales less than 2000000, can file by four – Monthly return. In order to complete this VAT returned, a tax payer needs to ensure that his book and records will provide the amount of VAT part on purchase, the amount of VAT collected on sales, a method of distinguishing between taxable and exempt sales, the time of goods and services were supplied and proof that goods were exported. The registrants who are under the threshold or compulsory registrants must submit the VAT return including the transactions of the branches also. The return can be divided in debit return credit return and zero return.

#### **2.1.10 Tax collection / payment**

The producer and suppliers are the agents for tax collection on behalf of VAT Department or VAT administration. Usually they collect VAT on sales and they deposit the collected amount after credit the tax in prescribed public treasury account. In Nepalese VAT system, the registrants or agents should collect and deposit the tax at 13 percent rate. Tax should be collected in selling price that comprises the costs related to transportation and distribution expenses as well as profit. Excise duty, custom and other tax except income taxes are also included under the selling price. But the trade discount and trade commission is not included under selling price. However, a person who is not registrant is not entitled to collect Tax

### **2.1.11 Tax Credit**

Tax credit is a facility for taxpayer. Under this system, a producer or distributor can deduct the tax paid on input or purchases from the tax-collected amount. The difference amount determines the amount of tax remit in treasury or claim for refund. For example if a distributor or trader collects the Rs.3000 on sales. In this case if his input tax is Rs.2500, he can get the tax credit amount, should be deposited in treasury as a VAT amount. However, if he collects only Rs.2000 he is entitled to return or credit Rs.1000 in next month. In other words, the registered businessmen are obliged to collect and remit VAT on their taxable transactions. These registrants are entitled to recover the tax paid on their purchase. This recovery or refund is known as input tax credit. The input tax credit is the total of the tax paid or payable on taxable goods and services purchased in Nepal, and the tax paid on taxable goods imported into Nepal. Where VAT is paid or payable by a registrant on a purchase or on imports, the registrant is allowed to claim an input tax credit for those purchase of goods or services may relate in part to a commercial activity. However, even though the purchase of goods or services may relate in part to a commercial activity, in certain circumstances the purchase may not generate input tax credit prerogative when the sells goods or services that are tax-exempt. General terms/conditions to entitled for tax credit are (section17)

- ) Purchased goods and services should be purchased for taxable transaction.
- ) Tax invoice should be produced.
- ) If importation, import and tax paid documents should be produced.

#### **1) Full Credit**

If the total tax paid on purchase to fully creditable, it is called full tax credit. In this provision, a producer or distributor gets full credit full amounts from the collected amount.

## **2) Partial Credit**

In business, some goods are used for both the purpose of the business and for personal use. In such cases, it is very difficult to identify the proportion used in the taxable business activities. In other side, under partial tax credit system the taxpayer cannot get credit of all amounts paid on purchase. The tax credit facility only provide for the amount paid on purchase used in business purpose.

## **3) Proportionate Credit**

This credit generally exists in Industrial or production business. A business firm, company, person involved in mixed transaction, making of both taxable and non-taxable goods and services its entitled to claim input tax credit on the purchases related to the making of taxable sales only but not purchases related to their exempt sales.

### **2.1.12 Assessment of VAT of Tax refund**

#### **1) Assessment**

VAT system has introduced the self-assessment system. In other word, VAT system is based on self-assessment. In this system, taxpayers determine the tax liability by themselves and file the return in concern Inland Revenue office. However, if taxpayer fails to maintain the legal provisions, tax officer may assess the tax with this regard two type of assessment system are in practice. One is computer Assessment and another is Management assessment.

#### **2) Tax Refund**

In the VAT system producers, distributors and people providing services charge VAT for the product or the services sold or provided and then they claim a refund of VAT paid on the goods or services purchased to make these sales. The difference between the VAT collected on sales and the VAT charged on purchases determines the amount of tax refund. In other word if the tax on sales is more than the tax on purchases the persons remits the difference. If the tax in sales is less than the tax on purchase the persons claims a refund for the

difference with 12 percent interest. However, the interest will be calculated since after 60 days of the application submitted for refund.

### **2.1.13 Management Information System (MIS)**

Effective information system is an essential of taxpayer's friendly and goods tax administration. A scientific information system provides highly standard services to taxpayers and provides adequate information at right time to the management and decision maker. For this purpose, the department has established a separate Information Technology section. This section has developed computer network regarding the flow of information between department and offices. This network not only processes the statement and payment vouchers it also computes the interest, fees and penalties.

To facilities the management as well as taxpayers on –lining between the Department and Revenue offices and local area network (LAN) has been developed. Several modules are also in practice such as registration module return modules as well as return and refund modules. The Inland Revenue Department parts the data in taxpayer's account and sends the results to related Revenue offices. The data, which are not valid or does not match with the status of taxpayers, cannot be pasted. These are known as suspense filers. The suspense accounts are sent to relevant Revenue offices to correct. The Revenue offices enter and correct the data before transfer to Department. In brief, management Information system (MIS) in Department includes the works.

- ) Processing of tax application form and related Information.
- ) Updating the taxpayer's individual Account
- ) Entering, processing and preservation of central date.
- ) Preparing of master record in database regarding tax collection, refund, tax credit registration, deregistration, business closed.
- ) Managing of integrated information between department and field offices.
- ) Managing and preservation of data and information for long run.

The IROS receive the tax registration applications tax returns, tax assessments and tax-payment vouchers. These offices prepare the batches of

documents received and make entry in computers under designed program. Every batch contains the name of IRO, date number type numbers of returns or statements name of Batch maker. Then they transfer the data through on-living system of MIS division of IRD. The department identifies the suspense filers and non-filers. The date of finding payment and non-filers are 7<sup>th</sup> and 11<sup>th</sup> day of next month respectively. Then IROs may bourse the data required. The computer itself manages of CA, who falls under non-filers. The response of CA would be sent to concern taxpayers.

### **2.1.13 Appeal system**

Appeal system is one of the major parts of VAT administration. A good and effective legal remedy system promotes the efficiency of the system. Under this system, administrative revision, appeal to revenue tribunal and additional fees and interest are major concerns. (Adhikari)

#### **1) Administrative Revision**

The value added tax act made the provision of administrative revision. Under this provision, Director General of Inland Revenue may review the decision made by tax officers. If he feels that the tax liability has been increased or decreased un-necessarily due to negligence of tax officer he may take departmental action against the tax officer involved in decision. However, the Director General must provide the opportunity to the tax officer to submit his statement regarding the decision before taking the action. However, tax officer will not be liable to punishment regarding the decision, which has been done under good conscience.

#### **2) Appeal to Revenue Tribunal**

A tax payers, who feels agressed, may appeal within 35 days to the Revenue Tribunal against the decision made by tax officer regarding the tax assessment or order of punishment and penalty on the decision made by director General regarding the suspend of transaction. In this case, the taxpayer should

pay the undisputed tax amount and should deposit full amount of penalty and fifty percent of disputed amount.

### **3) Additional fees and Interest**

If taxpayer fails to pay the any tax during the period prescribed by law or on and before 25<sup>th</sup> day of next month of tax period the taxpayer is liable to pay additional amount with ten percent per annum as additional fee. However, director general of IRD can dismiss this fee. If taxpayer fails to pay the any tax to pay under VAT Act, he is liable to pay interest in due amount. The taxpayer is also liable to pay interest in the case of appears to tribunal against tax officer decision. The Government determines the rate of Interest. Presently the rate of interest is 15 percent.

## **2.2 Review of related studies**

### **2.2.1 Review of Book**

“VAT is the most recent innovation in the field of taxation, which is levied on the value, added of goods and services and is shifted forward completely to the consumers” (Khadka : 1989). The major beauty of VAT is its neutrality or efficiency, more equitable than other forms of sales tax except retail sales tax. It avoids the problems of cascading or pyramiding, advantages to exemption of exports revenue production, and self-policing nature in administration and reduces tax evasion. Similarly, VAT is disapproval from the administrative point of view. It is very complex, cumbersome, and difficult to operate. Among these good and bad feature, he stated “VAT should be introduced in Nepal”. The main objectives of the study were “examine the structure and operation of VAT in the Asia and Pacific countries”, which also explores the possibility of introducing VAT in Nepal. He lastly developed a VAT proposed for Nepal. The major conclusions are as follows.

- ) VAT is theoretically accepted and it is neutral with respect to production and distribution as well as consumer choice.
- ) The broad base of VAT makes more revenue productive as well as horizontally equitable.

- ) However, it is complicated to administer, it provided self-policing nature and the catch up effect facilities the tax administration.
- ) Asian and pacific countries like china, Korea, New Zealand, Indonesia, Taiwan and Philippines have operated VAT from 1889 where VAT has been introduced as a part of large-scale tax reform programs. Except china, all countries have adapted the consumption type of VAT with tax credit method for computation of VAT base.

However, the study is not fully devoted to Nepal and lacks empirical study in Nepal, he lastly concludes with some recommendation for Nepal, he lastly concludes with some recommendation for Nepal.

- ) At the current period of study time there are one and half dozen of taxes which are governed by separate laws, own structures, operational system but very few of there taxes such as custom duties, sales tax, excise and income tax provide some volume of the tax revenue. The tax efforts is very low, the tax system is very inelastic. (i.e. in equitable), narrow base with multiple rate and wide exemption leads to inefficiency.
- ) VAT itself is not inflationary it is desirable for Nepal from several points of view.
- ) There is an urgent necessity for rationalization of tax system. VAT is also considered one of the series of measures of rationalization.
- ) It requires paper work for both taxpayer and tax administration because of its complexity and broad coverage.
- ) VAT should be seen as long term and major step for the rationalization of tax system, which would require a long preparation period.
- ) Any hasty decision regarding the introduction of VAT should be avoided, “VAT is applicable in Nepal in the sense of tax performance. Neutrality, revenue productivity, fairness and transparency are the desired goals to be achieved from VAT in Nepal” (Subedi)

Value Added Tax is most critical among other sales taxes because it has boarder coverage and offers great revenue potentiality as compared to other types of sales

taxes. VAT is the tax base defined as the difference between the sales of forms product and the sum of the amounts paid by the forms. On the ground of revenue potentiality and equity, it is related to sales tax. As the other part of coin, advantageous or good features of VAT are major sources of revenue. In fact, indirect tax revenue but there is many difficulties in under developed countries for effective operation of high income tax. It may be a key element to raise revenue. However, its administrative complexities are excess burden in developing countries. (Due & friendlender)

### **2.2.2 Review of Journal and Articles**

In the article named “The VAT and developing countries”, Carl S Shoup (1998) points out the importance of VAT in developing countries as.

- ) VAT reduces vertical integration because of its nature.
- ) VAT offers more revenue and coverage than other forms of sales tax.
- ) The tax is inflationary to some extent.
- ) The tax is relationally easy to administer.
- ) Basic Accounting problems and efficient and empirical tax administration are locking in developing countries, which are the main obstacles to VAT.
- ) The effects of VAT cannot be generalized for all developing countries.
- ) The study is mainly devoted in theoretical and policy issue.

In the article named “VAT Accounting and Auditing”. Pandit Shakti Prasad (2001) explained the following topics such as what is VAT? Why VAT audit is necessary? Self-Accounting, legal provision, tax invoice etc. The main points of the article are.

- ) VAT is a tax, which is based on the value added amount of goods or services.
- ) Value added is the difference between purchase price and selling price.
- ) VAT is based on self-assessment tax system.
- ) Accounting is the regard of transaction.
- ) Accounting is necessary for both government and trader.

- J VAT accounting is the self-assessment accounting system and is based on bill invoice.
- J Purchase book, sales book and VAT account are concerned with accounting.
- J VAT account is the total of purchase book and sales book in a math.
- J VAT Auditing is done to control the misuse by taxpayer in self-assessment.
- J VAT auditing examines the tax evasion and irregularities and ad extra tax and penalty if find irregularity and evasion.

In an Article “Probability of VAT in Nepal” Dr Khadka (1995) reached a conclusion that “A VAT Theatrically, is the best alternate to remove limitations of present sales tax system of Nepal”. He further Added” the merits of a VAT do not appear voluntary for the implementation aspect of VAT”. The successful operation of VAT depends on the capacity of the administration. Co partnership of taxpayers, accounting system of the business and political conference etc so, it needs full preparation before introducing VAT in Nepal.

In the Article names “VAT in Nepal; analysis and recommendation in the occasion of 5<sup>th</sup> year of VAT in 2058-08-04”, after analyzing the VAT system in Nepal, Dr. Rupjyoti (2058 Bs) reached a conclusion that “A VAT is operated with smoothly and continuously. Business firms have selected to carryout their transactions with efficiently and simply. But VAT is not successfully applied in trading business because there is no effective implementation of VAT due to weakness of rule act relating to VAT”. The main course of problem of VAT implementation is

- a) There is not invoicing system in effectively price and compulsorily.
- b) It has not been applied the VAT threshold effectively yet. Therefore there is possibility of tax evasion.

Further, he suggests solving the tax evasion problems that, it is better to include the private sector in marketing area. He explains that if one-tax payers adopt evasion and avoidance of value added tax then, it not only affects the government on collection of more revenue but also affects the honest full taxpayers.

He has given an idea to apply the threshold and accurate invoicing system for effective implementation of VAT.

VAT plays an important role to collect more revenue and it develops the Nepalese economy. So there should be attitude about VAT in the mind of public but VAT has not been effective yet due to inadequate, unforesight and unnecessary view or thoughts in policymaking and implementation. Dr. Rup Jyoti has in directed the some faults in implementation of VAT. Such as,

- ) Expiating (old) stock held by taxpayer should be included in VAT, which is opposite to VAT principle.
- ) To supervise the stock and cash balance of taxpayers and to develop appropriate invoicing system.
- ) Registered purchasers should by goods only with registered sellers.
- ) Taxpayer's Identification Number is to be mentioned compulsorily.

In conclusion, he has given suggestions for the effective implementation and utilization of VAT as main resource of revenue. The main suggestions are as follows.

- ) To centralize the attention of VAT administration of invoicing system in the retail level.
- ) To make effective participation of industrialists of private sector for effective utilization of threshold.
- ) To solve the problems of VAT quickly as soon as possible.
- ) To reduce custom duty after property developing the invoicing system.
- ) Not to apply any rule and policy against the basic principle of VAT for giving misuse to the taxpayer.
- ) Not to change the income act to reduce income rate, which directly affects the VAT and taxpayers want to change the track of tax.

In the article "Value added tax: Its past, present and future" Silwal Narayan Prasad (2058 BS.), explains that VAT has been emerged as new tax baby traci mate to many sections of the society. The VAT is now a four year old the first two years of the pre and post era heralded many ups and down. Many people thought that VAT would never see the light of the day despite long preparation by the

government, owing mainly to the volatile political situation. However, the VAT made history by emerging as winner despite all odds. As fate would have it, intractable negotiations, procrastinate action, resentment by traders etc put VAT off balance may believe that the VAT would not survive, but the fact is that it died. The outcome, however was unexpected, VAT could not broaden the tax base as desired. The crux of the problem was crucial then and even to date is the billing habit of the general business community. The success of VAT system hinges on how the billing habit will be improved in future. During the past few years, the income tax assessment rules were inconsistent with the VAT Books. Now that a new income tax act 2058 has been passed. The tax assessment rules will undergo changes. Excerptions and VAT complicate records were the additional factors that gave rise to negotiated settlement, during the initial period of VAT introduction enforcement was not existent at that time the prime task was to introduce VAT at all levels. Minor problems were ignored but this is not now. Mr. Silwal reached a conclusion that.

- ) VAT is now a four-year-old child.
- ) The first two years of the pre and post VAT era heralded many ups and downs.
- ) Even much type and preparation, the result of VAT has been debatable.
- ) There are still watching patiently for the delivery of what it was expected to do.
- ) The past of VAT was full of turmoil but even then, it had been glorious.
- ) Its present is less than immaculate but its future will be glorious again.

In the Article “VAT in Nepalese context” Thapa Dr. Govinda Badhur (1994), has stated considering the present condition of Nepal facing high government expenditure, low revenue effort high dependency on foreign loan, need of more economic growth of the economy, and because of low revenue potentiality from direct taxes, there is a prompt need to improve the sales tax in Nepal. But there is less chance to mobilize more revenue through existing form of sales tax. In this context, there was no other alternative except introducing VAT in Nepal.

In the article “VAT creates adverse effect” Pradhan Puspa Raj (1998) lack of foresight of the government while introducing VAT, may adversely affect the economy, say economic observers. The open border that Nepal shares with India is the main reason behind the failure of VAT, they opine. In fact, our trade is based on smuggling and local industries are badly suffering from high taxation and double taxation implemented in the country.

On the other hand, the Indian products imported through illegal trading have captured the local market they point out. They thus express the view that without checking the illegal imports of Indian products, to implement VAT is not a wise policy. Recent policies of government have cut down tax holidays for the industries, which has made difficult for local products to compete with the Indian products. In such a situation when local Industries are in a bad position, to introduce VAT is totally wrong on the part of the government, economic observer’s view.

Our economy has always required in a critical situation due to the small market and open border. Thus, the industries always need government protection. The government attitude to deregulate industries and send them in free competition with a heavy tax burden in direct message to short down the industries. It may also be mentioned that the economy is based on ninety percent imports. Such a policy is totally negative for the national industries. As India has not accepted VAT, this may also create direct negative impact for our local products, they view.

In the Article “Status of VAT implementation Necessity Realized” Published in the rising Nepal 14 November, 2002 by Rup Bahadur Khadka concluded that the number of VAT registrations was 1952 in the year of VAT implementation against 2045 sales tax registrations, which has increased almost to 27000 by mid November 2002. This indicates that there has been substantial increase in the tax base in terms of the number of taxpayers. However, refund system has also been becoming gradually effective. As there was no belief of taxpayers on the refund mechanism, no taxpayers applied for the refund in this first fiscal year of VAT implementation. However, after publicity regarding the tax system, the trust of the taxpayers regarding this process gradually increased. Then they started applying for the refund. The refund amount increased to Rs.17crore in

2001/02 from Rs.70 million in 1998/99 of the total returns the share of credit, debit and zero returns was 39 percent, 32 percent and 24 percent respectively at the end of the fiscal year 2001/02.

An analysis of “Appeal system in VAT act 2052” was undertaken by Iswor Kumar Sharestha, which was published in the Journal of finance and development (Rajaswa, 2004). In this Analysis, he identified the problem of VAT act system tax payers do not want to show the transparency in their transactions. They do not want to keep the accounts they all want to register the firm under small-scale business. Taxpayers generally show the low productivity and high wastage ratio. Likewise, they show the large amount of discount allowed to customers. Issues of billing is the serious problem of VAT system in Nepal, short coming of VAT implementation indicated in his study were not giving the information of preliminary tax assessment, not examining the accuracy of data, faulty explanation of act, No adopting the administration circular, not very flying the stock and not conducting link audit he further suggested what is to be done for correcting the mistake. Billing procedure through the help of computer, Taxpayer should be provided knowledge for keeping accounts to make aware about billing procedure is made in the field of tax administration and judicial administration. Consumer should be provided education for their right and duties.

### **2.2.3 Review of Dissertation/Thesis**

Basnet Dipendra (2002); in the dissertation “analysis of VAT in Nepal” has expressed, VAT is the best form of sales tax, especially because it is neutral regarding the methods of production and generation more revenue, Self-enforcing feature of VAT would make the administrative process easier. At the time of sales tax, the import/manufacturing level sales tax as well as other tax were seemed to be inefficient and less productive that had created cascading and pyramiding effects. To get rid of such effects, the VAT is implemented. In sales tax, multi rate was implemented according to the classification of goods. In general goods, the lower in VAT, the same tax rate is applied. In sales tax, it was applied at source but in VAT, it is applied at every level of sales and distribution. VAT can be taken as a single

form of sale tax, entertainment tax, hotel tax and contract tax was that it had the fastest growth rate among other indirect taxes. Most of the time, sales tax was implemented as a trial and error process. VAT is found to be the best alternative for increasing the efficiency of tax administration.\

Dahkal Argon (2002) in the dissertation “A study on VAT and its potential in Nepal” covering the period between financial years 1989/90 to 1992/2000. The major findings of the study in his own words are as follows. The share of tax and non-tax revenue conjunction the average ration of 77.78% and 22.21% during the study period. The ration seems to e stable with in the whole eleven years time. The contribution of total tax revenue from indirect tax has continuously declined and direct taxes have consciously risen which can be taken as satisfactory trend of revenue collection. Indirect tax still plays tax of VAT and custom duty respectively. Among the sub section of indirect tax, all are in declining tendency expect sales after allowing exception for the year 1998/1999 shows that the VAT base for the year would be Rs.1417624 million that could contribute 4.17% to GDP 49.30% to tax revenue and 66.75% to indirect tax. However, the government was able to collect revenue by sales tax or VAT just Rs.7882.2 million.

Katwal Padam Bahadur (2003) in his dissertation study on the management system of VAT in Nepal” has expressed “There is a need of effective implementation of VAT in Nepal. It is only five years child. Since the judgment of achieving, the degree of goals should be evaluated by comparing with previous situation as well as demonstration effect of international atmosphere. In Nepal VAT is suitable, effect, efficient, modern and transparent both theoretically and empirically. However, practically, it is extremely weak. It is not effectively implemented until its five-year implementation period since 2054/055 to 2058/059. Thus, only the introduction of VAT is not really acceptable as a tax reforms. There is need of great reforms of VAT system for the Nepalese context.

Sharma, Krishna Prasad (1998) in his dissertation entitled “VAT in Nepal”. Issue and options submitted to Tribhuvan University for a degree in economics, has concluded that Nepal has been undergoing through a several fiscal crisis due to limited sources of revenue and increasing government expenditure. Due to narrow

tax base, sales tax is not productive and elastic. Adoption of full-fledged VAT replacement would be helpful in removing the production diction and other under pressures on economic activities caused by the inherent defect of sales tax. The VAT would increase the compositeness of Nepalese products. Lack of administrative capability and under developed business structure, practices and under developed business structure, practices and under developed business structure, practices and distribution system are the greatest problem for the applicability of VAT in Nepal. Due to the existence of large proportion of small traders in trading activities, unfavorable business structure and practices and weak administration, there would be anarchy in the tax system, the existence of open boarder and a large amount of unauthorized trade from India to Nepal poses a great threat to success for implementing VAT in Nepal. The existing under valuation of imports in another big obstacle for implementing a VAT. A VAT is bound to have poor result than expected to the various applicability problems.

Bista Raghu Bir (1999) in his dissertation entitled “VAT in Nepal, its issue and effect” has concluded that VAT is applicable and feasible in Nepal in order to reduce the resource gap by mobilizing additional resource t meet the estimated revenue collection by boarding tax bases, to control the tax. Leakage, smuggling, unofficial trade and corruption through transparency account trade and corruption through trenchancy account based cross checking through Nepal has many issues; problem and constraints relating administration, politics, economy and society, if the government operates the VAT administration with effectiveness and efficiency. “The effect of VAT on all sector are to be positive and favorable.

Chaudhari Raju (2010), in his dissertation “ VAT in Nepal: an analysis of it’s problem and prospect” has concluded that the main problems for business houses are keeping and billing and the weakness of VAT administration are Lack of motivation and service minded attitude among tax official, lack of honesty in VAT officers. Though from the theoretical point of view, it is assumed that VAT system is the best and advanced fiscal tools, its effect in the context of Nepal is not as expected because of the lack of strong and honest tax administer, lack of honesty in VAT officers. Though from the theoretical point of view, it is assumed that VAT

system is the best and advanced fiscal tools, its effect in the context of Nepal is not as expected because of the lack of strong and honest tax administrator, lack of motivation and service minded attitude among the tax officials, lack of cooperation of business community, lack of strong co-ordination between tax collectors and tax payers, lack of strong political commitment and weak public consciousness. He has further recommended some suggestions for better solution of these problems. Tax related information should be published regularly. Interview programmers with professor researcher tax experts and economists should be conducted and published through advertising media often escape away from actual custom duty, as under valuation of the goods has been a tradition. Thus to overcome those problems, the government either has to collect the custom duty of the actual price of goods or it has to fix the actual price of the goods in the market. Enforcement should be effective through more audits, investigation and collection visits and integrated approach to total tax system should be introduced for successful implementation VAT.

Upadhyaya Prem (2002), in his dissertation “performance of VAT in Nepal” has concluded that implementation part of VAT is not working properly. Self-policing feature and catch up effect of VAT has not been satisfied in Nepal. No progress has been realized in the field of valuation even after adoption of transaction of Nepal Government. Tax administration and taxpayers have opposite interest in introduction all the consumers are not aware of VAT system and there by not sensitive of tax paid with purchase of goods and services. He has recommended that higher VAT paying taxpayers are to be provided with some monetary attractions as incentive to get real bill. Vigorous attempt should be done to exercise the provision provided by law for the correction of under invoicing. A compulsory price tag system must be developed and maintained so that consumers become aware to the price of goods and services; computer networking system should be established so that related information can be assessed to all concerned officials. In depth, training system must be provided to tax officials to expertise them in the field of taxation.

Gurung Kul Badhur (2002), in his dissertation “VAT implementation in Nepal in Reference to present position and future prospects” has concluded that successful implementation of VAT will require assessment of fundamental pillars, in our context with a view to gradually overcome inherent deficiencies in each of these sectors with a positive approach. Despite the faced any problem in the early years, VAT is now accepted by the business community and general people and is here to Nepal. The issue today is not whether VAT or no VAT but how to make the implementation of VAT effective and efficient. He has further suggested and recommended some points for prospect of VAT in Nepal, that point are :-

- ) The government should apply or use of automatic cash registers by large and medium business.
- ) An effective control measure to certain leakage like over claim of inputs omission of sales, falsified input. Check claim extenuated with vagarious audit campaign.

Finally, the effective and efficient implementation and development of VAT is only possible when they have fair understanding among the government, tax administration taxpayers and other concern parties also. Therefore, they must have commitment dedication, self-motivation to implement VAT in future prospect.

Thapa Manmohan (2003), in his dissertation “Resource Mobil ration Through value Added Tax in Nepal” has concluded that theoretically, VAT is the alternative of sales tax on the ground of economic Growth that VAT has high revenue potential power. The broad coverage of VAT would generate more revenue with out addressing the equity norms. Practically, it is found that the VAT is going to become the not milk in mouth due to in efficient tax administration. The analysis of elasticity co-efficient of overall selected taxes is less than unity, means inelastic in nature, his recommendation for better implementation of VAT that the concentration must be given to bring the use of billing in all trading concern, making tax officers more responsible accountable as well as competent and honest instead of powerful authorization by balancing the rights and duties mentioned in acts. There is no definite course about the degree of reform. Thus, the implementation of VAT by super sending sales, hotel, and entertainment and

contract taxes is only the partial reform that cannot address the equity into excise and non-tax portions.

Bidari Dinesh (2004), in the Dissertation “ value added tax in Nepal ; A crosscheck Analysis” has concluded that the prospect of VAT entirely depends on its implementation aspect. VAT has bright prospects in Nepal only when it can be implemented in a successful way. Further, the successful implementation depends on the strong fair and capable administration, strong political commitment, co-operation between the custom offices and Inland Revenue offices, co-operation between private sectors and the government bodies’ systematization of open boarder, high public consciousness level transparency and improvement of rules and regulation accordingly over time. Thus, VAT can be entrenched as an internal part of the Nepalese tax structure in the long run, if the issues mentioned above are taken seriously and solved accordingly. Then Nepal also will not be a country of exception in the line on successful VAT implemented countries in the world.

Suyal, Bishnu Bahadur (2005) in his dissertation, “The perspective of VAT performance in Nepal” has expressed, VAT was introduced as a part of the national tax from its inception has been facing innumerable. Its programs have been slow initially due to opposition from the business community and subsequently to administration problems. Even after its fulfilled implementation in 1999, the system has not been taking a considerable pace due to administrative inefficiency. Despite preliminary resistance, VAT has been largely accepted by the taxpayers as well as business communities of Nepal and related tool for mobilizing the revenue, which needed for public expenditure.

Shrestha Rupa (2006), in her Dissertation “Problems of Effective implementation of VAT in Nepal” has concluded the VAT is relatively more stable and reliable than other taxes. It will help to make the Nepalese tax system fair, Tax evasion will more different and less attractive under VAT for several reasons. The burden of this tax will be distributed among longer sections of populations. In this context, the structure and operation aspects of VAT should be designed. And effective and efficient tax administration must be developed for the successful implementation of this tax. There is still various challenge of the implementation of

VAT. It requires much bigger effort's and strategy to establish this tax on completely successful scale.

#### 2.2.4 Review of Others

In a Seminar "Value added tax an Asia" organized by IMF/UNDP, Alain a. Tail (1991), presented a paper entitled "VAT policy issues: structure Regressively inflation and export," in Jakarta of Indonesia and later arranged on the occasional paper (1988) IMF, Wasngtyon DC edited by the same author in 1991. The study concentrate on the policy Concerns on the basic illustrations of some theoretical as empirical proofs.

- a) VAT is an alternative of retailer sales tax; however both do not fully tax the unofficial business but the under reporting of sales value will show up under VAT.
- b) The VAT is for the buoyant base of revenue maintaining neutrality and efficiency in taxation.
- c) It is preferable that VAT has the capacity of covering all the stages of production to retail level and the services.
- d) Overall VAT may not contribution in promoting exports but is makes the system easier.
- e) Single positive rate of VAT and few examples prove regressive but is should be evaluated based on proofs relating less regressive than others. It should be weighted compared to the deficits.
- f) VAT is simply charges relative price but not the overall price increase. The increase should be deflationary.

A high-level task force added by prof. Madanm K. Dhual recovered the Nepalese tax system in 1995; the report outlined the following reason to adopt VAT in Nepal.

- ) To broaden the tax base and to increased the tax revenue.
- ) To make the tax system transparent and elastic.
- ) To make the system efficient and
- ) To encourage exports.

After analyzing the various aspect of tax structure and the position of the economy, the report finally recommended the following aspects due to be incorporated before adopting the VAT in Nepal.

- ) A functional organization pattern.
- ) Development of effective tax refunds system.
- ) Measure to increase self-compliance.
- ) Computerization of the administration.

Nepal chamber of Commerce also made a study to analyze the possible effects of VAT in Nepalese economy in 1997. Dr.Pushpa Raj Karnikar headed the team. The main finding of the study report was as follows.

- ) VAT effects adversely in price level.
- ) It increase the price of imported goods ultimately in crease the cost of production there by reduce the export business.
- ) Requirements of bookkeeping are complicated.
- ) It would finally affect the small traders.
- ) It is ultimately to implement.
- ) It would be unjustifiable on social group.
- ) Present administration is incapable for handling VAT.
- ) Computerization system is not sufficient and it is new concept for the tax administration.

The study report suggested for a partial VAT on some commodities. It was in favor of phase-wise implementation of VAT. the study analyses negative impact of VAT neglecting its positive impact. However, their division among the business people in the country. The Nepal chamber of organization (NCC) which is the oldest business organization, has directly opposed VAT; on the other hand, the federation of Nepalese chamber of Commerce and industries (FNNCCI) has come to claim that the government has related from full implementation of VAT and has agreed to form a committee to solve problems that have propped up after the

implementation of VAT. NCC has alleged that the federation has made a weak stand against the interest of Nepalese businessman and industries.

In a statement released by the anti VAT action committee of NCC, it was stated that the compromise reached between the government and FNCCI was misleading. A delegation of the NCC called on the prime minister on 23 November to reconsider the “Unilateral decision” to impose VAT which into effect on November 16 NCC and which called a three day strike which left its impact in many districts. NCC had claimed that the nation wide protest against VAT was a source. Business claimed that VAT would lead to inflation putting the consumer under pressure.

### **2.3 Research Gap**

From the above review of literature, researcher got that the countries except Nepal are operating VAT in positive way, contribution of VAT in those countries are increasing day by day. These countries have emphasized on the positive impacts, positive thinking of their countries towards VAT also have resulted positive. However, in Nepal VAT related persons researchers and general people have been viewed to the impact of VAT from negative side rather than its positive sides. The researchers and the journalists (related with VAT) have concluded many problems towards the implementation of VAT in Nepal. These problems are inefficient tax administration, lack of modern accounting system, lack of political commitment, lack of cooperation between private sectors and government bodies, lack of public consciousness, lack of cooperation between custom offices and Inland Revenue department etc. However, nobody has looked towards the factors creating the above problems. Nobody has focused on the contribution of VAT. VAT introducing in any country is the long-term objective. None study has focused on introducing a VAT as a long-term objective. We cannot give result about the success or failure of VAT introducing with in a short period.

This study will be distant from others in such areas or subjects as first of all, this study views the impact of VAT from positive side emphasizes on the factors

creating the problems on implementation of VAT in Nepal and recommends the best solution of these problems. This study will also recommend the improvement aspect of management system of VAT in Nepal and the future prospective of VAT in Nepal. This Research study will be fruitful to those interested persons, students teachers, scholar businessmen and government for academically as well as policy perspectives.

## **CHAPTER—III**

### **RESEARCH METHODOLOGY**

This study is undertaken to examine the effectiveness and contribution of VAT in economic development and evaluate the management system of VAT in Nepal. This study also to evaluate the problems regarding the collection and payment of VAT and the future prospective of VAT in Nepal. VAT is being applied instead of import/manufacturing level of sales tax, hotel tax and contract tax. Therefore, it should be sound and effective VAT system results the increasing rate of indirect tax on tax structure as well as national revenue at satisfactory and reasonable level. Therefore, the main concentration of this study is on the role of VAT, VAT structure, VAT coverage, planning, organizing and administration requirement. However, the major focus is on management system regarding the VAT and contribution and effectiveness of VAT in Nepal. The problem of delaying tax assessment, tax evasion and avoidance etc. may be solved through efficient management system. After performing analytical system or there subject matters it ties to recommend for tax administration and management to execute the plan and policy of VAT effectively. To achieve their objectives, a research methodology has been designed to in this chapter.

#### **3.1 Research Design**

This study is based on both descriptive as well as analytical methods. The analysis was done on the basis of available both primary as well as secondary data from relevant studies. Data are collected from statistical documents, publications, budget speeches, economic survey, journals, and other sources. The research consulted with various officials of Government of Nepal and other institutions.

#### **3.2 Populations and Sample**

To achieve the objective of the study, the whole area relating to government revenue or national revenue is set for the research presentation VAT is taken as sample is.

### **3.3 Nature and Sources of Data**

This study was mainly based on secondary data. Primary data also used where necessary. Primary and secondary data were collected in order to achieve the real and fruitful results. All the possible and useful descriptive data and views had been collected. The data were collected from the following sources.

#### **1. Sources of Primary data**

The primary data were collected from the different persons and officials who are concerned with collection and payment of VAT. They are VAT administrators, VAT payers and experts. The primary data were collected by the means of question for the research study, the interview and discussion method were performed. Again, for this purpose tax payers from the different sectors were also contacted.

## **CHAPTER –IV**

### **PRESENTATION AND ANALYSIS OF DATA**

Nepal has been adopting VAT system about ten years ago. The resulted outcome is not satisfactory as expected. In terms of revenue raised by it, cannot be termed successful because behind this is numerous problems including conflicting situation in the country. This study tries to carryout the problems faced by VAT system, Management system of VAT and the future perspective of VAT in Nepal through the analysis of primary as well as secondary data.

#### **4.1 Analysis of secondary data**

##### **4.1.1 Tax structure of Nepal**

Excluding foreign aid, tax is the main income source of nation's budgetary generation for self-reliance in economic growth of the economy, the government has to extent the domestic and international tax value generating the various resources and increase the per capita income of the people for the developing country like Nepal, the role of taxation in the process of economic development is thus considerably significant. In this respect, the tax structure has vital role in economic development. Government has introduced several taxes mainly to raise revenue in the recent year is examined here in this chapter.

##### **4.1.1.1 Trend and composition of total revenue**

Total revenue of Nepal can be tax revenue. Tax revenue contributes about three quarters of total revenue while non-tax revenue represents about the quarter of total revenue. This is shown in table 4.1

**Table4.1****Contribution of tax and non-tax revenue as percentage of total revenue.**

Rs in carore

Fiscal year	Total revenue		Tax revenue		Non-tax revenue	
	Amount(RS)	Percent	Amount(RS)	Percent	Amount(RS)	Percent
2058/2059	4044.55	100	3933.06	97.24	1111.49	2.76
2059/2060	5622.98	100	4258.69	70.73	1364.29	29.27
2060/2061	6229.1	100	4817.30	77.40	1415.80	22.06
2061/2062	7012.27	100	5410.47	77.15	1601.80	22.85
2062/2063	7228.2	100	5743.04	70.45	1485.16	29.55
2063/2064	8771.22	100	7112.67	81.09	1658.55	18.91
2064/2065	9359.37	100	8515.55	90.98	2246.70	9.01
2065/2066	12630.48	100	10212.03	80.85	2418.45	19.15

*Source : I.R.Department*

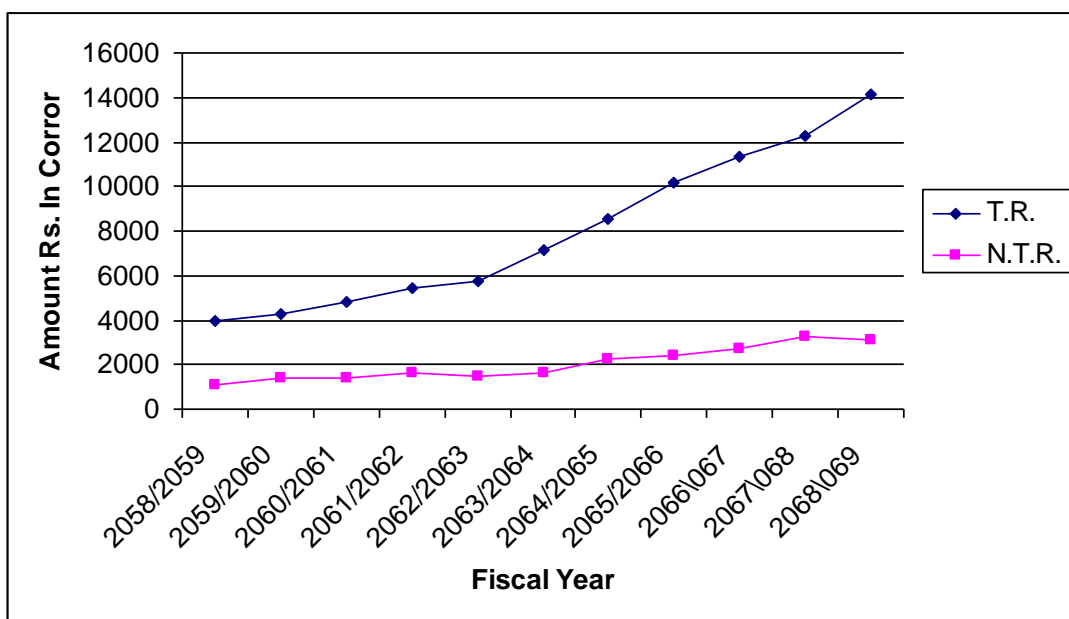
Forecasted data						
2066\067	13641.00	100	11060.17	80.43	2580.88	19.54
2067\068	14789.35	100	12039.4	79.06	2749.95	20.94
2068\069	15937.65	100	13018.63	82.03	2919.02	17.97

During the study period the amount of both Tax and Non Tax revenue were 3933.06 and 1111.49 carore. In 2058/059 respectively. Similarly the contribution of tax revenue and Non Tax revenue of f/y 2065/066 were 10212 and 2418.45 carore respectively.

In present age term the contribution of Tax revenue and non tax revenue on total revenue for the f/y 2058/059 were 97.24 and 2.76 percent respectively. These contribution were reached 80.85 % and 19.15 % in f/y 2065/066 respently. The dominated role of the tax revenue is thus quite satisfactory as it's amount has increase more significantly then the non tax revenue are the period 2058/059 to 2065/066.

The non- tax revenue comes to the forms of fees, fines, penalties, dividend, interest, sales goods and services and so on. There is some scope for generating more revenue through the rationalization of non-tax sources particularly by improving pricing policies and operational performances. This sources cannot be used effectively as a revenue raised since most of there sources are levied not for revenue purpose (khadka;2000). Following figure 4.1 clearly shows the trend of tax revenue and non- tax revenue to total revenue.

**Trend line of tax revenue and non-tax revenue to total revenue**



**Fig. no. 4.1**

Above the trend line show that the tax revenue was increasing trend during the f/y and the trend of non tax revenue also increase and decrease in the same period.

#### **4.1.1.2 trend & composition of tax revenue**

Total tax revenue is composed of direct tax and indirect tax for the study period there has simultaneous increase in total, indirect and direct tax revenue as shown table 4.2

**Table 4.2****Contribution of direct and indirect tax revenue as percentage of total tax revenue.**

Rs. In carore

Fiscal year	Total revenue		Direct Tax		Indirect Tax	
	Amount(RS)	Percent	Amount(RS)	Percent	Amount(RS)	Percent
2058/2059	3933.06	100	946.57	27.06	2886.48	72.94
2059/2060	4258.69	100	869.14	20.40	3389.55	79.6
2060/2061	4817.30	100	1021.51	21.20	3795	78.8
2061/2062	5410.47	100	1127.26	20.83	4283	79.17
2062/2063	5743.04	100	1178.70	29.53	4564.34	70.47
2063/2064	7112.67	100	1672.68	24.52	5439.99	75.48
2064/2065	8515.55	100	2014.70	24.66	6500.85	75.34
2065/2066	10212.03	100	2348.725	24.70	7662.40	75.63

*Source : I.R.Department*

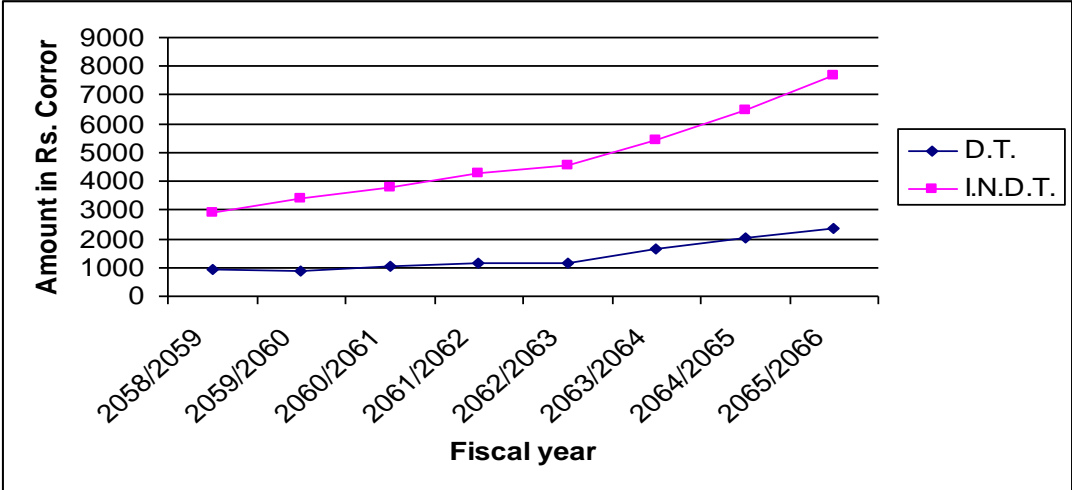
In FY 2058/059 or VAT Implementation year the amount of total Tax direct and Indirect tax revenue were Rs. 3933.06 carore Rs. 946.57 and 2886.48 carore respectively. Those amount were increase to 7112.67 carore, 1672.68 carore. In 2068/2064.

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

In the Nepalese prospective, while direct tax seems to be justified the indirect tax is unavoidable. The direct tax is justified because it helps to mobilize revenue for the national exchequer and assist to narrow the gap in the distribution of income and wealth between the richer and the poorer section of the society, which is essential for development. However, under the existing

circumstance, the direct tax cannot generate sufficient revenue to the nation exchequer. It is only through the indirect tax that adequate revenue can be mobilized and the consumption of harmful commodities or the investment in the unproductive sectors of the economy can effectively be discouraged, thus through there is the need for Nepalese government to rely upon the direct tax which would have a more dominating role in the Nepalese economy at least for mobilizing adequate resources for development following figure 4.2 clearly shows the trend of contribution of direct tax indirect tax to total tax revenue.

**Trend line of contribution direct tax and indirect tax to total tax revenue**



**Fig. no. 4.2**

Above trend line shows that contribution of direct tax is increasing trend during the study period and forecasted period. According to it’s trend, it is clear that the contribution of direct tax revenue will increase in future.

**4.1.1.3Trend and composition of direct tax**

In Nepalese tax structure, the main structure of direct tax are income tax and land and registration tax. Following table 4.3 shows the composition of direct tax from income tax and land and registration tax.

**Table 4.3****Contribution of Total Direct Tax, Income Tax, House and land Registration Tax**

<b>Fiscal year</b>	<b>Total direct tax</b>		<b>Income tax</b>		<b>House and land registration</b>	
	<b>Amount(RS)</b>	<b>percent</b>	<b>Amount(RS)</b>	<b>percent</b>	<b>Amount(RS)</b>	<b>Percent</b>
2058/2059	946.57	100	643.6	80.12	102.30	10.80
2059/2060	869.14	100	710.21		98.57	11.34
2060/2061	1021.51	100	851.25	80.33	109.62	10.73
2061/2062	1127.26	100	940.24	80.40	126.15	11.18
2062/2063	1178.70	100	959.88	81.43	128.93	10.93
2063/2064	1672.68	100	1357.91	80.57	206.42	10.34
2064/2065	2014.70	100	1622.32	80.52	228.46	11.34
2065/2066	2548.72	100	2123.20	80.30	336.28	10.15

*Source : I.R.Department*

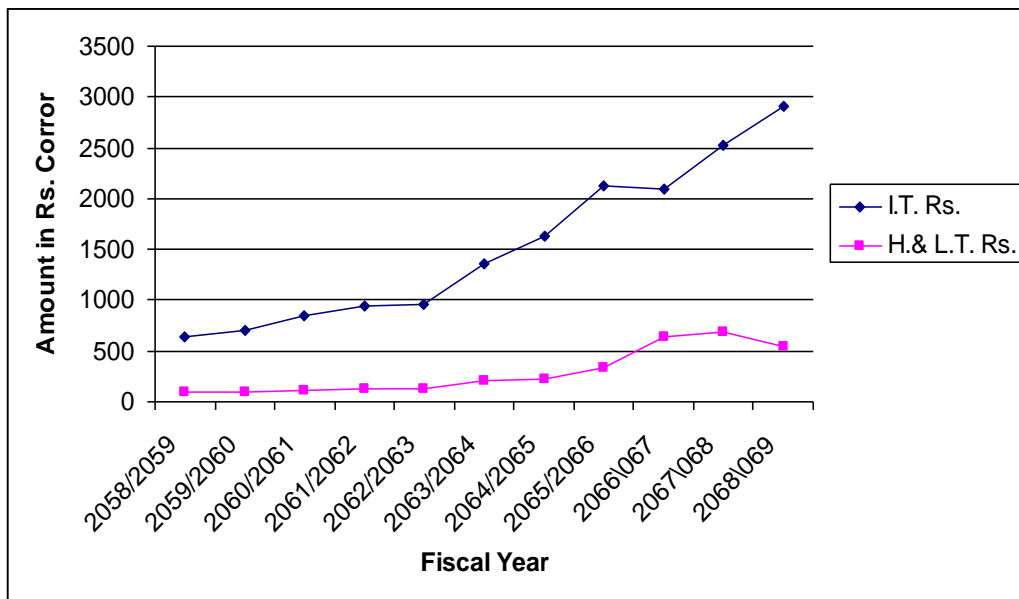
<b>Forecasted Data</b>						
<b>Fiscal year</b>	<b>Total direct tax</b>		<b>Income tax</b>		<b>House and land registration</b>	
	<b>Amount(RS)</b>	<b>percent</b>	<b>Amount(RS)</b>	<b>percent</b>	<b>Amount(RS)</b>	<b>percent</b>
2066/067	2432.6	100	2099.19	76.51	313.84	23.49
2067/068	2641.49	100	2295.11	78.52	344.56	21.48
2068/069	2856.38	100	2491.03	84.32	375.28	15.68

In FY 2058/059 the contribution of income tax and land & registration tax to total tax revenue 643.6 carore and 80.12 carore respectively as shown is table. During the same period their contribution in percentage term was 80.12 percent and 10.80 percent respect. The share of income tax was 80.40 in 2061/062 was to increase to 81.43 in fiscal year 2062/2063. How ever this contribution was decrease to 80.30 In fiscal year 2065/066.

The share of land and registration in direct tax in FY 2058/2059 was 10.80 also increase to 11.34 in 2059/2060. Against decrease to 10.19 in fiscal year 2065/066.

Following trend line clearly show the contribution of income tax and land and registration tax to total direct tax revenue.

**Trend line of composition of direct tax revenue**



**Fig. no. 4.3**

Above trend line show that both income tax and house and land tax increase during the study period.

#### **4.1.1.4 Trend and composition of indirect tax**

The term indirect tax in this study refers to three categories of taxes, customs duties, VAT and excise duties. This contributes about sixty percent of total revenue during the study period. The contribution of custom duty, VAT and excise duties to total indirect tax revenue are as follows in table 4.

**Table 4.4**  
**Composition of indirect tax**

Rs. In carore

F\Y	Total indirect tax		Custom duties		VAT/sales		Excise Duty		Other	
	Amt. RS	%	Amt. RS	%	Amt. RS	%	Amt. RS	%	Amt. RS	%
2058/059	2886.48	100	937.84	30.49	1226	40.47	81.74	8.17	630.9	21.85
2059/060	3389.55	100	1056.77	31.17	1345	30.68	85.56	5.24	902.00	25.61
2060/061	3795	100	1066.69	20.10	1447.89	30.15	57.71	1.55	1227.71	30.35
2061/062	4283	100	1229.91	20.71	1888.54	44.09	69.79	1.52	1014.76	25.56
2062/063	4564.34	100	1174.46	20.73	2161.06	47.34	62.56	1.07	1166.26	25.55
2063/064	5439.99	100	1362.61	25.04	2609.56	47.96	60.87	1.00	1406.95	25.86
2064/065	6500.85	100	1712.82	25.35	2981.57	45.87	44.56	0.60	1761	27.09
2065/066	7662.40	100	1915	25	3561	45.47	80	0.10	2106	274.8

*Source : I.R..Department*

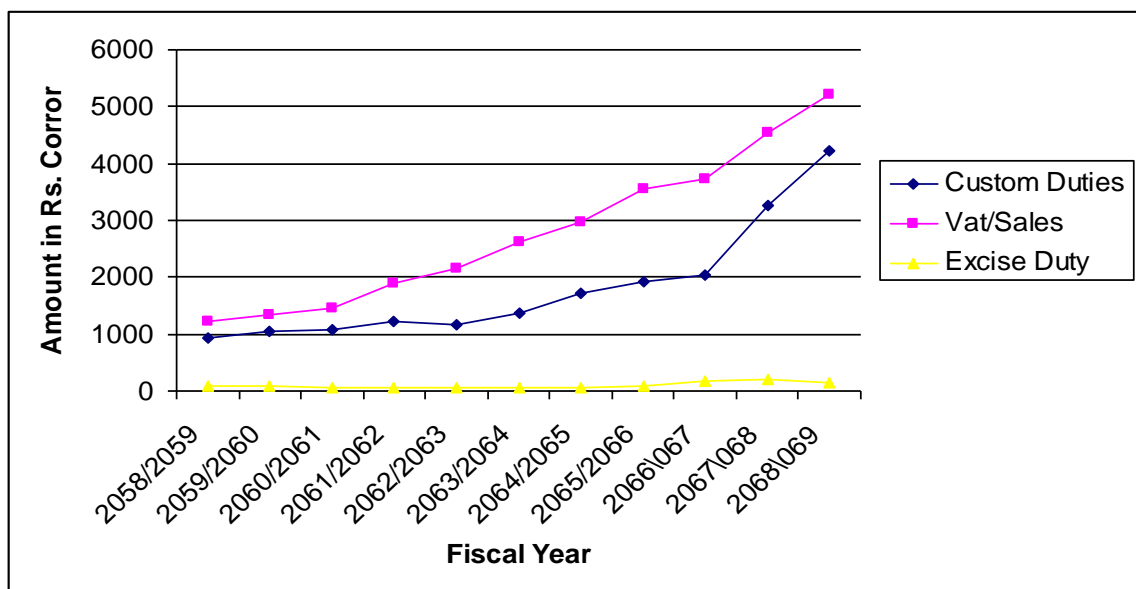
<b>Forecasted Data</b>										
Fiscal Year	Total indirect tax		Custom duties		VAT		Excise duty		Other	
	Amt. RS	%	Amt. RS	%	Amt. RS	%	Amt. RS	%	Amt. RS	%
2066/067	8084.04	100	1892.81	25.23	3806.88	46.38	177	2.20	2023	26.19
2067/058	8729.33	100	2023.19	34.09	4173.6	47.35	196	2.04	1580	16.52
2068/069	9374.58	100	2153.57	38.39	4480.32	47.51	149	1.35	1400	12.75

The table clearly show that the contribution of custom duties, VAT, Excise duties and other source in fiscal year 2058/059, 937.84 carore, Rs. 1226

carore, Rs. 91.74 carore and 630.9 carore respectively. In percentage term the contribution of custom duties, VAT, exciseduties and other in total indirect tax were 30.49%, 40.47%, 3.17% and 21.85% respectively. The total indirect tax revenue rise during the study period. VAT contributed the highest share following by custom duties and excise duties.

Improvement in VAT implementation is the main reasons for such satisfactory performance. Thus, the revenue from VAT has been increasing more significantly then other components (i.e. customs and excise duties) in the total indirect tax revenue following trend represents the compositing indirect tax from its components I.e. custom duty VAT exercise duty and other taxes.

**Trend line of composition of indirect tax**



**Fig.no.4.4**

Above trend line shows that the contribution of indirect tax from its component i.e. custom duties, VAT and excise duty are in increasing trend. According to its trend, it is clear that contribution of indirect tax from its component will increase in future

#### 4.1.1.5 Total Revenue, tax revenue and Non-tax revenue in G.D.P.

In order to understand the growth pattern to taxation properly, it would be desirable to examine the share of total revenue, tax revenue and non-tax revenue in GDP. Table 4.5 in this connection presents an account of total revenue, tax revenue and nontax revenue as percentage of GDP. In the GDP, tax revenue has been increasing much higher than the non-tax revenue over the period f\y 1997\98 to f\y 2005\06 and for the period f\y, 2004\05 tax revenue also increased much in comparison with non-tax revenue.

**Table 4.5**

**Total revenue, tax revenue and non-tax revenue as percentage of GDP.**

Fiscal year	GDP	Total revenue	Tax revenue	Non-tax revenue	Percentage of GDP		
					Total revenue GDP	Total revenue to GDP	Non-tax revenue GDP
2058/059	44206	4044.55	3933.06	111149	9.14	8.09	2.51
2059/060	45949	5622.98	4258.09	1364.29	10.23	9.06	2.06
2060/061	48100	6223.1	4817.30	1415.80	10.93	10.01	2.04
2061/062	49774	7012.27	5410.47	1601.80	14.08	10.87	3.04
2062/063	51449	7228.20	5743.04	1485.16	14.04	11.16	2.08
2063/064	53168	8771.22	7112.67	1658.55	14.04	13.37	3.11
2064/065	56012	9369.87	8515.55	2246.70	15.20	14.20	4
2065/066	58623	12630.48	10212.03	2418.45	21.54	16.02	4.12

*Source : I.R..Department*

Forecasted data							
2066/067	60125	13950	11221	2729	32.20	18.66	4.53
2067/068	62297	15495	12251	3244	24.87	19.66	5.20
2068/069	64231	17250	14150	3100	26.50	22.02	4.82

The share of tax revenue increase from 9.14% of GDP In fiscal year 2058/059 t 21.40%. In 2065/066. The share of non tax revenue increase from 8.09%. In fy 2058, 12059 to 16.02% In fy 2065/2066.

The relationship between tax revenue and GDP is known as tax GDP ratios .this is an indicator of the utilization of taxable capacity. The table shows rather disappointing scenario of tax GDP ratios for the study period. However, it increased from 9.14% to 21.54. However, this growth is not continuous. The ratio is still much lower than total of many other developing countries. by world standard, this is very low level of taxation.

### Trend line of tax and non-tax revenue in GDP

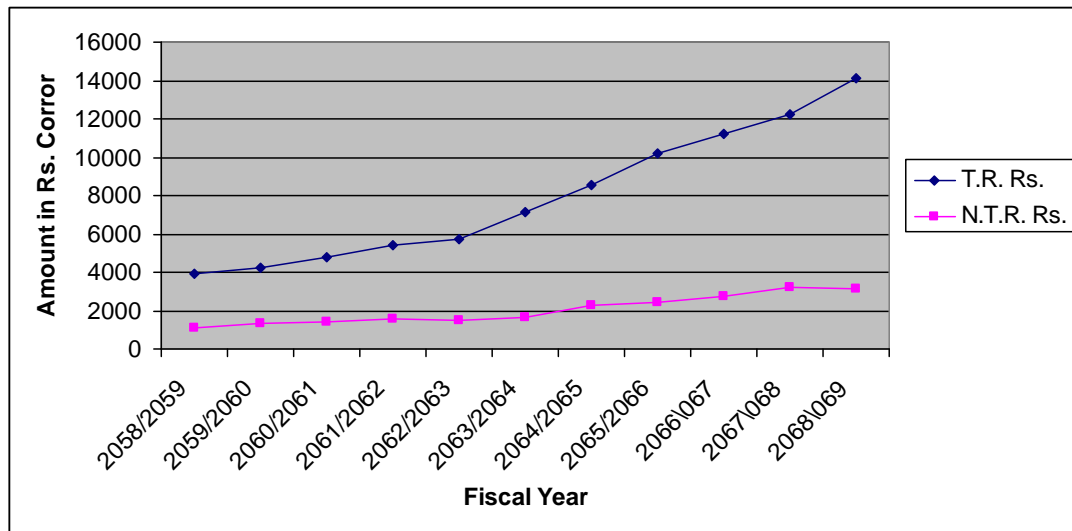


Fig.no.4.5

Above the trend line show that the contribution of tax and non tax revenue to GDP are increase trend during the study period.

#### 4.1.1.6 Direct and indirect tax revenue as percentage of GDP

Table 4.6 indicators the share of direct and indirect tax revenue in GDP. In terms of GDP, the share of direct tax revenue increased from 2.14 percent in fy 2058/59 to 4.04 percent in fy 2065/66 where as the share of indirect tax revenue increased from 6.52 percent in fy 2058/59 to 13.07 percent in fy 2065/66./ And the share of direct tax and indirect tax revenue in GDP were 2.29 percent and 8.57 percent respectively in the fy 2062/63 however this increment

is not continuous it is thus the direct tax through which larger percentage of revenue is transferred to government of Nepal.

**Table 4.6**  
**Direct and indirect tax revenue as percentage of GDP.**

Fiscal year	GDP	Direct Tax revenue	Indirect tax revenue	percentage of GDP	
				Direct tax	Indirect tax
2058/059	44205	946.57	2886.48	2.14	6.52
2059/060	45949	869.14	3389.55	1.09	7.07
2060/061	48100	1021.51	3795.0	2.12	7.88
2061/062	49774	1127.26	4243.0	2.26	8.52
2062/063	51449	1178.70	4564.34	2.29	8.57
2063/064	53168	1672.68	5440.0	3.14	10.23
2064/065	56012	2014.70	6500.85	3.59	11.60
2065/066	58623	2548.725	7662.40	4.04	13.07

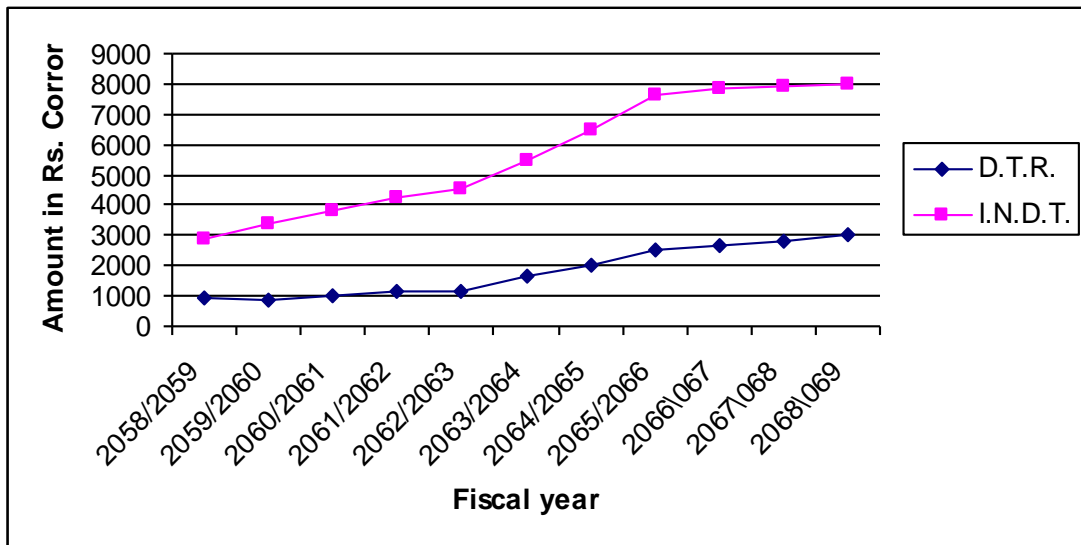
*Source : I.R..Department*

<b>Forecasted Data</b>					
2066/067	66188	24326	8084.04	4.43	12.97
2067/068	68189	2641.49	8729.33	4.47	12.53
2068/069	70191	2850.38	9374.58	4.60	12.22

According to the above table show that the direct tax revenue increase from Rs. 946.57 carore to 2548.725 In fy 2058/2059 to 2067/2066 like this indirect tax increase from Rs. 2886.48 carore to 7662.40 carore In fy 2058/2059 to 2065/066.

Following trend line show the direct tax revenue as percentage of GDP.

### Trend line of direct tax and indirect tax to GDP



**Fig. no 4.6**

Above trend line shows that the trend of direct tax and indirect tax to GDP are increasing trend during the study but in the f\y 2059/2060 it will decrease and than it will increase during the f\y 2065/2065. It is clear that the contribution of direct and indirect tax to GDP will increase in future.

#### **4.1.1.7 Share of VAT revenue in total revenue**

Following table 4.7 clearly shows the year wise collection of VAT revenue and contribution of total revenue.

**Table 4.7****VAT revenue as per percentage of total revenue.**

RS in carore

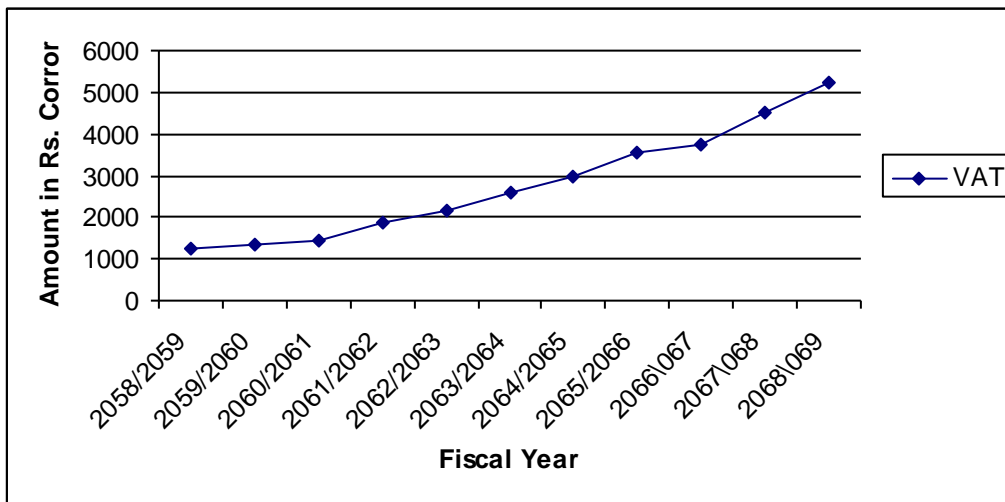
<b>Fiscal year</b>	<b>Total revenue</b>	<b>VAT revenue</b>	<b>% of total revenue</b>
2058/059	4044.55	1226	30.31
2059/060	5622.98	1345	23.91
2060/061	6223.1	1447.89	23.26
2061/062	7012.27	1888.54	26.93
2062/063	7228.20	2161.06	29.89
2063/064	8771.22	2609.56	29.75
2064/065	9369.37	2981.57	31.82
2065/066	12630.48	3561	28.19

*Source : I.R..Department*

<b>Forecasted Data.</b>			
2066/067	2580.88	3806.88	26.68
2067/068	2749.95	4143.6	29.26
2068/069	2919.02	4480.32	3028

The share of VAT revenue in the total revenue increase from 30.31 percent in fy 2058/059 to 31.82%. In fy 2065/066 and decrease in fy 2059/2060, 2060/061 the share of VAT revenue increase and decrease respectively. Following trend line show the contribution of VAT revenue to total revenue during the study period.

### Trend line of VAT revenue



**Fig. no. 4.7**

Above trend line chart shows that the contribution of VAT to total revenue is in increasing trend during study period and forecasted period. It is clear that the contribution of VAT revenue to total revenue will increase in future.

#### 4.1.1.8 Share of VAT revenue in GDP

**Table 4.8**

#### VAT revenue as percentage of GDP

Rs. in carore

Fiscal year	GDP	VAT revenue	Percentage of GDP
2058/059	44205	1226	2.77
2059/060	45949	1345	2.92
2060/061	48100	1447.89	3.01
2061/062	49774	1888.89	3.79
2062/063	51449	2161.06	4.20
2063/064	53168	2609.56	4.90
2064/065	56012	2981.57	5.32
2065/066	58623	3561	6.07

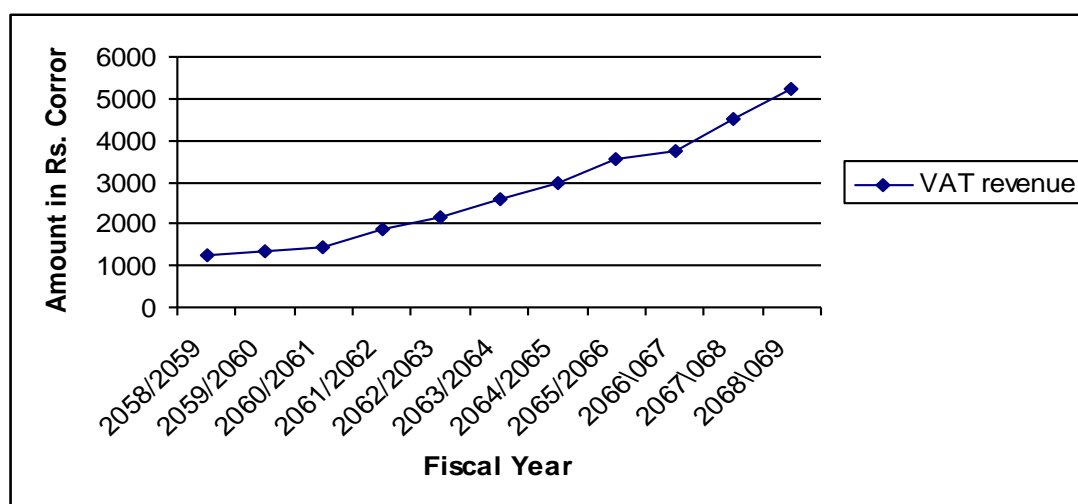
*Source: I.R.D. Department*

<b>Forecasted Data.</b>			
2066/067	66188.36	3806	6.17
2067/068	68189.7	4143.6	7.17
2068/069	70191.10	4480.32	7.96

As show in table the share of VAT revenue as percentage of GDP 2.77% in fy 2058/059 increase to 6.07 percent in fy 2065/066.

Following trend line show the contribution of VAT revenue as percentage of GDP during the study period.

**Trend line of VAT revenue to GDP**



**Fig. no.4.8**

Above trend line show that of VAT revenue to GDP is increasing trend during the study period and forecasted period. According to its trend, it is clear that the contribution of VAT revenue to GDP will increase in future.

## **4.1.2 Current status of VAT in Nepal**

### **4.1.2.1 Registration**

Despite having several problems in its operations, the total number of VAT registration has reached 39776 in the span of last thirteen years. Following table 4.9 shows the year wise number of VAT registration and percentage number of VAT registrants in different fiscal year in Nepal.

**Table 4.9**

**Year wise number of VAT registration**

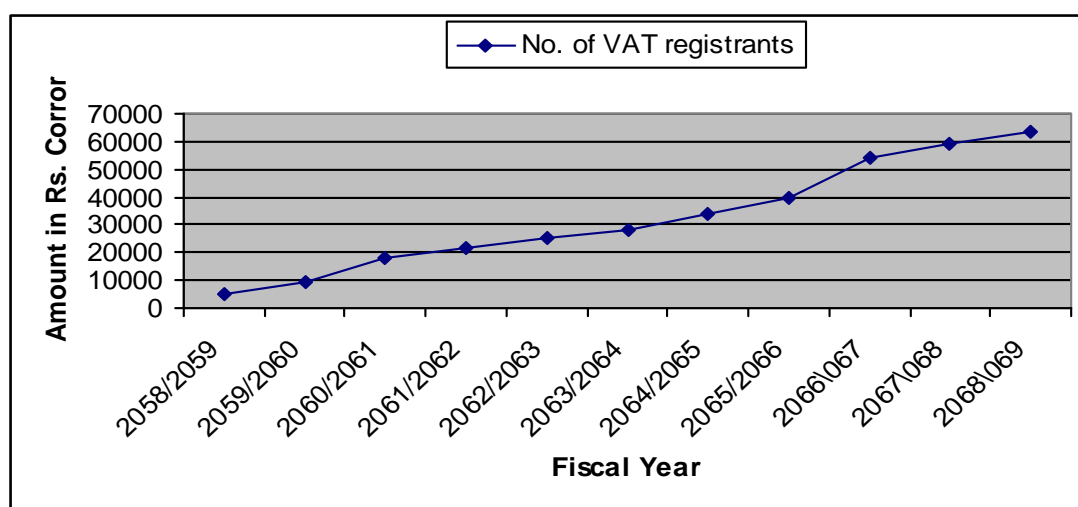
<b>Fiscal year</b>	<b>No. of VAT registrants</b>	<b>increase</b>
2058/059	4956	83.25
2059/060	9082	100.84
2060/061	18240	19.41
2061/062	21781	14.46
2062/063	25148	12.75
2063/064	28354	
2064/065	34174	20.53
2065/066	39776	16.39

<b>Forecasted Data</b>		
2066/067	36385.3	21.22
2067/068	38999.09	8.92
2068/069	41612.88	8.19

*Source : I.R..Department*

As shown in table 4.9, the number of VAT registrants has increased study period and forested period.

**Trend line of Yearwise no. of VAT registrants**



**Fig. no. 4.9**

Above trend line & pie chart shows that the trend of VAT registrants is increasing trend during the study period and forecasted period. according to its trend, it is clear that the number of VAT registrants will increase significantly in future. Government of Nepal. Table 4.10 shows the office wise registered status of VAT on the date of 10 april 2006.

**Table 4.10**  
**Office wise registered status of VAT in Nepal**

<b>Office code</b>	<b>Inland revenue offices</b>	<b>Total registrants</b>
11	Bhadrapur	1496
12	Biratnagar	2530
13	Dharan	1312
14	Janakpur	1281
15	Lahan	1220
16	Simara	896
17	Birgung	2413
18	Heatauda	788
19	Bharatpur	1272
20	Dhangadi	966
21	Mahendranagar	609
22	Pokhara	2495
2	Lalitpur	2362
24	Bhairahawa	2294
25	Kathmandu-3	6214
26	Nepalgung	1555
27	Kathmandu-1	6993
28	Kathmandu-2	4755
29	Bhaktapur	1698
30	Krishnanagar	490
51	Dang	750
52	Local tax office	164
<b>Total</b>		<b>44553</b>

*Source: WWW.ird.gov.np*

#### 4.1.2.2 VAT revenue performance

It is quite natural as in the world and especially among developing countries, the success story of VAT was very popular the rise of revenue mobilization in specially those countries under VAT regime was encouraging. In the backdrop of the failure of all known measures to increase revenue it was quite natural to expect that VAT would enhance revenue collection and this was exactly the case when VAT was first introduced in Nepal.

In the initial stage, only positive aspects of VAT were looked upon. Its negative aspects were completely ignored. VAT was presented as a panacea of revenue mobilization. It was treated like magical wind to increase revenue. It was told that with its implementation smuggling would be eliminated, leakage of revenue would be stopped, exports would be increased and with the increase in revenue, foreign aid would be reduced etc. it led to imposition of VAT replacing sales, contract and hotel and entertainment taxes from 1997. However, it is unable to collect revenue as per the expectation. The revenue collected from the VAT was not the expectation. The VAT revenue in the study period and forecasted period.

**Table 4.11**

#### **Year wise collection of VAT revenue**

<b>Fiscal year</b>	<b>VAT amount RS. carore</b>
2058/059	1226
2059/060	1345
2060/061	1447.89
2061/062	1888.54
2062/063	2161.06
2063/064	2609.56
2064/065	2981.57
2065/066	3561

*Source : I.R..Department*

Forecasted Data	
2066/067	3722
2067/068	4534
2068/069	5225

In table 4.11 show that the vat revenue of Rs. 2981.57 carore for the f/y 2064/065 was increase from Rs. 2609.56 for the f/y 063/064. From this, it is clear that the collection of VAT revenue is fluctuating. However in f/y 2065/066 the collection of VAT revenue Rs. 3561 correr was good collection with comparison of other fiscal year because of modern computerized VAT system. VAT registration, collection determination, VAT refund. Appeal and collection have been recovered according to this modern computerized VAT system following figger show the trend of VAT revenue performance.

#### Trend line of VAT revenue

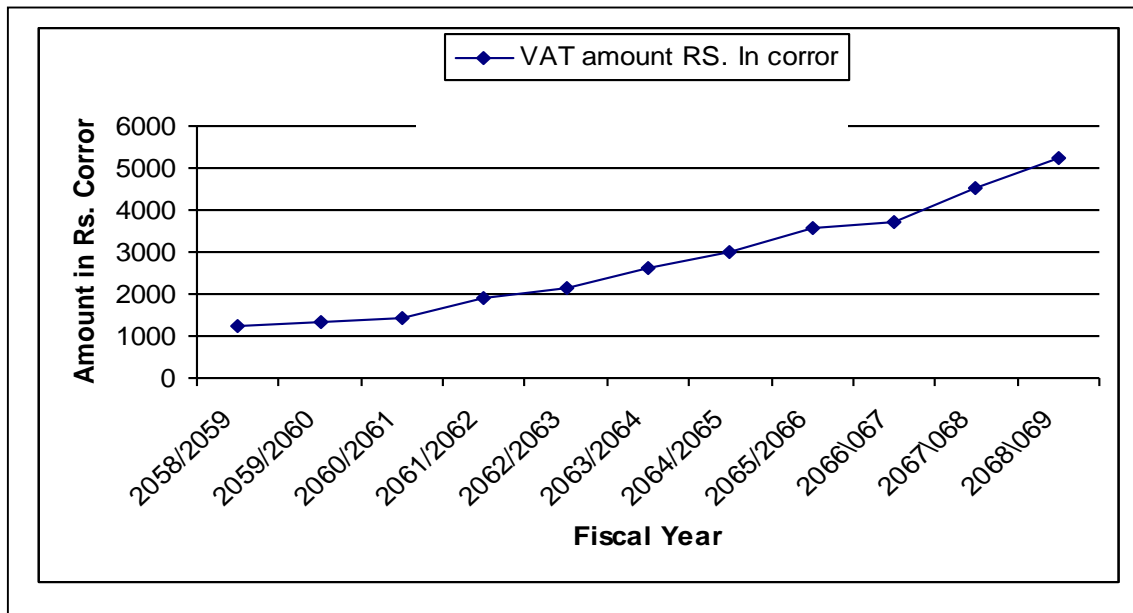


Fig. no. 4.10

Above trend line shows that VAT revenue performance is increasing trend during the study period and forecasted period. According to its trend, it is clear that the VAT revenue performance will increase in future.

#### 4.1.2.3 Composition of VAT revenue

Total VAT revenue is dividend into domestic and import components. As indicated in table 4.12 almost two third of VAT revenue is generated from imports and the rest from domestic products.

**Table 4.12**  
**Composition of VAT revenue**

Fiscal year	VAT revenue	Domestic product		imports	
		Amount (Po)	percent	amount	Percent
2058/059	1226	361.67	29.50	864.33	70.50
2059/060	1345	484.2	36.00	860.8	64.00
2060/061	1447.89	550.19	38.00	897.7	62.00
2061/062	1888.54	736.53	39.00	1152.01	61.00
2062/063	2161.06	842.79	39.00	1318.27	61.00
2063/064	2609.56	939.44	36.00	1670.12	64.00
2064/065	2981.57	1162.81	39.00	1818.76	61.00
2065/066	3561	1224.62	34.39	2336.38	65.61

*Source : I.R..Department*

<b>Forecasted Data</b>					
2066/067	3722	1488.8	40	2233.2	60
2067/068	4534	1904.28	42	2629.72	58
2068/069	5225	2246.75	43	2978.25	57

In f/y 2058/059 the share of domestic product and import in total VAT revenue was 29.50 and 70.50 percentage respectively where an in f/y 061/062 the share f domestic and imports in VAT revenue was 39 percent and 61 percent. Upto five year the imports component declining continuously and reach to 61 percent but afterward contribution of domestic product start to decreased and then the contribution of imports begin to increase.

The composition of VAT revenue from domestic product and imports were increasing trend during study period and forecasted period. According to its trend, it is clear that the composition of VAT revenue from domestic product and imports will increase in future.

#### **4.1.2 Administrative status of VAT**

With introduction of VAT, the previous administrative system had to be changed as well as we know VAT is more demanding then the sales tax system.VAT would bring more vendors including retailers in to the tax net. Consequently the number of taxpayers as well as the tax payers whose file returns will increase. This would necessitate more for functional organizational structure and office oriented would necessitate more for functional organizational structure and office oriented personnel system. VAT requires a modern, effective and administration for its effective implementation.

#### **1. Administrative Re-organization**

The organization structure of sales tax and excise duty was not appropriate for the VAT system. the organization of sales tax and excise office was not functional. The same officer was responsible of registration, assessment and collection. This led to the tendency of corruption. As such the need to set up a function based organizational structure was felt. A revised organizational system based on functional requirements with a well-mentioned hierarchy of personnel was recommended and approved. The new structure has separate

sections for registration collection, large taxpayers, tax refund, taxpayer's services, tax audit investigation internal monitoring.

## **2. Merging of Department of Taxation and Department of VAT**

In late 2000, government of Nepal took a wise decision. Consequently, on April 16-2001, inland revenue department was formed by merging the previous department of taxation responsible for income tax and VAT Department. this Department is responsible for administration of income tax, corporate tax, VAT excise Duty and other taxes. It was consequently decided to also merge the seventeen VAT offices with the forty existing income tax offices into a significantly reduced number of twenty-one inland revenue offices through the country. This was affected from July 16,2001. Therefore, in the administrative front, major reforms took place during the year 2001. Tax and VAT administration work merged to internal revenue administration. The decision was taken forcing many benefits like reduced cost of administration and improved monitoring of tax payers through cross check between income tax VAT data. In addition, permanent Account numbers were allotted to represent both VAT and income tax registrants.

## **3. Computerization**

Computerization has been a main feature of VAT system. The traditional manual system of keeping records from registration of taxpayers to tax audit activities has been replaced by computerization.

Computerization facilitates the audit process as it makes it possible to select suspect cause for audit, which would be very different to do manually, likewise computerization helps in detecting the non-filers and non-payers.

In the initial stages, computerization was not welcomed by the officials for reasons like computer illiteracy and the tendency to work in the traditional way with the assistance of Danish agency for international Development VAT personnel were imparted computer training and begin to accept the advantages of using computers.

#### **4. Audit and investigation**

Audit is a new term for the tax administration in Nepal. However, under VAT system, auditing has been initiated and it holds an important place. The objective behind auditing is to ensure that the right amount of tax is paid to the government.

Sales tax was based on official assessment. Under the sales tax administration, the same officer was responsible for registration, assessment and collection thus leading to corruption. There was lack of inspection, audit and enforcement. In addition. The tax authorities enjoyed several controls over the taxpayers like renewal of registration, approved of prices by tax officials, certification of tax invoices by tax offices. Such system can lead to arbitration by the tax officials and thus lead to misuse of their authority. No auditing was conducted for sales tax purpose.

However, under VAT system, the tax authorities do not enjoy such controls. VAT is based on the principle of self- assessment by the taxpayers. This meant that under VAT, the taxpayers had to determine their tax liability themselves. It is their responsibility to collect taxes and submit to government. Under such conditions, since there is the responsibility of the taxpayer's not carryout responsibility thus resulting in revenue leakage the need of tax audit or VAT audit arises. During the time of VAT implementation, most of the taxpayers has protected against tax audit. The bodies representing the businessmen like NCC, FNCCI has alleged that the motive of tax audit was to discourage the businessmen.

Under VAT, tax audit and investigation section has been set up and the positions of tax auditors have been created. At present, Tax officials are being given training for tax audit,. The tax audit is carried out in the premises of the taxpayers and mainly comprises two type namely regular visit and special visit.

##### **Regular visit**

This kind visit is under taken as a part of regular work process to ensure that no revenue leakage has taken place and if any evasion is found to recover it.

### **Special visit.**

This kind of visit is undertaken with special purpose and all tax payers are not paid this kind of visit.

This visit is undertaken under the following cases.

#### **1) In relation to registration**

If the taxpayers have failed tax refund, the auditor will visit the premises to ascertain the validity of such tax refund.

#### **2) In relation to registration**

VAT officials have to conducted sunny of potential tax payers from time to time to ensure that they do not remain out of tax net. They have process the returns submitted by the tax payers on a continuous basis and should inform the tax payer incase of any mistakes indeed auditors have found out the cases of fraud through audit.

#### **3) In order to registration cancellation**

If a taxpayers, files has final return after which he wants to cancel the registration then in such case the VAT officials pay such a visit to assess the validity.

#### **4) In relation to investigation**

If the tax officials come to know about taxpayers carryout illegal activities leading to tax leakages then the need of tax investigation arises.

### **4.2 Analysis of Primary Data**

The primary data were collected from different respondent like tax officials tax payers\businessmen and intellectuals. According to view of respondent different aspect of VAT has been analyzed as follows.

#### **4.2.1 VAT and TAX evasion**

Tax evasion is the way of reducing tax liability by illegal means. Action taken by the tax payer which entails breaking the law and which moreover can be shown to have been taken with the intention of escaping payment of tax

generally regarded as tax evasion. Tax evasion is unethical, illegal and uneconomic activity.

As per the principle, the self-enforcing nature of VAT help to reduce the chances of evasion tendencies. Here it is appropriate to discuss the self-enforcing characteristics of VAT.

Under VAT, the tax paid to the government is difference between the VAT collected on sales and the VAT paid on purchases. So only, the amount mentioned in the tax invoice can be deducted. The taxpayers will lose if the full amount of his purchase is not mentioned or if the invoice is under stated. Therefore, since he would be at loss, he will demand the accurate invoice from the seller. In this way, a self-enforcing environment is created under VAT where one-tax payers ensure tax compliance by the previous taxpayers. However, this self-enforcing nature of VAT becomes questionable because of smuggling and selling to tax exempted small vendors.

Tax evasion has been taking place even with VAT system in Nepal. One can also argue that the VAT would lead to substantial revenue leakage associated with times such as tax evasion tax-free allowances for various small imports and revenue lost from the exemption of small traders. There is no incentive to comply in the case of sales by retailers to consumers who are not registrants and cannot claim input tax credits. Moreover, there is an incentive for retailers to evade the tax there by reducing the overall price in order to secure a sale. The incentive can be expected to be even stronger for service transactions where value added at the final stage normally constitutes a large proportion of the final price. Such transaction may further provide the basis for additional evasion of income tax by vendors. This cannot be attributed to the VAT system itself- but due to the lack of its effective implementation.

However tax evasion becomes less attractive under VAT due to the fact that if goods imported illegally are purchased the registered buyer will not be able to deduct any tax. This leads to an increase in his tax liability. Therefore, the registered buyer will not try to buy from such vendors who import illegally. Therefore, this will minimize the chances of doing illegal business.

**Table 4.13****Responsible person for tax evasion in Nepal**

Respondents	Total	Tax payers		Tax administrators		Inefficient Administrators	
Tax officials	40	27	67.5%	0	0%	13	32.5%
Tax payers\ Businessmen	40	3	7.5%	15	37.5%	22	55%
Intellectuals	40	23	57.5%	4	10%	13	32.5%
Total	120	53		19		48	
percent	100	44.17%		15.83%		40%	

*Source: Opinion Survey 2066*

Out of total respondent about 44.17 percent attributed the taxpayers for tax evasion in Nepal and this seems to be very much true. About 40 percent inefficient administration and about 15.83 percent blamed tax administration.

The tax officials blamed taxpayers completely for tax evasion. As per them taxpayers, engage in under invoicing and maintaining of dual accounts to evade tax. On the country, taxpayers opined that had the tax administration been more alert and effective evasion would have been controlled. Also, some of them revealed that it was the taxpayers who encouraged them to evade taxes.

**Table 4.14****VAT will be useful to lower tax evasion in Nepal.**

Respondents	Total	Yes		No		Don't know	
Tax officials	40	26	65%	7	17.5%	7	17.5%
Tax payers businessmen	40	4	10%	36	90%	0	0%
Intellectuals	40	16	40%	20	50%	4	10%
Total	120	46		63		11	
Percent	100	38.33%		52.5%		9.17%	

*Source: Opinion Survey 2066.*

Out of total respondents 38.33 percent believed that VAT helps to reduce tax evasion and 52.5 percent believed VAT would not solve the problem of tax evasion in Nepal. About 9.167 percent seemed to be confused about it. While 90

percent of businessmen believed that VAT will not help to minimize tax evasion, 65 percent of the tax officials believed that VAT will help to lower tax evasion, 40 percent of intellectuals viewed that tax evasion can be lowered if VAT is implemented well.

#### 4.2.2 VAT and inflation

While introducing VAT, the prime fear of consumers was that VAT was inflationary in nature, i.e. it raises the prices of goods and services. This was the reason why the general public raised voice against VAT. Theoretically, the principle of VAT does not allow inflation because VAT is substitute to sales and other taxes. VAT does not necessarily add extra burden to the consumers especially to the low- income bracket of the population since this tax replaces other forms of tax including sales tax. However, in reality VAT may be inflationary due to its lenient implementation and the ignorance on the part of the consumers.

**Table 4.15**

**VAT raises the price of goods and services.**

Respondents	Total	Yes		No		A simple price rise	
Tax officials	40	0	0%	33	82.5%	7	17.5%
Tax payers (Businessmen)	40	22	55%	13	32.5%	5	12.5%
intellectuals	40	0	0%	35	87.5%	5	12.5%
Total	120	22		81		17	
percent	100	18.33%		67.5%		14.17%	

*Source: Opinion Survey 2066.*

Out of total respondents 67.5 percent thought that increase, the price of goods and services and 14.5 percent thought that VAT will simple rise the price of goods and services. About 18.33 percent respondent believed that VAT raises the price of goods and services.

### 4.2.3. VAT Education

VAT education is necessary in Nepal to increase consciousness of taxpayers and awareness of consumers who think that VAT increases the cost the goods and services. Mostly consumers do not want to receive bill because if they demanded bill they have to pay extra 13 percent as VAT. Therefore, VAT administration must be conscious about the fact and inform to consumers that if they do not take bill, they as well as government may be cheated by seller determine the price of the goods and services by themselves.

There is a general impression that VAT is a complicated tax although it is implemented ten year before industrialist and businessmen fear that this tax will be complicated to comply with and they will require hiring a separate accountant for VAT purpose so VAT education is needed for consumers tax payer and however will require more work from those tax payers that are currently not registered for any of the existing taxes which is replaced by VAT and VAT education programmed must be lunched on a wider scale for the public as well. Information should be disseminated on a large scale through the media, seminars and public speeches organized at various places throughout country and need to launch education program for consumer, trader, taxpayers, and other at large.

**Table 4.16**

**VAT education for effective implementation of VAT in Nepal.**

<b>Repeat</b>	<b>Total</b>	<b>yes</b>		<b>No</b>		<b>Don't Know</b>	
Tax officials	40	40	100%	0	0%	0	0%
Tax payers	40	40	100%	0	0%	0	0%
Businessman	40	40	100%	0	0%	0	0%
Total	120	120		0		0	
Percent	100%	100%		0%		0%	

*Source : Opinion Survey 2066.*

This table clearly says that VAT education is necessary in situation of Nepal for conscious on and awareness to taxpayers and consumers. Cent percent

answer goes to VAT education, so government should educate by different ways in large scale with big business area.

#### 4.2.4. VAT and Registration

For successful implementation of VAT, it is essential to have registration of all taxable producers and suppliers timely. All persons who deal with taxable goods and services and do the transaction above threshold level are required to register. Person whose annual sales do not exceed the relevant limit should be allowed to apply for registration on voluntary basis.

However, in Nepal the voluntary registration is very weak, the person were fear from it because of negative publicity of VAT. Many concern people said that VAT raises the price of goods and services. Due to negative publicity of VAT. Registration attitude of them also negative. Now a day the government launched different programmed about VAT to make consciousness of people. Due to this, the registration attitude of people is changed. Table 4.18 shows the Registration attitude of Taxpayers in Nepal.

**Table 4.17**  
**VAT registration attitude of taxpayers in Nepal.**

<b>Respondents</b>	<b>Total</b>	<b>Positive</b>		<b>Moderate</b>		<b>Negative</b>	
Tax Officials	40	8	20%	13	32.5%	19	47.5%
Tax payers/ Businessman	40	27	67.5%	13	32.5%	0	0%
Intellectuals	40	11	27.5%	17	42.5%	12	30%
<b>Total</b>	<b>120</b>	<b>46</b>		<b>43</b>		<b>31</b>	
<b>Percentage</b>	<b>100</b>	<b>31.33</b>		<b>35.83</b>		<b>25.84</b>	

*Source: Opinion Survey 2066.*

Out of total 31.33 percent people said that the registration attitude of taxpayers to VAT is positive. About 35.83 percent people said that the registration attitude of taxpayers to VAT is moderate and about 25.84 percent people said that the registration attitude of tax payers to VAT is negative.

#### 4.2.5. VAT Training

For successful implementation of VAT, the VAT officials are well trained to file return, calculation of tax liability, and Accounting system etc. The tax official may be familiar about VAT account system, collection system calculation of tax liability and refund system of VAT. If they are not familiar about the system of VAT there is question marks for successful implementation of VAT.

In Nepal, the tax officials are not well trained about VAT. Table 4.19 shows the need of training program to VAT official in Nepal.

**Table 4.18**

#### **VAT Training to tax administrators for effective implementation in Nepal.**

<b>Respondents</b>	<b>Total</b>	<b>Yes</b>		<b>No</b>	
Tax officials	40	3	7.5%	37	92.5%
Tax payers/ Business man	40	33	82.5%	7	17.5%
Intellectuals	40	40	100%	-	0
Total	120	76		44	
Percent	100%	63.33%		36.67%	

*Source: Opinion Survey 2066*

Out of total respondents 63.33 percent people said that training program is needed for tax officials and about 36.67 percent people are against training program. They said that the VAT officials are well trained about VAT. Mainly the Majority of tax officials are against VAT training program because they believed that the tax officials are well trained. However, Majority of Tax payers and intellectuals are support of VAT training programmed because they believed that the VAT administrators are not well trained.

#### 4.2.6. VAT Administration and Management

In general, the prime goals of VAT administration are to promote Voluntary compliance and to promote the VAT revenue by effective, efficient and way of economy, Identification of taxpayers, tax registration processing of

returns, tax audit, assessment collections credit, refund and control of stop filers are main functional areas of VAT administration.

Strong and capable administrative system is the milestone of successful of VAT. However, in Nepal the administrative system of VAT is weak. There is poor relationship between taxpayers and tax administrations. The authority and responsibility is not delegate properly. Information gap of weak power delegation authority is also a problems of effective management of VAT.

**Table 4.19**  
**Administrative system of VAT in Nepal**

<b>Respondents</b>	<b>Total</b>	<b>Yes</b>		<b>Moderate</b>		<b>No</b>	
Tax officials	40	18	45%	14	35%	8	20%
Tax Payers/ Businessman	40	6	15%	24	60%	10	25%
Intellectuals	40	3	7.5%	18	45%	19	47.5%
<b>Total</b>	<b>120</b>	<b>27</b>		<b>56</b>		<b>37</b>	
<b>Percent</b>	<b>100%</b>	<b>22.5%</b>		<b>46.67%</b>		<b>30.83%</b>	

*Source: Opinion Survey 2066.*

Out of total Respondent 22.5 percent people said that the administrative system of VAT is effective. About 46.67 percent respondents said that the administrative system of VAT is moderate and about 30.83 percent respondents said that the tax administrative system is not effective in Nepal. According to this survey, it is clear that the administrative system of VAT is ineffective in Nepal.

**Table 4.20****Management System of VAT in Nepal.**

Respondents	Total	Yes		Moderate		No	
		Count	Percentage	Count	Percentage	Count	Percentage
Tax officials	40	19	47.5%	21	52.5%	0	0%
Tax Payers/ Businessman	40	0	0%	13	32.5%	27	67.5%
Intellectuals	40	0	0%	20	50%	20	50%
Total	120	19		54		47	
Percent	100%	15.83%		45%		39.17%	

*Source: Opinion Survey 2066.*

Out of total Respondents 15.83 percent people said that the Management system of VAT is effective in Nepal. About 45 Percent people said that the management system of VAT is moderate in Nepal. About 39.17% management system of VAT is not effective in Nepal.

### **4.3. VAT and its problem in Nepal**

It has been more than nine years of implementation of VAT in Nepal. One of the reasons behind implementation of VAT is to control tax evasion. As per the principles of VAT, tax evasion cannot take places. However, in reality tax evasion can still take place owing to many reasons one of them being the non-issuance of invoice at the retail level. VAT in Nepal is not without problems. There are obstacles in smooth implementation of VAT in Nepal as discussed below.

#### **1) Non-Issuance of Invoices**

The major problem associated without VAT is the lack of compliance on the part of businessmen with the billing requirements. They hardly issue bill to customers though it is mandatory under the VAT act and if the customers insist they would charge extra money. Such practice has also discouraged the customers to demand VAT bill. Low valuation of imported goods at the customs

is another major obstacle in the successful implementation of VAT and is the root cause of the failure of the billing system.

As we know, issue of an invoice is necessary under VAT system. Like wise, it is the responsibility of the consumer to ask for the invoice. However, at the retail level, on one hand consumers are not interested in asking for invoices as they consider it unless and wastage of time, in the other hand retailers are under no pressure to issue an invoice. Thus at the retail level, tax evasion is must likely to take place because crosschecking is not possible at this level. Even the registered ones may not be interested to obtain invoices from the sellers. The reason behind this is by not taking an invoice they can omit some of accounts. By understanding purchases, they can understate their sales. Thus, they would be able to avoid both VAT as well as income tax. On the other hand, they would get a price reduction for their purchase until a situation created where the consumer is self-motivated to ask for an invoice it will be an uphill road for VAT.

## **2) Under invoicing prices**

One of the challenges lying ahead of VAT implementation is the rampant practice of under invoicing.

In Nepal majoring of goods are imported and the imports are allowed to enter the country only after paying custom duty at the specified rate. Depending upon the price of the goods imported less or more custom duty has to be paid and as a result, other taxes are affected. Therefore, if an invoice with a less amount is made and goods are imported then the less custom duty has to be paid. The practices of making invoices with less amount on imported goods so as to evade customs along with other taxes is called under invoicing. Ones the goods enter the country by undervalued billing the VAT revenue along with customs duties are evaded and this cannot be caught up in later stages of distribution if similar undervalued billing continuous to take place.

Retailers complain that they are not able to issue invoices because they them selves do not get proper invoices from the suppliers. They get an invoice from the suppliers. They get an invoice for a less amount then what they actually pay. Such a situation arises due to the low valuation at the customs. Through

under valuation, the importer pays less custom duty and VAT. Since the importer has a document showing artificial price, that is less than the actual price paid by him, it creates problems, to maintain proper records the entire key to the retail level. Therefore, he is bound to issue a bill for a lesser amount than what he charges to his customer. The customer who may be a wholesaler would do the same as the importer. As a similar process would occur at the retail level.

This in fact a serious problem. It was the government who had encouraged under invoicing in the beginning and the practice has remained until now. Currently the legal business of the third countries is in the decline where as the business of the northern and a southern boarder of Nepal is flourishing. In the boarder's areas, business transactions can be conducted without opening later of credit inhering other banking documents and so under invoicing still gets a boost.

### **3) Administrative weaknesses**

Another loophole for tax evasion is administrative weakness. The effort that should have been put by the administrative staff has not been made qualified, well trained and competent manpower is necessary to investigate and audit the business transactions for tax purposes. Most important is the good audit and service oriented on the part of VAT administrators. In other words, administrative capacity is the perquisite for success of VAT in Nepal.

### **4) Refund Aspects**

To import confidence among the taxpayers on the VAT system, the VAT administrators should not neglect the refund Aspect. Through the VAT act prescribe a simplified procedure for this in reality it is quite different. There have been widespread complaints regarding the system of tax refund. The tendency is to set for cash refunds against future earnings even when cash refund is due. This is of particular concern to tax payers at the time of capital investment or at he time of decline business environment.

#### **5) Lack of Confidence**

On one hand, the taxpayers do not have confidence on the tax officials. On the other hand, the tax officials do not have confidence on the taxpayers. Tax payers do not believe that the tax officials will follow the principles of VAT but believe they would run VAT in a similar way as other taxes. Likewise, the tax officials are of the opinion that taxpayers would understate the taxable value to pay less tax as they do not need to get the prices approved by the tax officials.

#### **6) Geographical Problems**

Nepal shares an open border with India and China, which encourages a large volume of smuggling business, most of the imports, are made through the secret ways without having to pay custom duties and VAT. Unless this practice of smuggling is not solved, VAT can do nothing to prevent evasion. To overcome this problem the border areas should be strictly guarded.

#### **7) Registration Problem**

Those vendors whose taxable transaction is above the threshold limit must be registered with VAT but vendors whose taxable transaction is below the threshold are not compulsorily registered but if they want they can enter with VAT net voluntarily. The threshold is fixed based on the administrative capacity such limit is NRS twenty lac. The vendors who are above the threshold have to do unfair competition with other seller. There are a large number of potential taxpayers but not registered until now. Among them there is illegal import and under invoice on the other. By this way, the registered and honest taxpayers are facing the problem of non-registration the government should perform investigation in the market and try to cover the non-registration in the VAT net as soon as possible by making transparent tax laws. Following Table 4.22 shows the most serious problem of VAT in Nepal.

**Table 4.22**  
**Serious problems of VAT in Nepal.**

Respondent	Total	Administrative inefficiency		Lack of Public awareness		Lack of Proper Accounting		Lack of co-operation between tax payers and tax administrative	
Tax officials	40	9	22.5%	21	52.5%	5	12.5%	5	12.5%
Tax payers	40	27	67.5%	6	15%	4	10.5%	3	7.5%
Intellectuals	40	17	42.5%	9	22.5%	9	22.5%	5	12.5%
Total	120	53		36		18		13	
Percent	100%	44.17%		30%		15.5%		10.83%	

*Source:- Opinion Survey 2066*

Out of total Respondents 44.17 percent attributed administrative inefficiency as the major problem. About 10.83 percent viewed that lack of cooperation between taxpayer's and tax administrators as the major problem about 30 percent opined that lack of public awareness was the major problem for VAT implementation. About 15 percent opined that lack of proper accounting system is the major problem of VAT implementation.

This opinion survey clearly shows that the major problem of VAT implementation in Nepal is Administrative inefficiency and lack of public awareness. Lack of proper accounting system and lack of co-operation between tax payers and tax administration also the problem of VAT implementation in Nepal.

#### **4.6 VAT and its management in Nepal**

Management aspect is more important in the VAT system. In fact, the success of VAT depends upon the capability for its administration and management. This is because VAT would bring a large number of businessmen into tax net. All management aspect of VAT is designed to increase the "voluntary compliance" by the taxpayers. In addition, the collection, controlling, auditing, fine and appropriate penalties are important aspect of Management. A

basic requirement for the successful management of VAT is the identification of appropriate taxpayers. A simple VAT returns form, effective taxpayers, assistance program, a reliable electronic data processing system provide accurate and timely information. An effective penalty system is needed for non-compliance.

Generally, in Nepal, VAT management has three levels viz-central offices, regional offices and district offices. The function of each office are clearly defined, coordinated and controlled. Offices are sheltered to make the efficient and successful operation of VAT.

The need of different types of staff depends upon the factors such as the organizational structure and operation system. The number of staff in VAT management is determined by many factors. For example, a relatively more complex VAT structure demands more staff and vice versa. In order to manage the administrative process of VAT, it has divided basically into three levels viz Director General, Directors Department head and other related sub-departments to do participatory activities.

Effective information system is an essential of taxpayer's friendly and good tax administration. A scientific information system provides highly standard services to tax payers and provides adequate information at nighttime to the management and decision maker. For this purpose, the Department has established a separate information technology section. This section has developed computer network regarding the flow of information between the department and offices. This network not only processes the statement and payment vouchers it also computes the interest, fees and penalties.

To facilitate the management as well as taxpayers on living between the department and revenue offices and local area network has been developed. Several modules are also in practice such as registration module, return modules as well as return and refund modules.

The management system of VAT is not effective as shown in theoretical aspects. Weakness of VAT administration and lack of information flow to taxpayers and tax officials are main hindrance of successful implementation of

VAT in Nepal. The management system of VAT is not transparent enough. Although there is establishment of well management information system but implementation is not effective and transparent. There is lack of proper delegation of authority and responsibility to tax officials. There is remaining to do a lot for well, transparent and effective management system of VAT in Nepal.

#### **4.7 VAT and its perspective in Nepal**

Though VAT at present, is still facing problems, these problems can be overcome if VAT is implemented honestly and effectively and this will help to change the whole revenue structure of the country. For this if the government has to tackle strict action against anyone who does not comply by its regulations, it should not hesitate to do so. However, at the first and foremost step the governments officials must show their integrity to implement VAT. The following can be the measures to make VAT success in Nepal.

##### **1) Creating public awareness about VAT.**

In Nepal, main glitch in the system is lack of public awareness. Many people are not still clear about the concept of VAT. Even after nine years of its effects are still unclear to them. The culture of asking for bills while purchasing goods has not developed.

At the time when VAT was introduced, the government had launched component through TV, Radio and newspaper to educate the public. The efforts to educate the public should be continuous. At present, Inland Revenue department through the media has been creating awareness among the consumers on their need to ask for the invoice for purchase. The advertisement and hoardings have been quite successful in convincing the customers of their rights and how the vendors have exploited them. Thus, the vendors will be bound to issue invoices.

##### **2) Decreasing the custom Duties**

The problem of under invoice to a great extent can be solved by the reduction in the rates of custom Duties and increase in the exemption limit of

income tax. Accurate invoicing is likely to take place only if the government pays heed to the please of the taxpayers.

#### **4) Simplifying the refund system**

The tax refund is the basic essence of VAT. The refund system, if improved can do wonders with the VAT system. Delays in the refund of tax should be avoided in order to impart confidences in the VAT system. Obviously, people would object to VAT if refund are not made timely by the tax authorities.

Even now, the question that arises is "Why is the number of refund claims so low as compared to the potential number of refund claimed?" The reasons may be any of the following.

- Tax payers do not have confidence in the refund system since they already have faced many hassles in the past while trying to get the money back.
- Tax payers do not want their records audited due to the fact that they have not been maintained properly.
- Tax payers do not have enough knowledge about the refund system.

Making due refund claims is the right of the taxpayers and making the refund system systematic and easy is to duty of the tax officials. Only by making the refund system simple until the appropriateness of the VAT system and its credibility increase. However, the tax officers should be equally cautions to detect fraudulent fund claims made.

#### **5) Increasing Administrative efficiency**

Improving the administrative capability is the key requirement to ensure that VAT achieves success. VAT system requires extra skills and knowledge especially for auditing and investigation purposes. comprehensive training should be imported to tax officials which covers everything from theoretical aspects of VAT, operational issues, interpretation of VAT laws, Rules and regulations, registration procedures, filling returns and payments compliance tax payers services tax credit, auditing and investigation skills, general knowledge of computers, spot observations and interaction with the business.

#### **4.8 Major findings of the study**

VAT has bright prospect in Nepal only when it can be implemented in a successful way. Further, the successful implementation depends on the strong fair and capable administration, strong political commitment cooperation between custom offices and Inland Revenue offices, systemization of open border, high public conscious level, transparency and improvement of rules and regulations accordingly over time. Thus, VAT can be entrenched as an integral part of the Nepalese tax structure in the end if the issues mentioned above are taken seriously and accordingly. then Nepal also will not be a country exception nation countries in the world on the basis of analyzing primary as well as secondary data for "VAT it's problems, management and prospective" in Nepal. Some major findings are summarized below.

1. Tax is the primary source of revenue collection. Many developing countries around the world have begun to focus their attention on reforming their properly designed defective tax structures as and integral part of their development efforts. Such reforms have been established as a new trend. On of such trend is the increased acceptance of a VAT as an important part of their tax reform program in the world.
2. VAT is a modern and transparent tax. It is less distinctive and more revenue productive. That is why the tax has become since 1980s in Nepal. After all having many debtors and contradictory views among businessmen, tax expert and government officials, VAT system was introduced in 16<sup>th</sup> November 1996.
3. The contribution of tax revenue and non-tax revenue on total revenue for the FY 2058/059 was 97.24 percent and 20.76 percent respectively. This contribution was reached 80.85 percent and 19.15 percent respectively in the FY 2065/2066.. The dominated role of tax revenue is thus quite satisfactory as its amount has beer increased more significantly than the non-tax revenue over the period 2058/059 to 2065/066.

4. The contribution of Direct Tax revenue and indirect tax revenue on total tax revenue for the FY 2058/059 was 27.06 percent and 72.94 percent respectively. This contribution was reached to 24.52 percent and 75.48 percent respectively in the FY2063/064. The indirect tax revenue still contributes about three quarters of total tax revenue while direct tax revenue represents only about one quarter of total tax revenue.
5. The contribution of Income tax and land and registration tax to total direct tax revenue were 80.12 percent and 10.80 percent respectively. The share of Income tax 80.57 percent in FY 2063/064.
6. The contribution of custom duties, VAT and Excise duties to total indirect tax revenue were 30.49 percent, 40.47 percent and 8.17 percent respectively. This contribution was reached to 25.35 percent, 47.96 percent and 1 percent respectively in FY 2063/064. This contribution clearly shows that the contribution of VAT revenue to total indirect tax revenue is increasing trend and excise duties and custom duties are in decreasing trend.
7. Total revenue GDP ratio and Tax revenue GDP ratio have been increased but not Tax revenue GDP ratio has been decreased during the study period. Therefore, it is clear that the contribution of tax revenue on GDP has been increasing. Total revenue GDP ratio and tax revenue GDP ratio were average 13 percent and 11 percent respectively during the study period.
8. The contribution of VAT revenue on total, revenue has been increasing during the study period. Its contribution on total revenue was average 24 percent in this period. The contribution of VAT revenue on GDP has been increasing during study period. The VAT revenue GDP ratio was average 2.80 percent in this period.
9. Total number of VAT registrants has been increasing and reached to 39776 numbers but the percentage increment of registrants is a fluctuating condition. Year wise collection of VAT revenue has been increasing during the study period.

10. Application of single VAT rate system in all types of products, produces complicated issues in accounting system. VAT rate must be varied, according to the product type. Regarding the allocation of resources, the VAT is tax that is more natural.
11. Businessmen, traders and industrial where yearly income exceed Rs. 2000000 must register into VAT as per "Value added tax act 1997", Numbers of VAT registrant are increase in the beginning area of VAT implementation and then after increasing in slowly. Beyond the registration in the VAT, collection of VAT registrants is also taken please.
12. Contribution of VAT share in total revenue tax revenue and GDP was increased satisfactorily after implementing if in some extent.
13. Increasing VAT registrant, VAT revenue at the same time increase VAT due amount also. This due amount has been seen about nine percent total revenue collection. It shows that there has been effective implementation of VAT.
14. Under invoicing and the problem of billing have been recognized as the major reason for VAT correctly not being successful. Due to this VAT officials are facing the problems in inspecting of records and accounts of transaction uneducated and improper records, ignorance of mechanism of VAT and not keeping supportive documents are the main reasons to show transparent information.
15. Lack of public awareness and education VAT cannot implement effectively. Most of the taxpayers are illiterate and not conscious about VAT.
16. Ultimate reasons of ineffective VAT are smuggling. Having open borer with India and China, probability of smuggling is high.
17. Weakness of VAT administration and management is a main hindrance for successful implementation of VAT, VAT system is not transparent enough. Most of the taxpayers and tax administrator were found in tax evasion and tax avoidance activities.

18. The major problem on registration is regarded as high threshold limit.
19. Management system of VAT is not effective in Nepal. Lack of delegation of power and authority, communication gap between tax officials and taxpayers, are the main hindrance of effective management system.

## **CHAPTER-V**

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

#### **5.1. Summary**

VAT is the most recent innovation in the field of taxation. VAT was introduced in the world by Wislom V. Sinens in 1919 in Germany, and then entered in to France in 1994. Then after, it has been spread all over the world with in a short period. It becomes effective in Nepal since 16<sup>th</sup> November 1997.

VAT is modified and improved from of sales tax. VAT is the alternative of sales tax on ground of revenue productivity, equity norms. Superfine economic growth without economic distortions, export promoting, price stability and neutrality on production and distribution etc. Further the hypothesis of self-policy or cross checking channel without cascading and pyramiding effects has made the VAT 'mile-stone" in the history of reforming of the indirect tax system.

Nepal has adopted a consumption type, tax credit method, principle of destination with international standard, provision of exemption and zero-rates goods and services, tax refund facility with single positive rate of VAT.

It is 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 on of the most important tools, element and component of indirect tax.

It is a broad base and self-motive tax. The government of Nepal has been charging 13 percent VAT rate at percent. The level of threshold of Rs twenty lack, who do taxable transaction more than it, must be registered in to revenue tax offices but who do less transaction can enter VAT net voluntary.

Around nine years have already been passed since VAT came into implementation in Nepal but is has not satisfactory result. It has only partly been success. View of implementation of VAT has non-onwards but no achieved its target up to now. There are certain problems associated with VAT, the most serious problems beings the non-issuance of invoices by vendors, especially refiners. There is a tendency to deceive the consumers that if they demand the

invoice, they will be charged VAT while in reality, the amount which the vendors charge is inclusive of VAT even though they do not issue the invoice. This clearly shows that most of the consumers are still ignorant of VAT and the vendors have been taking undue advantage of the consumer's ignorance. The open border with India poses another problem, which encourages smuggling. It has often been argued that the existing tax administration is not capable enough to handle VAT in Nepal. Underbelly administrative inefficiency has been found to be serious problems in the smooth implementation of VAT in Nepal. The Management system of VAT is also not systematic and effective. Lack of coordination and delegation of authority and responsibility is not clear. It is also a serious problem of effective implementation of VAT in Nepal.

## **5.2. Conclusion**

The introduction of VAT in Nepal was inevitable for several reasons, including broadening the tax base and creating a transparent and fair tax system. That is why no major political party has opposed it so far. While some politicians may be influenced by the business community that is against VAT and might oppose it in the first quarter of 1999 since an election was expected in April 1999, the government of any party was; likely to implement VAT effectively after election. A detailed preparation was made for its introduction. Despite taxpayer's resistance, the government has gone ahead with implementation without second thoughts although it has made several compromises in response to opposition from the business community. VAT has survived and its implementation has been gradually improving.

- 1) VAT implementation could have been even better had the government adopted an integrated approach and a proper strategy and coordinated all tax measures in a proper way. Past experience indicated that there is need to develop professionalism both at policy and implementation levels so that there are people who understand the overall Tax system, are familiar with the main stream of the current tax policy; and tax development taking place around the world, who can analyze the intricacy, of the tax

measures and who can think in longer- term prospective. It is also equally necessary to minimize if not eliminate the lack of confidence between the government and the private sectors on tax matters, which has been increasing trend.

2. Effective and proper implementation of VAT is necessary in order to streamline the overall tax system. Since the collection of both customs duties and income tax depends largely upon the effectiveness of VAT, every effort must be made to strengthen the tax that will help enhance revenue collection and avoid possible fiscal crisis.
3. A high quality computerization mechanism has been implemented for the purpose. At present, the registrants, returns, collection, payment, audit and penalties are all handled through computers, This mechanism is not used only for VAT registration but also for computer, generated assessments for taxpayers who fail to file tax returns. A computer-based mechanism is also in place to select taxpayers for audit.
4. The increase in the taxpayer's number and the collection of tax has been partly satisfactory and various effects are being made its implementation fully successful. Government has adopted the policy of developing value Added tax as the main stake of its revenue. Tax revenue covers more than seventy five percent of total revenue, comparing with non-tax revenue. Tax revenue can be collected from Direct tax revenue and indirect tax revenue. Indirect tax revenue occupied about more than sixty percent of total tax revenue. Share of VAT revenue is around twenty percent of total revenue and three percent of GDP.
5. Collection of VAT revenue is not satisfied yet. So only implementation of VAT is not enough to collect more revenue, there should be perfect relation between related parties of VAT and its rules and regulation must be fluctuated.
6. Issuance of under invoicing system is the major problems relating to VAT system. Main reason for existence of such type of activities is smuggling. However, the government negligence and weak controlling mechanism

does not eliminate illegal and unauthorized business. In addition, the competitive capacity of authorized business becomes lesser.

7. VAT education of business community and taxpayers is another critical problem of Nepalese Environment. There is also lack of effective accounting system, ineffective under- invoice system and smuggling, lack of perfect tax administration design, unclear rules and regulation, political issues, existence of large volume of small vendors, geographical disturbance and tradition of corruption.
8. There is weak administrative system of tax management. There is poor relationship between taxpayers and Tax administrators. The authority and responsibility is not delegate properly. Gap of information system and weak power delegation authority is also a problem of effective management of VAT.
9. The Conclusion is that the prospects of VAT entirely depend on its implementation aspects. VAT has bright prospects in Nepal only when it can be implemented in a successful way, further, the successful implementation depends on the strong fair and capable administration, strong political commitment, cooperation between the consumer's office and Inland Revenue offices, cooperation between the private sectors and government bodies, system utilization of open borders, high public consciousness level, transparency and implement of rules and regulations accordingly over time. Along with the improvement in the implementation, the structure of VAT can be developed to broad on existing base. In this process, the successive reduction in the existing exemptions and lowering the existing threshold are of prime importance.

### **5.3. Recommendations**

Despite the existing constraints and oppositions Government of Nepal has implemented value added tax since 1997. VAT act, rules and regulations have been set up in the line of international standard and its preparation has been

made comprehensive and much more extensive as compared to the other taxes. The preparation has assisted towards creating a favorable environment for the implementation of VAT and VAT is now gaining gradual acceptance of the business community and general public at large scale.

Since the implementation of VAT is a great jump from the traditional tax system to a modern one, several things are still taking to be done for the successful implementation of VAT in Nepal. In such circumstances, following recommendations have been made to make VAT effective and more efficient on the basis of findings and conclusions of the study.

- 1) Most of the taxpayers as well as general public are still unknown about the VAT and its effects on various aspects. They have developed a kind of misconception regarding VAT. They do not think that sellers already in charge of VAT in their goods rather they do think VAT is an extra charge. So proper publicity for all related persons is the fundamental tool to the success of VAT. Tax related information should be published regularly through journals, magazines, newspapers and researchers, tax experts and economists should be consulted and published through advertising media.
- 2) An effective computer program for invoicing and record keeping according to the need of VAT should be developed and provided to different businessmen at a nominal cost. Concentration must be given to apply the billing system in all business. Similarly, government should give the continuity of the special gift program. Reward and punishment system must be strictly followed.
- 3) VAT is a transparent system and it tries to make transparency. Revenue department should be transparent. Tax evasion and avoidance must be checked by various monitoring systems like crosschecking, good governance program.
- 4) The key to the success of VAT implementation is now government of Nepal should arrange the staff positions. The ministry of finance must

bear in mind that in the absence of dedicated and committed staffs with a positive attitude the system will not succeed. As custom and income tax administration get high preference in the internal, position, the ministry must come out with some institutional arrangements which retains qualified staffs in the administration of the VAT, otherwise, there is a danger, which is a current saving, that why should be businessmen kill the VAT the staff in the VAT will kill it themselves so that the government should produce Gazette manpower and to trained them well.

- 5) There should be a close cooperation between the private sector and public sectors for the successful implementation of VAT. Both sectors should always be taken into confidence by each other.
- 6) Border should effectively be controlled to prevent the illegal trade. There should be a border tax adjustment between Nepal and India, warehouse checking and highway checking should be practiced effectively to prevent any kind of illegal trade.
- 7) The effective and efficient implementation and development of VAT is only possible when there have fair understanding arrange the government tax administration, tax payers and other concern parties, so that they must have committed dedicated and self motivated to implement VAT in future prospects.
- 8) There is equally necessary to reorganize the tax administration in the light of this modern tax. Officials should be mentally prepared to accept the prices declared by taxpayers at face values. Tax investigators and audits should be effective in order to make taxpayers more careful in fulfilling their duties.
- 9) The administration should be very watchful to prevent any kind of malpractice, fraud and evasion and avoidance of tax. Utmost care should be taken to prevent any kind of birthing and corruption. Tax officials should effectively be monitored.
- 10) The implementation of VAT cannot consider successful unless under invoicing on imports is discouraged. In fact it is the under invoicing that

takes place on imports that leads to under invoicing at the later stages of distribution. Under invoicing can be discouraged by decreasing the rates of customs. Duties, strict monitoring of the business activities in the border area. Banking channels like letter of credit should be made compulsory for the imports.

- 11) VAT refund mechanism should be simplified so that the refund can be made without delay and the taxpayers have confidence in the system.
- 12) Tax audits should be given more emphasis. The tax officials should also carry out random inspection visits in addition to regular tax audits. The businessmen should cooperate with tax officials on tax audit matters. Still many taxpayers hold negative opinion about tax audit and they are incorporating this matter.
- 13) As most of taxpayers are still ignorant about account keeping under VAT and who get this job by paying other people, taxpayer's education program should be continued. Extensive taxpayer's education should be conducted from time to time to familiarize the potential taxpayers and others with various aspects of VAT. Seminars, interaction preprograms newspaper articles, brochures, leaflets posters, VAT videos, radio and television programs, advertisement in newspapers, radios and television celebration of VAT week, arrangement of VAT volunteers are the tools, which can educate the potential taxpayers. Call centers should be set up to give information to tax payers.
- 14) Incentives should be schemed to increase registration and tax compliance. The non-filers should be motivated to file the tax reforms.
- 15) Last but not least, the government should the commitment of implement VAT effectively. No matter which political party is ruling the roost, it should be honest and serious about VAT implementation.

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# APPENDIX I

## Questionnaire

### Value Added Tax, its problem, Management and Prospective in Nepal

Name : ..... Post : .....

Office/Occupation: .....

1. Who is more responsible for tax evasion in Nepal?
  - a. Tax payers
  - b. Tax administration
  - c. Inefficient of administrators
2. Will VAT be useful to lower tax evasion in Nepal?
  - a. Yes
  - b. No
  - c. Don't no
3. Is VAT rise the price of goods and services?
  - a. Yes
  - b. No
  - c. A simple price rise
4. What are the most serious problems of VAT in Nepal?
  - a. Administrative inefficiency
  - b. Lack of public awareness
  - c. Lack of proper accounting.
  - d. Lack of co-operation between tax payers and tax administrators.
5. Is VAT education is needed for it's effective implementation?
  - a. Yes
  - b. No
  - c. Don't know
6. What is VAT registration attitude of tax payers in Nepal?
  - a. Positive
  - b. Moderate
  - c. Negative
7. Is VAT training is needed to tax administrators for it's effective implementation?
  - a. Yes
  - b. No
8. Is management system of VAT is effective in Nepal?
  - a. Yes
  - b. Moderate
  - c. No
9. Are VAT administrators capable in Nepal?
  - a. Yes
  - b. Moderate
  - c. No

10. If any comments about VAT administrators and its management system? Please specify.

a. ....

b. ....

c. ....

11. If any others about the betterments of VAT and weakness to be remove please specify.

a. ....

b. ....

c. ....

## APPENDIX-II

Fitting the trend line by least square method let the trend line between the dependent variable y (total Revenue) and independent variable x (time) be represented by  $y = a + b x$  .....

- i) Since the number of year  $x = 8$  so the deviation are taken from the 2061/062.

Fiscal year	Total Revenue (y)	Mid Value (x = a-2062/063)	$x^2$	xy
2058/059	4044.55	- 4	16	(16178.2)
2059/060	5622.98	- 3	9	(16868.94)
2060/061	6229.1	- 2	4	(12458.2)
2061/062	7012.27	1	1	(7012.27)
2062/063	7228.2	0	0	0
2063/064	8771.22	1	1	8771.22
2064/065	9359.37	2	4	18718.74
2065/066	12630.48	3	9	37891.44
N = 8	$y = 52126.95$	$x = -4$	$x^2 = 44$	$12863 = 79$

$$Y = a + bx$$

$$b = \frac{N \sum XY - \sum X \cdot \sum Y}{N \sum X^2 - (\sum X)^2} = \frac{8 \cdot 12863.79 - 44}{8 \cdot 44 - (4)^2}$$

$$= 306.80$$

$$a = \frac{\sum x^2 \cdot \sum y - \sum x \cdot \sum y}{n \sum x^2 - (\sum x)^2}$$

$$= \frac{44 \cdot 52126.95 - (-4) \cdot 52126.95}{8 \cdot 44 - (4)^2}$$

$$= 774.92$$

$$Y = a + bx$$

Fiscal year	a	bx	y
2066/067	774.92	$306.80 \times 4$	2002.12
2067/068	774.92	$306.80 \times 5$	2308.92
2068/069	774.92	$306.80 \times 6$	2615.72

### APPENDIX-III

Let the trend line between the dependent variable y (Tax revenue) and Independent variable x (Time) be represented by  $y=a+bx$  ..... I Since the number of series  $N=8$  the deviations are given from fiscal year 2062/ 063.

Fiscal year	Tax Revenue (y)	Mid Value (x = a-2062/063)	$x^2$	xy
2058/059	3933.06	- 4	16	(15732.24)
2059/060	4258.69	- 3	9	(12776.07)
2060/061	4817.30	- 2	4	(9634.6)
2061/062	5410.47	1	1	(5410.47)
2062/063	5743.04	0	0	0
2063/064	7112.67	1	1	7112.67
2064/065	8515.55	2	4	17031.1)
2065/066	10212.03	3	9	30636.09
N = 8	$y = 50002.81$	$x = -4$	$x^2 = 44$	$xy = 16126.48$

$$b = \frac{N \sum xy - \sum x \cdot \sum y}{N \sum x^2 - (\sum x)^2}$$

$$= \frac{8 \times 16126.48 - (-4) \cdot 50002.81}{8 \cdot 44 - (-4)^2}$$

$$= 979.23$$

$$a = \frac{\sum x^2 \cdot \sum y - \sum x \cdot \sum y}{N \sum x^2 - (\sum x)^2}$$

$$= \frac{44 \times 50002.81 - (-4) \times 50002.81}{8 \times 44 - (-4)^2}$$

$$= 7143.25$$

Fiscal year	a	bx	y
2066/067	7143.25	979.23   4	11060.17
2067/068	7143.25	979.23   5	12029.4
2068/069	7143.25	979.23   6	13018.63

## APPENDIX-IV

Let the trend line between the dependent variable y (Non tax revenue) and In evident variable x (Time) be represent by  $y=a+bx$  .....i Since the number of s N=8 the deviation are given from fiscal year 2062/ 063.

Fiscal year	Non tax Revenue (y)	Mid Value (x = a-2062/063)	$x^2$	xy
2058/059	1111.49	- 4	16	(4445.96)
2059/060	1364.29	- 3	9	(4092.87)
2060/061	1415.80	- 2	4	(2831.6)
2061/062	1601.80	1	1	(1601.80)
2062/063	1485.16	0	0	0
2063/064	1658.55	1	1	1658.55
2064/065	2246.70	2	4	4493.4
2065/066	2418.45	3	9	7255.35
N = 8	y =13332.24	x = -4	$x^2 =44$	xy=435.07

$$b = \frac{N \sum xy - \sum x \cdot \sum y}{N \sum x^2 - (\sum x)^2}$$

$$= \frac{8 \times 435.07 - (-4) \times 13332.24}{8 \times 44 - (-4)^2}$$

$$= 169.07$$

$$a = \frac{\sum x^2 \cdot \sum y - \sum x \cdot \sum y}{N \sum x^2 - (\sum x)^2}$$

$$= \frac{44 \times 13332.24 - (-4) \times 13332.24}{8 \times 44 - (-4)^2}$$

$$= 1904.6$$

Fiscal year	a	bx	y
2066/067	1904.6	169.07   4	2580.88
2067/068	1904.6	169.07   5	2749.95
2068/069	1904.6	169.07   6	2919.02

## APPENDIX-V

Let the trend line between the dependent variable y (Direct tax ) and Independent variable x (Time) be represented by  $y=a+bx$  ..... I Since the number of series N=8 the deviations are given from fiscal year 2062/ 063.

Fiscal year	Direct tax(y)	Mid Value (x = a-2062/063)	x <sup>2</sup>	xy
2058/059	946.57	- 4	16	(3786.28)
2059/060	869.14	- 3	9	(2607.42)
2060/061	1021.51	- 2	4	(2043.02)
2061/062	1127.26	1	1	(1127.20)
2062/063	1178.70	0	0	0
2063/064	1672.68	1	1	1672.68
2064/065	2014.70	2	4	4029.4
2065/066	2348.72	3	9	7046.16
N = 8	y =11179.28	x = -4	x <sup>2</sup> =44	xy=3183.86

$$b = \frac{N \sum xy - \sum x \cdot \sum y}{N \sum x^2 - (\sum x)^2}$$

$$= \frac{8 \times 3183.86 - (-4) \times 11179.28}{8 \times 44 - (-4)^2}$$

$$= 208.89$$

$$a = \frac{\sum x^2 \cdot \sum y - \sum x \cdot \sum y}{N \sum x^2 - (\sum x)^2}$$

$$= \frac{44 \cdot 11179.28 - (-4) \cdot 11179.28}{8 \cdot 44}$$

$$= 1597.04$$

Fiscal year	a	bx	y
2066/067	1597.04	208.89   4	2432.6
2067/068	1597.04	208.89   5	2641.49
2068/069	1597.04	208.89   6	2850.38

## APPENDIX-VI

Let the trend line between the dependent variable y (Indirect tax ) and In evident variable x (Time) be represent by  $y= a+bx$  ..... I Since the number of s N=8 the deviation are given from fiscal year 2062/ 063.

Fiscal year	Indirect tax (y)	Mid Value (x = a-2062/063)	x <sup>2</sup>	xy
2058/059	2886.55	- 4	16	(11545.92)
2059/060	3389.55	- 3	9	(10168.65)
2060/061	3795	- 2	4	(7590)
2061/062	4283	1	1	(4283)
2062/063	4564.34	0	0	0
2063/064	5439.99	1	1	5439.99
2064/065	6500.85	2	4	13000.17
2065/066	7662.40	3	9	22987.02
	<b>∑y= 38521.68</b>	<b>∑ x = -4</b>	<b>∑x<sup>2</sup> = 44</b>	<b>∑xy= 7839.79</b>

$$b = \frac{N \sum xy - \sum x \cdot \sum y}{N \sum x^2 - (\sum x)^2}$$

$$= \frac{8 \times 7839.79 - (-4) \times 38521.61}{8 \times 44 - (-4)^2}$$

$$= 645.25$$

$$a = \frac{\sum x^2 \cdot \sum y - \sum x \cdot \sum y}{N \sum x^2 - (\sum x)^2}$$

$$= \frac{44 \times 38521.61 - (-4) \times 38521.6}{8 \times 44 - (-4)^2}$$

$$= \mathbf{5503.08}$$

Fiscal year	a	bx		y
2066/067	5503.08	645.25	4	8084.04
2067/068	5503.08	645.25	5	8729.33
2068/069	5503.08	645.25	6	9374.58

## APPENDIX-VII

Let the trend line between the dependent variable y (Income Tax ) and In evident variable x (Time) be represent by  $y = a+bx$  ..... I Since the number of years  $N=8$  the deviation are given from fiscal year 2062/ 063.

Fiscal year	Income Tax (y)	Mid Value (x = a-2062/063)	$x^2$	xy
2058/059	643.6	- 4	16	(2574.4)
2059/060	710.21	- 3	9	(2130.63)
2060/061	851.25	- 2	4	(1702.5)
2061/062	940.24	1	1	(940.24)
2062/063	959.88	0	0	0
2063/064	1357.91	1	1	1357.91
2064/065	1622.32	2	4	3244.64
2065/066	2121.20	3	9	6369.6
<b>N = 8</b>	<b><math>\sum y = 9208.61</math></b>	<b><math>\sum x = -4</math></b>	<b><math>\sum x^2 = 44</math></b>	<b><math>\sum xy = 3624.38</math></b>

$$b = \frac{\sum xy - \sum x \cdot \sum y}{\sum x^2 - (\sum x)^2}$$

$$= \frac{8 \mid 3624.38 - (-4) \times 9208.61}{8 \times 44 - (-4)^2}$$

$$= 195.92$$

$$a = \frac{\sum x^2 \cdot \sum y - \sum x \cdot \sum y}{N \sum x^2 - (\sum x)^2}$$

$$= \frac{44 \times 9208.61 - (-4) \times 9208.61}{8 \times 44 - (-4)^2}$$

$$= 1315.51$$

Fiscal year	a	bx	y
2066/067	1315.51	195.92   4	2099.19
2067/068	1315.51	195.92   5	2295.11
2068/069	1315.51	195.92   6	2491.03

## APPENDIX-VIII

Let the trend line between the dependent variable y (House and Land Registration Tax ) and In evident variable x (Time) be represent by  $y = a+bx$  ..... I Since the number of years  $N=8$  the deviation are given from fiscal year 2062/ 063.

Fiscal year	House and Land Registration Tax (y)	Mid Value (x = a-2062/063)	$x^2$	xy
2058/059	102.30	- 4	16	(409.20)
2059/060	98.57	- 3	9	(295.71)
2060/061	109.62	- 2	4	(219.24)
2061/062	126.15	1	1	(126.15)
2062/063	128.93	0	0	0
2063/064	206.42	1	1	206.42
2064/065	228.46	2	4	456.92
2065/066	336.28	3	9	1008.84
<b>N = 8</b>	<b><math>\sum y = 1336.73</math></b>	<b><math>\sum x = -4</math></b>	<b><math>\sum x^2 = 44</math></b>	<b><math>\sum xy = 621.89</math></b>

$$b = \frac{\sum xy - \sum x \cdot \sum y}{\sum x^2 - (\sum x)^2}$$

$$= \frac{8 \mid 621.89 - (-4) \times 1336.73}{8 \times 44 - (-4)^2}$$

$$= 30.72$$

$$a = \frac{\sum x^2 \cdot \sum y - \sum x \cdot \sum y}{N \sum x^2 - (\sum x)^2}$$

$$= \frac{44 \times 1336.73 - (-4) \times 1336.73}{8 \times 44 - (-4)^2}$$

$$= \mathbf{190.96}$$

Fiscal year	a	bx	y
2066/067	190.96	30.72   4	313.81
2067/068	190.96	30.72   5	344.56
2068/069	190.96	30.72   6	375.28

## APPENDIX-IX

Let the trend line between the dependent variable y (Custom Duties) and Independent variable x (Time) be represented by  $y = a + bx$  ..... I Since the number of years  $N=8$  the deviations are given from fiscal year 2062/063.

Fiscal year	Custom Duties (y)	Mid Value (x = a-2062/063)	$x^2$	xy
2058/059	937.84	- 4	16	(3751.36)
2059/060	1056.77	- 3	9	(3110.31)
2060/061	1066.69	- 2	4	(2133.38)
2061/062	1229.91	1	1	(1229.91)
2062/063	1174.46	0	0	0
2063/064	1362.61	1	1	1326.61
2064/065	1712.82	2	4	3435.64
2065/066	1915	3	9	57.40
<b>N = 8</b>	<b><math>\sum y = 10456.1</math></b>	<b><math>\sum x = -4</math></b>	<b><math>\sum x^2 = 44</math></b>	<b><math>\sum xy = 248.29</math></b>

$$b = \frac{\sum xy - \sum x \cdot \sum y}{\sum x^2 - (\sum x)^2}$$

$$= \frac{8 \mid 248.29 - (-4) \times 10456.1}{8 \times 44 - (-4)^2}$$

$$= 130.38$$

$$a = \frac{\sum x^2 \cdot \sum y - \sum x \cdot \sum y^2}{N \sum x^2 - (\sum x)^2}$$

$$= \frac{44 \times 10456.1 - (-4) \times 10456.1}{8 \times 44 - (-4)^2}$$

$$= \mathbf{1371.29}$$

Fiscal year	a	bx	y
2066/067	<b>1371.29</b>	<b>130.38 <math>\hat{1}</math> 4</b>	1892.81
2067/068	<b>1371.29</b>	<b>130.38 <math>\hat{1}</math> 5</b>	2023.19
2068/069	<b>1371.29</b>	<b>130.38 <math>\hat{1}</math> 6</b>	2153.57

## APPENDIX-X

Let the trend line between the dependent variable y (VAT) and Independent variable x (Time) be represented by  $y = a + bx$  ..... I Since the number of years  $N=8$  the deviations are given from fiscal year 2062/ 063.

Fiscal year	VAT (y)	Mid Value (x = a-2062/063)	$x^2$	xy
2058/059	1226	- 4	16	(4904)
2059/060	1345	- 3	9	(4035)
2060/061	1447.89	- 2	4	(2895.78)
2061/062	188.54	1	1	(1888.54)
2062/063	2161.06	0	0	0
2063/064	2609.56	1	1	2609.56
2064/065	2981.57	2	4	5963.14
2065/066	3561	3	9	10683
<b>N = 8</b>	<b><math>\sum y = 1720</math></b>	<b><math>\sum x = -4</math></b>	<b><math>\sum x^2 = 44</math></b>	<b><math>\sum xy = 5532.38</math></b>

$$b = \frac{\sum xy - \sum x \cdot \sum y}{\sum x^2 - (\sum x)^2}$$

$$= \frac{8 \mid 5532.38 - (-4) \times 1720}{8 \times 44 - (-4)^2}$$

$$= 336.72$$

$$a = \frac{\sum x^2 \cdot \sum y - \sum x \cdot \sum y}{N \sum x^2 - (\sum x)^2}$$

$$= \frac{44 \times 1720 - (-4) \times 1720}{8 \times 44 - (-4)^2}$$

$$= 2460$$

Fiscal year	a	bx	y
2066/067	<b>2460</b>	<b>336.72 <math>\hat{1}</math> 4</b>	3806.88
2067/068	<b>2460</b>	<b>336.72 <math>\hat{1}</math> 5</b>	4143.6
2068/069	<b>2460</b>	<b>336.72 <math>\hat{1}</math> 6</b>	4480.2

## APPENDIX-XI

Let the trend line between the dependent variable y (GDP) and Independent variable x (Time) be represented by  $y = a + bx$  ..... I Since the number of years  $N=8$  the deviation are given from fiscal year 2062/ 063.

Fiscal year	GDP (y)	Mid Value (x = a-2062/063)	$x^2$	xy
2058/059	44206	- 4	16	(176824)
2059/060	45949	- 3	9	(137847)
2060/061	48100	- 2	4	(96200)
2061/062	49774	1	1	(49774)
2062/063	51449	0	0	0
2063/064	53168	1	1	53168
2064/065	56012	2	4	112024
2065/066	58623	3	9	175869
<b>N = 8</b>	<b><math>\sum y = 407281</math></b>	<b><math>\sum x = -4</math></b>	<b><math>\sum x^2 = 44</math></b>	<b><math>\sum xy = (119584)</math></b>

$$b = \frac{\sum xy - \sum x \cdot \sum y}{\sum x^2 - (\sum x)^2}$$

$$= \frac{8 \mid 119584 - (-4) \times 407281}{8 \times 44 - (-4)^2}$$

$$= 2001.34$$

$$a = \frac{\sum x^2 \cdot \sum y - \sum x \cdot \sum y}{N \sum x^2 - (\sum x)^2}$$

$$= \frac{44 \times 407281 - (-4) \times 407218}{8 \times 44 - (-4)^2}$$

$$= \mathbf{58183}$$

Fiscal year	a	bx	y
2066/067	<b>58183</b>	<b>119584 <math>\hat{1}</math> 4</b>	66188.36
2067/068	<b>58183</b>	<b>119584 <math>\hat{1}</math> 5</b>	68189.7
2068/069	<b>58183</b>	<b>119584 <math>\hat{1}</math> 6</b>	70191.10

## APPENDIX-XII

Let the trend line between the dependent variable y (No of VAT Registrants) and In evident variable x (Time) be represent by  $y = a+bx$  ..... I Since the number of years N=8 the deviation are given from fiscal year 2062/ 063.

Fiscal year	No of VAT Registrants (y)	Mid Value (x = a-2062/063)	$x^2$	xy
2058/059	4956	- 4	16	(19824)
2059/060	9082	- 3	9	(27246)
2060/061	18240	- 2	4	(36480)
2061/062	21781	1	1	(21781)
2062/063	25148	0	0	0
2063/064	28354	1	1	28354
2064/065	34174	2	4	68348
2065/066	39776	3	9	119328
<b>N = 8</b>	<b><math>\sum y = 181511</math></b>	<b><math>\sum x = -4</math></b>	<b><math>\sum x^2 = 44</math></b>	<b><math>\sum xy = 100699</math></b>

$$b = \frac{\sum xy - \sum x \cdot \sum y}{\sum x^2 - (\sum x)^2}$$

$$= \frac{8 \mid 100699 - (-4) \times 181511}{8 \times 44 - (-4)^2}$$

$$= \mathbf{2613.79}$$

$$a = \frac{\sum x^2 \cdot \sum y - \sum x \cdot \sum y}{N \sum x^2 - (\sum x)^2}$$

$$= \frac{44 \times 181511 - (-4) \times 181511}{8 \times 44 - (-4)^2}$$

$$= \mathbf{25930.14}$$

Fiscal year	a	bx	y
2066/067	<b>25930.14</b>	<b><math>2613.79 \hat{=} 4</math></b>	36385.3
2067/068	<b>25930.14</b>	<b><math>2613.79 \hat{=} 5</math></b>	38999.09
2068/069	<b>25930.14</b>	<b><math>2613.79 \hat{=} 6</math></b>	41612.88