

IMPLEMENTATION OF VAT IN NEPAL
(A Study of Achievement and Challenges)

A Thesis

Submitted By
Sadikshya Karki
Nepal Commerce Campus
T.U Registration Number: 7-2-25-853-2005
Class Roll No: 09/065
2nd Year Exam Roll No.: 250796

Submitted To
Office of the Dean
Faculty of Management
Tribhuvan University

In fulfillment of the requirement of the degree of
Master of Business Studies (MBS)

Kathmandu, Nepal
March, 2014

RECOMMENDATION

This is to certify that the thesis

Submitted by
Sadikshya Karki

Entitled:

IMPLEMENTATION OF VAT IN NEPAL
(A Study of Achievement and Challenges)

has been prepared as approved by this Department in the prescribed format of the Faculty of Management. This thesis is forwarded for examination.

.....
Prof. Dr. Sushil Bhakta Mathema
(Head of Research Department & Thesis Supervisor)

.....
Jyoti Pandey
(Campus Chief)

VIVA-VOCE SHEET

We have conducted the viva –voce of the thesis presented

by:

SadikshyaKarki

Entitled:

IMPLEMENTATION OF VAT IN NEPAL
(A Study of Achievement and Challenges)

And found the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for the degree of

Master of Business Studies (MBS)

Viva-Voce Committee

Head, Research Department

Member (Thesis Supervisor)

Member (External Expert)

Date: _____

Declaration

I hereby declare that the work reported in this thesis entitled **“IMPLEMENTATION OF VAT IN NEPAL (A Study Of Achievement And Challenges)”** submitted to Nepal Commerce Campus, Faculty of Management, Tribhuvan University is my original work done in the form of partial fulfillment of the requirement for the Master’s Degree in Business Studies (MBS) under the supervision of Prof. Dr.Sushil Bhakta Mathema Of Nepal Commerce Campus.

.....

SadikshyaKarki
Campus Roll No.: 09
TU Regd. No.: 7-2-25-853-2005
2nd Year Exam Roll No.: 250796
Nepal Commerce Campus
Minbhawan, Kathmandu

Acknowledgement

This thesis entitled “IMPLEMENTATION OF VAT IN NEPAL (A study of achievement and challenges)” has been prepared in partial fulfillment for the degree of masters of Business Studies (MBS) under the supervision of Prof. Dr. Sushil Bhakta Mathema, Nepal Commerce Campus.

The study report is divided into five chapters. Chapter one comprises Introduction of study, chapter two comprises a conceptual framework of taxation and deals with literature review, Similarly, chapter three comprises research methodology, chapter four comprises presentation & analysis of data and last but not the least chapter five comprises summary conclusion and recommendations of the whole study.

It is my privilege of getting helps and co-operation from different persons. It is not possible to enumerate the names of all of them. However, it will be matter of injustice if I forget the names of those personalities whose valuable suggestions and Co-operation escorted to complete this thesis report. First and foremost, I would like to offer special thanks to Prof. Dr. Sushil Bhakta Mathema for his proper supervision and suggestions. I could not remain without thanking my teachers and lecturers; who all helped me during my study of MBS and during preparation of this thesis report. Thanks to all of them.

It was a novel experience of doing a thesis work which certainly helped me to gain deep knowledge in the subject. But accomplishment of the objective was not easy. The foremost difficulty was the scarcity of data and information, which I experienced as the most difficult work during any type of research study in Nepal. Nevertheless, it was a pleasant feeling to accomplish the thesis report finally.

Sadikshya Karki

TU Reg. No: 7-2-25-853-2005

TABLE OF CONTENT

| | | |
|------------------------------------------------|----------------------------------------------------------|-----------------|
| Recommendation | | |
| Viva Voce Sheet | | |
| Declaration | | |
| Acknowledgement | | |
| Table of Contents | | |
| List of Tables | | |
| List of Figures | | |
| Abbreviations | | |
| | | Page No. |
| CHAPTER – I | INTRODUCTION | |
| 1.1 Background of Study | | 1 |
| 1.2 Focus of the Study | | 4 |
| 1.3 Statement of the Problem | | 5 |
| 1.4 Objectives of the Study | | 7 |
| 1.5 Research Methodology | | 7 |
| 1.6. Limitation of the Study | | 10 |
| 1.7 Organization of the Study | | 10 |
| CHAPTER – II | CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE | |
| 2.1 Meaning of Tax | | 12 |
| 2.2 Value Added Tax | | 13 |
| 2.3 Evolution of Vat | | 14 |
| 2.4 How Does It Work? | | 15 |
| 2.5 Principle Governing VAT | | 15 |
| 2.5.1 Principle of Transparency | | 15 |
| 2.5.2 Principle of Removing Cascading Effect | | 16 |
| 2.5.3 Principle of Neutrality | | 16 |
| 2.5.4 Principle of Destination and Zero Rating | | 16 |
| 2.6 Method of Computing Value Added Tax | | 16 |

| | |
|-------------------------------------------------------------|----|
| 2.6.1 Addition Method | 16 |
| 2.6.2 Tax Credit Method | 17 |
| 2.6.3 Subtraction Method | 18 |
| 2.7 Types of VAT | 19 |
| 2.7.1 Consumption Type VAT | 19 |
| 2.7.2 Income Type VAT | 19 |
| 2.7.3 Gross National Product Type VAT | 19 |
| 2.8 Necessities of VAT in Nepal | 20 |
| 2.9 VAT Preparation | 21 |
| 2.9.1 Design of VAT Law and VAT system | 22 |
| 2.9.2 Taxpayer Education Program | 23 |
| 2.9.3 Administrative re-organization | 23 |
| 2.9.4 Training | 23 |
| 2.9.5 Computerization | 24 |
| 2.9.6 Manual system | 24 |
| 2.10 Governance of VAT | 25 |
| 2.11 VAT Implementation Status | 27 |
| 2.11.1 Registration | 28 |
| 2.11.2 Return Submission/Non-Filers | 28 |
| 2.11.3 VAT Position | 29 |
| 2.11.4 Tax Refund | 30 |
| 2.12 Factors Affecting on Implementation of VAT | 31 |
| 2.12.1 Political Factor | 31 |
| 2.12.2 Social Factor | 31 |
| 2.12.3 Technological Factor | 31 |
| 2.13 Problem and Emerging Challenges for VAT Implementation | 32 |
| 2.14 VAT Reform | 35 |
| 2.15 Tax Compliance | 37 |
| 2.16 Revenue Collection and Government Expenditure | 37 |
| 2.16.1 Resources Mobilization | 37 |
| 2.16.2 Economic Growth Rate | 38 |

| | |
|----------------------------------------------------------|----|
| 2.16.3 National Economy | 39 |
| 2.16.4 Structure of GDP | 39 |
| 2.16.5 Income Per Capita | 40 |
| 2.16.6 Gross National Disposal Income | 41 |
| 2.16.7 Structure of Public Finance | 41 |
| 2.16.8 Revenue | 43 |
| 2.16.9 Share of Tax Revenue | 45 |
| 2.17 Inland Revenue in Nepal: Compliance Environment | 46 |
| 2.18 Tax Assessment | 47 |
| 2.18.1 Self Assessment | 47 |
| 2.18.2 Official Assessment | 47 |
| 2.18.3 Sales Tax Assessment | 48 |
| 2.18.4 Excise Tax Assessment | 48 |
| 2.18.5 Tax Base | 48 |
| 2.18.6 Excise Duties and Arrear | 49 |
| 2.19 Collection Cost | 49 |
| 2.20 Compliance Cost | 49 |
| 2.21 ICT Context | 50 |
| 2.22 Organization and HR Management | 50 |
| 2.23 Taxpayer Service | 51 |
| 2.24 Domestic Tax Development | 51 |
| 2.25 Challenges | 52 |
| 2.26 Expected Results of Strategic Plan | 53 |
| 2.27 Review of Previous Related Studies | 54 |
| 2.27.1 Review of Related Books | 54 |
| 2.27.2 Reviews of Related Thesis | 55 |
| 2.27.3 Review of Related Articles, Journals and Workshop | 57 |
| 2.28 Research Gap | 59 |

CHAPTER – III RESEARCH METHODOLOGY

| | |
|----------------------------------------------------|----|
| 3.1 Rationale of Selection of the Study Area | 60 |
| 3.2 Research Design | 60 |
| 3.3 Nature and Sources of Data | 61 |
| 3.3.1 Review of Secondary Data | 61 |
| 3.3.2 Primary Data Collection Technique | 61 |
| 3.4 Sampling Strategy and Selection of Respondents | 62 |
| 3.5 Method of Data Collection | 62 |
| 3.5.1 Interview Schedule | 62 |
| 3.5.2 Focus Group Discussion (FGD) | 62 |
| 3.6 Data Processing and Analysis | 62 |
| 3.7 Statistical Tools | 63 |
| 3.8 Reliability and Validity of the Data | 63 |

CHAPTER – IV PRESENTATION AND ANALYSIS OF DATA

| | |
|---------------------------------------------------------------------------------------|----|
| 4.1 Analysis and Presentation of Secondary Data | 64 |
| 4.1.1 Tax Revenue Structure in Nepal | 64 |
| 4.1.2 Internal Revenue Collection (Inland Revenue Collection) | 66 |
| 4.1.3 VAT Collection: Internal and Import | 70 |
| 4.1.4 VAT Registrants, Information Filers and Non Filers | 72 |
| 4.1.5 Impact of VAT on Government Revenue Correlation Analysis | 75 |
| 4.2 Presentation & Analysis of Primary Data | 77 |
| 4.2.1 Knowledge about VAT | 77 |
| 4.2.2 Why Businessmen Register In VAT? | 78 |
| 4.2.3 Problem in VAT Registration and Deregistration | 79 |
| 4.2.4 Demand of Different VAT Rate Is Appropriate? | 81 |
| 4.2.5 What Should Government do for Effective Implementation of VAT? | 83 |
| 4.2.6 VAT System has Practical Difficulties in Accounting and Hard System to Apply | 87 |

| | |
|-----------------------------------------------------------------------------------------------------------|-----|
| 4.2.7 Does Shopkeeper use VAT bill on Every Purchase and Sale? | 88 |
| 4.2.8 As a Customer you ask & Receive tax Invoice from Businessmen at the time of Purchasing | 89 |
| 4.2.9 VAT Increase Price of Commodities Increase Compared To Earlier Tax System | 91 |
| 4.2.10 What is Possible Loopholes on VAT Implementation? | 92 |
| 4.2.11 Difficulty Faced in Implementation Procedure of VAT | 93 |
| 4.2.12 Benefit from Registration of More than One VAT Unregistered Business | 95 |
| 4.2.13 VAT Makes no Discrimination of Rich and Poor | 96 |
| 4.2.14 Reasons of Tax Office for Being Unable to Extend area and Amount of Tax Collections | 96 |
| 4.2.15 Reasons for Inability in Improvement, Maintenance and Record Books of Account as per VAT System | 98 |
| 4.2.16 Reason for Resistance on Implementation of VAT by Business Community | 100 |
| 4.2.17 How VAT Challenges can be Effectively Handle in Current Scenario? | 102 |
| 4.3 Major Findings | 103 |

CHAPTER – V SUMMARY, CONCLUSION AND RECOMMENDATIONS

| | |
|---------------------------------------------------------|-----|
| 5.1 Summary | 106 |
| 5.2 Conclusion | 109 |
| 5.3 Recommendations | 111 |
| 5.3.1 What should the Administration and Government do? | 113 |
| 5.3.2 What Should The Businessmen Do? | 114 |
| 5.3.3 What Should The Consumers Do? | 114 |

Bibliography

Annexure

LIST OF TABLES

| Table No. | Title | Page No. |
|------------------|----------------------------------------------------------------------|-----------------|
| 1 | Sample Framing | 8 |
| 2 | Additional Method of Computing VAT | 17 |
| 3 | Tax Credit Method of Computing VAT | 18 |
| 4 | Subtraction Method of Computing VAT | 18 |
| 5 | No. of VAT Registrants | 28 |
| 6 | Status of VAT Returns | 29 |
| 7 | Revenue Collected from VAT Registrants | 29 |
| 8 | Details of VAT claimed and refunded amount. | 30 |
| 9 | Economic Growth Rate of Neighboring Countries | 38 |
| 10 | Public Finance and their ratios to GDP | 42 |
| 11 | Capital Expenditure, Principal Repayment and Sources of Financing | 43 |
| 12 | Expenditure Bearing Sources | 43 |
| 13 | Details of Government Income | 45 |
| 14 | Flash View of Research Design and Data Analysis | 61 |
| 15 | Total Tax Revenue Structure | 64 |
| 16 | Internal Revenue Collection Trend | 67 |
| 17 | VAT Collection: Internal & Import | 70 |
| 18 | VAT Registrants, Information Filers & Non Filers | 72 |
| 19 | Calculation of Correlation Co-efficient Impact of VAT on Revenue | 75 |
| 20 | Why Businessmen Register in VAT | 78 |
| 21 | Problem in VAT Registration and Deregistration | 79 |
| 22 | Demand of Different VAT Rate is Appropriate | 81 |
| 23 | If yes, what the Government Should do? | 81 |
| 24 | What should Government do? Consumers | 83 |
| 25 | What should Government do? Businessmen | 84 |
| 26 | What should Government do? Experts | 85 |

| | | |
|----|-------------------------------------------------------------------------------------------------|-----|
| 27 | VAT System has Practical Difficulties in Accounting and Hard System to Apply | 87 |
| 28 | Does Shopkeeper VAT use Bill on Every Purchase and Sale? | 88 |
| 29 | As a Customer you ask & Receive Tax Invoice from Businessmen at the time of Purchasing | 89 |
| 30 | VAT Increase Price of Commodities as Compared To Earlier Tax System | 91 |
| 31 | What is Possible Loopholes on VAT Implementation? | 92 |
| 32 | Difficulty Faced in Implementation Procedure of VAT | 93 |
| 33 | Benefit from Registration of More than One VAT Unregistered Business | 95 |
| 34 | VAT Makes no Discrimination of Rich and Poor | 96 |
| 35 | Reason for IRD Being Unable to Extend Area and Amount of Tax Collection | 97 |
| 36 | Reasons for Inability in Improvement, Maintenance and Record Books of Account as per VAT System | 99 |
| 37 | Reason for Resistance on Implementation of VAT by Business Community | 101 |
| 38 | How Challenges can be Effectively Handle in Current Scenario? | 102 |

LIST OF FIGURES

| Figure No. | Title | Page No. |
|-------------------|-----------------------------------------------------------------------------------------------|-----------------|
| 1 | Component of Tax Revenue | 65 |
| 2 | Structure of Revenue Contribution | 66 |
| 3 | Inland Revenue Collection (Trend Analysis) | 67 |
| 4 | Income Tax Collection (Trend Analysis) | 68 |
| 5 | Expected Income Tax Collection up to FY 2072/73 | 69 |
| 6 | VAT Collection (Trend Analysis) | 69 |
| 7 | Expected VAT Collection up to 2072/73 | 70 |
| 8 | Composition of VAT Collection | 71 |
| 9 | Expected VAT Collection up to FY 2072/73 | 71 |
| 10 | Trend of VAT Registrants | 73 |
| 11 | Expected VAT Registrant up to FY 2072/73 | 73 |
| 12 | Trend of Information Filers | 74 |
| 13 | Trend of Information Non Filers | 74 |
| 14 | Why Businessmen Register in VAT | 79 |
| 15 | Problem in VAT Registration and Deregistration | 80 |
| 16 | Demand of Different VAT Rate | 82 |
| 17 | What should be done for the Effective Implementation of VAT | 86 |
| 18 | VAT System has Practical Difficulties in Accounting and Hard System to Apply | 87 |
| 19 | Does Shopkeeper use VAT Bill on Every Purchase and Sale | 88 |
| 20 | As a Customer you ask & Receive Tax Invoice from Businessmen at the time of Purchasing | 89 |
| 21 | As a Customer you ask & Receive Tax Invoice from Businessmen at the time of Purchasing: if no | 90 |
| 22 | VAT Increase Price of Commodities as Compared To Earlier Tax System | 91 |
| 23 | What is Possible Loopholes on VAT Implementation? | 93 |

| | | |
|----|----------------------------------------------------------------------------------------------------|-----|
| 24 | Difficulty Faced in Implementation Procedure of VAT | 94 |
| 25 | Benefit from Registration of More Than One VAT Unregistered Business | 95 |
| 26 | VAT Makes no Discrimination of Rich and Poor | 96 |
| 27 | Reason for IRD being unable to extend Area and Amount of Tax Collection | 98 |
| 28 | Reasons for Inability in Improvement, Maintenance and Record Books of Account as per VAT System | 100 |
| 29 | Reason for Resistance on Implementation of VAT by Business Community | 101 |
| 30 | How Challenges can be Effectively Handle in Current Scenario | 103 |

ABBREVIATIONS

| | | |
|-------|---|-----------------------------------------------------------|
| CFY | = | Current Fiscal Year |
| CIT | = | Corporate Income Tax |
| EEC | = | European Economic Community |
| Etc | = | Etcetera |
| EU | = | European Union |
| F/Y | = | Fiscal Year |
| FGD | = | Focus Group Discussion |
| FNCCI | = | Federation of National Chamber of Commerce and Industries |
| GDP | = | Gross Domestic Product |
| GNP | = | Gross National Product |
| GON | = | Government of Nepal |
| GTZ | = | German Technical Cooperation |
| HIID | = | Harvard Institute for International Development |
| HRM | = | Human Resource Management |
| i.e. | = | That is |
| ICAN | = | Institute of Chartered Accountant of Nepal |
| ICT | = | Information & Communication Technology |
| IFC | = | International Finance corporation |
| IMF | = | International Monetary Fund |
| IRD | = | Inland Revenue Department |
| IRO | = | Inland Revenue Office |
| ITC | = | Input Tax Credit |
| LTO | = | Large Taxpayer Office |
| MBS | = | Master of Business Studies |
| MIS | = | Management Information System |
| MOF | = | Ministry of Finance |
| No. | = | Number |
| NRB | = | Nepal Rastra Bank |

| | | |
|-------|---|--------------------------------------------------------|
| NRNA | = | Non Resident Nepali Association |
| OECD | = | Organization for Economic Co-operation and Development |
| PAN | = | Permanent Account Number |
| PEFA | = | Public Expenditure & Financial Accountability |
| PFMRP | = | Public Financial Management Reform Program |
| RAS | = | Revenue Administrative Support Project |
| Rs. | = | Rupees |
| S.N. | = | Serial Number |
| TDS | = | Tax Deducted at Sources |
| USAID | = | United States Agency For International Development |
| VAT | = | Value Added Tax |
| WTO | = | World Trade Organization |

CHAPTER -I

INTRODUCTION

1.1 Background of Study

The revenue of government comes basically from two sources non-tax and tax. Tax becomes the main source of revenue for every country. According to Seligman, “Taxation is the contribution from a person to the government to defray expenses incurred in the common interest of all without reference to special benefit conferred”. Taxation is the main source for implementation of country budget hence the government collect tax by direct and indirect method. Indirect method earlier than VAT was sale tax, hotel tax, and entertainment tax etc applied in different rate by government. Sale tax was criticized by cumulative system as it was consumption oriented and one –sided not neutral in saving and investment lack of credit system.VAT is recent innovation in the field of taxation. It was developed by Dr. Wilhelm Von Siemens of Germany in 1919A.D.

Value Added Tax is the latest innovation in the field of taxation. VAT is considered as the reform tax system of the 21st century, which has already been implemented popularly in more than 135 countries in the world. VAT is multi staged, commodity and services based tax which is levied on the value added of business at different stages of production and distribution. It is imposed on different stages. It imposed on value of goods and services. The VAT is indirect tax depends upon consumer.

Indirect tax system plays an important role in the economic development of a country by influencing the rate of production and consumption. Different views on VAT provided by economists like:

“A properly implemented VAT is equivalent to corresponding single stage tax, unlike the expenditure tax; the VAT is not a genuinely new form of taxation but merely a sale tax administered in different form.-R.A Musgrave and P.G. Musgrave”. “Value Added Tax in its comprehensive form is a tax on all goods and services (except export and government services), its special characteristic is being that it falls on the value added of each stage from the stage of production to retail stage.- the Indian taxation enquiry committee’ (Adhikari, 2060).

“The depression has reduced revenues from other taxes and at the same time need of relief was increasing. The sales tax, with its low rates; large yield was a relatively

painless collection and was especially attractive. The post war period also shows increasing trend towards adaption of sales virtually in all countries of the world” (Terre, 1990).

VAT was introduced to remove the evil of sale tax and includes small & medium enterprises on it. After democracy the government has introduced different system of tax collection. Nepal Government’s tax reformation programmed with a long term prospective development plan to increase the revenue for poverty reduction implemented VAT on 16th November 1997 as a major part of an overall tax reform. Its objective is to promote economic growth, and to establish a transparent and fairer tax system. VAT plays great role in the revenue mobilization in Nepal. The reason behind adaption of VAT system, it makes transparency in all kinds of transaction, helps to cover the wide area in tax bracket and discourages tax evasion. So it is needless to say that VAT is the most important sources of the government revenue.

In SAARC region, Pakistan was the first adaptor of VAT. It implemented VAT in 1990. India introduced VAT first as modified value added tax (MOD VAT) in 1996. But actually in India, VAT replaced sales tax on 4th January 2005. Though some state didn’t adopt VAT (for political reasons), majority of the state embraced VAT, states like Andhra Pradesh and Maharashtra taking the lead. The Empowered Committee, constituted by Government of India, provided the basic framework for uniform VAT laws in the states but due to the federal nature of Indian constitution, States do have a liberty to set their own valuations for the VAT levied in their own territory.

Modern taxation system’s pillars are computerization, strong administration and MIS. Origination of Inland Revenue Department is based on the functional structure the major function are taxpayer service, collection, audit and investigation. The operation of tax system is based on self-assessment and management audit. Investigation is the only tool, which helps to establish a self –assessment more effectively. The system itself generates the computer assessment of the taxpayer who did not submit the tax return as well as is payment. It is also known as “Machine made assessment”. According to the economist view “value added is the value that a producer adds to his raw materials or purchases before selling the new or improved product or service. A tax based on this base is called VAT. Theoretically, VAT is defined in term of earning factors receives rent, wage, interest and profit respectively” (Silwal, 2000).

The GON has after committing to the WTO regime, decided to modernize and streamline its indirect taxation, in the light of the experience of other WTO member countries. VAT means the tax which is payable only on value-added. It is multi-point tax system, without the effect of double taxation. Value is added to the products, which an organization buys

from other organizations such as raw materials, partly finished goods etc. After buying the organization applies its own labor and machine to manufacture the final products.

Government is only to levy tax under constitutional framework. According to the constitution of Nepal, no taxes shall be levied without framing laws hence many laws are in force to implement charge taxes. Government collections are called as revenue, the revenue comes from economic transaction within the country such revenue can be tax and non tax revenue. Non tax revenue include different sources like grants & gifts, administrative incomes and another source tax revenue custom, exercise, value added tax, corporate and personal tax.

VAT is a major source of tax revenue. VAT is charged on goods and services on making value addition. Value addition in case of VAT is slightly different than usual use on economics. In economics, value addition means additional cost incurred plus profit on the process, but in VAT accounting value addition means all the cost on which VAT has paid on purchase (or not allowed for set off) plus profit. VAT required being collected in the transaction value on sale of taxable transaction by registered person. VAT is charging on the person dealing VAT attractive goods or services.

Charging of VAT = output tax- allowed input tax credit.

According to the economist view “Value added is the value that a producer adds to his raw materials or purchases before selling the new or improved product or service. A tax based on this base is called VAT. Theoretically, VAT is defined in term of earning factors of production such as labor, land, capital and entrepreneur. Each factor receives rent, wage, interest and profit respectively” (Silwal, 2000).

Value Added Tax helps to make the Nepalese tax system fairer and transparent. Tax evasion would be more difficult and less attractive thorough “catch –up effect” mechanism. Similarly, it help in reduces the problem relating to the customs and excises duties than enhanced revenue collection. If VAT is implemented effectively then its features of the self–policing system make controls of evasion and fraud. It strengthens income tax administration by generating required information regarding the transaction of the taxpayer by cross verification of buyer and seller books. The mentality and working style of tax officials have not changed drastically hence, effective and efficient tax administration can only be possible after the successful implementation of the tax system. There are a number of enforcing tools such as visits, investigation and auditing that help to establish self–assessment to enhance the tax collection transparent. Tax officials have right to investigate the accounts as well as the stock of the vendors. A vendor has a right to appeal against decision relating to tax assessment or penalties made by a tax officer.

Such a provision would make VAT officials more rational and cautious while making decision.

In conclusion, VAT has been the most essential choice for most developing countries as an ingredient of their tax reforms because it is the most improved form of sale tax, which leads to revenue enhancement and economic efficiency. The import valuation system for customs by controlling under valuation of goods and making compulsory payments made through banks. VAT is levied on all goods and services excluding those that VAT been exempted by law and it levied on each level of sales from the production and input of distribution of all goods and services except ones.

1.2 Focus of Study

In today's world of rapidly changing technology, wholesale trade firms are essential to the economy, for channel of distribution. To meet this changing environment, the wholesalers sell the products to be used primarily for resale or for industrial use with the current Value Added Tax scheme. The study is focused on implementation of value added among the wholesalers, Retailers, and Consumers and other Stakeholder in Nepal. The common objective of Value Added Tax is to simplify the tax structure, to create a uniform common market within the country which will bring down prices that would enable the producers of goods to reduce costs, face competition from abroad and to increase exports. Value Added Tax will help the common people, traders and also the government as it is the main sources of revenue generation.

VAT is a tax, which is imposed at every stage of production, i.e., from production level to retail level. Under VAT tax is calculated on value Added where value added is the difference between sales value and purchase value. The VAT as a system of tax, conceptually, has been of great interest among the early writers in public finance. In this research, researcher try to explain the concept of VAT, their procedures, challenges among the Nepalese environment and opportunities, which are available under this regime. Implementing VAT in Nepal in context of economic reforms has paradoxical dimensions. On one hand economic reforms have led to more decentralization of expenditure responsibilities which in turn demands more decentralization of revenue raising powers if fiscal accountability is to be maintained.

Value added tax (VAT) is a type of indirect tax that is imposed on goods and services. Sometimes, when the government operates on a budget surplus or wants to increase its revenue in order to finance its budget deficit. A question that arises is whether value added tax has been a boon or misery for a developing country like Nepal. Around 136 countries in Asia have recognized the importance of value added tax. In one of the most large scale reforms of the country's public finances in over the past 50 years, Nepal has

finally agreed the launch of its much delayed value added tax from 16th November 1997 designed to make accounting more transparent, to cut short trade barriers and boost tax revenues. The tax is levied not only on products but services that is the source of revenue for the government to plan for development activities in the country. Since Nepal is a developing country, the main source for revenue is generated through tax levied on the individual on the purchase of goods or services.

The government imposes taxes and duty charges on the fellow people for fulfilling the infrastructural, technological, entrepreneurial demand of the country. Whether the imposition of high tax on the society is favorable or unfavorable in the present scenario to meet the technological and infrastructural demand, it has been identified that rural people are charged more tax than urban people due to subsidized rate provided to them in food products, transportation, electricity, water etc. For these facilities they are charged indirectly from their source of income like agricultural and allied activities. The question that arises is: do value added taxes promote prosperity and well being for the common men? VAT is omnipresent in all goods and services provided to the consumer. The paper aims at presenting the importance of value added tax in the Nepalese Society, its impact and the future prospect for product and service industry in Nepal.

In addition to consumers, person, involved in commercial activities is affected by VAT. A person means in individual, firm, company, associations, cooperative, institution, joint business, partnership, trust, government body or religious organizations. There are categories of person and organizations which are neither required to collect VAT nor allowed to claim a refund of the VAT. They have paid in producing their goods and services for sale. These would include unregistered small suppliers, that is, person with annual sales of taxable goods and services of Rs. 2million or less. But even such people can voluntarily register for VAT purpose.

Besides the persons who are affected by VAT for the production and consumption of goods and services, this research is very useful for those persons like students, researchers , scholars , professors, journalist, legislators, planners, and the person who is interested in the VAT system of Nepal.

1.3 Statement of Problem

In the implementation of VAT, the main glitch has been in terms of lack of public awareness. Until the time when a situation is created where the consumer himself/herself is self-motivated to ask for an invoice, it will be an uphill to climb for VAT. In the beginning stage of implementation of VAT, government had face defense from the market. VAT was a subject of strict opposition from the business community in the period of introduction. There was an eleven-day strike in the main city of the country-

Kathmandu based. The administration had to struggle to get tax payers registered. The businessmen and industrialist, who directly or indirectly benefited from the Sale Tax, were motivated to spread negative publicity.

Lack of proper implementation of tax policies, lack of knowledge, lack of public awareness and lack of efficient tax management are creating obstacles on revenue collection. At this critical situation, the government introduces the VAT system as a scientific and modern tax system. Introducing of VAT is a positive process on revenue collection, which helps to increase the government revenue. For easy operation of VAT, its implementation part must be strong, but we don't feel that situation. Before the implementation of VAT, our existing tax system faces unskilled manpower, weak administration, inefficient management and other problems. Availability of information about VAT is very essential to make people conscious about VAT. So, the researcher selects this topic for providing a list of information about VAT to the businessman, consumers, researchers and other interested parties who like to collect information about it and to provide suggestions and give recommendations to the concerned authority with the view to improve the existing taxation system

General expenditure only could not cover by the internal source of revenue. IRD has given top priority to raise billing habit of the taxpayer but the result has not been as desired. Moreover, operation of this tax system is based on self-assessment but the qualities of tax returns are not so good and it does not represent the fair, true and correct statement of the book of accounts. Now revenue saving is zero. This discourages the foreign assistance and only one way to the government is to broaden the tax base. Therefore the following problems arise and given study will try to find out solution of these problems.

- What are the major loopholes?
- What are the major challenges and difficulty face by the taxpayer?
- What are the major problems of VAT implementation of Nepal?

The primary objective to introduce VAT was to enhance revenue and to introduce the system as efficient, transparent, neutral, uniform, simple system and revenue potential. At this critical situation, the government introduces the VAT system as a scientific and modern tax system .Introducing of VAT is a positive process on revenue collection, which helps to increase the government revenue. For easy operation of VAT, its implementation part must be strong. But we don't feel that situation. For the implementation of VAT, our existing system faces unskilled manpower, weak administration, inefficient management ,non refund of VAT to the government and other problems.

Availability of information about VAT is very essential to make people conscious about VAT. So, the researcher selects the topics implementation of VAT in Nepal for providing a lost information for implementation to the businessman, customers, researchers and other interested parties who likes to collect information about it and to provide suggestions about it and to provide suggestions and give recommendations to the concerned authority with the view to improve the existing taxation system.

1.4 Objectives of Study

Value added tax is now an innovation of a modern tax. It has been implemented from 16 November 1997 in Nepal. But there are many difficulties and problems to make it effective implementation. The research is carried out in fulfill of the requirements for the Master Degree in Business Studies as well as to judge the present implementation of VAT by Inland Revenue Department and to suggest recommendations for reforms. The major objective of the study is ;

To study the implementation status of VAT and identify major problems on the implementation of VAT in Nepal and To recommend for making VAT effective in mobilizing resources.

To achieve main objective , research studied and analyzed ;

- a. Conceptual framework and review of legal provisions
- b. To study the implementation status of VAT Contribution of VAT on total revenue and total tax revenue of Nepal.
- c. To identify major problems in the implementation of VAT and its causes and consequence .

1.5 Research methodology

The research methodology is a systematic, scientific, and planned way of collection, analysis and interpretation of data and fact to solve the research problems and accomplish the basic objectives of the study.

Research Design

Research design is the plan, structure, and strategy of investigation conceived so as to obtain answers to research questions and to control variance. The research can preferably be said descriptive and explanatory as its attempt to describe and explore various aspects and dimensions of VAT.

Nature and Sources of Data

The study is of qualitative nature and subjective one. The quantitative data though secondary means and primary data is to use for analyze and test the status.

Population and Size of Sample

The population of the study is infinite. It was impossible and not reasonable to make a census study of the research. So sample size was carried out in this study. The methodology used in this study is descriptive, and qualitative methods and secondary data used are mostly from published books, magazines, and other officials references. A sample size of 55 respondents is found useable for completion of the project and three set of questionnaires. The respondents were from Kathmandu valley only. Due to time and resource constraints the research was limited within Kathmandu.

Table 1
Sample Framing

| S.N | Types | Sample Size | Total Population |
|-----|-----------------------|-------------|------------------|
| 1. | Tax Experts | 10 | Infinite |
| 2. | Big business firms | 5 | Infinite |
| 3. | Middle business firms | 5 | Infinite |
| 4. | Small business firms | 10 | Infinite |
| 5. | Consumers | 25 | Infinite |

Data Collection

Data collection of the study is based on both primary and secondary data. The primary data was collected from the tax officials, chartered accountants, wholesalers, retailers and consumers. The questionnaire comprises three broad categories namely business profile, tax implementation stage, tax output stage and its impact over marketers and consumers. It is better to collect the wide responses from the major metro and cosmopolitan cities.

Primary Data

The primary data shall be collected through questionnaires. The questionnaires shall be developed as required and level of satisfaction.

Secondary Data

The secondary data were collected from an economic survey published by Ministry of finance, the annual report of IRD and unpublished data from information technology.

Data Collection, Analysis and Interpretation

Data collection from secondary sources will be properly organized and presented in appropriate tables, figures and charts. The means of statistical tools like percentage, arithmetical mean, standard deviation and correlation are used. The primary data collected through questionnaires are mostly subjective and qualitative in nature.

Analysis of Data and Tools

- 1.** Factor Analysis followed by Cluster to reduce the number of variables into predominant factors and to classify the perceptions regarding VAT implementation.
- 2.** A Parametric Approach through T-Test to determine the significant difference among the categorical variables. This will be useful in obtaining the widest range of perceptions from different domains.
- 3.** GLM (Generalized Linear Model) with both Univariate and Multivariate method and indispensable in explaining the influence of the independent variable on dependent variables problems and prospects of VAT implementation.
- 4.** Sum, Average, Standard Deviation and percentage to determine the variables regarding details from tax Department after VAT implementation.

1.6 Limitation of Study

Each and every study has its own limitations and boundaries. The study also has some limitations, they are following:

1. Major source of data was secondary sources, thus the error consisted in those sources may perceive in this research.
2. The person selected for interview may not be sufficient to represent the universe.
3. It is assumed that the existing self –assessment system is functioning as per the spirit of tax reform programs of Nepal government.
4. The view regarding the system is based on obstacle and informal discussion with concerned staff. Some data are available in round figures. The taxation law has restricted to disclose the financial statement of taxpayers.
5. Respondents' views and opinion may hold good for the time being and may vary in the future.
6. Lack of Nepalese literature study in VAT.
7. Due to time and resources constraint data and information which were collected might not be sufficient to represent the universe.
8. By nature of research, all the factors of VAT could not be explored in detail.
9. The research covers the secondary data from FY2064 \65 to FY 2068\069 only.
10. The findings of the study will be helpful to all concerned stakeholders through the country. The findings, however should be applied with due care as it studied only of particular place i.e. .Kathmandu valley.

1.7 Organization of the study

The study report is divided into five chapters:

Chapter 1. Introduction

This chapter comprises background of study, the focus of study, objectives of the study, the problem of study, research methodology, limitation of the study, and organization of study.

Chapter 2. Conceptual framework and review of literature

This chapter comprises a conceptual framework of taxation and deals with literature review of the book and previous studies. Meaning of Tax and Value Added Tax, Evolution of VAT, Principle Governing VAT, Method of Computing Value Added Tax, Types of VAT and Revenue Collection and Government Expenditure

Chapter 3. Research methodology

The third chapter is research methodology. It contains rationale of the selection of the study area, research design, the universe and sampling.

Chapter 4. Presentation and analysis of data

In the fifth chapter ,data are presented, analyzed and interpreted by applying statistical and mathematical tools, accounting and financial tools.

Chapter 5. Summary conclusion and recommendation

This chapter comprises the summary of the whole study. The conclusion of the study is presented and a list of recommendations is suggested. A bibliography and appendixes will incorporate in the end of the study.

CHAPTER II

CONCEPTUAL FRAMEWORK AND REVIEW of LITERATURE

2.1 Meaning of Tax

The concept of taxation had started as mankind organizing in- group. According to Oxford Dictionary it is a system by which a government takes money from people so that it can pay for public services. (Steel: 2000). Traditionally, tax was collected through goods. There was a system named barter exchange system, which means a transaction, whether by products or by services is directly exchanged between two suppliers without using money as the medium of exchange. Barter transactions have the advantage of avoiding instability of currency values and create a problem regarding the correct valuation of the goods being exchanged (Lyons: 1996). According to H. Dallon, tax is a compulsory contribution imposed by a public authority irrespective of the exact amount of services rendered to the taxpayer in return and not imposed as a penalty for any legal offense.

P. E. Taylor said, “Taxes are compulsory payments to government without exceptions of direct return or benefit to the taxpayers”. Similarly, W. Taussing emphasis the essence of a tax, as distinguished from other changes by government is the absence of a direct “quid-pro-quo” both taxpayer and public authority. Taxes are levied on income and expenditure, property and capital transactions, commodities and services. A tax is a compulsory levy by an economic unit to the government without any corresponding entitlement to receive a definite and direct quid-pro-quo from the government. (Bhatia: 1976). The characteristics of taxation are: compulsory contribution to the state, personal obligation to pay taxes, social interest, and no direct relationship between state service and a legal collection principle the taxes was levied in accordance with the benefit arising from government services provided by the tax or who is benefiting more from public goods.

Hence, Tax is compulsory in nature to those failing to pay are subject to punishment. Tax is levied on persons as per the prevailing laws, even persons do not get corresponding benefits from government. Tax is collected from haves and spent for the interest of have-nots in the society. As this way government sets the rules of road, levies tax and tools to pay for collective activities and construct/buys public goods.

2.2 Value Added Tax

VAT is the latest innovation in the indirect tax system .VAT is general tax that applies in principle, to all commercial activities involving production and distribution of goods and the provision services. It is charged as a percentage of prices, which means that the actual tax burden is visible at each stage in the production and distribution chain.

It is based on self assessment systems that provide the facility of tax credit and tax refund. It avoids cascading effect existed in the sales tax and contains the catch up effect.It is based on value added principle; value added can be obtained either by adding payments to factors of production or deducting costs of inputs from sale values.

$$\begin{aligned}\text{Value Added} &= \text{wage} + \text{rent} + \text{interest} + \text{profit} \\ &= \text{sales value} - \text{cost of inputs}\end{aligned}$$

The burdens of VAT depend upon the final price to the proportion of value added at different stages in the process of import, production and distribution. It places an equal burden on both imports and domestic products & on the items which have a high value at the import \manufacturing level or in the distribution.

The business firms add value to purchase items by processing or handling them with the help of its own factors of production such as labor, land, capital, etc. and sell their finished products to the other firms or consumers for profit motives. This increase in the value of outputs over inputs is the value added by a firm is equivalent to its payment of wages, salaries, rent, and interest plus its profit and this value added is the base of VAT.

We know that the production process has many stages, right, from the manufacture to the retailer before the goods finally reach the consumer .In this respect, VAT is imposed on each stage of the transaction, such as production, import and distribution stage of the transaction, such as production, import and distribution stages of goods service. It affects the added portion of price i.e. the value of goods and service added in the various stages of goods and services .VAT is levied in the accordance with the price rise at different levels from the production of goods and services to their distribution.

In conclusion, VAT merits as compared to other type of sales tax are outlined, as the VAT being able to prices identification and rebate of tax on exports. VAT doesn't distort domestic production and distribution. It is exceptionally stable and flexible sources of government revenue, neutral regarding production, broadly based and easiness in checking or auditing and in integrated marketing.

2.3 Evolution of VAT

During the First World War, the German Government introduces a multiple state tax as a temporary measure to mobilize the much needed resources. The German government debated a lot on this and held many discussions, but since this was a totally new concept and had not been implemented anywhere in the world. Wilhelm van Siemens is often credited as the first to propose this tax for Germany in 1919 A.D. Then it was developed further in 1949 A.D. by a tax mission to Japan headed by Prof. Carl S. Shoup. "This mission suggested the VAT for Japan in order to avoid the undesirable and unintended effects of the Japanese enterprises and turnover taxes." (Khadkha, 1994). It remained as the only topic of academic interest until 1953. After three and a half decades of the evolution of the concept of VAT, France took the courage to put VAT into practice. In 1954 A.D. France levied this tax initially to replace the turnover tax, covering the industrial sector and limited up to the wholesale level. Despite this pioneer work VAT could not cross to the boundary of France until 1959.

After that, all the countries through worldwide accepted VAT in a growing trend. VAT has been a very popular subject of tax reform; in the field of indirect taxes the reform has mainly taken the form of the introduction of VAT in the Asian region as well as, in the world.

In Nepal, the eighth plan announced applies VAT in Nepal at the end of the plan. The budget speech of F/Y 1993/94 extended its complements towards VAT saying that "to make sales tax as a principle source of revenue mobilization, government attempts will be directed to change sales tax into VAT gradually". The government set up a task force in sales tax and excise duty department to make necessary preparations for an early introduction of VAT. Budget speech of 1994/95 presented by the government of CPM (UML) showed the need for further study on VAT by setting new tax force.

The study conducted by a Task Force headed by Professor Dr. Madan Kumar Dahal and assisted by Dr. Rup Bahadur Khadka reached conclusion that "there is not any other reliable measure without changing the existing sales tax to VAT". Then government on budget speech 1995/96 announced to introduce VAT from next fiscal year in apparent to make sales tax opportune in Nepal. Facing transitional problems as well as sharp opposition from business community VAT was implemented from 13 February 1998 in real practice in Nepal.

In Nepal, VAT was introduced on 16, Nov 1997 as Value Added Tax Act 2052 and thereafter Value Added Tax Regulation, 2053. However, it could not be implemented fully until the FY 1998/99 due to political instability and strong opposition from the business community. There is a persistent increase in the number of VAT registrants, increasing the amount of revenue collection and level of tax compliance is improving.

2.4 How Does It Work?

VAT as an indirect tax simply implies that a tax in which the burden of tax shifts to other persons than taxpayers. Indirect tax can be categorized in two kinds (a) internal tax on consumption of goods and services & (b) taxes on international trades and transactions.

VAT is a tax imposed on the value added to goods and services consumed in the country or exported outside. The tax is based on the principle that each producer or distributor added 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. There is the presumption that VAT is shifted forward completely to the consumer.

In the VAT system, producers or distributors or people providing services raise VAT on the products or services sold or provided. The difference between the VAT collected on sales and the VAT charged on purchases determines the amount registrant must remit or claim a refund. In other words, if the tax on sales is more than the tax on purchases, the dealer\ businessman remits the difference. If the tax on sales is less than the tax on purchases, the dealer may carry forward this credit to the next month or claim refund.

Nepal has adopted the consumption type multistage VAT system. Under this system tax is levied on the value added at each stage in the process of production and distribution. In this system, there is a provision of input tax credit mechanisms from the producer to the retailer level. So, VAT is calculated indirectly using input tax credit mechanism. In which the taxpayer pays VAT on its value added only. Because of destination based principle Nepalese VAT system has made the provision of tax free to export.

VAT differs from turnover tax as the turnover tax is imposed on total value at each stage, which VAT is imposed only on the value added at that stage. In the production and distribution process a firm buys materials, auxiliary raw materials, chemical electricity and capital goods such as machinery, equipment, buildings, furniture, vehicles, etc.

2.5 Principle Governing VAT

The following are the principles which govern Value Added Tax

2.5.1 Principle of Transparency

Value added tax is transparent tax. It is an account based tax system. VAT has made the tax system transparent. Tax evasion is not pervasive where accounting system is transparent.

2.5.2 Principle of Removing Cascading Effect

VAT removes cascading effect. Cascading effect means a tax on tax, i.e., tax is not including tax, i.e., tax is not charged on the value including tax. But VAT has removed this effect by not including the VAT in the cost price to the second stage of the distribution channel. But under sale tax system, sales tax paid at one stage is included in the cost price for another stage.

2.5.3 Principal of Neutrality

Neutrality means not to discriminate one to another. VAT does not discriminate one economic activity against others. Tax rates or goods and services to be taxed are discriminated by VAT. So, in this regard, VAT is neutral.

2.5.4 Principle of Destination and Zero Rating

Under this principle, goods and services are taxed at consumption point, not based on production. Goods and services that are exported are taxed at a zero rate (i.e. The taxpayer gets a refund of VAT earlier paid in purchasing raw materials and interrelated goods, but he should not pay tax on added value).

2.6 Method of Computing Value Added Tax

There are practically three methods of computing VAT base:

- Addition Method
- Tax credit method
- Subtractive method

2.6.1 Addition Method

Under this method, the tax base is obtained by adding the payments made by a firm to the factors of production employed in production process such as wages, rent, interest, profit, etc. Thus the tax base is computed by adding the payments made by the firms to factors of productions employed in turning out the product such as wags, interest, rent, royalties (Clara 1965). This method is suitable for income type VAT:

Table 2
Additional method of computing VAT

| Item | Raw material producer | Manufacturer | Wholesaler | Retailer | cumulative |
|-----------------------|-----------------------|--------------|------------|------------|-------------|
| Purchase Input(A) | 0 | 200 | 620 | 930 | 1750 |
| Value added: | | | | | |
| Wages | 100 | 265 | 175 | 75 | 615 |
| Rent | 20 | 40 | 50 | 55 | 165 |
| Other Expenses | 30 | 30 | 40 | 35 | 135 |
| Interest | 20 | 40 | 20 | 10 | 90 |
| Profit | 30 | 45 | 25 | 15 | 115 |
| Total Value(B) | 200 | 420 | 310 | 190 | 1120 |
| Added VAT @ 13% | 26 | 54.6 | 40.3 | 24.7 | 145.6 |
| Sale output(A+B) | 200 | 620 | 930 | 1120 | 2870 |

Assumed data

Note:- Value added can be calculated in two ways,

1. Deducting purchases from sales of output (Rs. 2870-Rs.1750=Rs.1120)
2. Adding input by the firm itself (excluding inputs supplied by others i.e.wages + rent + other expenses +interest +profit)

This method of calculating VAT base is difficult to apply when a VAT seeks to avoid capital goods from its base which is the primary concern of modern VAT.

2.6.2 Tax Credit Method

Under this method, tax is imposed on total values of sales and taxpayers are allowed to deduct their gross tax liability from the taxes already paid by suppliers and pass on to them. More clearly, the VAT liability is calculated by deducting tax on inputs from the tax on outputs during a taxable period, under this method net VAT liability = tax on sale – tax paid on purchases (or output tax-input tax). This method is also known as invoice method:

Table 3
Tax Credit method of computing VAT

| Terms | Raw materials producers | Manufacture | Wholesaler | Retailer |
|---------------------------|--------------------------------|--------------------|-------------------|-----------------|
| Sales of output | 100 | 500 | 800 | 1000 |
| Less : purchase | | 100 | 500 | 800 |
| Value added | 100 | 400 | 300 | 200 |
| Tax on total sale | 13 | 65 | 104 | 130 |
| Less : credit on purchase | | 13 | 65 | 104 |
| Tax liability | 13 | 52 | 39 | 26 |

Assumed data

Note: Assume 13% on a consumption basis.

The tax credit method offers some merits in handling exceptions and rate differentiation, reduces double taxation (cascading), providing more ease evidence for refund on exported goods and services having the ‘catch up’ effect, simple to compute, reducing problem of valuation and provides more incentives credit for input taxes based on mechanism of self assessment.

2.6.3 Subtraction Method

Under this method, the value added is determined as Net turnover. The net turnover is obtained by subtracting the cost of materials from sales proceeds. Means, value added equals to sales minus purchase by a business entity during a taxable period (i.e. Value added = sales – purchases). This difference is the value that a firm adds by its own activity. This is a suitable consumption type VAT.

Table 4
Subtraction method of computing VAT

| Items | Raw material producers | Manufacture | Wholesaler | Retailer |
|--------------------|-------------------------------|--------------------|-------------------|-----------------|
| Sales | 200 | 1000 | 1600 | 2000 |
| Cost of material | | 200 | 1000 | 1600 |
| Value added | 200 | 800 | 600 | 400 |
| Value @ 13% | 26 | 104 | 78 | 52 |

Assumed data

Out of the three methods of computing VAT, the tax credit method is widely used in the countries of EC and elsewhere. The reason behind this method possesses several advantages over additional and subtraction methods.

Business firms are required to save the tax on invoices under the tax credit method it facilities border tax adjustments. This implies that the amount of tax that levied on exports can be returned to exporters. Similarly, this method is effective under the destination principle where exports are zero rated and tax credit chain is not broken. It also provides the facility of cross checking.

2.7 Types of VAT

The types of VAT are determined on the basis of treatment of capital goods of a firm. Input tax paid for capital goods is allowed or not is the fundamental questions in the study of types of VAT .There are three types of VAT. They are;

- **Consumption Type**
- **Income Type**
- **Gross National Product (GNP) Type**

2.7.1 Consumption Type VAT

Under consumption type VAT, all capital goods purchased from other firms, in the year of purchased, are excluded from the tax base while depreciation is not deducted from the tax base in subsequent years. The base of tax is consumed since investment is relieved from taxation under this type. Consumption type VAT is widely used. Hence, by the term ‘VAT’ was basically mean the consumption type VAT.

2.7.2 Income Type VAT

The income type does not exclude capital goods purchased from other firms from the tax base in the year of purchase. This type, however, excludes depreciation from the tax base in subsequent years. The tax falls both on consumption and net investment. The tax base of this type is the net national income.

2.7.3 Gross National Product Type VAT

Under this type, capital goods purchased by a firm from other firms are not deductible from the tax base in the year of purchase. It also does not allow the deduction of depreciation from the tax base in subsequent years. Tax is levied both on consumption and gross investment. The tax base of this type is gross domestic product.

2.8 Necessities of VAT in Nepal:

Nepal introduced VAT in 1997 for several reasons. One of the important reasons was to develop a stable source of revenue by broadening the tax base. It must be noted that Nepal had been generating the bulk of its tax revenue from import duties. Indian tourists were attracted to buy goods imported from the third countries in the Nepalese market. These goods also used to be deflected to India by both the Indian and Nepalese traders. The scope of this type of trade, however, has been decreasing due to the opening up of the Indian economy since the early 1990s. As a result, the volume of the third country import in the Nepalese market meant for the Indian buyers has been shrinking. Furthermore, Nepal will not be in a position to levy import duties on trade that takes place within the South Asian Association for Regional Co-operation (SAARC) region after the implementation of the South Asian Free Trade Agreement (SAFTA). This means that Nepal will have to become less dependent on international trade taxes for its revenue, which is also desirable from an economic resource allocation point of view. The base of the domestic trade taxes has been narrow as well since the share of the total economy that flows through market channels is relatively small. The potential tax base became even smaller as sales tax used to be collected at the import/manufacturing point. Since the sales tax was not levied at stages beyond the import/manufacturing point, there was no possibility of capturing the evaded tax at a point further down the trade channels. It has also been necessary to transfer some of the national level taxes such as land revenue, house and land tax and vehicle tax to the local bodies in order to make them financially more autonomous. This means that there is no choice but to introduce VAT in Nepal to generate revenue required to improve its deteriorating macro-economic performance. A VAT system is needed for revenue purposes as an alternative tax system to import tariffs. The VAT should not only be an effective instrument to generate substantial revenue at customs points, but also help streamline tax policy in general. VAT has a natural link with the income tax. Currently, the main basis of the income tax assessment in the case of importers is the information supplied by the customs. But only a fraction of such information reaches the tax administration. VAT will provide the information on imports, local sales and input costs that can be used to assist in the effective implementation of the income tax. Furthermore, it is necessary to introduce VAT for several other reasons. The import/manufacturing level sales tax discriminated against the domestic products vis-à-vis imports because the profit margin of the manufacturers were included under the base of this tax but not the profit margin of the importers. Further, there was chronic undervaluation in the case of imports. This means that the effective rate of import/manufacturing level sales tax became higher on domestic products than on imports, although the nominal tax rate was the same for both sets of goods. A VAT system puts an equal burden on both imports and domestic products since the burden of this tax depends upon the final price irrespective of the proportion of value

added at different stages in the process of import/production and distribution. Further, VAT can be applied anywhere in the economy without leading to a cascading/pyramiding because it employs a credit mechanism. It also relieves exports completely free from the burden of taxation through the zero-rating of exports and the refund system for excess credit.

The implementation of a VAT in Nepal was also expected to establish an account-based modern transparent tax system. The import/manufacturing level sales tax was not levied on the actual selling price but on the notional sale value which included the ex-factory price/import value and the amount of excises/import duties. This means that the determination of the sales tax base invited the problems associated with the determination of the base of the excises or import duties. In the case of domestic products, sales tax registered manufacturers were also required to get their prices approved by the tax officials. In the case of excisable items, manufacturers have not only to get their ex-factory prices but also dealer, wholesale and retail level prices approved by the excise authorities. There was a possibility of either collusion or prices negotiated by harassment between tax officials and taxpayers. There was a general lack of administrative capability to determine the taxable value in a realistic way. So the prices were fixed arbitrarily. Taxpayers also used to complain that tax officials give their approval only when prices had to be raised, but not when they had to be reduced, meaning that manufacturers had to pay tax on previously determined high prices even if the actual prices had fallen due to the reduction in the prices of raw materials and other market conditions. As VAT is based on transaction value, there is no need to fix arbitrary or artificial values for tax purposes under this system. For the above-mentioned reasons, GON decided to introduce VAT. The Eighth Plan (1992/93-1996/97) adopted a policy to introduce a VAT in place of several minor commodity taxes in order to establish a sustainable source of government revenue.

2.9 VAT Preparation

VAT preparation began in September 1993 when a VAT task force was created in order to make necessary preparations for the introduction of VAT. A VAT Steering Committee was also set up to evaluate and monitor VAT preparatory activities. The United States Agency for International Development (USAID) provided financial assistance in order to support the VAT preparation and implementation process in Nepal. Under this project, the technical assistance of the Harvard Institute for International Development (HIID) began in the fall of 1993. Members of the VAT task force and the HIID consultants worked together. Assistance for the implementation of the VAT was continued beyond September 1997 through financing provided by the Danish Government. The DANIDA assistance, which was originally meant for 2 years, is likely to be extended for another 2 years.

2.9.1 Design of VAT Law and VAT system

The VAT law was drafted in 1994. It was discussed in depth at several stages within the VAT task force, with the Secretary of the Law Reform Commission and with various business groups. It was reviewed by the VAT Steering Committee. The draft was sent to various business groups, including the Federation of Nepal Chamber of Commerce and Industry (FNCCI) and Nepal Chamber of Commerce for their comments. While this was a good beginning to seek the opinion of the Private sector on the proposed VAT law before its passage by the parliament, no written comments were received from the Private sector on the draft VAT Act. The VAT Bill was presented to the parliament in December 1995. The Lower House of Parliament passed the VAT Bill on 30 December 1995 and the Upper House of Parliament on 4 January 1996. The VAT Act received the Royal seal on 20 March 1996. The VAT regulations were drafted in July 1996. Like the VAT Act, the regulations were discussed at different stages. The cabinet approved the regulations on 27 January 1997.

The Operational Manual was initially drafted in 1996 and was finalized in the fall of 1997. GON approved the operational manual on 21 September 1997. The manual has been prepared in nine volumes covering all aspects of VAT from the law through to the investigation of offenses. They are:

- (1) Organization and management,
- (2) Charging and accounting for value added tax,
- (3) VAT registration,
- (4) Collection and enforcement,
- (5) Payment of claims for refund,
- (6) Verification and audit,
- (7) Fraud investigation,
- (8) The VAT computer system, and
- (9) VAT Act and Rules,

The Manual is expected to facilitate day-to-day administration and reduce the risk of varying interpretations of the tax laws by different officials. In addition, a number of computer user manuals have been produced.

2.9.2 Taxpayer education program :

As VAT is a tax based on the self-assessment of taxpayers, their cooperation is essential for the success of this tax. It was, therefore, planned to educate the potential taxpayers before the tax was introduced. It was also necessary to dispel some of the fears of VAT held by business communities and to give them and others, some idea of the structure and operation of VAT and its possible effects on their particular businesses. To this end, a comprehensive VAT education program was launched. Information was disseminated on a large scale through the media. Seminars and public speeches were organized at various places for various groups. General brochures for all, and special brochures for particular groups (such as hotels, travel agencies, importers and exporters, consumers) were developed and distributed. Most of the brochures were produced in both English and Nepali versions. In addition to the above, many articles on aspects of VAT were written and published in national newspapers. Different posters were also prepared. Similarly, three VAT videos have been produced and broadcast.

2.9.3 Administrative re-organization

The sales tax and excise administration were made responsible for the administration of VAT. The Sales Tax Department, which was established only in 1992, was in its infancy. The unification of the Excise and Sales Tax Department in 1993 had expanded the scope of this administration regarding the number of tax officials and tax offices. A study of the sales tax and excise administration was conducted. This established that the sales tax and excise administration was not functional and unsuited for VAT. A revised organizational system based on functional requirements and setting out a hierarchy of personal responsibility was drawn up and recommended. This had been largely accepted and the new system was approved and implemented in July 1996. Under the new structure sections and subsections were created on the basis of the function of VAT administration. Large taxpayer, tax refund, taxpayer services, tax audit and investigation, internal monitoring, collection and registration are important sections of VAT administration.

2.9.4 Training

It was necessary to train officials recruited for VAT administration on various aspects of VAT before they were assigned particular jobs. To this end, various training programs were organized in order to familiarize tax officials with VAT. These programs were mounted not only for VAT Department and VAT District office personnel, but also officials of the Customs Department, Tax Department, Ministry of Finance, Revenue Investigation Department, Revenue Administration Training Center, the Accountant General's Office, and the Auditor General's Office. Training of tax officers continued

even after the introduction of VAT. Training programs organized before the introduction of VAT were more general. After the introduction of the VAT, the concentration was on specific training programs. In this connection, special training programs on specific issues such as refunds, collection, accounting and auditing were organized.

2.9.5 Computerization

VAT Department is fully computerized regarding registration, returns, collection, payment, audit and penalties. The computer system provides such outputs as registration certificates, a registrants' list, a non-filers list, posting reports, outstanding reports, audit trial reports, refund claims, revenue reports, suspended reports, and closing reports. These are generated by the taxpayer and the VAT office. The growing importance of new technology is focused on e-governance. IRD has become a role model, introducing web-based applications and a comprehensive ICT architecture connecting all Inland Revenue Offices (IRO). E-filing has been used by more than 90 percent of VAT returns, simplifying compliance processes, providing information and reducing costs. IT-assisted services will be of further relevance in the development of customer-friendly approaches to enhance voluntary tax compliance.

2.9.6 Manual system

A manual system was set up in all VAT offices to keep track of at least large taxpayers. The purposes of this manual system are:

- To make the tax officers familiar with VAT procedures;
- To compare output from the computer with calculations made manually;
- To ensure that large taxpayers submit returns and pay VAT.

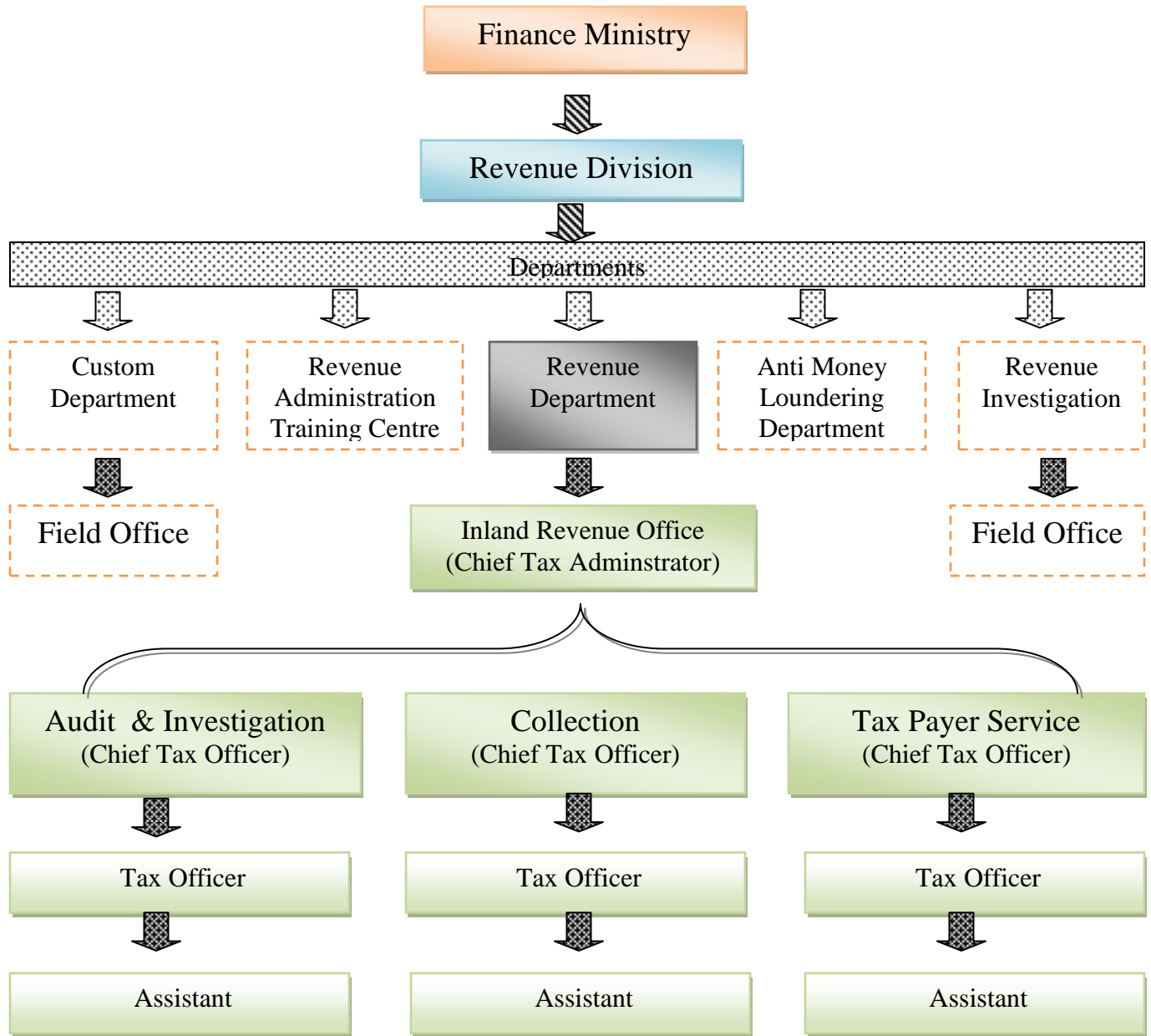
The tax offices have been asked to inform the Department in case of differences between manual calculations and computer printouts. This information was used to analyse the function of the computer system. The Department selected companies to be handled under the manual system parallel to the computer system. Total taxpayers selected for the manual system covered 6% of the total number of registered businesses and 20% of total transaction value.

2.10 Governance of VAT

In line with the introduction of an internationally compatible Income Tax Act 2002, the Inland Revenue Department (IRD) was established by merging the Tax Department and the VAT Department. In Nepal IRD has full authority to implement taxation system. The IRD falls under the auspices of the Ministry of Finance and was established on July 16, 2002 as a result of a merger of the Income Tax Department and the Value Added Tax Department. It is responsible for the administration of domestic tax revenue emanating from Income Tax, Value Added Tax, Excise (the three major taxes in revenue administration), Health Services Tax and the Education Services Fee.

In order to tax reform and streamline; broadening the tax base and lowering the tax rate, rationalization of assessment and simplification Value Added Tax Act, 2052 B.S. were implemented for effective tax administration and raising the revenue as to meet the development efforts. The objective of modern tax is; modernization of the tax system, making the tax system more transparent, extending tax net and avoiding the chance of cascading and pyramiding of Indirect Tax (Kandel: 2005).

Taxpayers receive notice of the processed assessment before finalizing the tax assessment, and any action may be taken to recover the tax. Value Added Tax assessments will normally extend back for four years from the time of the submission of tax returns. Taxpayers can file an appeal at the revenue tribunal against a tax assessment or penalty order to the tax office within thirty –five days from the date of receiving. The department of VAT and Income Tax Department have merged together as Inland Revenue Department. Since then, the practice of audit system has changed from a total assessment to selected taxpayer's audit and the basis and criteria for selection of the taxpayers for audit is determined by the department and is responsible to select such list for large taxpayer office and district officers. IRD with a mandate to levy tax in accordance with the law, to collect centrally levied taxes, to administer the tax system, and advise the Government of Nepal on tax policies. IRD currently has 22 Inland Revenue Offices (IROs), one Large Tax Office (LTO), and 13 Taxpayers Service Offices (TSO's) inside Kathmandu valley and 13 outside Kathmandu. Two more TSO's are yet to be established.



IRD's mandate can be summarized as follows:

- Tax Administration
- Tax Collection
- Tax Reform
- Advice on Tax Policies
- Taxpayer Service and Education
- Management of ICT system
- Organizational and Human Resource Development
- Research and Development
- Logistic Management

A dedicated governance structure will be put in place to manage, implement and monitor progress of these reforms. A Reform Steering Committee, chaired by the Director General is already in place. The Steering Committee will have overall responsibility to guide the reforms and provide advice to the sections in the department responsible for implementation of the Reform Plan. Formal reviews of the Reform Plan will be undertaken every four months to assess progress on all program interventions against the detailed operational plans and to agree any adjustment or re-alignments required. The eight sub-committees that were convened to propose activities to be included in the Reform Plan will now be aligned with the priority areas set out in Section IV of this plan. A dedicated reform management unit will be established in the department, consistent with international practices in project management. It will be staffed at the required level to fully coordinate, monitor and report on progress of the reform program. In addition to this Reform Plan, the Strategic Plan will be supported and complemented by the following additional action plans, which will be managed in a coordinated way:

- The Human Resource Development Strategy, to modernize the approach to human resources management and strengthen staff capacity.
- The current e-governance strategy, which guides developments in e-commerce and information technology. It is expected that other stakeholders will be interested in the progress of the reforms.

The Director General will regularly report progress to the Ministry of Finance in particular, and will provide opportunities for collaboration and consultation with other interest groups and industry stakeholders.

The IRD is committed to working cooperatively and transparently with business partners. The department will endeavor to consult with business and professional associations to seek their input on the issues that the Reform Plan will address and encourage their support for the ongoing reform program. The IRD will also hold regular briefings with the development partners to report on progress.

2.11 VAT Implementation Status:

VAT Act came into force on 16 November 1997 when the Sales Tax Act 1966 was repealed. The import/manufacturing level sales tax was converted into VAT on this date.

2.11.1 Registration

As per the gazette notification of the government, all sales tax registered firms were supposed to be converted into VAT registrants by 16 November 1997. Other firms, which were not registered under the sales tax, were required to be registered within 90 days from 16 November 1997. A number of taxpayers registered under the sales taxes were found not to have converted to VAT by 16 November 1997. VAT officers visited some of these. Some of them assumed that since they were already in the tax net, they would be automatically converted to VAT. A list of these firms was sent to each VAT office for further action. A few more firms were converted into VAT registrants after action by the VAT offices. Despite the strong opposition to VAT from the business community, the number of VAT registrants increased gradually, reaching about 5,000 by the end of the fiscal year FY 2064/65 (i.e. 15 July 1998). The current trend of the number of VAT registrants is given in Table .

Table 5
Number of VAT Registrants

| Year | 2064/65 | 2065/66 | 2066/67 | 2067/68 | 2068/69 |
|--------------------------------------|----------------|----------------|----------------|----------------|----------------|
| No. of Taxpayers | 59,707 | 69,653 | 83,658 | 97,467 | 118,556 |
| No of Tax Payer growth rate % | 12.73 | 16.66 | 20.11 | 16.51 | 21.63 |

Source: Annual Report F/Y 2068/69,IRD

As shown in this table, the total number of VAT registrants in FY 2065/66 was 69,653. The number increased to 83,658 in 2066/67 and reached almost 120 thousand by the end of FY 2068/69.

2.11.2 Return submission/Non-filers

The first VAT return was to be submitted on 9 January 1998. A large number of taxpayers since then have submitted returns by the due date. Until now, the number of credit returns has been higher than the debit returns. VAT returns are being scrutinized on a regular basis. Not all taxpayers, however, submit returns on time. The status of VAT returns of latest three years are given in Table.

Table 6
Status of VAT Returns

| Year | 2067/68 | 2068/69 | 2069/70 |
|---------------------------------------------|----------------|----------------|----------------|
| % of Debit VAT Returns | 18% | 17.42% | 16.20% |
| % of Credit VAT Returns | 49% | 49.32% | 51.52% |
| % of Zero VAT Returns | 33% | 33.27% | 32.28% |
| Total Debit Amt (in billion) | Rs 19.03 | Rs 22.7 | Rs.24.2 |
| Total Credit Amt (in billion) | Rs 106.96 | Rs145.32 | Rs.175.39 |
| Ratio of Credit Amt to Debit Amt (in times) | 5.62 Times | 6.4 Times | 7.2 Times |

Source: Annual Report F/Y 2069/70,IRD

Among the registered taxpayers about 21% of registrants have been non-filers in the recent year. Non-filers are mainly small taxpayers, particularly small contractors, whose turnover is lower than the threshold but have been registered for VAT due to the requirement to submit a copy of the VAT registration certificate in order to bid for government contracts.

2.11.3 VAT position

VAT is expected to generate NPR 80,965,046 thousands in 2069/70. Out of this NPR 51,50,76,20,000 is expected to be collected on import at customs points and the rest from VAT registrants. This means that almost 64% of total VAT revenue will be collected from imports and about 36 % from VAT registrants. The trend of VAT revenue collected from VAT registrants in various fiscal year is given in Table below:

Table 7
Revenue Collected From VAT Registrants

(Rs.in 000)

| FY | 2068/69 | 2069/70 | 2070/71 |
|-----------------|-------------------|-------------------|-------------------|
| Internal source | 25,949,278 | 29,457,426 | 32,965,574 |
| Import | 45,385,803 | 5,150,7620 | 57,629,437 |
| Total | 71,335,081 | 80,965,046 | 90,595,011 |

Source: Annual Report F/Y 2069/70,IRD

Besides, due to the resistance of the business community, not all potential taxpayers have been registered for VAT and not all registered taxpayers have submitted returns and paid tax on time. Also, the government did not take firm action due to the political situation.

Further, since not many potential vendors are registered, cross-checking has not been possible and undervaluation and dummy sales by VAT registrants have been common. VAT has not been able to run properly. However, the tax will generate more and more revenue in the days to come when it is fully operational. It will provide a stable base of revenue for the government since it is a tax based on consumption.

2.11.4 Tax refund

The tax refund is the basic essence of VAT. So it must function properly. The credibility of the VAT system will be questioned if refunds are not processed timely. On the other hand, the tax refund system will be abused if the refund claims are not scrutinized properly. So a proper balance needs to be maintained between the two. Latest three years figures also indicate vast gap between VAT claimed Amount and refund amount which are as follows;

Table 8
Details of VAT Claimed and Refunded Amount

| Year | 2066/67 | 2067/68 | 2068/69 |
|-----------------------|----------------|----------------|----------------|
| Claimed Amount | 7.61 | 10.61 | 13.52 |
| Refund Amount | 2.27 | 3.39 | 3.42 |

Source: Annual Report F/Y 2068/69, IRD

The number and amount of refund claims made so far is still very low compared to the potential. This might be for the following reasons:

- Taxpayers do not have confidence in the refund system due to past experience where it used to be a Herculean task to get money back from the government;
- Taxpayers are scared of having their records audited which might not be maintained properly;
- Tax officers discourage taxpayers from claiming refunds;
- Taxpayers do not know enough about the VAT refund system.

Whatever may be the reason, it is not a good situation because taxpayers' money is unnecessarily blocked. This leads to an increase in the cost of the economy and reduction in economic activities and ultimately brings contraction in the tax base, leading to a lower amount of tax collected. So tax officials should facilitate, not discourage tax refunds. The VAT administration must make an effort to run the refund system properly, but this certainly does not mean that tax officials should not scrutinize fraud cases.

2.12 Factors affecting on Implementing of VAT

2.12.1 Political Factors

There is always the possibility of changing government priorities and the creation of new policies that impact on tax administration. Decisions on a new Constitution and a federal structure for Nepal could have an impact on the tax system, for example by redefining the types of taxes to be collected at a national level and determining a new revenue sharing model. The first year of this Reform Plan coincides with Nepal Investment Year, planned to start later this year. Economic activity is expected to increase. New international investment in Nepal has implications for the IRD, because the simplicity and ease of compliance is often a factor in such decisions. The department may anticipate pressure to accelerate reforms and at the same time a growing complexity in administration, for example in subjects such as transfer pricing and other cross-border transactions. These developments will require greater technical expertise than the IRD currently has.

2.12.2 Social Factors

In general, society's behavior in any country is to try to avoid paying taxes. This tendency is exacerbated if compliance with the tax system is perceived to be onerous. The recent IFC survey noted that some believe that the compliance cost of tax administration exceeds the tax itself, and therefore reducing compliance costs is one of the major challenges the IRD faces. A persistent public perception exists in Nepali society that it is only people who are in "business" who have to pay tax. This incorrect perception needs to be addressed so that in future all citizens who have income of any kind know that they are a taxpayer and should be registered in the tax system.

2.12.3 Technological Factors :

E--filing initiatives have been successful, with more than 90% of VAT returns now submitted electronically. This is not restricted to large enterprises-recent survey results show that small businesses are open to the prospect of electronic filing as they gain access to personal computers and the internet and to the computer facilities provided in the IROs and TSOs. There is already and economic transactions and advances in electronic business, and the IRD must stay apace with a demand for expanded e-services, for example an e-payments system following on from the successful introduction of e-filing, and the IRD anticipates that the demand for electronic services will continue to increase in the future. Increasing the use of electronic processing will have material benefits for both the taxpayer and for the tax administration. It will lead to increased services, timelier processing, and better account management and decreased

administrative costs for the department. Staff no longer required for manual processes may be transferred into other activities such as compliance. The IRD will be able to have better information about taxpayers, better data for risk management purposes, and an environment which will foster increased integrity. The use of technology also presents the opportunity to exchange data more effectively with other stakeholders, both government bodies within the Ministry of Finance and outside, and Private sector parties such as financial institutions. The taxpayers' satisfaction level survey conducted in 2003 and 2010 reflect the perception of taxes and tax administration. Among others, success depends on the perceived fairness of the tax structure, its stability value attached to government activities and the legitimacy of governments. In the past, IRD initiated a dialogue with stakeholders on particular tax issues, i.e. with the Federation of Nepalese Chambers of Commerce and Industry (FNCCI), the Law Society and the Institute of Chartered Accountants of Nepal (ICAN).

The Non Resident Nepali Association (NRNA) and civil society organizations promoting accountability and transparency might be potential cooperation partners in the future. While reforming the tax system, it is critical to achieve fiscal consolidation, minimize distortion in the economy, and create a stable and predictable environment for the markets to function. The wave of internationalization of economic activities across the world in the 1990s necessitated the alignment of tax policy to Nepal's development strategy, which required a wide range of tax reforms. With past initiatives, the government has aimed for more efficiency in the management of public finances and to achieve defined objectives linked to taxation.

2.13 Problems and Emerging Challenges for VAT Implementation:

Nepal is in a transition period following a long political conflict and facing several challenges due to limited resources. The GON has needed to generate more funds through internal sources to fulfill its core functions in providing public services and to promote socioeconomic development. Especially in view of future changes, internal revenues will be required to cover the increasing demands of a growing population, to meet development expectation of people and increasing administrative expenditure of the government.

The estimated annual growth rate of double digits will cause the need to bring in more taxpayers under the tax net in order to mobilize distinctively more revenue and distribute the tax burden. Due to the large informal sector and a tendency to avoid taxes, revenues are currently dependent on a small share of registered taxpayers. Out of nearly 30 million and a per capita income of less than US\$ 1500, around 80 percent of the tax revenue is currently collected by the LTO, which serves about 700 taxpayers. However, Nepal has

made some encouraging progress in the past years by reducing the percentage of people living below the international poverty line (people earning less than US\$1.25 per day) to almost half in seven years (from 53.1 percent in 2003/2004 to 24.8 percent in 2011/2012).

Political instability has hampered creating an enabling environment for economic growth, investment and trade as well as revenue collection. Moreover, the adoption of the budget and the implementation of policies were delayed in the past due to unresolved disputes and demonstrations. In recent years, reforms have been initiated by the Ministry of Finance to enhance the country's development. Supported by an Investment Board, the F/Y 2012/13 has been declared as Nepal investment year to promote economic initiatives against declining foreign direct investment commitments.

There is a clear and stated need for domestic revenue mobilization. Nepal's tax to GDP ratio of 13.2% (2012) is low when compared to similar countries, which have an average comparable ratio of 15.2%. With the informal economy estimated at 38% of GDP, there is no accurate estimate of the tax gap and this is a subject of concern. There are approximately 600,000 taxpayers who have a PAN. Of these; approximately 115,000 are registered for VAT purposes. The IRD has made significant efforts in recent years to increase the registration base, showing a growth of 83.2% and 60% respectively for PAN and VAT over the past four years.

In 2012, 518 suspected VAT fraud cases were assessed worth Rs. 6.6 billion, especially caused by the informal economy. Currently 495 new fraud cases and around 4,400 cases of mismatch data are under investigation. These numbers indicate a tendency of using fake and false bills and invoices to evade tax, concerning vulnerable aspects of VAT non-compliance. Nepal's VAT design is based on the principle of neutrality, applicability and proportionality with the basic characteristics of deductible input taxes, single standard rate, zero rate and exemptions. The level of VAT evasion and fraud is influenced by the complexity of processes within the tax administration, government regulations, and systemic default in VAT design and implementation weaknesses. Various types of VAT evasion and fraud are prevailing in practice and the scale is increasing. Beside conventional methods of evasion and fraud, new methods such as 'Carousel' fraud, 'Bogus Traders' 'invoice milling' and 'cloning' types of frauds are increasing. A report presented to the Public Accounts Committee revealed that VAT frauds are dominated by the use of fake and forged invoices.

The experience of the European Union (EU) single market in tackling with 'Carousel' and 'Missing Trader' fraud postulate that the future federal structure of the country should carefully determine VAT jurisdiction. Fraud in tradable services is rather difficult

to detect. Improvement in the quality of audit and investigation, as well as application of available legal provisions, is needed to tackle fraud. For example, VAT evasion and fraud control cases are dealt with through general laws (civil codes, i.e. Muluki Ain) and also through specific laws on the basis of gravity of offence. Muluki Ain has the provision of criminal prosecution on fake and forged documents. Notwithstanding this effort, there is more work to be done and a need to ensure that the registration database is accurate and reliable. The current registrants pose some compliance issues. By international standards, filing compliance for Income Tax is particularly poor. Unpaid tax arrears are high, although the IRD .

Although the IRD plans to place a more concentrated effort on arrears collection in the upcoming fiscal year. The department faces challenges in enforcement: as evidenced by the recent investigation of more than 500 taxpayers for tax evasion, with a further 5,000 identified for follow up in a compliance targeting exercise. Although the IRD plans to place a more concentrated effort on arrears collection in the upcoming fiscal year. The department faces challenges in enforcement: as evidenced by the recent investigation of more than 500 taxpayers for tax evasion, with a further 5,000 identified for follow up in a compliance targeting exercise. Amidst these findings, over 80% of taxpayers surveyed in the cost of compliance studies reported that VAT compliance was difficult; the survey also highlighted the regressive nature of the cost of compliance, with smaller taxpayers carrying a disproportionate share of the cost. The cost of compliance study also reported a poor public perception of the tax appeals process. There are issues of timeliness, availability of representative to sit on the second level Tribunal, and the perceived fairness of the system. While other parties also have a part to play in this process, the IRD has a strong interest in ensuring that taxpayers have access to a fair and reliable redress process, which is an important part of promoting voluntary compliance in a self-assessment system.

The impact of any tax system is determined by the quality of the staff of the tax administration. The IRD faces significant challenges to recruit qualified staff and, more importantly, to retain them. Training costs are high as the organization continually tries to bring inexperienced staff up to a functioning level when staff transfers occur every two years. In a world of increasing complexity of tax planning and increasing sophistication of taxpayers, it is important that the department's staff is equipped to interact with taxpayers on an equal footing. Enhancing the professionalism and integrity of staff is a high priority. The IRD aims to provide a continuous training program for all staff and an appropriate combination of classroom training and on-the-job learning to equip new recruits for the workplace. Moreover, the frequency of changes at the management level has an impact on the continuity of reform initiatives, and therefore opportunities must be provided for managers to gain more experience in their positions and acquire greater leadership skills.

Finally, the nature of business evolution itself is a constant challenge. Commercial enterprises continuously evolve their business models in response to the accelerating globalization of trade this evolution. As expected, some teething problems appeared after the introduction of VAT. Taxpayers have to maintain purchase and sales books for VAT purposes. In the case of some taxpayers, these books are in addition to their other books showing similar information. Recording of each and every purchase and sales invoices has also created additional work for those taxpayers that were not doing it before the introduction of VAT. As explained earlier, some accounting problems also occurred due to the customs.

It was common for the tax authorities to demand certain standards on audit. A qualified independent auditor has to certify that accounts rendered by a taxpayer in support of his declaration of profits or income are correct. This requirement was embodied in the tax law, but more often, it is not and it is usual to expect a higher standard for larger business than small ones. An element of the compulsions tax department established what standard of accounting and audit system expected of the taxpayer when rendering their tax declaration and what procedures to be followed to appeal against the tax assessment. (Khadka: 2000)

2.14 VAT Reform :

The Inland Revenue Department (IRD) falls under the auspices of the Ministry of Finance and was established on July 16, 2002 as a result of a merger of the Income Tax Department and the Value Added Tax Department. It is responsible for the administration of domestic tax revenue emanating from Income Tax, Value Added Tax, Excise (the three major taxes in revenue administration), Health Services Tax and the Education Services Fee. The department has an authorized staff complement of 1,040 positions. Nearly 20% of positions are currently vacant. The administration is decentralized, in a functional organizational structure.

The IRD has one Large Taxpayer Office (LTO) to service the largest taxpayers, 22 Inland Revenue Offices (IRO) nationwide, and 13 Taxpayer Services Offices (TSO) in the Kathmandu Valley with 15 more being established outside the Valley. In recent years the IRD has achieved significant revenue growth, including an increase of 27.4 % in collections in fiscal year 2009/10 when compared to fiscal year 2008/09, additional growth of 20.4% in the fiscal year 2010/11, followed by further growth of 23% in the most recent complete fiscal year, 2011/12. Registration activity has increased substantially over the last four years but has been accompanied by increasing non-filing compliance. It is estimated that the shadow or informal economy accounts for 38% of

economic activity and that there are significant gaps in filing, payment and reporting compliance for the remaining 62%.

Inland Revenue Department completed investigation against 468 firms, this might be a positive step towards VAT reform. Out of a total of 518 cases — of Value Added Tax (VAT) fraud scam. “The department slapped Rs 4.55 billion tax and fine to the 468 firms that were involved in evading VAT compliance by producing fake invoices.

Significant improvements have been made in taxpayer service using automation to increase efficiency (e.g. e-services in registration and filing), broadening the audit approach (e.g. introduction of current audits for value VAT and TDS, standardizing performance (e.g. promulgation amongst staff of an audit manual for the three major taxes), and working with external partners. The IRD has a strong appetite for increased data sharing and analysis, for enhancing risk assessment processes, and for exploiting the benefits of information technology. Notwithstanding these achievements, there is a need for comprehensive reform to build a tax administration that can meet the challenges of the future. Several factors influence this need for reform, including:

- a tax revenue to GDP ratio which is approximately 13.2% and which needs to be continuously enhanced
- Continuing positive revenue growth over several years, leading to a 23% increase in the target for tax revenue in the fiscal year 2011/12
- The need for more vigilance in enforcing the tax legislation and to increase deterrence of noncompliant behavior as evidenced by the results of recent successful VAT fraud investigations
- Concerns about the compliance burden, particularly regarding VAT, the need for simplification of processes, and concerns about the efficiency and transparency of the appeals process as revealed by the preliminary findings of the recent survey of taxpayers regarding compliance costs and their perceptions of the tax system
- e-filing success, where more than 90% of VAT returns are currently submitted electronically, leading to the need to extend and enhance e-services in other areas
- The need to increase compliance, starting with the integrity of the registration database and following through to increasing filing, reporting and payment compliance.

After completion of the Public Expenditure and Financial Accountability (PEFA) assessment several reforms were identified to improve Nepal’s public financial management systems.

2.15 Tax Compliance

The primary goal of a revenue authority is to collect payable taxes and duties in accordance with the law. This needs to be done in such a manner that it will sustain the confidence of the taxpayers in the tax system and administration. Noncompliant behavior is based on various reasons. According to the traditional Fischer model on tax compliance (1992), the key determinants can be categorized as follows:

1. Tax system structure (tax rate, penalty, and probability of detection, complexity of tax system);
2. Attitude and perception (fairness, ethics, and peer influence);
3. Noncompliance opportunity (income level, income sources and occupation) and
4. Demographic factors (age, gender and education).

2.16 Revenue Collection and Government Expenditure

2.16.1 Resources Mobilization

Developing countries with economic transactions are confronting unsustainable fiscal deficit, unabated debt –service charges, and declining external assistance that has seriously affected their development. They need to overhaul their domestic and external financial resource mobilization strategy and adopt tax and non-tax instruments. It must be fair, equitable and create minimal disincentives to increase economic efficiency and initiate reforms that simplify and rationalize the tax structure.

Government emphasis is in improving efficiency and effectiveness of revenue administration, strengthening the institutional framework, selecting administratively feasible and realistic collectable taxes and duties, widening the tax base and integrating the informal factor into the mainstream of the national economy. Earlier the government had mobilized revenue in three ways by levying taxes, by generating non-tax revenue and by borrowing from local or international capital market. Most of the off-market resources were raised through taxes; non tax revenues have less than 5% contribute in most countries. A country's capacity to raise tax revenues depends not only on tangible economic factors such as political will, administrative efficiency, but also on culture of tax compliance. GDP is not always a tool to measure it, but there are also several different techniques and measures to evaluate a country's tax system. (Shande: 2003).

It states that one can estimate a hypothetical tax to GDP ratio by isolating several independent variables such as per capital income, share of agricultural output, the openness of the economy and ratio of money supply to GDP and comparing tax performance to that of similar countries.

2.16.2 Economic Growth Rate

The world experienced a decline in economic growth rate in comparison to 2011 than in 2010. According to International Monetary Fund (IMF) published World Economic Outlook, the world economy that grew by 5.3 percent in 2010 grew only by 3.9 percent in 2011. Observation from a regional perspective shows that, except for Eastern and Eastern Europe, growth rates in all other regions slumped in 2011 than in 2010. The economic growth rate in the next year also is projected to remain low due to reasons like slower global economic recovery than expected; European debt crisis; natural disaster in Japan; sluggish economic recovery of the emerging economies of the world; rise in the price of petroleum products, which is the most necessary source of energy for the people's livelihood; and persistent recession in the real estate business in Europe. According to the same document of IMF, the world economy has grown by 3.5 percent in 2012, expected to record higher growth rates in succeeding years. Amid projection of economic slowdown throughout all regions of the globe, the growth rate of Central and Eastern Europe is far worse in 2012.

Likewise, economic growth of China, the close neighbor of South Asian countries able to maintain an outstanding double digit growth rate in the decade of 2000, has also declined in 2011. Table below depicts the growth trend of neighboring countries.

Table 9
Economic Growth Rate of Neighboring Countries

(Annual percentage change)

| Country | 2010 | 2011 | 2012 | Forecast | | |
|--------------------|------|------|------|----------|------|------|
| | | | | 2013 | 2014 | 2018 |
| Afghanistan | 8.4 | 7.0 | 10.2 | 3.1 | 4.8 | 4.8 |
| Bangladesh | 6.4 | 6.5 | 6.1 | 6.0 | 6.4 | 7.2 |
| Bhutan | 11.7 | 8.5 | 9.7 | 6.3 | 8.6 | 10 |
| India | 11.2 | 7.7 | 4.0 | 5.7 | 6.2 | 7.0 |
| Maldives | 7.1 | 7.0 | 3.5 | 3.8 | 4 | 4.1 |
| Nepal | 4.8 | 3.9 | 4.6 | 3.0 | 4 | 4.1 |
| Pakistan | 3.1 | 3.0 | 3.7 | 3.5 | 3.3 | 3.0 |
| Sri-Lanka | 8.0 | 8.2 | 6.4 | 6.3 | 6.7 | 6.5 |
| China | 10.4 | 9.3 | 7.8 | 8.0 | 8.2 | 8.5 |

Source: International Monetary Fund, 2013

2.16.3 National Economy

According to preliminary data, economy in FY 2012/13 is estimated to grow by 3.56 percent at base prices and 3.65 percent at producers' prices against the estimated 5.5 percent. Such growth rates at the base price were 4.48 percent in previous FY 2011/12 and 3.85 percent in its preceding year. A number of factors like ever extending political transition, problems in industrial environment, low private sector investment, energy crisis, lower credit expansion of banks have restricted the growth of industrial production resulted in sluggish economic activities of the non-agriculture sector thereby restricting this sectors growth to 4.98 percent. Growth rate of agriculture also stood at 1.26 percent with decline in production of food grains due to absence of timely monsoon rainfall and insufficient rainfall in the winter.

As per preliminary data, GDP in fiscal year 2011/12 is estimated at growth to grow at 4.5 percent at the base price and 4.63 at producers' price against the target of 5.0 percent set for the year. In the previous fiscal year, GDP growth rate stood at 3.81 percent and 4.26 percent at the base price in fiscal years 2010/11 and 2009/10 respectively. Non agricultural GDP could grow only by 4.27 percent due to ever extending the political transition, problems in industrial environment, lack of Private investment, and energy crisis.

From GDP growth perspective, the past decade was not encouraging for Nepal. GDP growth rate that had recorded 5.8 percent in fiscal year 2007/08 covered around 4.0 percent in other years. For instance, the GDP rate in the fiscal year 2006/07 grew at merely 2.8 percent. The GDP growth rate in the past decade 3.51 percent on an average, while sector-wide growth also was not encouraging with 3.18 percent, 2.14 percent, and 4.52 percent growth rate in agriculture, industry, and services sectors respectively. In the preceding years, the growth rate of the industry sector has been decreasing while that of the services sector has been increasing.

2.16.4 Structure of GDP

Statistics reveal gradual changes occurring in the GDP structure of Nepalese economy. Decreasing trend of the contribution of agriculture and industry and increasing that of the services sector is apparently visible. From a sector perspective, the primary sector contribution to GDP in this current FY 2011/12 at current prices is estimated at 35.68 percent. Such contribution is less by 1.75 percentage points than in the previous fiscal year. The share of this sector in GDP was 37.01 percent in the fiscal year 2000/01, which gradually came down in succeeding years. But, the contribution of this sector increased in the fiscal year 2010/11. The GDP share of sector averaged 34.43 percent in preceding

five years. Reason for the decline in the ratio of the contribution of this sector to GDP in this fiscal year is a higher rate of growth in the service sector despite the growth in agricultural production.

The contribution of the Secondary sector to GDP has been gradually coming down. This sector shared 16.86 percent of GDP in FY 2000/01 at current prices, which is estimated to be contained at 14.02 percent in this fiscal year from 14.29 percent in the previous fiscal year. Reason of such decreasing trend is attributable to decline in the industry and construction activities in this fiscal year. Share of this sector in GDP averaged 15.31 percent in preceding five years. Despite gradual rise in contribution of the Tertiary sector to GDP, it slightly came down in Fiscal years 2009/10 and 2010/11. This sector shared 46.13 percent of GDP in 2000/01 at current prices, which grew to 48.28 percent in FY 2010/11. The sector's share is estimated to rise further by 2.03 percentage points reaching 50.31 percent. Reason for this sector's comparative increase in the share of GDP is due to growth in outputs of the wide ranging sub-sectors including business, hotel and restaurant, transport, communications, financial intermediation, real estate transaction, public administration and defense, education, health, and other community social and personal services. GDP classification into agriculture and non-agriculture sectors as per industrial classification reveals the declining trend of the contribution of agriculture while share of the non agricultural sector has increased to some extent. The contribution of this sector to GDP in FY 2000/01 was 36.6 percent, which is estimated at 35.1 percent in the current fiscal year 2011/12 slipping from 36.9 percent in FY 2010/11. The share of this sector in GDP in the preceding five years averaged 33.9 percent. Observation of data shows that the share of agriculture sector dropped to 31.7 percent in FY 2007/08, while it stood highest in FY 2010/11 with 36.9 percent. Despite increased agricultural production in this fiscal year, its contribution to GDP appears low due to higher growth rate achieved in the services sector under the non-agriculture category.

2.16.5 Income Per Capita

For the F/Y 2011/12 Per capita income of Nepalese has risen. Per capita GDP at current prices has increased by 12.2 percent reaching Rs. 57,726. Likewise, gross national income per capita also grew by 12.7 percent reaching 58,274. Such growth in per capita GDP and gross national income per capita at current prices, however, has been 3.2 percent and 3.3 percent reaching Rs. 24,908.0 and 25,393 respectively.

2.16.6 Gross National Disposable Income

Disposal income of Nepalese has been on increase since past few years. Such income in the fiscal year 2011/12 is estimated to grow by 17.2 percent totaling Rs. 1.974 trillion at current prices. This growth is due to increase in remittance income for the last few years. In the current fiscal year, GDP at current prices is estimated to grow by 13.8 percent reaching Rs. 1.558 trillion. As compared to its preceding fiscal year, disposable income in FY 2010/11 rose by 13.4 percent, while GDP grew by 14.7 percent totaling Rs. 1.685 trillion and 1.369 trillion respectively.

Based on gross national disposable income, ratios of consumption vs. national saving come out to 71.1 percent vs. 28.9 percent respectively. Such ratio in FY 2010/11 was 74.2 and 25.8 percent respectively. In the previous fiscal year, growth rates of all among GDP, Gross National Income, Gross National Disposable Income, Gross Domestic Saving and Gross National Saving had decreased, while in the current fiscal year, except for GDP and Gross National Income, all others are estimated to record growth. Saving in this year is estimated to increase as the share of consumption expenditure to GDP has been lower than in the previous fiscal year.

2.16.7 Structure of Public Finance

Nepal is heavily depends on the revenue collection for meeting its expenses. But in recent times the government has failed to meet the target for revenue mobilization, despite several initiatives. The financial transaction statistics of the government of Nepal show that expenditure in the fiscal year 2010/11 grew by 13.7 percent reaching 295.36 billion. Such expenditure is estimated to grow by 23.8 percent in the current FY 2011/12 reaching 365.72 billion. Of this total, share of recurrent and capital expenditure is estimated at Rs. 256.86 billion and 62.90 billion, with the remaining Rs. 45.94 billion shared by fiscal arrangement. Revenue mobilization in the current fiscal year is estimated to grow by 20.5 percent totaling Rs. 240.81 billion. This total comprises of Rs.205.22 as tax revenue and the remaining Rs.35.59 billion as non-tax revenue.

Looking at the expenditure trend of the past years, the share of recurrent expenditure in total expenditure remained close to 60 to 62 percent between fiscal years 2002/03 and 2005/06 while such ratio has declined in subsequent years, which is considered as positive from public financial management perspective. The share of capital expenditure in total expenditure was about 26 percent between fiscal years 2002/03 and 2005/06 while it showed gradual improvements in the subsequent years reaching 36.5 percent in the fiscal year 2010/11. Similarly, revenue mobilization covered about 63 to 70 percent of the total expenditure between fiscal years 2002/03 and 2009/10. During this period, average gross revenue grew by 17.5 percent, while the average growth rate of gross expenditure stood at 17.3 percent.

Table 10
Public Finance and their Ratios to GDP (In Percent)

(In Rs. 10 Million)

| Description | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13* |
|-------------------------------------------|----------------|----------------|----------------|----------------|-----------------|
| GDP | 98827.20 | 119277.40 | 137495.30 | 153600.00 | 170119.40 |
| Expenditure | 21966.20 | 25968.91 | 29536.34 | 33916.75 | 40482.47 |
| Government Income (Including Grant) | 16985.57 | 21849.18 | 24574.12 | 28537.14 | 34098.92 |
| Budget Deficit | 4980.47 | 4119.73 | 4962.22 | 5379.61 | 6383.55 |
| Description | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13* |
| Ratio to GDP (In Percent) | | | | | |
| Expenditure | 22.23 | 21.77 | 21.48 | 22.08 | 23.80 |
| Government Income | 17.19 | 18.32 | 17.87 | 18.58 | 20.04 |
| Budget Deficit | 5.04 | 3.45 | 3.61 | 3.50 | 3.75 |
| Revenue | 14.16 | 14.92 | 14.69 | 15.91 | 17.02 |

**Estimated*

Source: Financial Comptrollers General Office

The total expenditure of the government budget for fiscal year 2012/13 announced on 9 April 2013 is estimated at Rs. 404.82 billion. The total expenditure of this year is higher by 19 percent as compared to the actual of fiscal year 2011/12. Such expenditure stood at Rs. 295.36 billion in fiscal year 2010/11 while it had by 15 percent to Rs. 339.16 billion in fiscal year 2011/12. The government revenue (revenue and grants) was Rs. 285.37 billion in fiscal year 2011/12 while this revenue is expected to grow by 19 percent reaching Rs. 340.98 billion in current fiscal year 2012/13.

Budget deficit of the government of Nepal that stood at Rs. 53.79 billion in fiscal year 2011/12 is expected to reach Rs. 63.83 billion in the current fiscal year. The growth rate of the budget deficit was only 8.4 percent in fiscal year 2011/12 while both the total expenditure and revenue are expected to grow by around 19 percent causing the budget deficit in the current fiscal year to grow by 18.7 percent. Analyzing the trend of revenue and expenditure, budget deficit and their ratios to GDP of last five years, the budget of this year that has been presented amid special political scenario of the country is also not different from the trend and structure of revenue and expenditure of previous years.

Table 11
Capital Expenditure, Principal Repayment and Sources of Financing

(Rs In million)

| Heads | 2003/04 | 2004/05 | 2006/07 | 2007/08 | 2008/09 | 2009/10 | 2010/11 | 2011/12 |
|------------------------------------------------------------|---------|---------|---------|---------|---------|---------|---------|---------|
| Total Capital & Principal Repayment Expenditure | 33890.5 | 40874.0 | 43871.4 | 56482.2 | 69903.0 | 91923.0 | 108670 | 125068 |
| A. Capital Expenditure | 23095.6 | 27340.7 | 29606.6 | 39729.9 | 53516.1 | 73088.9 | 90237.7 | 107847 |
| B. Principal Repayment Expenditure | 10794.9 | 13533.3 | 14264.8 | 16752.3 | 16386.9 | 18834.1 | 18432.3 | 17220.5 |

Source: Financial Comptrollers General Office

Table 12
Expenditure Bearing Sources

(In percent)

| Heads | 2003/04 | 2004/05 | 2006/07 | 2007/08 | 2008/09 | 2009/10 | 2010/11 | 2011/12 |
|----------------------------------------|---------|---------|---------|---------|---------|---------|---------|---------|
| A. Revenue Surplus | 20.0 | 20.6 | 12.0 | 18.7 | 23.1 | 17.1 | 26.6 | 23.6 |
| B. Foreign Grant | 33.3 | 35.2 | 31.5 | 28 | 29.1 | 28.7 | 35.5 | 36.7 |
| C. Sources of Deficit Financing | 46.7 | 44.2 | 56.5 | 53.3 | 47.8 | 54.2 | 37.9 | 39.7 |
| A. Foreign Loan | (22.5) | (22.7) | (18.8) | (17.8) | (12.9) | (10.8) | (10.3) | (9.7) |
| B. Domestic Borrowing | (16.5) | (21.9) | (26.9) | (31.7) | (29.3) | (20.0) | (27.5) | (34.0) |
| C. Change in Reserves | (7.7) | (0.4) | (10.8) | (3.8) | (5.6) | (23.3) | (0.1) | (4.0) |

Source: Financial Comptrollers General Office

Of the sources of deficit financing, the share of foreign loan stood at 9.7 percent, share of domestic borrowings at 34.0 percent and the share of change in reserves 4.0 percent in the fiscal year 2010/11. The share of foreign loan was notable from the fiscal year 2004/05 up to 2006/07. In the fiscal year 2010/11, of the sources to finance capital and principal repayments, the share of revenue surplus stood at 23.6 percent, share of foreign grants 36.7 percent, and the share of deficit financing remained at 39.7 percent. The share of revenue surplus in the fiscal year 2010/11 is less by 3.0 percentage points than that of FY 2009/10 while share of foreign grants is more by 1.2 percentage points.

2.16.8 Revenue

Revenue mobilization, foreign grants and loans, domestic borrowings and change in cash reserves are used as fiscal instruments for financing government expenditures. Government income increased by 16.1 percent totaling Rs. 285.37 billion in fiscal year 2011/12. It is estimated to grow further by 19.5 percent in this fiscal year and reach to a total of Rs. 340.98 billion. When compared to the fiscal year 2009/10, revenue mobilization in 2010/11 grew by 11.0 percent totaling Rs. 199.82 billion. In the fiscal year 2009/10, revenue collection had increased by 25.4 percent as compared to its preceding fiscal year. The Government revenue had financed 69.3 percent of the total

government expenditure in the fiscal year 2009/10 while contribution of this source accounted for 67.7 percent of the total expenditure in the fiscal year 2010/11. Of the total revenue, shares of tax revenue and non-tax revenue in the fiscal year 2010/11 stood at 86.5 percent and 13.5 percent respectively. Such shares in the previous year were 86.9 percent and 13.1 percent respectively.

Tax revenue grew by 10.5 percent in the fiscal year 2010/11 compared to that of the previous fiscal year. Such revenue had increased by 33.5 percent in the fiscal year 2009/10 compared to its preceding fiscal year. Of the total tax revenue in the fiscal year 2010/11, the share of customs duty was 20.6 percent, while the share of tax on production and consumption of goods and services was 51.2 percent. Likewise, the share of land revenue and registration was 2.1 percent and that of the total of income, profit, and property tax was 26.1 percent.

Customs revenue collection in the fiscal year 2010/11 grew nominally by 1.6 percent, while tax levied on production and consumption of goods and services rose by 11.4 percent. The total of income, profit, and property taxes increased by 24.4 percent. In the same period, however, land revenue and registration fees dropped by 35.2 percent. Of the customs revenue, revenue from imports increased by 5.1 percent, while that from exports rose by 60.9 percent. Indian excise refund and Excise Duty under the production and consumption category of taxes slipped by 9.2 percent and 12.3 percent respectively in the fiscal year 2010/11.

Non-tax revenue in the financial year 2010/11 increased by 14.3 percent reaching the total of Rs. 27.04 billion in the as compared to that of the fiscal year 2009/10. Of the total non-tax revenue in the fiscal year 2010/11, the share of fees, fines, forfeitures was 37.7 percent; income from the sale of government goods and stood at 6.0 percent; dividend 31.9 percent; sales of royalty and government properties 9.8 percent; principal and interest 9.7 percent; and miscellaneous non-tax revenue 4.9 percent. On non-tax revenue front, firm registration fees increased 8.8 percent while the total of administrative fees, penalties, fines and forfeitures decreased by 89.6 percent in the fiscal year 2010/11 as compared to the previous fiscal year. Dividend of service-oriented organizations rose by 14.3 percent other government sector in come robe by 88.8 percent and income of principal payment receipt from companies and enterprises fell by 27.0 percent while interest payments rose by 166.7 percent in the fiscal year 2010/11 in non-tax revenues category.

2.16.9 Share of Tax Revenue (%)

Remittances have enhanced the consumption level and thus increased the VAT revenue substantially. A stronger investment of remittances in productive sectors could create revenue in the long-term. The growing importance of global businesses, international trade and foreign employment changes the economic climate in Nepal. The recently concluded Bilateral Investment Promotion and Protection Agreement (BIPPA) with India is one example for future cooperation with neighboring countries. Managing liabilities without double taxation, but also by preventing tax avoidance requires better information exchange. This need is currently covered by 10 Double Taxation Agreements of the Nepalese state with Thailand, Sri Lanka, Pakistan, Norway, Mauritius, Korea, India, Austria, China and Qatar. The treaties are expected to become more relevant in the future and require the fulfillment of specific obligations by the tax administration. The details of government expenditure is shown on the table below:

Table 13
Details of Government Income

(In Rs. 10 Million)

| Description | 2009/10 | 2010/11 | 2011/12 | 2012/13* |
|--------------------------------|-----------------|-----------------|-----------------|-----------------|
| Tax Revenue | 15978.53 | 17722.71 | 21172.26 | 25257.25 |
| Non-Tax Revenue | 1820.56 | 2114.87 | 3265.15 | 3703.24 |
| Total Revenue | 17799.09 | 19837.63 | 24437.41 | 28960.49 |
| Foreign Grants Principle | 3854.60 | 4592.22 | 4081.03 | 4698.92 |
| Repayment of Loan | 195.40 | 144.27 | 18.70 | 439.50 |
| Total Government Income | 21849.08 | 24574.07 | 28537.14 | 34098.91 |

*Estimated

Source: Financial Comptroller General Office

Of the government's income sources, tax revenue grew by 21.1 percent on an average between fiscal years 2009/10 to 2011/12. Government income from principal repayment, however, has been declining significantly every year. Non-tax revenue decreased by 20.5 percent in fiscal year 2009/10 compared to its 35 preceding year, increased by 16.2 percent in fiscal year 2010/11, and by 54.4 percent in fiscal year 2011/12. The foreign grants increased by 46.1 percent in fiscal year 2009/10 and decreased by 11.1 percent in fiscal year 2011/12 as compared to its preceding year. This is expected to grow by 15.1 percent in the current fiscal year.

2.17 Inland Revenue in Nepal: Compliance Environment

Different aspects are influencing the implementation of tax policies in Nepal. The large informal economy, tax fraud and evasion, insufficient information about the tax system, as well as limited organizational capacities have been identified to impede progress of the tax system and change processes within IRD. At the core of the improvement of tax compliance is the context or the 'environments' in which the tax administration operates. A variety of environmental and organizational factors needs to be considered: Over the years, tax policy in Nepal has evolved in response to the development strategy and its changes. From 1951, land revenue, custom duties and excise duties were in existence in Nepal. The Excise Act, 1958 and the Customs Act 1962 consolidated respective laws and improved both the excise and customs systems throughout the country. However, the foundation of the modern tax system was initiated in 1959/60 (*Byapar Munafa Ra Parisramik Kar Ain, 2017*) after the introduction of income tax, urban house and land tax, and foreign investment tax, followed by sales in 1965. In 1969/70, the foreign investment tax was merged with income tax.

Furthermore, the corporate income tax was separated from the individual income tax in 1986/87 when public corporation and public limited companies listed on the Nepal Stock Exchange were subjected to a flat corporate tax rate. This tax was extended to Private limited companies in 1993/94. Significant reform progress was recognized with the implementation of initiated reform processes starting in 1974: the self-assessment system, changes in accounting system, and introduction of a presumptive tax payment system assured the GON steady and predictable revenue. In the process of tax reforms, VAT was introduced in the FY 1997/98, replacing the Sales Tax, Entertainment Tax, Hotel Tax, and Contract Tax.

Nepal not only acceded to the WTO regime in 2004/05 but is also a member of SAFTA. International exchange entails potential benefits from trade with neighboring countries, but especially from Nepal's transit position between two emerging countries, with India and China estimated to have economic growth rates of 8 percent and 9.5 percent respectively. Regional and international cooperation agreements further require measures to compete on global markets, manage cross-border businesses and transactions. International commitments necessitate promoting modernized public financial management systems.

A five year Strategy and Action Plan have been recently announced to take action against anti-money laundering and counter-terrorism. Those measures can further contribute to develop an investment-friendly environment. Cooperation efforts, such as the WTO membership, on the other hand have also had an impact on the revenue compilation of

the country: The WTO membership made it obligatory for the Nepalese government to reduce tariff rates on imported goods and services. The share of customs tariff is on a declining trend and the contribution of VAT has increased; a marginal rise in the share of direct taxes has been noticed. VAT has been a major source of tax revenue, followed by income tax. The share of VAT in total tax revenue stands at 35.92 percent in FY 2010/11 with a propensity of further rise, together with the rise in consumption level, and has been established as the major source of revenue. After accession to the WTO, the share of customs in the revenue collection has declined. Excise duty has become more significant in raising government revenue currently comprising a number of around 22,800 registered taxpayers.

(Source: http://www.mof.gov.np/economic_policy)

2.18 Tax assessment:

2.18.1 Self Assessment :

Self assessment was introduced for public limited companies and firms in 1991 A.D. In the beginning the implementation of this system was not effective due lack of an action plan for implementation .The self assessment return should audit by permitted tax auditor. The system demanded proper documentation and the process was lengthy. There is a tendency that the business community understated their income and in response to it the tax officer made full tax audit on self – assessment report. Practically, it is not possible for the tax department to make full tax audit to each and every business firms. Theoretically, tax payers under the self – assessment system are responsible for his tax assessment and should perform his responsibilities more accurately. The practice was different and the self – assessment system was not effective in practice. In most cases taxpayer did not report their income correctly and tax officer use their best judgments in assessment. Committee assessment system was generally for small size business. This committee assessment system had also become unnecessary in the content of increasing use of presumptive system. (khadka :2000).

2.18.2 Official Assessment

Under income tax system, it is required to furnish a report within three months by the end of the fiscal year to the tax office. Official assessment system tax could be assessed either on the basis of accounts maintained by a taxpayer of a tax office or by a committee. There was a provision in income tax law for additional or supplementary assessment in case of tax payer who could assess fewer amounts than their true taxable income. The best judgment method generally was used when a taxpayer did not maintain record or record was unsatisfactory. The system was based on arbitrary method. Most tax

officers assessed income tax using their best judgment. There was a tradition in tax officers to assess a higher amount of tax in the annual year than in the previous year. Large part of total income tax was assessed on the best judgment basis by applying presumptive rate for the determination of taxable income. The target system that has been in practice for so long is mainly responsible for the development of such arbitrary system of assessment. Under the target system, each tax officer was given revenue target for each fiscal year. (khadka: 2000).

2.18.3 Sales Tax Assessment

Sales tax was introduced for the first time in 1965 by the finance Act 1965 and later implemented under the sales tax 1966. Initially the tax was levied at retails level and later it was moved to the whole scale level in 1968 and again to the import \manufacturing point in 1974. This tax was finally converted into Value Added Tax in 1997. There was provision of sales tax assessment by tax officer. Almost all retails return was to be assessed by tax officers'. It was similar as income tax assessment system. (khadka :2000)

2.18.4 Excise Tax Assessment

There was provision of self –assessment in the excise tax system. Before the implementation of this system offices directly controlled all the excisable items.(khadka : 2000).

2.18.5 Tax Base

The last budget introduced measures to extend the revenue base by imposing registration of some new sectors, mainly those in service sectors. However, there is a need to improve consistency of tax laws and exemptions as well as incentives. Efficient mechanisms are necessary to take action against fraudsters and non-filers. At the same time, investigation and audit processes has to be redefined and streamlined. The taxpayers' registration trend has been positive over the years. In case of income tax, the trend shows that taxpayers' registration has been increasing at an average rate of 20.17 percent, whereas in the case of VAT, the average growth rate had been 21.09 percent over the last four years. Moreover, by the end of April 2012, 263,250 Personal Income Tax (PIT) registered taxpayers were noted who are not required to submit an annual tax return provided they have only final withholding income. There are 34,923 Tax Deduction at Source (TDS) with-holders who reported a the TDS amount of Rs 8.61 billion to IRD in FY 2010/11.

2.18.6 Excise Duties and Arrears

Conducting regular audit on the principles of risk management and selection of criteria on input/output analysis is vital for successful compliance. Regular audit of taxpayers gives the IRD a high and fair chance of detection of fraud and thereafter strict application of penalties. Therefore, a good and effective system of audit is important for tax administrations. It provides an effective paper trail of the input and output activities of a registered taxpayer to tax administrators. With the execution of a regular and the investigative audit program, potential fraudsters are deterred by the belief that they see a reasonably high chance of detection and punishment.

2.19 Collection Cost

The collection cost of IRD substantially increased in FY 2010/11 due to costly collection processes (e.g. of excise stamp cost) and infrastructure measures. 13 TSOs were newly established in the Kathmandu Valley. The cost of collection for one thousand rupees tax has been recorded to be Rs.16.38 in FY 2006/07 and gradually plummeted to Rs.4.99 in FY 2009/10, but shot up to Rs.12.72 in FY 2010/11.

2.20 Compliance Cost

A fair and simple taxation system reduces complexity, costs to fulfill obligations and legal requirements as well as non-compliance. The complexity in the Nepalese tax system on the contrary has further accelerated with the perennial amendments in the tax legislation and influenced tax compliance. Together with the constant changes in the tax laws, limited administrative capacities and inadequate responsiveness towards taxpayers contribute to creating higher tax compliance cost. The compliance cost referred here includes the accounting cost for taxpayers. In 2012, the International Finance Corporation (IFC) had conducted a compliance cost survey for a sample of 990 businesses in Nepal. The survey focused especially on smaller and medium sized enterprises taking into account the Corporate Income Tax (CIT), VAT, and withholding tax. According to the results of the survey, the overall average compliance cost (accounting cost) for taxpayers amounts.

Cost of Collection for One Thousand (Rs) Rs. 9,382 across business with various turnover groups, whereas the highest cost arises for time consuming VAT compliance with Rs. 14,756. In addition, the survey indicates that an average Nepali enterprise spends over 300 hours on tax compliance related matters per year. Higher compliance cost imply

a disincentive to small and large entrepreneurs. The simplification of processes, prompt response and responsiveness is needed to reduce compliance cost.

(Source: IRD)

2.21 ICT Context

In line with the initiation of an electronic Information and Communication Technology (ICT) system, web-based applications for the registration of taxpayers and their tax returns and assessment have been developed. More and more taxpayers have started using e-taxation platforms and submitting tax returns online. Although the online revenue reporting system is yet to be developed, a centralized networking system has been established resulting in an increase of tax revenue collection. All IROs and the LTO are connected to the web-based revenue collection system. At present, IRD maintains over 600,000 tax files, and the number is increasing. Given the huge amount of tax data involved and to meet the demands from the public, IRD has to strategically maintain and upgrade its ICT system to enhance the efficiency of its day-to-day operations and to provide a wide range of electronic services to the public. The major components of IRD's existing ICT infrastructure (comprising mainframe, midrange, personal computer (PC) and local area network (LAN) platforms) were implemented in 2000/01. Technological advancements can support a secure and reliable ICT platform to meet its operational requirements. It is anticipated that IT-assisted services will be of growing relevance in the future.

2.22 Organization & HR Management

Reforms require efficient management and administration, as well as technical capacities supporting tax legislation. According to the Income Tax Act, the superior role of the Inland Revenue Department comprises responsibilities in the implementation and administration of tax laws as well as the establishment of tax offices as part of the department in order to facilitate the fulfillment of delegated responsibilities. The further structure comprises one LTO, 22 IROs, and 28 TSOs. In order to manage a functional division of labor and the organization's workforce, human resource development and improvement is an on-going process within IRD. Skilled employees are required to assure quality performance based on job descriptions. Measures have been taken in the past to strengthen knowledge, skills and positive behavior. Further tailor-made training measures will be based on a thorough review of the current Human Resource Management in order to support the positive process. Following the encouraging results from the established Performance Based Incentive Scheme on the overall organization's performance, a review of internal mechanisms based on a sufficient monitoring allows a critical reflection for further improvement.*(Source: IRD)*

2.23 Taxpayer Service

Especially since the introduction of the self-assessment system in 1993, the tax administration has identified the need to empower citizens by providing improved information access and assistance in 22 IROs as well as educating taxpayers to comply with tax laws. Attempts for effective communication strategies and initiatives to provide assistance to individuals and businesses have been undertaken in the past to strengthen the capabilities of citizens to manage own tax liabilities:

- Information campaigns were conducted using different channels, such as newspapers, radio, TV, microphone, brochures and direct interactions.
- Manuals on income tax, VAT and excise have been developed and published, in order to provide a clear reference and interpretation of tax laws.
- Online applications were introduced and demonstrated, such as the opportunity for registration and filing. Further applications are yet to be developed.
- The Personal Account Number System, introduced in 2009, has been further developed as an internet based system allowing online access by all taxpayers (e-PAN)

Taxpayer service has become essential in providing quality assistance to taxpayers, improving the perception of IRD and enhancing voluntary tax compliance. Services provided to citizens have resulted in progress of taxpayer-friendly services throughout the country. By enhancing the communication between taxpayers and the revenue authority, IRD is directly contributing to create confidence in state institutions.

2.24 Domestic Tax Development

Government expenditures are financed foremost by domestic revenue. Reform initiatives undertaken by the tax administration over the past years have resulted in an encouraging volume of revenue collection. The contribution of revenue to the annual budget oscillated from 64 to 69 percent during the last three years. The share of tax revenue has increased to 85 percent of total revenue and share of non-tax revenue is getting lower day by day. In the FY 2011/2012 the government could increase revenue collection by 21 percent compared to the previous year. Tax revenue, the most reliable and non-debt creating resources to finance government spending, is preferred to external resources because of unpredictable nature and strings associated with the latter.

- IRD has maintained fiscal stability by keeping the fiscal deficit down to 3.5 percent of GDP in FY 2009/10. Tax revenue to GDP ratio has increased from 8.62 percent in FY 1997/98 to 12.74 in FY 2010/11, whereas non-tax revenue covered around less than 3 percent of the GDP during the last decade.
- In 1997/98 the ratio of total revenue to GDP was 10.95, maintaining a steady growth, it reached 13.34 in 2009/10. However, it declined slightly to 14.9 percent in 2010/11.
- The total public expenditure to GDP ratio stands at 22.16 percent (FY 2010/2011), which caused a budget deficit of 6.8 percent of GDP. The collected tax also hasn't reached the expected target of the Three Year Plan (2010/11–2012/13), which states:

“During the Plan period, it is estimated to raise total revenue amounting to Rs 677.99 billion at 2009/10 prices. While projecting revenues, it is estimated that the revenue will increase on an annual average by 8.7 percent at constant prices and the ratio of revenue to GDP, which is estimated to be 16.1 percent in the FY 2009/10 is projected to reach 17.3 percent at the final year 2012/13 of the Plan.”

So far, there has not been a comprehensive strategic program plan that guides the IRD to deal with the national, regional and international complex business environment. Taking developments in different areas, external influences and the understanding of the tax composition as a starting point for the review, the following determining factors have become decisive for the compliance environment:

2.25 Challenges

By considering the different organizational, technical and social factors in the reform environment of IRD, future challenges can be summarized as follows:

1. The informal economy prevents IRD to a large extent to obtain sufficient revenue to finance public services, and increases the tax burden for those following the tax obligations. In order to bring the informal sector into the tax net and enhance voluntary tax compliance, compliance costs need to be reduced through different approaches and mechanisms.
2. A complex, unpredictable tax system and inconsistent laws increase the probability for noncompliance. IRD therefore needs to establish a taxpayer-friendly environment by providing accessible information and services in order to create a better understanding on tax legislation and administrative processes.
3. Tax systems with a low risk of detection motivate citizens to avoid the registration to pay taxes. In order to effectively mitigate noncompliance and to

take efficient action against tax fraud and evasion, enforcement mechanisms of IRD need to be strengthened.

4. Limited resources, technical capacities and infrastructure impede quality services throughout the country. A competent Human Resource System is the prerequisite to initiate change processes. In order to build on the progress achieved by IRD so far and to be prepared for future challenges, the enhancement of organizational capacities is an on-going process.
5. Change processes within an organization require new ideas and team-play to progress and succeed with reform efforts. IRD wants to create an atmosphere for on-going learning and the development of innovative input. In line with the code of conduct and the values defined in the Strategic Plan, IRD promotes transparency, participation, accountability and responsiveness. Adherence can not only improve the organization's performance, but also contribute to a positive image of the tax administration and support creating confidence in state institutions.
6. The purpose of the integration of IT-assisted systems is multi-functional. It simplifies administrative operations, empowers taxpayers and enhances independency. It reduces compliance costs and fosters transparency through standardized processes. IRD is committed to creating an effective IT architecture and improve the technical capacities of a comprehensive network together with relevant stakeholders in order to serve customers' needs. The Strategic Plan contributes to achieving IRD's objectives and shows measures of how to address the challenges summarized above.

2.26 Expected Results of Strategic Plan

- Full Integration and full automation of VAT, IT and excise system
- Full implementation of an accessible, simplified and taxpayer-friendly ICT system
- Establishment of transaction-based taxpayer categories
- Implementation of e-banking systems
- Operationalization of Functional Data Analyzing Networking
- Full operationalization by ABBS System for tax collection
- 100 % Taxpayer Registration by the online system
- 100 % Collection of tax returns through e-filing

2.27 Review Of Previous Related Studies

On Value Added tax several studies have been undertaken on VAT, which has been a major instrument of tax reform since last decades. Their finding in various books, research papers, seminar papers, reports of international institutions and issues of journals and articles. IMF staffs undertook a study of seven developing countries that adopted VAT in their respective countries. The study shows that VAT helps to increase the government revenue by 10 to 30 percentages if VAT is effectively implemented which depend on administrative capacity. It is very difficult to find published researchers on the Nepalese taxation system. Some of the college students relating to business administrations and public administrations were found to have written their thesis and dissertations in partial fulfillments of the requirement for the Master's Degree. Most of such researchers followed the descriptive methods, which emphasized on what dimensions rather than how and why dimensions.

2.27.1 Reviews Of Related Books

In 2006, the book named, “**Tax Laws and Tax Planning**” by Mr. Ishwor Bhattarai and Mr. Girija Prasad Koirala describes the income tax system in depth. This book includes the separate chapter of Value Added Tax. It describes VAT practices in Nepal with several theoretical as well as with examples. This book specifically designed for study of MBS 2nd year under Tribhuvan University. However, the book has not mention about the legal provisions. (Bhattarai and Koirala: 2006).

Mr. Puspa Raj Khadel, published a text book entitled, “Tax Laws and Tax Planning in Nepal” in 2004. The book was designed to fulfill the needs of MBS level under Tribhuvan University. This book very useful to the students and teachers to know the legal provision of Income tax act 2058. This book has attached acts, rules related to Value Added Tax. (Kandel, 2004)

Mr. Surendra Keshar Amatya, Dr. Bihari Binod Pokharel and Mr. Rewanta Kumar Dahal published a book entitled in 2004. This book makes an in-depth approach to the study of income tax, property tax and VAT in Nepal in order to meet the specific requirements of the students studying taxation. This book includes legal provisions of Income Tax Act 2058 and VAT 2052. Not only theoretical but also numerical problems of income tax and value added tax are shrewdly presented in this book.

(Amatya, Pokharel & Dahal: 2004)

2.27.2 Review of Related Thesis

In Nepal VAT was introduced on 16 November 1997. This tax was levied in place of the sales tax, hotel tax, contract tax and entertainment tax. A total of 2045 firms was registered under the sales tax at the time of the introduction of VAT. They were required to be converted into VAT registered by 16 November 1997. During the course of its development various experts and researchers express their view regarding the problems and the future prospects of VAT. This chapter includes the summary of many theses given by students.

Bista, Rup Bahadur (1999) in his thesis. They are effective revenue mobilization, industrial development, strong administration, transparency and avoiding all tax loopholes. VAT helps to reduce the resource gap by broadening the tax base and mobilizing additional resource by controlling tax leakage, smuggling, unofficial trade and corruption through transparency and account based cross- checking. In his research, the major findings were about a VAT being account based, invoice based and record based; it checks the tax loopholes such as under valuation, on- recording and unauthorized trade. It discourages such issues and problems existed in the sales tax system. (Bista:1999)

Dhakal (2000), in his dissertation analyzed the Nepalese tax structure and potential revenue of VAT in Nepal. He has provided the following conclusions. Theoretically VAT is the attractive alternative of sales tax on the ground of revenue productivity equity norms, supporting economic growth without economic distortions; export promoting, price stability and neutrality on production and distribution etc. Further, the hypothesis of self polishing or 'Cross-checking' channels without cascading and pyramiding effect has made VAT 'milestone' in the history of reforming of the indirect tax. Empirically, he has found that VAT has high revenue potential power. Even the broad coverage of VAT would generate more revenue without addressing the equity norms. But, it would be noted that, achieving both efficiency and equity objectives simultaneously is a difficult task under the consumption levy. Practically, he has found that the VAT is going to become 'hot milk in mouth' due to inefficient tax administrators.

He has expressed that VAT is suitable both theoretically and empirically but the practical aspect is extremely weak. Thus only the introduction of VAT is not really acceptable as tax reform. The system of VAT itself has great need of reforming for the Nepalese context.

Chaudhari, Raju (2001) VAT in Nepal: An Analysis of its problems and prospects structure of VAT in Nepal, to observe the contribution of VAT to resource mobilization and to analyze the existing problems of VAT in Nepal through the primary and secondary

data and information, has concluded that the main problems for business houses are account keeping and billing and the weakness of VAT administration are lack of motivation and service minded attitude among tax officials lack of honesty in VAT officers. (Chaudhari: 2001)

Karki, Babu Ram (2003) Revenue Mobilisation through Value Added Tax' explained that the strong commitment from grassroots level to the top level is prerequisite to make VAT success, which seems lack in Nepalese tax environment. An efficient, strong and fair administration is the most crucial for the proper implementation of VAT. But the VAT administration is still weak, traditional, corrupted and even physical infrastructures are not available properly. Even if the VAT system is bad on the computerized system, the data arrangement is not so good. It is necessary to develop and expand the networking of data box and information system at all levels. Therefore, it is necessary to promote it in tax system so that the existing problems such as under invoicing, non issuance of bills, and enforcement of law would be automatically solved. (Karki: 2003)

Neupane, Nabin (2006) in his thesis, Resource Mobilization through Value Added Tax in Nepal' has examined historical background of VAT and analyze mobilization of revenue through VAT. He has also provided the bird eye view of the practicing scenario of VAT in the foreign countries. He concludes that VAT is most scientific innovation and modern in the sales tax family. The collection of revenue is always moral than the regular expenditure in each and every fiscal year. Tax administration has to begin its program package very strictly and immediately to register the traders who are supposed to get registered in the VAT in order to control the leakage of revenue and tax evasion so that the number of the taxpayers would increase and hence the revenue collection would also increase.

According to him, implementation of VAT as a tax reform system is not enough to collect more revenue. Though an attempt was made to inform the public about the some non-VAT including commodities through the public media of communication. But as a result, the businessmen raised the price of daily consumption goods and on the other hand, the government could neither reduce price nor punish those businessmen against such acts. He has given some recommendation on increasing the boundary of VAT instead of increasing the rates; also the concentration should be given to bring the use of the billing system and consumers should be made to educate regarding the aspects and benefits of VAT. So, there should be Co-ordination between Government, taxpayer and tax administration to achieve best results. (Neupane: 2006).

Wagle, Mahesh (2010) in his thesis entitled has described that the after implantation of VAT in Nepal and promulgate the VAT Act, there has been legal changes made; rates were increased for the effectiveness of VAT but still there are many problems, hurdles

ahead to simply the whole system. He also carried out on to review the some new changes (e.g. Tax Plate, E-TDS and compulsory sales register) made in the business sector by the revenue administration. According to his field survey, levels of awareness of the accountant, businessman paying VAT is at low level on some provision of VAT Act. He recommended that VAT areas should be increased, proper coordination between IRD & MOF, Taxpayer, customers who are ignoring the VAT system should be given the proper knowledge about VAT and its benefits, Revenue administration may draft a policy to collect the arrear of VAT may be like Tax settlement committee and should be implemented with honestly, for improving billing condition, regular supervision, audits and investigation applied. Threshold of VAT should be decreased substantially. (Wagle: 2010)

2.27.3 Review Of Related Articles, Journals And Workshop

Nepal Chamber of Commerce also made a study to analyze the possible effects of VAT in Nepalese economy in 1997. **Dr. Puspa Raj Karnikar** heading the team. The main findings of the study report were as follows:-

- VAT effect adversely in price level
- It increases the price of imported goods. Ultimately increase the cost of production there by reduces the export business.
- Requirement of book-keeping is complicated.
- It will finally affect the small traders.
- It is untimely to implement.
- It would be unjustifiable on the social ground.
- Present administration is incapable of handling VAT.
- Computerization system is not sufficient and it is new concept for the tax administrator.

The study report suggested for a partial VAT on some commodities. It was in favor of phase wise implementation of VAT. The study analyses the negative impact of VAT neglecting its positive impact. (Source: Nepal Chamber of Commerce, 1997)

Department (Ministry of Finance) and the German Technical Cooperation (GTZ) on August 2010. Existing tax policy, the quality of services and tax documents, tax procedures and administrative mechanisms, and the overall performance of the tax administration.

The majority of the sampled taxpayers stated that people should pay taxes and deserve to be penalized if they fail to do so. Only one third of the respondents was satisfied with the delivery of public services in the fields of the security, electricity, supply, drinking water

and social benefits, whereas about 50 percent of the respondents were satisfied with the services in the telecommunication, transportation and education sectors. Less than 40 percent were satisfied with the quality of the services of IROs (except for location and accessibility) in spite of the perception that services during the past seven years have improved. The majority of the respondents was reasonably satisfied with the tax procedures and administrative mechanisms, except with tax refunds. Four out of five respondents have observed improvements in this respect in the past several years. The most important source of information on tax issues are newspapers. Regarding the availability of information and the comprehensibility of the printed documents, three out of four were satisfied for income and other taxes, and four out of five for VAT. With reference to the contents and coverage of the documents, over 83 percent were satisfied. An overwhelming majority of the interview partners noted the importance of knowledge and information about the tax system and tax policy. Four out of five respondents observed improvement in the tax policy and tax system during the past three years. However, over two thirds of the respondents felt that the tax money has not been utilized properly by the government about the tax system and tax policy. Four out of five respondents observed improvement in the tax policy and tax system during the past three years. However, over two thirds of the respondents felt that the tax money has not been utilized properly by the government.

Based on the major findings of the study, one can draw the conclusion that the tax administration in Nepal has been improving over the past seven years. As contributing factors for the improvement, the GTZ-ITAC and RAS, Danida VAT, and RAS projects, which have been implemented in the IRD for over a decade, should be mentioned. It is very encouraging to note that the overwhelming majority of the respondents see paying taxes to the government as their duty. When taxpayers are not satisfied, the tax authorities have to identify the reasons for their dissatisfaction and take corrective measures. Although the performance of the Nepalese tax administration has been improving over the past years in the perception of taxpayers, it still remains on a comparatively low level. A better reputation of the public administration is critical in order to encourage more taxpayers to comply with tax laws. This would lead to more tax generated income for the public sector and it would provide additional budgetary room in the long run. However, good reputation can only be achieved if citizens feel significant improvements in the service delivery. Apart from that, the tax administration needs to establish an effective system of penalization for citizens who fail to fulfill their tax duty.

The Journal of Nepalese Business Studies Vol. VII No. 1 Published article on “Value Added Tax (VAT) in Nepal: A Critical Assessment of Its Performance” **Kamal Koirala** December 2010/11. The Abstract of article Value Added Tax (VAT) is a recent phenomenon in the arena of tax administration in Nepal. This paper aims to assess

critically the performance of VAT in Nepal since its inception to date, focusing basically on three aspects of it, viz,

- (i) Current scenario of VAT administration
- (ii) Major issues, and
- (iii) Urgent Corrective Actions Required

2.28 Research Gap

With reference to above review of related literature of a level in the concern field of VAT, this study chiefly focused on vat i.e. implementation of VAT in Nepal. For that various accounting and statistical tools as well as regression models are built to measure the interrelationships of the concerned variables of the concerned area. The concerned variables are composition and contribution of VAT in GDP and total revenue, total tax revenue, total indirect tax.

This research work is based (not completely but major part) on primary data, which is updated to recently changed situations. The data collected is diversified to major three category of the society i.e., Businessmen, consumers and experts. This is done with objective to find out the problems from different eyes. Secondly, the analysis of data presented is done with consideration of conditional state of respondents. For example, Among 30 consumers, some were bachelor or degree level educated, some were only S.L.C. or less than that, some were from highly sophisticated family who entered only to departmental stores and some were street buyers.

CHAPTER III

RESEARCH METHODOLOGY

3.1 Rationale of Selection of the Study Area

The research should be done covering the whole nation, as this is the main agenda for the development of the nation being a major source of revenue. The time and financial constraints of the researcher, this could not be possible to cover the whole nation. Therefore, Kathmandu valley is considered as the Universe. But some of the data are collected outside valley and some are based on the newspapers as well. Kathmandu valley contains major three districts- Kathmandu, Lalitpur and Bhaktapur. As per the data, 2069 Asadh shows that 118,556 business get registered with VAT among all the registered business over the country. (*Source: Annual report FY 2068/69, IRD*).

It is assumed that where there is more business, there are more consumers too. As a policy maker to businessmen and high class consumer to the low class consumer inhabited here, the selected area is the best area. The category (Experts, Businessmen and Consumers) wise respondent is selected using random sampling method

3.2 Research Design

The research design is mainly based on descriptive studies, but primary data have an objective of exploratory studies as well. For this research, small-scale field survey questionnaire is used for information gathering. Field surveys emphasize on personal interviews. A case study (Singapore's successful story of implementation of VAT, the efforts she made is presented in detail in Review of Literature) is also given place to investigate the reasons of our failure/weaknesses of the VAT implementation.

The research is planned to be conducted based on primary data. Data from secondary sources are also collected in some extent to make the report more fruitful. To collect primary data, Quantitative survey (Questionnaire) is used. The only straight questionnaire may hide the true secrets behind the curtains, therefore cross check is applied. The following sections explain more about how research is designed.

Table 14
Flash View of Research Design and Data Analysis

| Universal/ Population | KTM Valley (Kathmandu, Lalitpur and Bhaktapur) |
|------------------------------------|-------------------------------------------------------------------------------------------------------|
| Method of selection of Interviewee | Systematic Random Selection Technique |
| Type of Respondent | Consumers, Businessmen, and Experts |
| No. of Respondents | Consumers 25 Businessmen 20 Experts 10 |
| Method of Data Analysis | Qualitative, Quantitative, Group discussion |
| Type of Research Design | Descriptive and Exploratory |
| Tolls used for Analysis | Percentages, Correlation and Trend analysis |

3.3 Nature and sources of data

3.3.1 Review of secondary data

Secondary data needed for study is collected from following sources:

- 1) Published and unpublished report articles and thesis on the concerned subject.
- 2) Publications and annual reports of Internal Revenue Department (IRD).
- 3) Various books written by tax officers and scholars.
- 4) Publication of Nepal Rastra Bank
- 5) Various publications of the central bureau of statistics.
- 6) Related articles and journals.

3.3.2 Primary data collection technique

Questionnaires are developed based upon the research questions and interviews were conducted to the randomly selected respondents. Three separate questionnaires were prepared for administrative experts, businessmen and consumers. Opinion and information are also collected from FGD and interaction with colleagues, experts, policy makers and other intellectuals.

Data table is prepared from the questionnaire collected and then analyzed by using statistical tools. Data collected from questionnaire is supported in some cases by secondary data. Cross analysis is made seriously considering the probability of misleading of data.

3.4 Sampling strategy and selection of respondents

Simple Random Sampling is applied for the staffs of Tax Offices and Tax Administration. While selecting different clusters and respondents for questionnaire, purposive sampling technique is applied. Consumers and businessmen are two different parts of our research as different questionnaire are prepared to them. Clusters are selected without bias from businessmen of different parts of the Kathmandu, Lalitpur and Bhaktapur Districts (Universe) as well as from consumers of these three districts. In total 25 consumers, 20 businessmen and 10 experts (includes both tax officers, tax auditors and other experts) were randomly selected and taken as respondents. The hypothesis behind this study is that the Government could not effectively apply the VAT system of tax collection. There are so many weaknesses from the part of government, businessmen and consumers. If the government fined the core idea of being unsuccessful in the effective implementation of VAT, she could improve the regulation process then VAT will lay a golden egg.

3.5 Method of data collection

Secondary data were collected using the above mentioned tools. Primary data were collected by using the questionnaire. Following primary data collection techniques were used during the research.

3.5.1 Interview Schedule

Semi-structured interview schedule was conducted with the selected respondents. To make the interview effective, convenient time and place for respondent was selected. 25 consumers, 20 businessmen and 10 administrative experts, which include both tax officers, tax auditors and other experts, were randomly selected for interviews.

3.5.2 Focus Group Discussion (FGD)

Opinion and information are also collected from group discussion and interaction with colleagues, experts, policy makers and other intellectuals.

3.6 Data processing and analysis

Data collected through questionnaire was tabulated and analyzed. Relevant data from secondary sources, observation and focus group discussion were processed and used to complete the findings from interview. Data collected from primary and secondary sources

are analyzed using tools like percentage, correlation and trend. The regression equation $Y = a + bt$ (where a =constant variable, b =slope and t =time or no. of year) is used to find out the future trend.

3.7 Statistical Tools

The data and information are tabulated and analyzed, ratio, percentage and estimated data are used to discuss and explain these data and information. The assumed data are also used in few cases to verify and explore the working nature of VAT. Bar diagrams and chart have also been used to illustrate the findings. On the basis of the findings from this analysis, the steps need to be taken from all the responsible parties have been recommended.

3.8 Reliability and validity of the data

Since both the quantitative and qualitative tools are applied, there are high possibilities of getting reliable data. Besides this triangulation of information collected through questionnaire also help to make data more reliable and valid. Percentage, regression and trend are used as analytical tools which may be incomplete for data analysis. Limitations may arise, as it could not represent the whole of our country as the samples are taken in Kathmandu, Lalitpur and Bhaktapur only. The people of these three districts are more aware and educated than of other parts of our country. So there is possibility of getting fictitious data, which could not represent the whole of Nepal and probably could not access the real objective of the research work. This is due to the lack of financial assistance and time required for the research.

CHAPTER IV

PRESENTATION AND ANALYSIS OF DATA

4.1 Analysis & Presentation of Secondary Data

Revenue mobilization is the major source of government expenditure. Taxation is one of the key internal sources of total government revenues. However, trend of revenue mobilization has remained satisfactory in recent years. To maintain this, there is a challenge to control tax leakages after identifying the possible leakage areas, and increase the revenue mobilization specially the VAT and income tax, which are the major instruments of tax revenue. Since, there is a need to enhance work efficiency, effectiveness and professionalism of revenue administration, a strong challenge has been there to make necessary arrangements for achieving desired results. The Government expenditure in FY 2067/68 totaled Rs. 257.50 billion. Among the sources of financing the expenditure in FY 2067/68 revenue mobilization contributed 66.59%. Of the total revenue, shares of tax revenue and non-tax revenue in FY 2068/69 are 85 % & 25 % respectively.

4.1.1 Tax Revenue Structure in Nepal

Tax is compulsory contribution by the taxpayer to the government. Taxation is the main source of income of the government, excluding foreign aid. In the fiscal trend of Nepal, the tax revenue structure is a combination of two tax elite. They are namely direct tax and indirect tax. The table presented below shows that the trend of tax revenue has been increasing.

Table 15
Total Tax Revenue Structure

Rs. In '000'

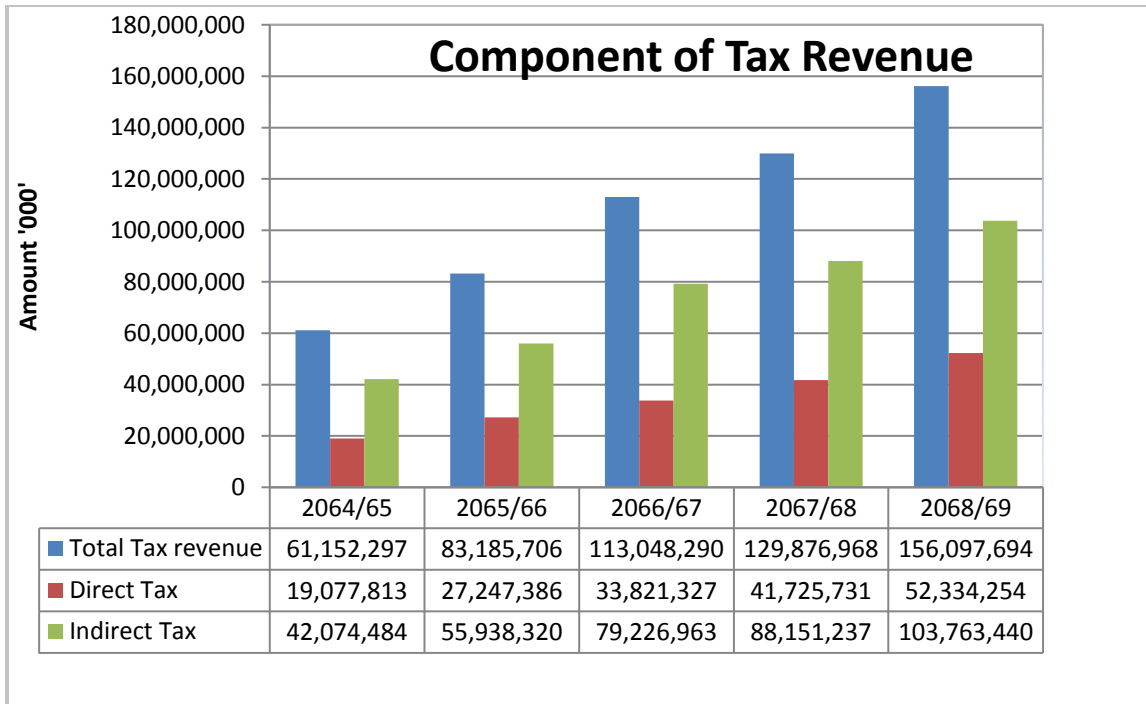
| Fiscal Year | Total Tax Revenue | Direct tax | | Indirect tax | |
|-------------|-------------------|------------|--------------------|--------------|--------------------|
| | | Amount | % as total Revenue | Amount | % as total Revenue |
| 2064/65 | 61,152,297 | 19,077,813 | 31.19 | 42,074,484 | 68.81 |
| 2065/66 | 83,185,706 | 27,247,386 | 32.75 | 55,938,320 | 67.25 |
| 2066/67 | 113,048,290 | 33,821,327 | 29.91 | 79,226,963 | 70.09 |
| 2067/68 | 129,876,968 | 41,725,731 | 32.12 | 88,151,237 | 67.88 |
| 2068/69 | 156,097,694 | 52,334,254 | 33.52 | 103,763,440 | 66.48 |

Source: Annual Report F/Y 2068/69, IRD

Total revenue increased by 20.18 percent in FY 2068/69 compared to that of the previous fiscal year. Such revenue had increased by 14.88 percent in FY 2067/68 compared to its preceding fiscal year. Of the total tax revenue in FY 2068/69, the share of customs duty

was 18.1 percent while the share of tax on production and consumption of goods and services was 42.7 percent and that of income, profit, and property tax was 25 percent.

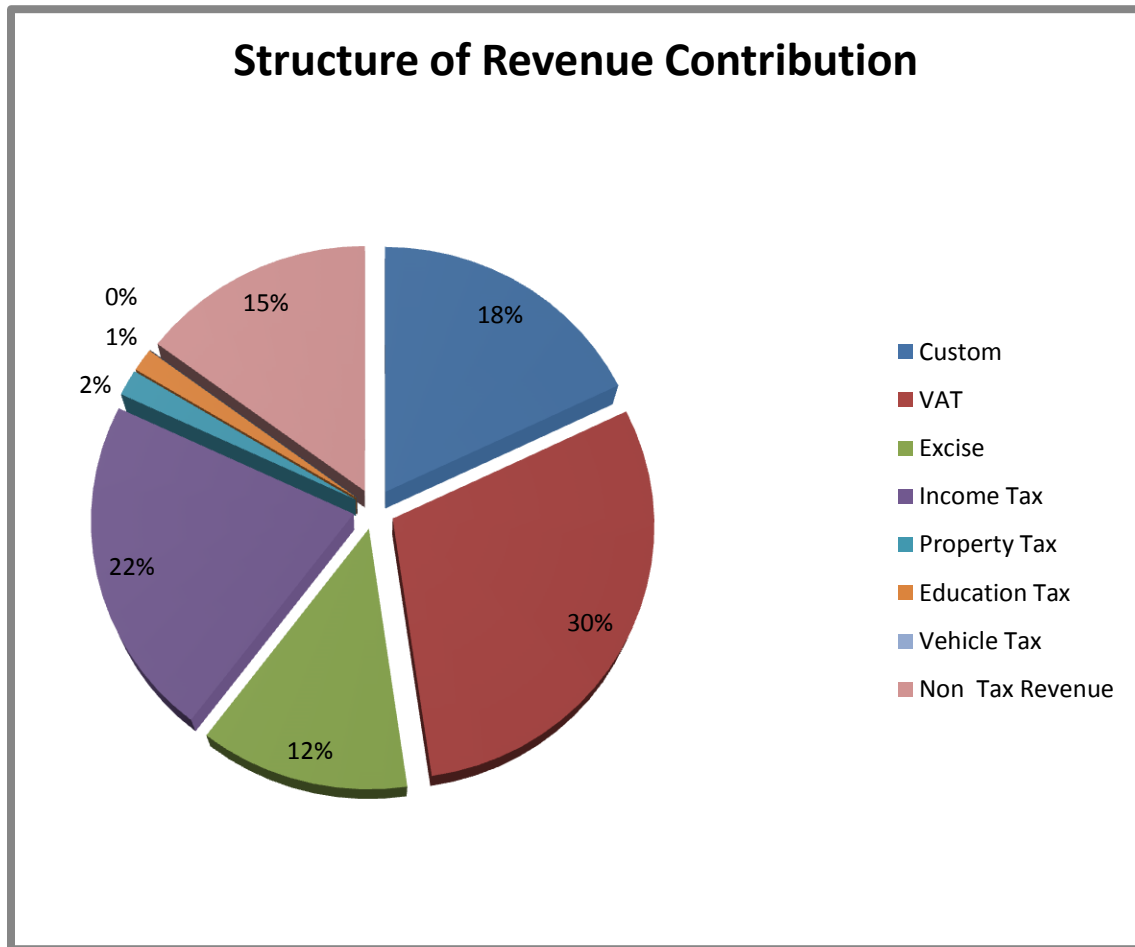
Figure 1



Total tax revenue from FY 2064/65 to 2068/69 is in increasing trend, where tax revenue grew in FY 2065/66, FY 2066/67, FY 2067/68 and FY 2068/69 by 36.03%, 35.89%, 14.88% & 20.18 % respectively. In total tax revenue, share of direct tax in FY 2064/65, FY 2065/66, FY 2066/67, FY 2067/68 and FY 2068/69 are 31.19%, 32.75%, 29.91%, 32.12% & 33.52% respectively. On the other hand, share of indirect tax in FY 2064/65, FY 2065/66, FY 2066/67, FY 2067/68 and FY 2068/69 are 68.81%, 67.24%, 70.08%, 67.87% & 66.47% respectively.

This shows the IRD has made good progress in taxpayer service. Many new service initiatives have been introduced, including establishment of 28 TSOs. E-filing and e-registration have been introduced. A single taxpayer identification number is in place. Taxpayers welcomed the introduction of e-filing, and the department will now develop e-payment options so that taxpayers no longer need to visit the IRD offices to confirm their payments to higher government revenue.

Figure 2



The above chart shows that VAT only contributed 30% of total revenue collection. The second by income tax contribution which is 21.8% and third one is custom and other duty which contributes 18.1%. The contribution of excise duty is 12.7% ,tax on house, land & property is 2%and the tax on education is 1.5%.

4.1.2 Internal Revenue Collection (Inland Revenue Collection)

In FY 2068/69, Rs129.88 billion tax revenue (Income Tax, VAT, and Excise Duty & Vehicle Tax) collected which is 94.65% of target, achievement and grew 14.89% than last year. IRD contribution to the total revenue of GON is Rs. 129.88 billion, which share is 53.16% and grew by 0.50% than last year. IRD had contributed 14.9% on GDP.

Table 16
Internal Revenue Collection Trend

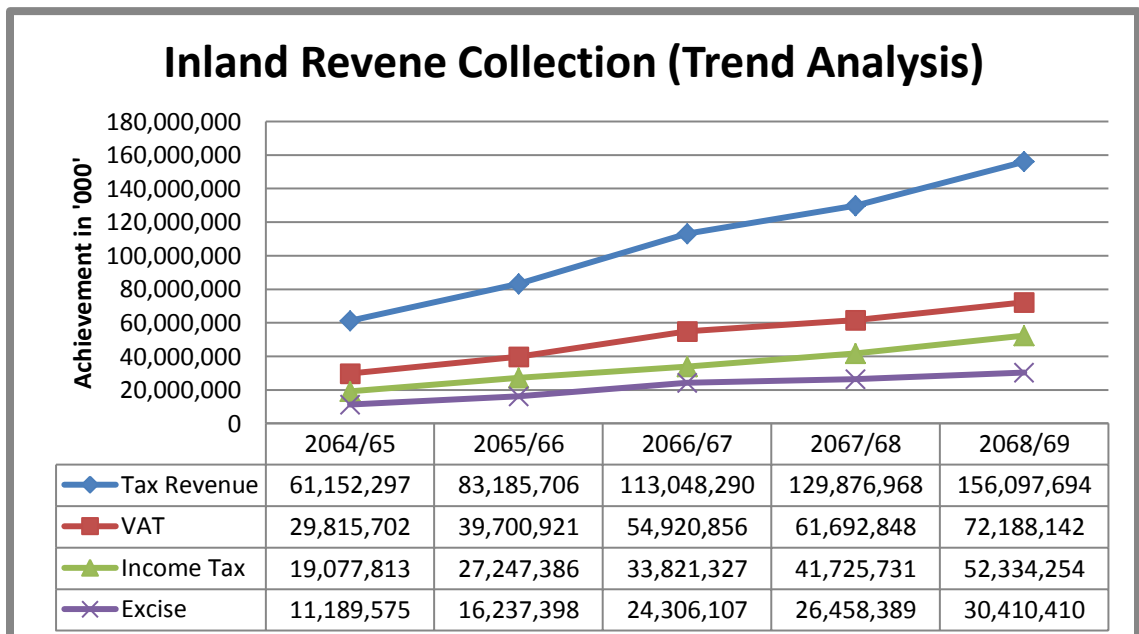
Rs in '000'

| Budgeted In F.Y | | | | | |
|--------------------|------------|------------|-------------|-------------|-------------|
| FY | 2064/65 | 2065/66 | 2066/67 | 2067/68 | 2068/69 |
| Tax Revenue | 58,126,800 | 85,660,000 | 106,499,900 | 137,225,337 | 154,060,501 |
| VAT | 29,651,900 | 41,000,000 | 51,560,000 | 67,371,628 | 72,743,000 |
| Income Tax | 16,869,200 | 27,087,000 | 36,298,000 | 40,242,332 | 50,813,500 |
| Excise | 10,523,200 | 14,073,000 | 18,641,900 | 29,611,377 | 30,254,001 |
| Actual In FY | | | | | |
| FY | 2064/65 | 2065/66 | 2066/67 | 2067/68 | 2068/69 |
| Tax Revenue | 61,152,297 | 83,185,706 | 113,048,290 | 129,876,968 | 156,097,694 |
| VAT | 29,815,702 | 39,700,921 | 54,920,856 | 61,692,848 | 72,188,142 |
| Income Tax | 19,077,813 | 27,247,386 | 33,821,327 | 41,725,731 | 52,334,254 |
| Excise | 11,189,575 | 16,237,398 | 24,306,107 | 26,458,389 | 30,410,410 |
| Increment % | 18.64 | 39.00 | 36.00 | 15.00 | 19.42 |

Source: Annual Report FY 2068/69, IRD

The data presented in the above table is presented separately in the following trend analysis graph.

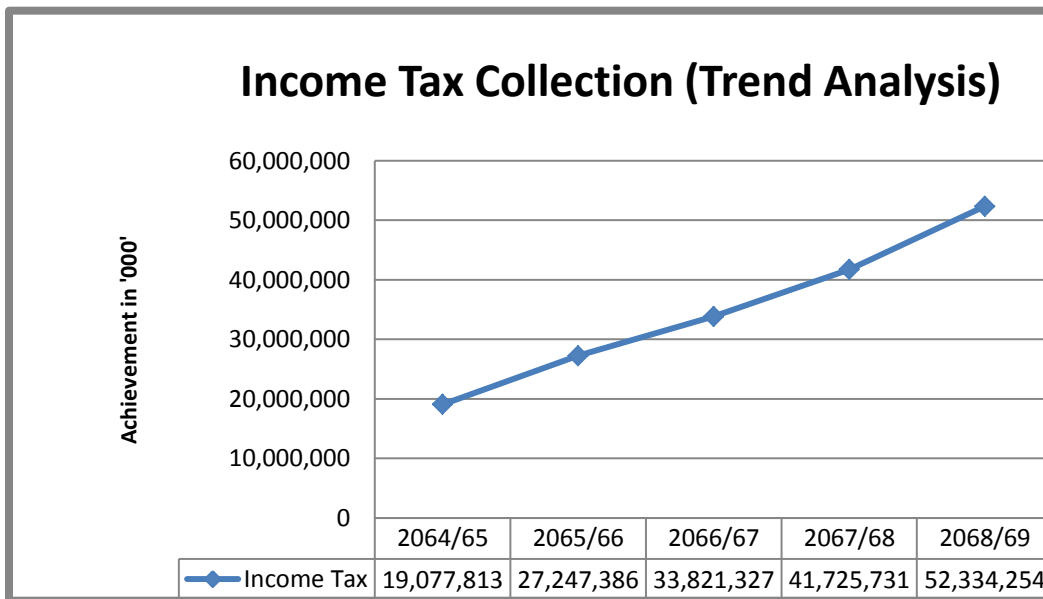
Figure 3



Among four types of tax, VAT contributes the highest value and followed by Income Tax, Excise and Vehicle Tax. Total tax revenue growth rate was 36 % in FY 065/66 but in FY 066/67 and FY 067/68 it decreases to 35.8 % and 14 % respectively which is a negative symptom whereas in FY 068/69 growth rate is slightly increased to 20% as compared to previous FY growth rate. It can be expected that the future collection will drastically improved as our country is going to resolve the current conflict and war, which is true.

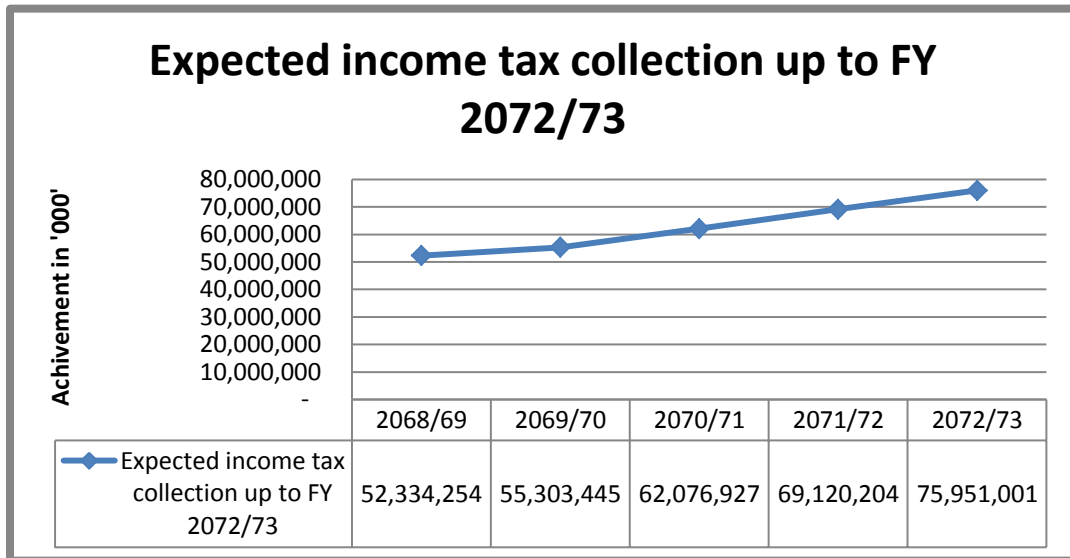
As above trend line of Tax Revenue collection by IRD is increasing trend. All segments of Tax Revenue; Income Tax, VAT, Excise and Vehicle taxes are also in increasing trend. Among all these types of tax, VAT and Income Tax are presented separately in the following figures.

Figure 4



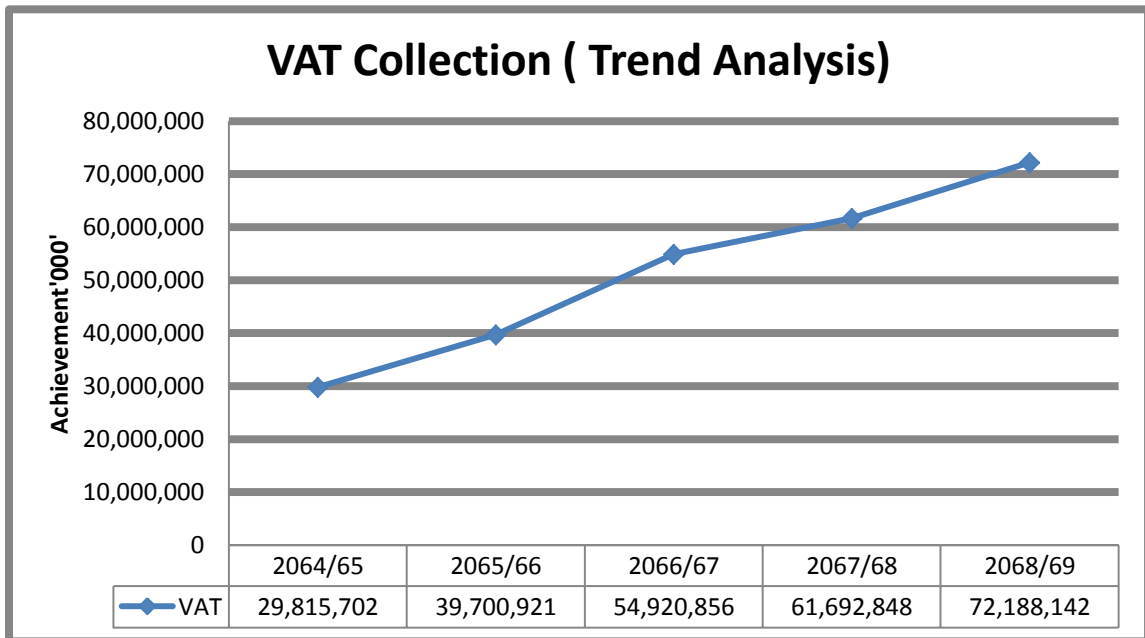
Income tax collection trend line is in increasing trend. In FY 065/66, pace of growth rate of income tax increased. There is a positive sign from the FY 066/67 as it increases from 19.07 billion to 52.33 billion in the FY 064/65 to 068/69. Growth rate of income tax collection in FY 064/65 is 21% while in FY 065/66 it boost to 42.8% and it was shrink in FY 066/67 by 24.1% further in FY 067/68 it is decrease by 21.27% and it increases to 25 % in FY 2068/69. The government should give great attention in this matter why income tax growth rate is very fluctuating. The expected income tax collection up to FY 2072/73 is presented as follows:

Figure 5



Expected income tax collection in the FY 2072/73 will reach to NRs. 75.95 billion.

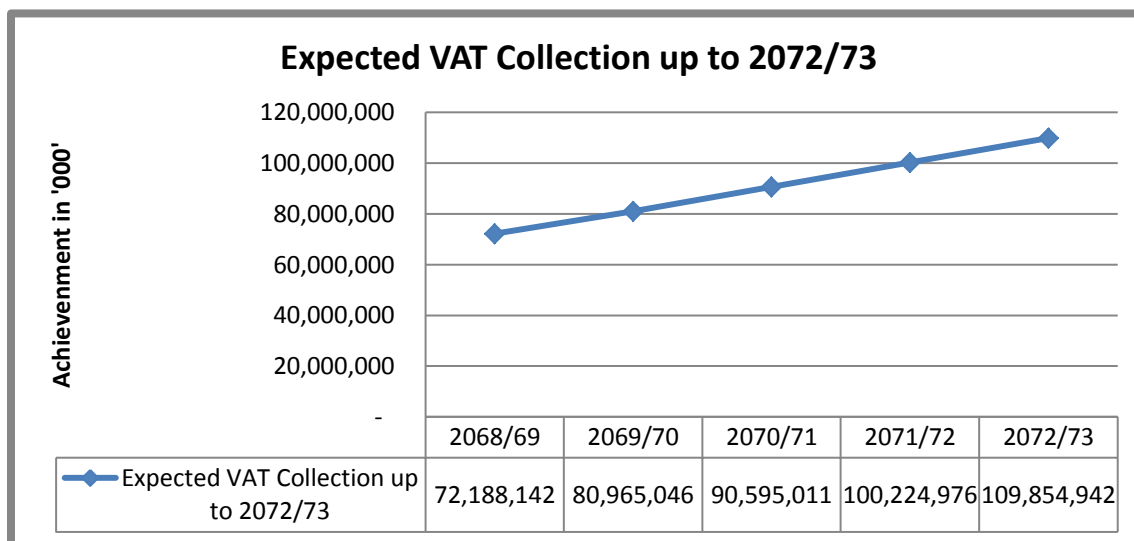
Figure 6



VAT collection is increasing regularly from FY 064/65 to FY 068/69 as it is increased from 29.81 billion to 72.18 billion. The growth rate is fluctuating, where in FY 064/65 growth rate is 20.74%, in FY 065/66 growth rate is 14.26%, in FY 066/67 growth rate is

33.15%, in FY 067/68 growth rate is 38.34% and in FY 068/69 growth rate is 12.33%. But this does not indicate the improvement in our system. There are so many other reasons which contribute in the increment in total VAT collection. The other things such as increase in no. of tax registrants and increase in business volume play a great role. The expected VAT collection up to FY 2072/73 is presented below.

Figure 7



The expected VAT collection of FY 2072/73 would be Rs. 109.85 billion if VAT increases in the same trend as of past five years. But the increment should be more than this as there would be more suitable environment for the growth of trade and services.

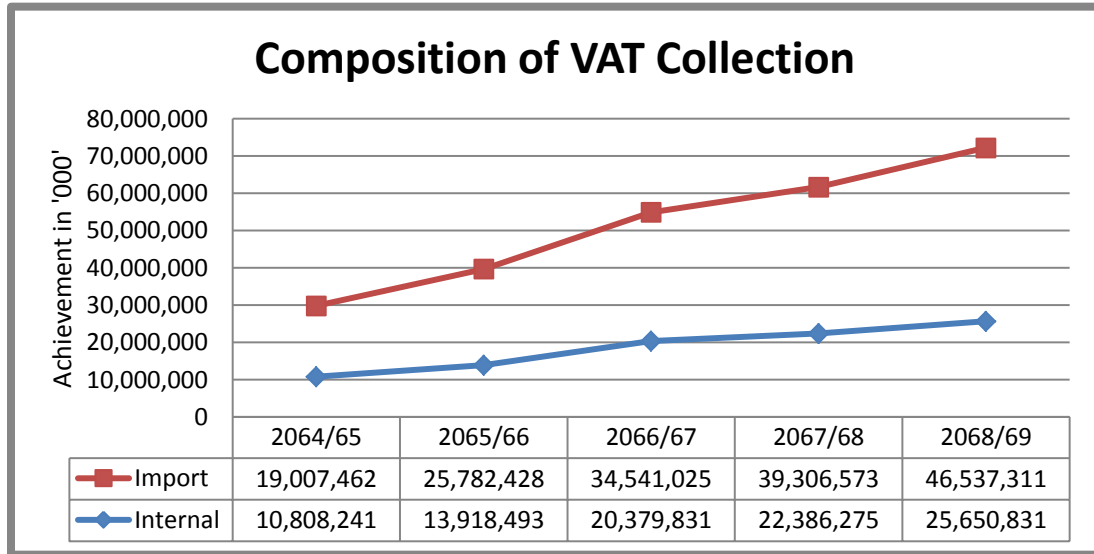
4.1.3 VAT Collection: Internal and Import

Table 17
VAT Collection: Internal & Import

| | Rs. In '000' | | | | |
|------------------------------|----------------|----------------|----------------|----------------|----------------|
| FY | 2064/65 | 2065/66 | 2066/67 | 2067/68 | 2068/69 |
| VAT Collection | 29,815,703 | 39,700,921 | 54,920,856 | 61,692,848 | 72,188,142 |
| Internal | 10,808,241 | 13,918,493 | 20,379,831 | 22,386,275 | 25,650,831 |
| Import | 19,007,462 | 25,782,428 | 34,541,025 | 39,306,573 | 46,537,311 |
| Internal/Import Ratio | 36:64 | 35:65 | 37:63 | 36:64 | 36:64 |
| Increment % | 14.74 | 33.15 | 38 | 12.33 | 17.01 |

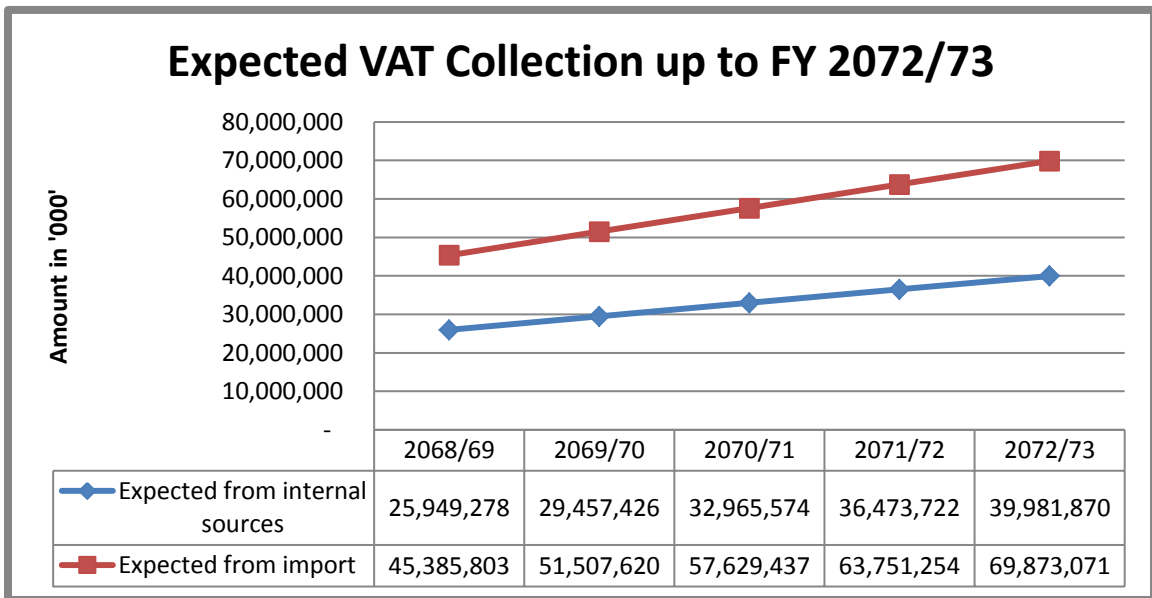
Source: Annual Report FY 2068/69, IRD

Figure 8



The above table shows the data of VAT collection from internal trade and VAT collection from importing goods to abroad. VAT collection from Import is more than the collection from internal sources. The ratio of collection from internal sources and import is almost all constant from FY 2064/65 to FY 2068/69. The trend is still optimistic as it is increasing till 2068/69. The expected VAT collection up to FY 2072/73 is presented below.

Figure 9



Expected VAT collection from internal sources is not satisfactory compared to import. More import is not good for the country's development so our government should be very aware to this composition. If we are able to produce more in our own country we can save foreign currency, increase employment, expand infrastructure and finally we can generate a huge amount of tax within the boundary.

4.1.4 VAT Registrants, Information Filers and Non Filers

Table 18
VAT Registrants, Information Filers & Non Filers

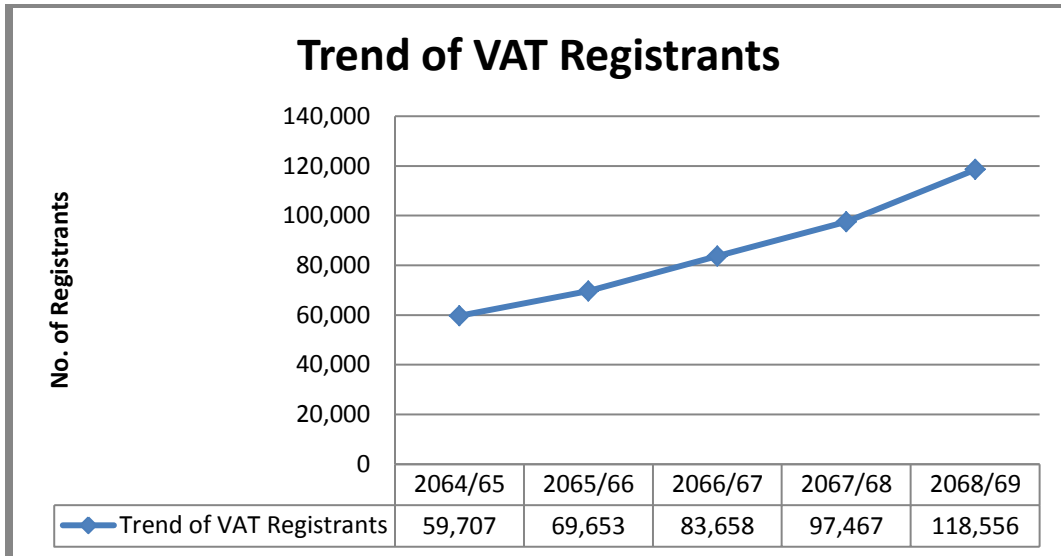
Rs in '000'

| Year | 2064/65 | 2065/66 | 2066/67 | 2067/68 | 2068/69 |
|--------------------------------------|---------|---------|---------|---------|----------|
| 1. No. of Tax payers | 59,707 | 69,653 | 83,658 | 97,467 | 1,18,556 |
| No of Tax Payer growth rate % | 12.73 | 16.66 | 20.11 | 16.51 | 21.63 |
| 2. Information Filers | 40,139 | 56,613 | 61,071 | 76,756 | 90,553 |
| % | 67.23 | 81.28 | 73 | 78.75 | 76.38 |
| Dr. Information | 12,052 | 13,491 | 10,565 | 13,816 | 15,774 |
| % | 30.03 | 23.83 | 17.30 | 18.00 | 17.42 |
| Cr. Information | 15,050 | 16,952 | 30,474 | 37,610 | 44,660 |
| % | 37.49 | 37.60 | 49.9 | 49.00 | 49.32 |
| Zero Information | 12,779 | 14,371 | 20,031 | 25,329 | 30,126 |
| % | 31.84 | 31.88 | 32.8 | 33 | 33.27 |
| 3. Information Non Filers | 9,050 | 13,040 | 22,587 | 20,711 | 28,003 |
| % | 15.16 | 18.72 | 27.00 | 21.25 | 23.62 |

Source: Annual Report FY 2068/69, IRD

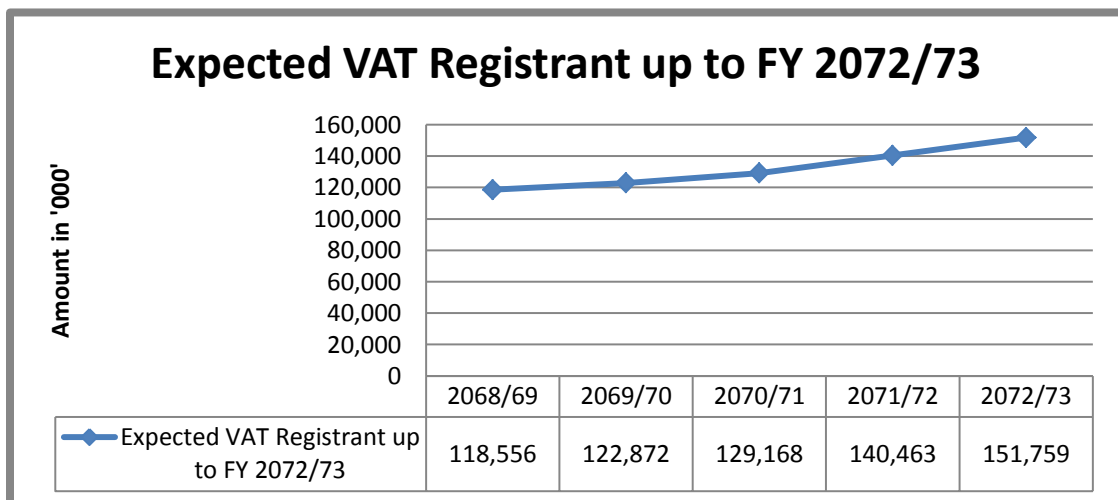
The above table represents the data from various aspects. The data mainly focuses on the trend analysis of VAT registrants, Information filers & non-filers etc. are represented separately in the following figures.

Figure 10



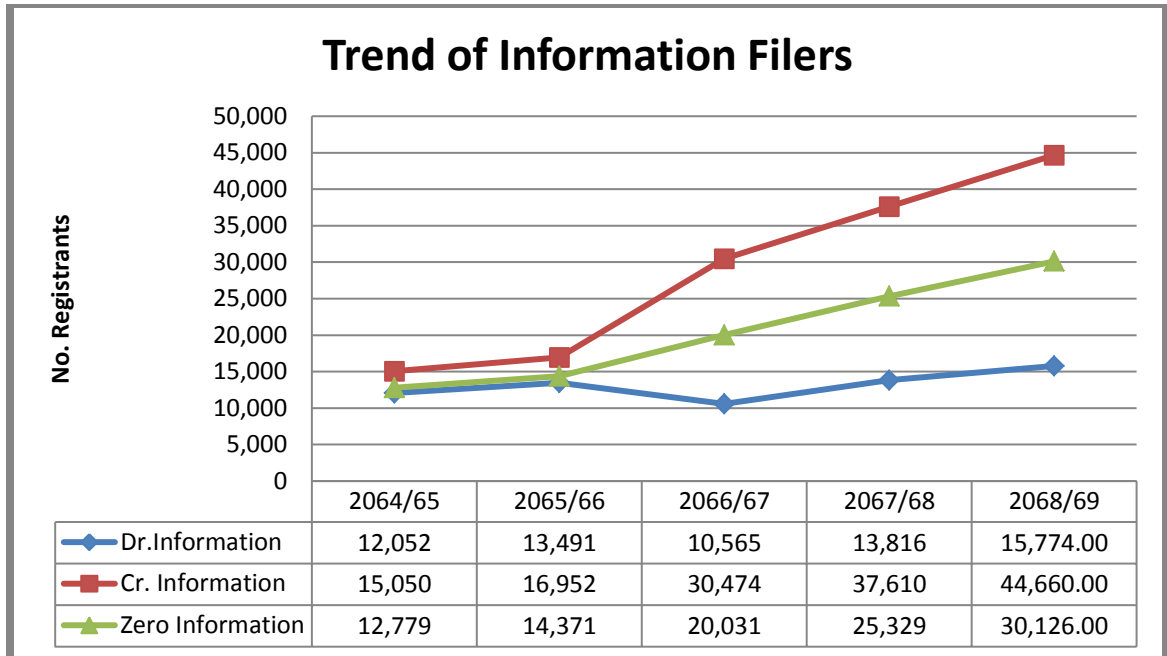
The trend of VAT registration is continuously increasing from FY 2064/65 to 2068/69. At the end of ashad 2065 it was 59,707 and reached to 97,467 and 118,556 at the end of ashad 2068 and ashad 2069 respectively, The growth percentage is fluctuating between 13.10% to 16.51%. Though the total no. of tax payers is increasing it is not sufficient to meet the government's need. To increase the VAT collection; the no. of tax payers should be increased faster than in the previous year. VAT should cover more and more businessmen in its mainstream.

Figure 11



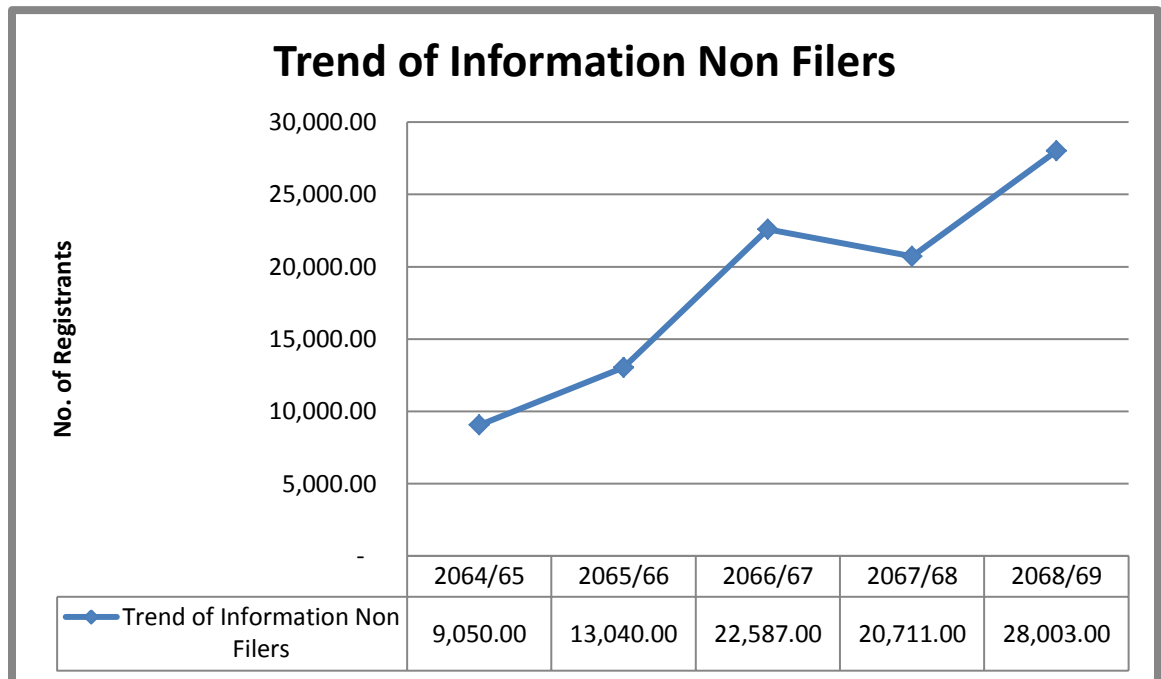
The no. of VAT registrants would be 1, 51,759 till the end of Ashad 2073, if the same trend of increment is followed in the coming years. The government should try to increase the no of registrants by creating a suitable environment for business development.

Figure 12



The trend of information filers shows that there is positive sign in Dr and Cr information filers are increasing but it is sad to increase the zero information filers.

Figure 13



The above data shows the trend of information non-filers. It is not good symptom to increase the information non-filers, as it is a sign of business recession. The Nepal Government should be very sincere in the improvement of political situation and in conflict management to make the economic depression recovered.

4.1.5 Impact of VAT on Government Revenue Correlation Analysis

VAT being a major source of Government revenue, its contribution to total revenue should be highly associated. By analysis we conclude that unless and until VAT collection increases total revenue could not increased. Therefore Government revenue and VAT are correlated things and it is very important to analyze the degree of association between these two variables (Government revenue and VAT). This correlation analysis results out the impact of VAT on Government revenue. In this analysis VAT is independent variable and Government revenue is dependent variable, as Government revenue tends to increase or decrease due to change in VAT collection. The given table of VAT collection and total revenue collection for the period from 2064/65 to 2068/69 are presented as below

Table 19
Calculation of Correlation Co-efficient Impact of VAT on Revenue

| Rs in '000' | | | | | | | |
|--------------------|------------------------|--------------------------|------------------|------------------|----------------------|----------------------|---------------|
| Fiscal Year | VAT Revenue (X) | Total Revenue (Y) | u=X-39701 | v=Y-83186 | u² | v² | uv |
| 2064/65 | 29,816 | 61,152 | (9,885) | (22,034) | 97,713,225 | 485,497,156 | 217,806,090 |
| 2065/66 | 39,701 | 83,186 | 0 | 0 | 0 | 0 | 0 |
| 2066/67 | 54,921 | 113,048 | 15,220 | 29,862 | 23,164,8400 | 891,739,044 | 454,499,640 |
| 2067/68 | 61,692 | 129,877 | 21,991 | 46,691 | 483,604,081 | 2,180,049,481 | 1,026,781,781 |
| 2068/69 | 72,188 | 156,098 | 32,487 | 72,912 | 1,055,405,169 | 5,316,159,744 | 2,368,692,144 |
| Total | 258,318 | 543,361 | 59,813 | 127,431 | 1,868,370,875 | 8,873,445,425 | 4,067,779,655 |

Source: Annual Report FY 2068/69, IRD

In above table, X represents the VAT revenue, Y represents the total revenue, u represent, the deviation taken from assumed mean X, v represents the deviation taken from assumed mean of Y. and uv represents the multiple of u and v, $\sum uv$ represents the summation of u x v, $\sum u^2$ represents the summation of u^2 , $\sum v^2$ represents the summation of v^2 , r correlation co-efficient and n represents the number of observation. Karl Pearson correlation co-efficient (r) is calculated below for analysis.

Now,

$$r = \frac{n\sum uv - \sum u \sum v}{\sqrt{n(\sum u^2) - (\sum u)^2} \times \sqrt{n(\sum v^2) - (\sum v)^2}}$$

$$r = \frac{5 \times 4067779655 - 59813 \times 127431}{\sqrt{\{5(1868370875) - (59813)^2\}} \sqrt{\{5(8873445425) - (127431)^2\}}}$$

$$r = \frac{12716867872}{75923 \times 167716}$$

$$r = 0.9987$$

Here is positive high degree of positive correlation between VAT revenue and total revenue. Above calculation shows the result + 0.9987. It means there, exist positive correlation to the extent +0.9987 between the VAT revenue and total revenue deposit of Nepal.

“Correlation Coefficient value lies between -1 and +1. The following general rules are mentioned for interpreting the value of r.

When $r = +1$, there is positively perfect correlation between the two variables.

When $r = -1$, there is a negatively perfect correlation between the two variables

When, $r = 0$, the variables are uncorrelated

Nearer the value of $r + 1$, closer will be relationship between two variables and nearer the value of r to 0, lesser will be relationship.

Again,

$$\begin{aligned} P.E &= 0.6745 * \frac{1-r^2}{\sqrt{n}} \\ &= 0.6745 * \frac{1-0.99741}{\sqrt{5}} \\ &= 0.00078 \end{aligned}$$

$$\begin{aligned} \text{Now, } 6 * P.E. &= 6 * 0.00078 \\ &= 0.0047 \end{aligned}$$

Since, r is $> 6.P.E.$, so the value of r is significant

The correlation between these two series of data is +0.9987 which shows positive correlation between two variables. Or, VAT and Government revenue is highly associated therefore the increase in VAT will increase the collection of Government

revenue and vice versa. The positive correlation means increase in Government revenue is an effect on increase in VAT.

Now, it is very important to understand that VAT which comprises more than 30 % in government revenue and having highly positive correlation (+0.9987) is a backbone of current revenue collection portfolio. Its development and improvement will surely be beneficial for the whole nation, no doubt. Therefore the previously concluded problems from field survey should be seriously thought and applied to improve the VAT collection system.

4.2 Presentation & Analysis of Primary Data

4.2.1 Knowledge about VAT

Though the government used various tools for the improvement of VAT, it is still in the shadow. So there is a huge need to aware those stakeholders for the smooth functioning of tax system. VAT envisages a self assessment process; it requires the highest level of compliance. The dealers are expected to be fully in compliance with the VAT laws and procedures. Further, the VAT system envisages a trail of transactions to be recorded and consequently maintenance of proper books and accounts becomes an essential business imperative.

The self assessment system has its own advantages. The dealers are relieved of the burden of getting the assessments done while the tax administrators concentrate only on major dealers on an exception basis. In order to achieve 100% tax compliance, awareness of VAT in an organization is a pre-requisite. Further, the organization needs to keep abreast of the frequent changes that are announced by the State Governments in relation to VAT. These changes are expected to be high in the initial years of VAT implementation as it will take time for the new system to stabilize.

But there are only a few people who are familiar with the actual meaning of this term. Today most people have the misconception that all types of tax is VAT; be it the income tax deducted at source or any type of fees. Even the educated community, university students, teachers and the ones studying related subjects or planning its curriculum have not been able to grasp a comprehensive understanding of its principle and practical aspects.

Not only in the diploma-level curriculum but also in the degree-level curriculum there is only one optional subject related to tax of a total 100 marks. The main objective of this curriculum is to produce tax experts but out of the total 100 lecture hours, 50 lecture hours allotted to income tax; 15 lecture hours are for tax planning and 15 hours for VAT

this shows how little importance has been given to VAT in this curriculum as well; out of total 100 lecture hours only 15 lecture hours i.e. only 15% have been allotted to VAT.

However, it is sad to say that the main institutions responsible for producing the country's human resource have not shown genuine interest in this. The high-level education is very far away from the nation's agenda.

Knowledge of VAT is a most important question because unless and until the businessmen and consumers are aware enough to this subject, the implementation would be weak. The following table shows the awareness gained by consumers and businessmen in present situation.

4.2.2 Why Businessmen Register In VAT?

This question is asked to find out the reason why businesses should be registered on VAT of among the various reasons which force the businesspersons to go to the tax office. This would help the planner to find out the best and easy way for the businesspersons to register on VAT. On question asked to businessmen '*why you register your business on VAT*', the following response.

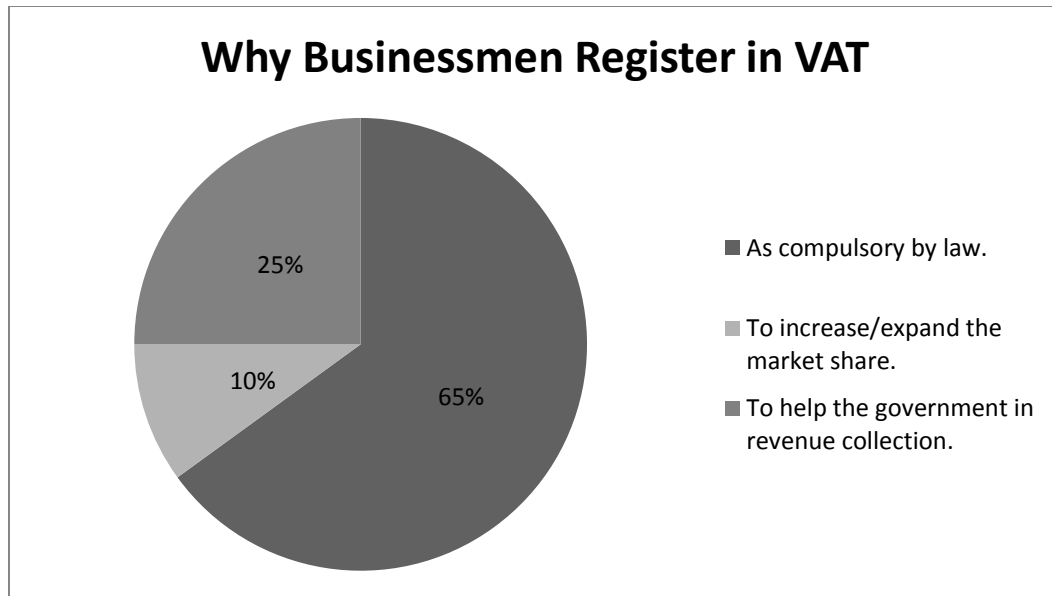
Table 20
Why Businessmen Register in VAT

| Respondent Type | Response | No. of Respondent | % |
|------------------|--------------------------------------------------|-------------------|----|
| Businessmen N=20 | 1. As compulsory by law. | 13 | 65 |
| | 2. To increase/expand the market share. | 2 | 10 |
| | 3. To help the government in revenue collection. | 5 | 25 |

Source: Field Survey, 2013

There are many reason behind the businessmen get registered in Tax office among them 65% business personnel think as law make compulsory for them to registered if they adopt certain business and cross limit of their transaction. 10% think it is need because it help to expand the market share and rest 25% think it is main source of government revenue show they help government for contribution in revenue generation. It can be further clarified by given Pie chart as

Figure 14



As clarified by the chart we can say that if tax office wants to increase government revenue collection through VAT they should implement VAT by monitoring, controlling & bring more unregistered person in the net VAT area.

4.2.3 Problem in VAT Registration and Deregistration.

It is very crucial that the process of VAT registration should be easy and encouraging. Despite that, there are so many obstacles and problems during registration process and after registration too and for deregistration also there are lengthy process to follow. To solve the problems of businesspersons is a main responsibility of government for the smooth functioning of the system.

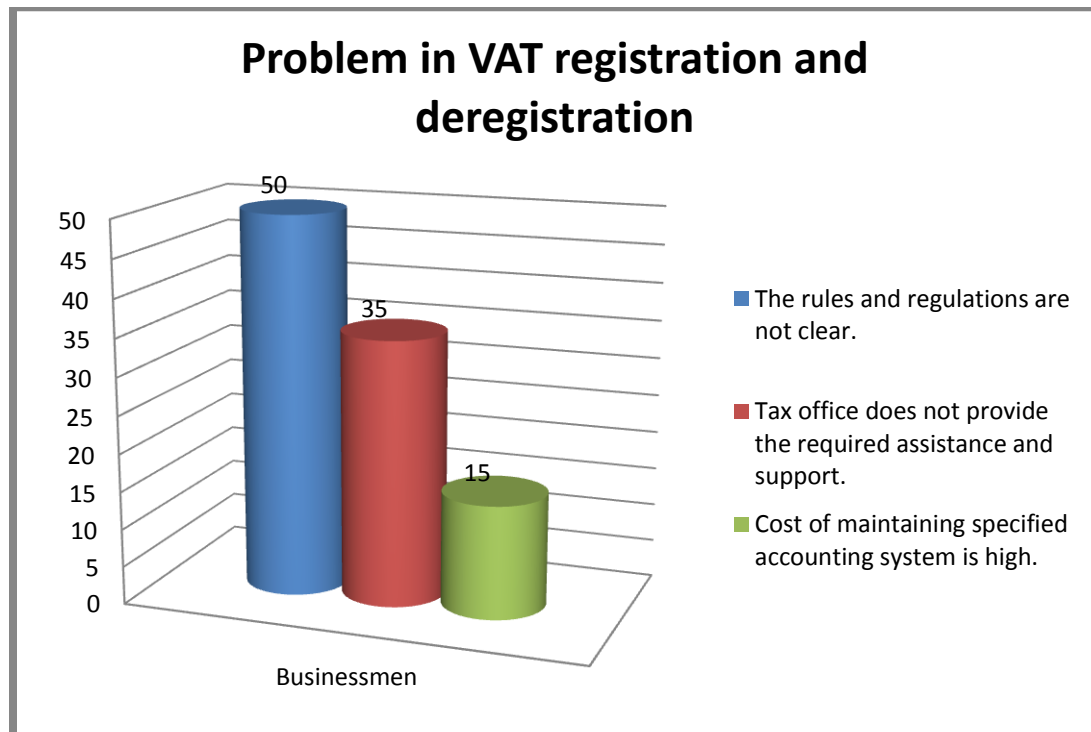
Table 21
Problem in VAT registration and deregistration

| Respondent Type | Response | No. of Respondents | Percentage |
|------------------------|------------------------------------------------------------------|---------------------------|-------------------|
| Businessmen N=20 | The rules and regulations are not clear. | 10 | 50 |
| | Tax office does not provide the required assistance and support. | 7 | 35 |
| | Cost of maintaining specified accounting system is high. | 3 | 15 |

The businessmen's problems on before and after registration on VAT are ranked here as per their preferences.

1. The rules and regulations are not clear.
2. Tax office does not provide the required assistance and support.
3. Cost of maintaining specified accounting system is high.

Figure 15



By analysis above table and figure we found the major problems that businessmen are facing under VAT registration process and post registration is very crucial question as this is important for the motivation of businessmen. The Tax Office could not provide required assistance to the business ventures. On the question asked ' Problem in VAT registration and deregistration.' to 20 businessmen 50% (10 businessmen) said that rule and regulation are not clear. 35 % businessman thinks that the tax office does not provide the required assistance and support. 15% businessmen said that the cost of maintaining specified accounting system is high. Therefore government should correct the system wherever is possible and give training as well as incentive for the tax officers. Government should also punish hard to those who are abusing their authority for vested interest.

4.2.4 Demand of Different VAT Rate Is Appropriate?

Government increased the VAT rate to 13% from 10%. This is done to increase the tax revenue in the national coffer. Due to it consumers, businessmen suffered and experts give their negative views on it. So, now businessmen demand that different rate as per the nature of business. Whether the demand for different VAT rate is ok or not, If yes what should be done?

Table 22
Demand of different VAT rate is appropriate

| Respondent Type | Response | No. of Respondent | Percentage (%) |
|----------------------|----------|-------------------|----------------|
| Consumers No. = 25 | Yes | 18 | 72 |
| | No | 7 | 28 |
| Businessmen No. = 20 | Yes | 12 | 60 |
| | No | 8 | 40 |
| Experts = 10 | Yes | 8 | 80 |
| | No | 2 | 20 |

Source: Field Survey, 2013

The Above table shows the result found on asking the question "Is the demand for different VAT rate is appropriate or not?" and the result shows that the same rate is not good and it should be changed. 72% Consumers, 60% Businessmen and 80% Experts have their view on the not appropriateness of same VAT rate. This represent that the Government should be very much serious on fixing the rate and it should soon address on the need of the market. The experts who think the rate is not good have feeling ± in country like ours where income of people is very low, tariff should be minimum for daily consumable goods and basic services.

Table 23
If yes, what the government should do?

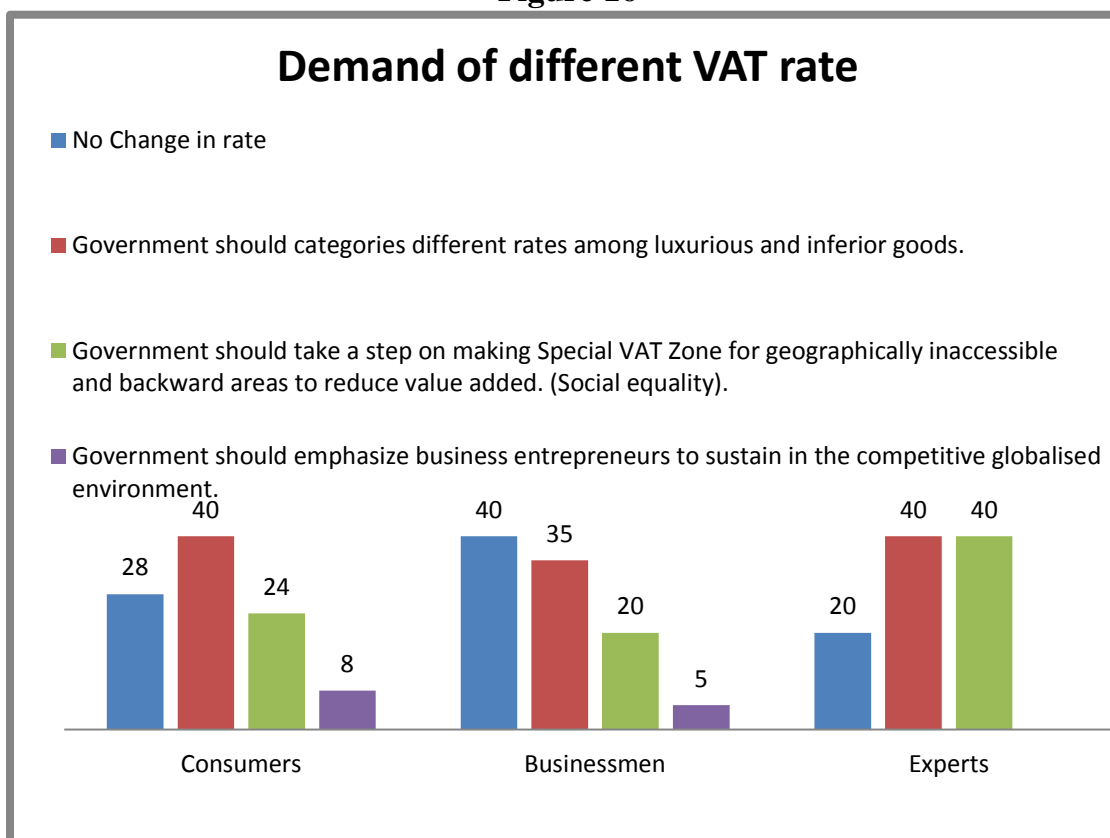
| Respondent Type | Response | No. of Respondent | % |
|--------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|----|
| Consumers No. = 25 | Government should categories different rates among luxurious and inferior goods. | 10 | 40 |
| | Government should take a step on making Special VAT Zone for geographically inaccessible and backward areas to reduce value added. (Social equality). | 6 | 24 |
| | Government should emphasize business entrepreneurs to sustain in the competitive globalised environment. | 2 | 8 |

| | | | |
|-------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------|---|----|
| Businessmen No. = 20 | Government should categories different rates among luxurious and inferior goods. | 7 | 35 |
| | Government should take a step on making Special VAT Zone for geographically inaccessible and backward areas to reduce value added. (Social equality). | 4 | 20 |
| | Government should emphasize business entrepreneurs to sustain in the competitive globalised environment. | 1 | 5 |
| Experts = 10 | Government should categories different rates among luxurious and inferior goods. | 4 | 40 |
| | Government should take a step on making Special VAT Zone for geographically inaccessible and backward areas to reduce value added. (Social equality). | 4 | 40 |
| | Government should emphasize business entrepreneurs to sustain in the competitive globalised environment. | - | - |

Source: Field Survey, 2013

It can be further clarified by the given below figure.

Figure 16



Those saying VAT rate is not appropriate were asked, "What should government then do?" 28% Consumers, 40% Businessmen and 20% Experts agree that demand is not appropriate. 40% Consumers, 35% Businessmen and 40% Experts suggest that government should Government should categories different rates among luxurious and inferior goods. 24% Consumers, 20% Businessmen and 40% Experts think that it is preferable to government should take a step on making Special VAT Zone for geographically inaccessible and backward areas to reduce value added (social equality). Other option is unlike by all stakeholders. Hence expert's views reducing the rate as it directly affects the purchasing power of the consumers.

4.2.5 What Should Government do for Effective Implementation of VAT?

The factors such as custom valuation not being based on actual price, lack of tendency to execute fair business amongst the businessmen, taxpayers not used to paying taxes, inability of the revenue administration to make the audit systematic and reliable, instability and insincerity of the government may be the main reasons for this system not being as successful as in other countries. Invoices are the main basis not only for VAT but also for income tax and customs duty. Now income tax is based on the accounts maintained for VAT, similarly, in connection with the implementation of VAT, the old valuation system regarding customs duty has been replaced with the transaction value system. Under the VAT system, even if the tax is evaded at the customs point by reducing the import value, it will be recovered at a later stage.

There are lots of things to be checked and corrected. The change needed and the step that should follow by the government may be different for different people within the stakeholder. Various stakeholders of the society, towards the taxation policy of the government, give their view in different ways. Here is the summary of the list that people think- government should do in the near future.

Table 24
What should Government do?-consumers

| Respondent Type | Response | No. of Respondents | % |
|-------------------------------|---------------------------------------------------------------------------------|---------------------------|-----------|
| Consumers No. = 25 | Discover corruption by making strong rules against sources unidentified income. | 6 | 24 |
| | Increase public awareness through various programs. | 7 | 28 |
| | Monitoring the effectiveness of VAT should be improved. | 5 | 20 |
| | Control custom point for low valuation of goods. | 4 | 16 |
| | Make every trader compulsory on VAT registration. | 3 | 12 |

Consumers' view on what should Government do to make VAT system effective and transparent is ranked as per their preferences and found as follows:

1. Increase public awareness through various programs.
2. Discourage corruption by strong rule against unidentified income and giving more social pressure.
3. Monitoring should be improved and in regular interval of times.
4. Control custom point for valuation of goods.
5. Make every trader compulsory on VAT registration.

Table 25
What should Government do? Businessmen

| Respondent Type | Response | No. of Respondents | % |
|---------------------------------------|---------------------------------------------------------------------------------------------------|---------------------------|-----------|
| Businessmen No. = 20 | Discourage corruption by strong rule against unidentified income and giving more social pressure. | 6 | 30 |
| | Increase public awareness through various programs | 5 | 25 |
| | Control custom point for valuation of goods. | 3 | 15 |
| | Monitoring should be improved and in regular interval of times. | 4 | 20 |
| | Make every trader compulsory on VAT registration. | 2 | 10 |

Source: Field Survey, 2013

Businessmen's view on what should Government do to make VAT system effective and transparent is ranked as per their preferences and found as follows:

1. Discourage corruption by strong rule against unidentified income and giving more social pressure.
2. Increase public awareness through various programs.
3. Monitoring should be improved and in regular interval of times.
4. Control custom point for valuation of goods.
5. Make every trader compulsory on VAT registration.

Table 26
What should Government do? Experts

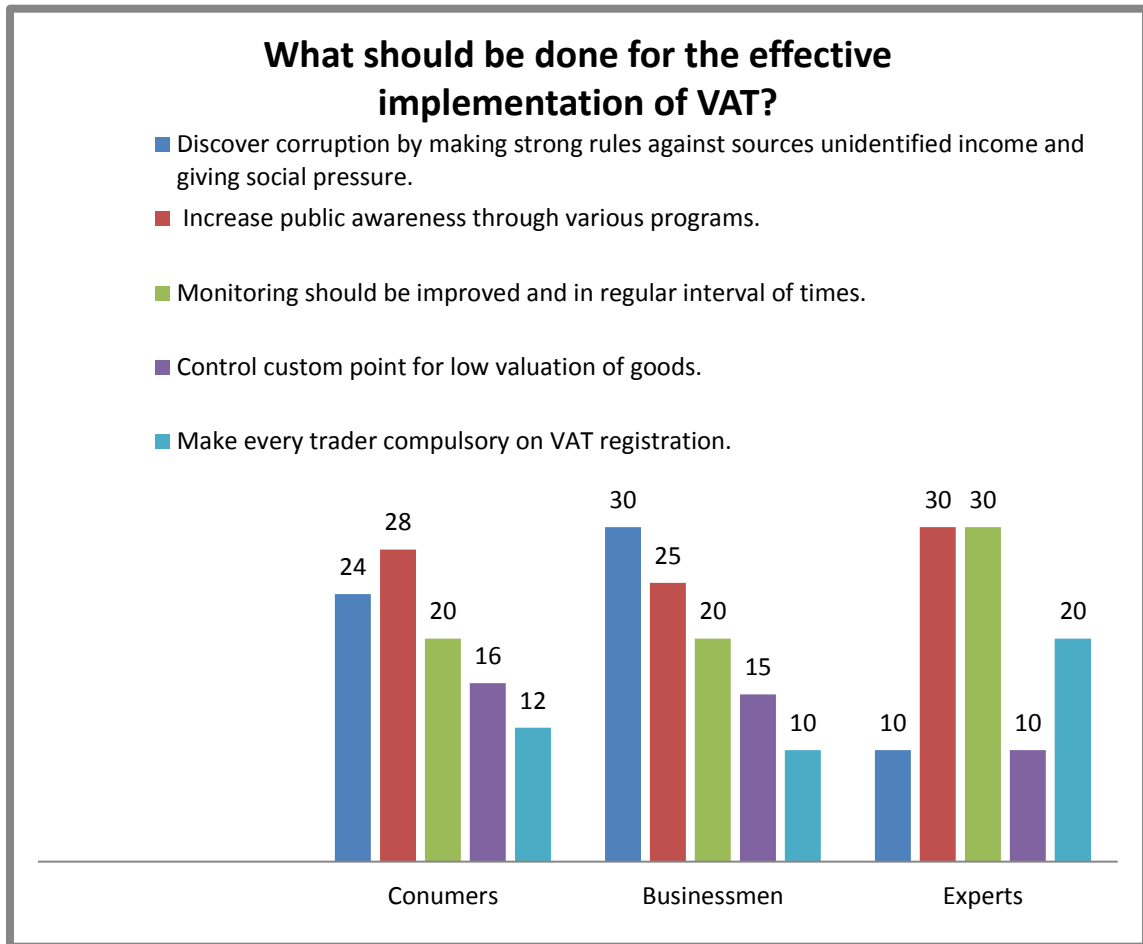
| Respondent Type | Response | No. of Respondents | % |
|----------------------------|---------------------------------------------------------------------------------|---------------------------|-----------|
| Experts No. =10 | Discover corruption by making strong rules against sources unidentified income. | 1 | 10 |
| | Increase public awareness through various programs. | 3 | 30 |
| | Monitoring the effectiveness of VAT should be improved. | 3 | 30 |
| | Control custom point for low valuation of goods. | 1 | 10 |
| | Make every trader compulsory on VAT registration. | 2 | 20 |

Source: Field Survey,2013

Experts' view on what should Government do to make VAT system effective and transparent is ranked as per their preferences and found as follows:

1. Increase public awareness through various programs.
2. Monitoring the effectiveness of VAT should be improved.
3. Make every trader compulsory on VAT registration.
4. Control custom point for low valuation of goods.
5. Discover corruption by making strong rules against sources unidentified income (social pressure).

Figure 17



So many times government is changing tax policies to make the system more effective and transparent. But the efforts are gone in vain as it could not change the weaknesses of the system. This happens because of various weaknesses. Therefore I prepared this question to find out the real problems from the experts, consumers and businessmen's point of view. On the question asked to consumers, businessmen and experts ' what should do for the effective implementation of VAT?' 24% consumers, 30% businessmen and 10% experts say that the there must create environment for discovering corruption by making strong rules against sources unidentified income and give such individual social pressure. 28% consumers and 25% businessmen and 30% experts agree on increasing public awareness through various program is necessary. 16% consumers and 15% businessmen and 10% of experts request the government to control custom point for low valuation of goods. Another important finding is making compulsory on VAT registration viewed by 12% consumers and 10% businessmen and 20% experts.

4.2.6 VAT System has Practical Difficulties in accounting and Hard System to Apply.

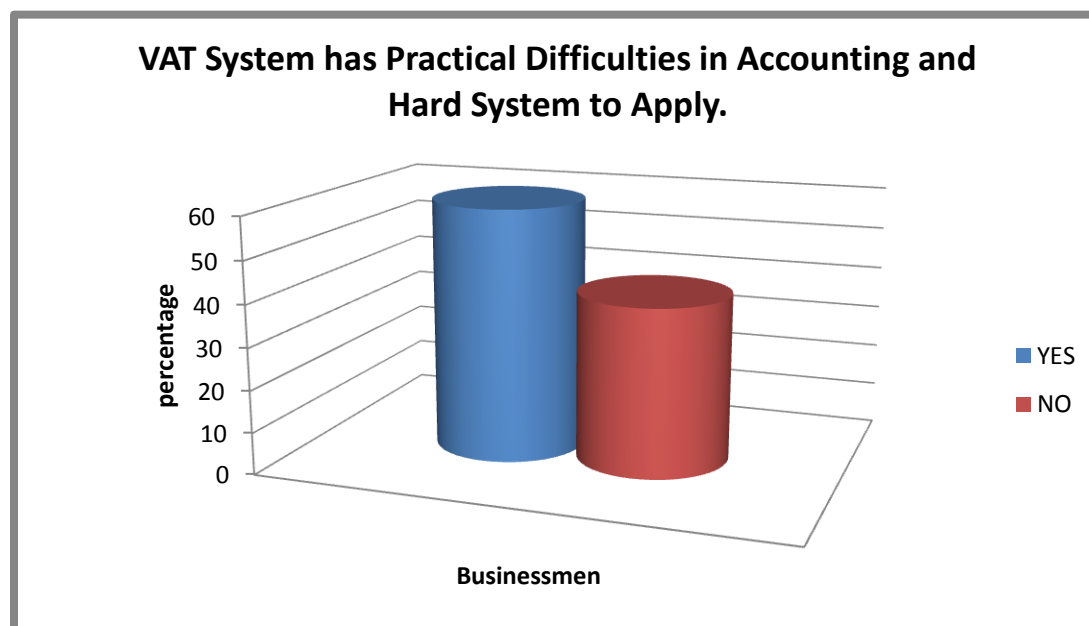
Another problem of VAT is its accounting system. Though current accounting system is good, businessmen are not aware enough behind the reason why these types of accounting are needed? There are at least three types of VAT collection method. Among them consumer type VAT is assumed well in the context of Nepal and applied.

Table 27
VAT System has Practical Difficulties in Accounting and Hard System to Apply.

| Respondent Type | Response | No. of Respondent | % |
|-------------------------|----------|-------------------|----|
| Businessmen No. = 20 | Yes | 12 | 60 |
| | No | 8 | 40 |

Source: Field Survey, 2013

Figure 18



The above table shows that the major problems that businessmen faced on maintaining the books. 60% businessmen told that VAT is difficulties system to apply. Similarly 40% agree that it can be apply easily. Small traders could not maintain all the required books as stock books are almost impossible to maintain for the small retailer shops. This create

many problems on maintaining the books as they could not get the real bill for purchase which makes them bound to issue false bill or not issue bills.

4.2.7 Does shopkeeper use VAT bill on every purchase and sale?

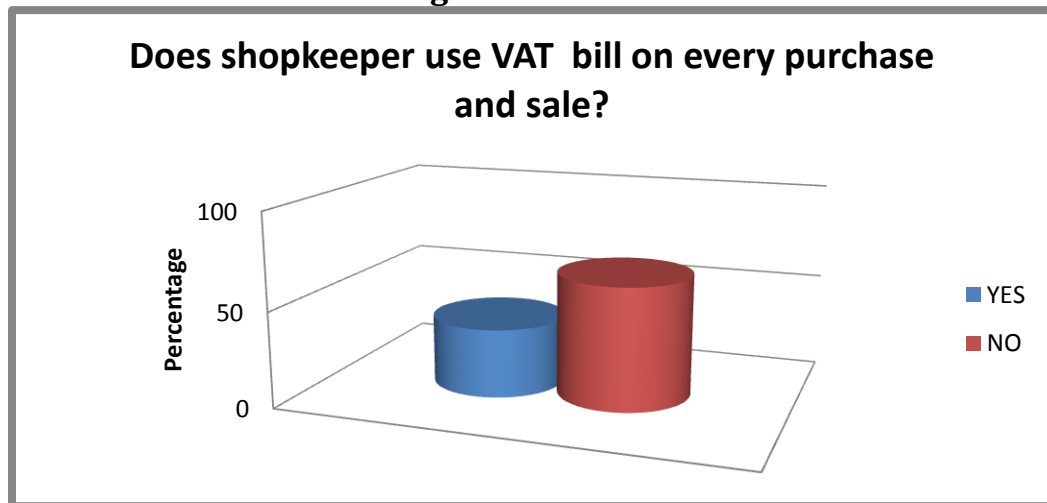
The main backbone of VAT system is billing system. The main problem identified by various previous studies is fall under weak billing system. Most of the sales and purchases are not billed and in billed that are in low price- called low invoicing. Therefore this affects the whole system of taxation. Here also effort is made to identify the current situation of perfect invoicing. Even the tendency of tax evasion has not declined after the implementation of VAT. There is feeling that tax evasion has increased because VAT and Income tax can both be evaded if a vender is able to issue false invoices during sales and hence the tendency to issue invoices has further declined. The inability to get purchase invoices from the businessmen while purchasing goods from the market proves this point. On the question asked, “Does shopkeeper VAT use bill on every purchase and sale?” the following result is found.

Table 28
Does shopkeeper VAT use bill on every purchase and sale?

| Respondent Type | Response | No. of Respondent | % |
|------------------------|-----------------|--------------------------|-----------|
| Consumers No. = 25 | Yes | 9 | 36 |
| | No | 16 | 64 |

Source: Field Survey,2013

Figure 19



Looking at the data we can easily say that the trend of issuing invoices is still weak. Only 36% shopkeepers issue invoices in their sales without asking. Even those who issue

invoices in their sales are mostly fixed priced shop and departmental stores, many of the businessman told that price is determined by bargaining and customers do not ask about the bill. Therefore we can easily conclude the weakness on this part of the VAT's backbone. And thus need a huge change to develop the trend of issuing invoices.

4.2.8 As a customer you ask & receive tax invoice from businessmen at the time of purchasing.

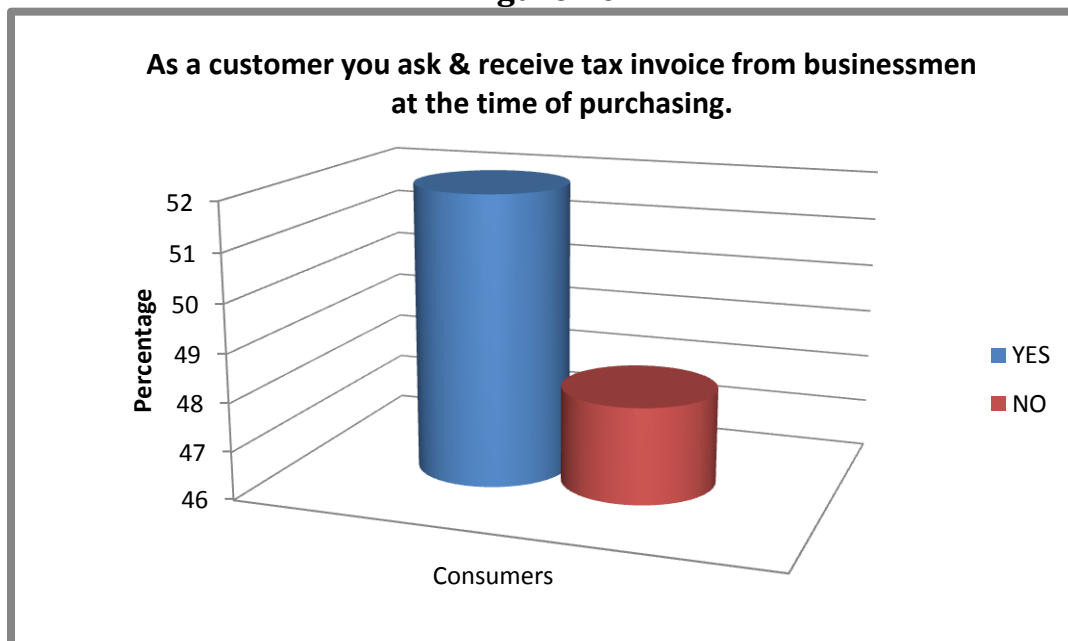
The main reason of this is the lack publicity and effective monitoring in the implementation of VAT the main glitch has been in terms of the lack of public awareness. Until a time when a situation is created where the consumer himself/herself is self motivated to ask for an invoice, it will be very difficult to apply this system for smooth functioning as we thought.

Table 29
As a customer you ask & receive tax invoice from businessmen at the time of purchasing.

| Respondent Type | Response | No. of Respondent | % |
|------------------------|-----------------|--------------------------|----------|
| Consumers No.= 25 | Yes | 13 | 52 |
| | No | 12 | 48 |

Source: Field Survey,2013

Figure 20

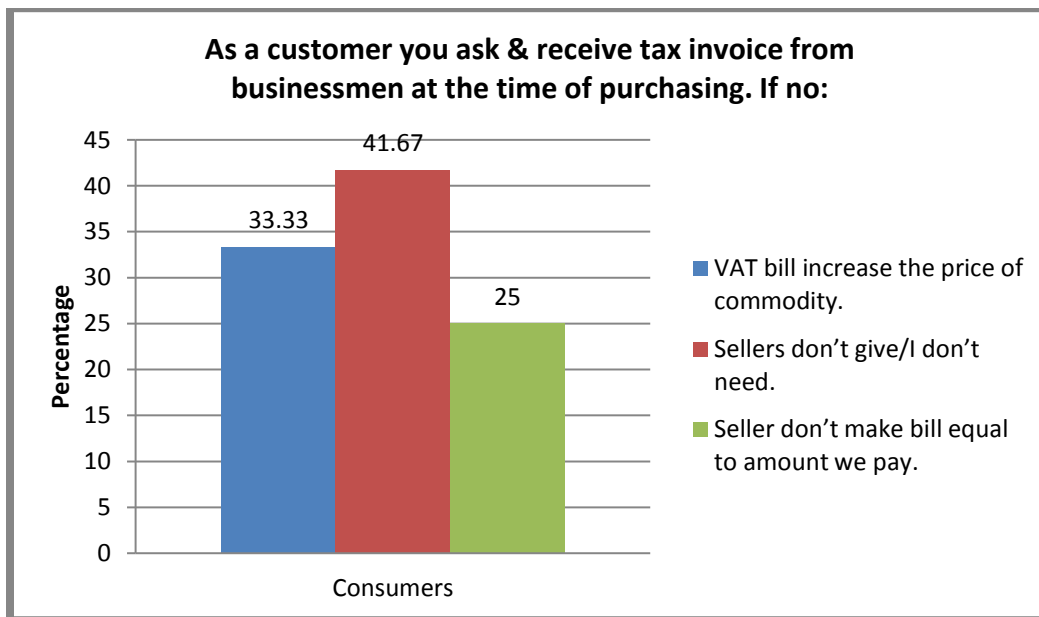


The data shows that consumers asking VAT bill is very low. Businessmen had experience that consumers are afraid of the increment in price due to VAT bill. 48% consumers said that they are not aware of when to ask the invoice from businessmen for VAT bill and 52% of consumers asking for bill also reply that businessmen either issue lower than value of goods.

If No, (Select any one option)

- VAT bill increase the price of commodity.
- Sellers don't give/I don't need.
- Seller don't make bill equal to amount we pay.

Figure 21



As researcher provide above option consumers give their view as 33.33% reason on VAT bill increase the price of commodity, 47.67% says sellers don't give / I don't need and rest view seller don't make bill equal to amount we pay. It is found in the previous research also that consumers do not ask for invoices while making purchase due to afraid of increase in the price of goods and services. Everyone wants to pay less which is the nature of consumers worldwide. By not taking invoice if the goods is found cheaper then why to take bill is a common thought.

4.2.9 VAT Increase Price of Commodities Increase Compared To Earlier Tax System.

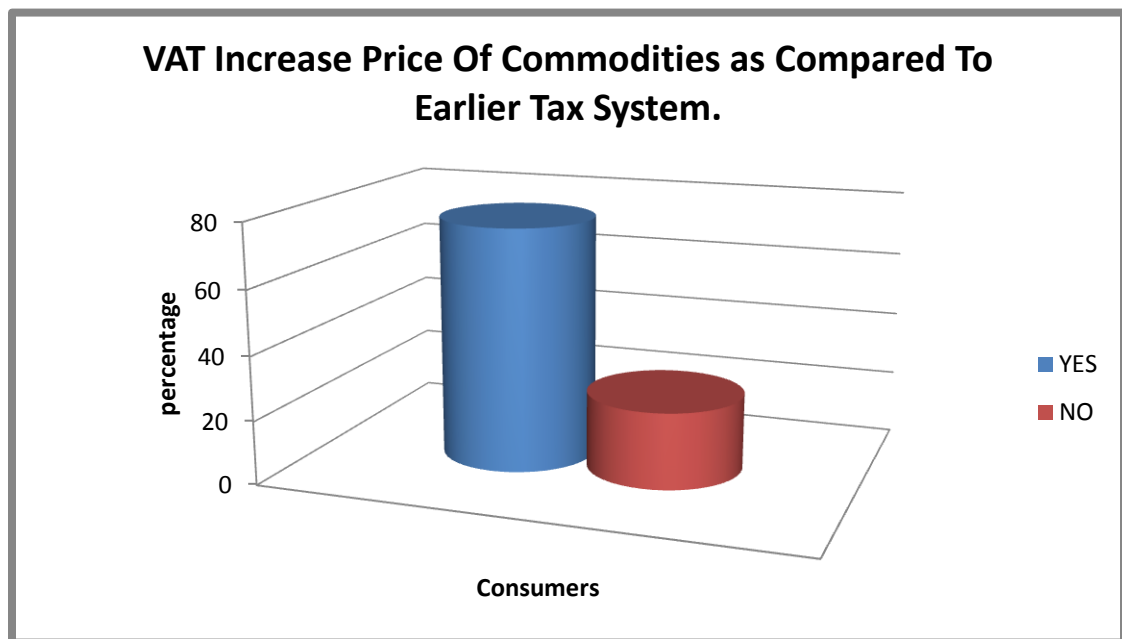
As compared to the earlier sale tax system current VAT is systematic and cost compliance but to the consumers it increases the cost of consumption. Base on this following it is found that people have the insecurity that price of commodity gets increased with the VAT related invoices and they just don't opt for the invoice and bills. Also VAT implies to levy tax on different level as compared to earlier system which ultimately will have the burden on consumers regarding double taxation and higher value added.

Table 30
VAT Increase Price of Commodities as Compared To Earlier Tax System.

| Respondent Type | Response | No. of Respondent | % |
|-------------------|----------|-------------------|----|
| Consumers No.= 25 | Yes | 19 | 76 |
| | No | 6 | 24 |

Source: Field Survey,2013

Figure 22



One of the important findings of this research is to know why consumer hesitates to take bill or afraid of taking bills as 76% consumers thought that VAT increases the price of the commodities. But the major problem is not from the side of consumers but from the side of the businessmen as they make consumers convince that if they demand VAT invoice they have to pay extra amount on VAT.

4.2.10 what is Possible Loopholes on VAT Implementation?

False and duplicate VAT bill is major problem in VAT implementation as in previous year IRD made investigation on 518 firms among them 227 business firms found guilty of hiding their actual transaction. Hence VAT is self policing system tax behavior largely affect it.

Table 31
What is Possible Loopholes on VAT Implementation?

| Respondent Type | Response | No. of Respondent | % |
|------------------------|--------------------------------------------------------------|--------------------------|----------|
| Experts No.= 10 | Misuse of debit note and credit note | - | |
| | Direct posting of tax return without account keeping | 2 | 20 |
| | Weak communication channel in government system. | 3 | 30 |
| | VAT implementation largely depends upon taxpayer's behavior. | 5 | 50 |

Source: Field Survey,2013

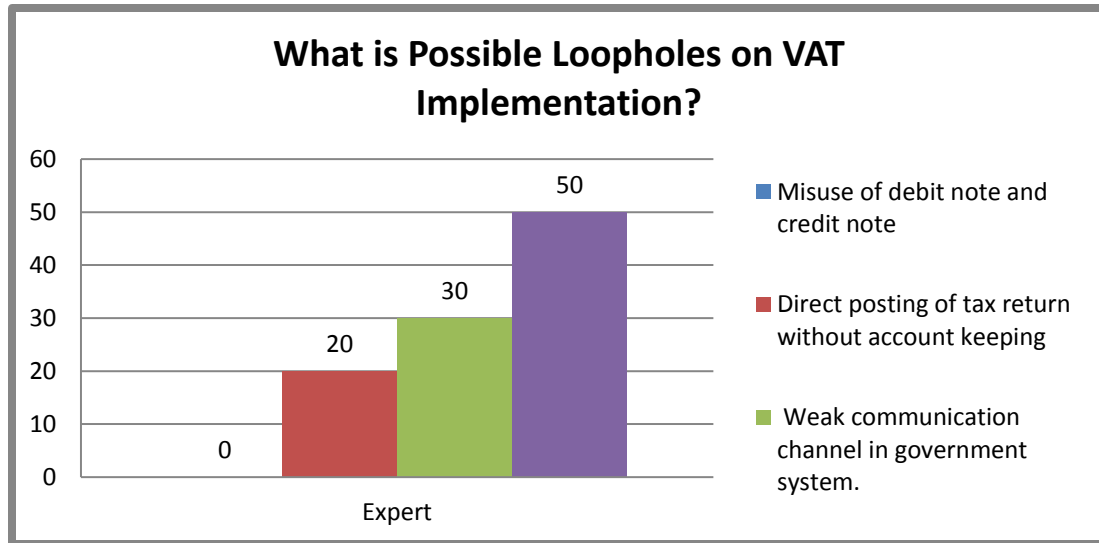
The major loopholes of VAT system are presented below as per the rank made from experts' view.

- Misuse of debit note and credit note
- Direct posting of tax return without account keeping
- Weak communication channel in government system.
- VAT implementation largely depends upon taxpayer's behavior.

It is found from the study that the major problem of VAT's leakages is an unofficial trade from the southern and northern borders. Under valuation of goods is rampant which cause problems from the very initial stage of VAT. Once the problems started in the chain of VAT, it affects the whole system.

The above table shows that 50% experts agree on VAT implementation largely depends upon taxpayer's behavior is one of the causes of VAT leakages. And 30 % experts have feeling that Weak communication channel in government system.

Figure 23



IRD should control VAT weakness by identifying risk as checking invoice, audit of purchase & sale book, mismatch of transaction of business firms to effective implementation of VAT.

4.2.11 Difficulty Faced in Implementation Procedure of VAT.

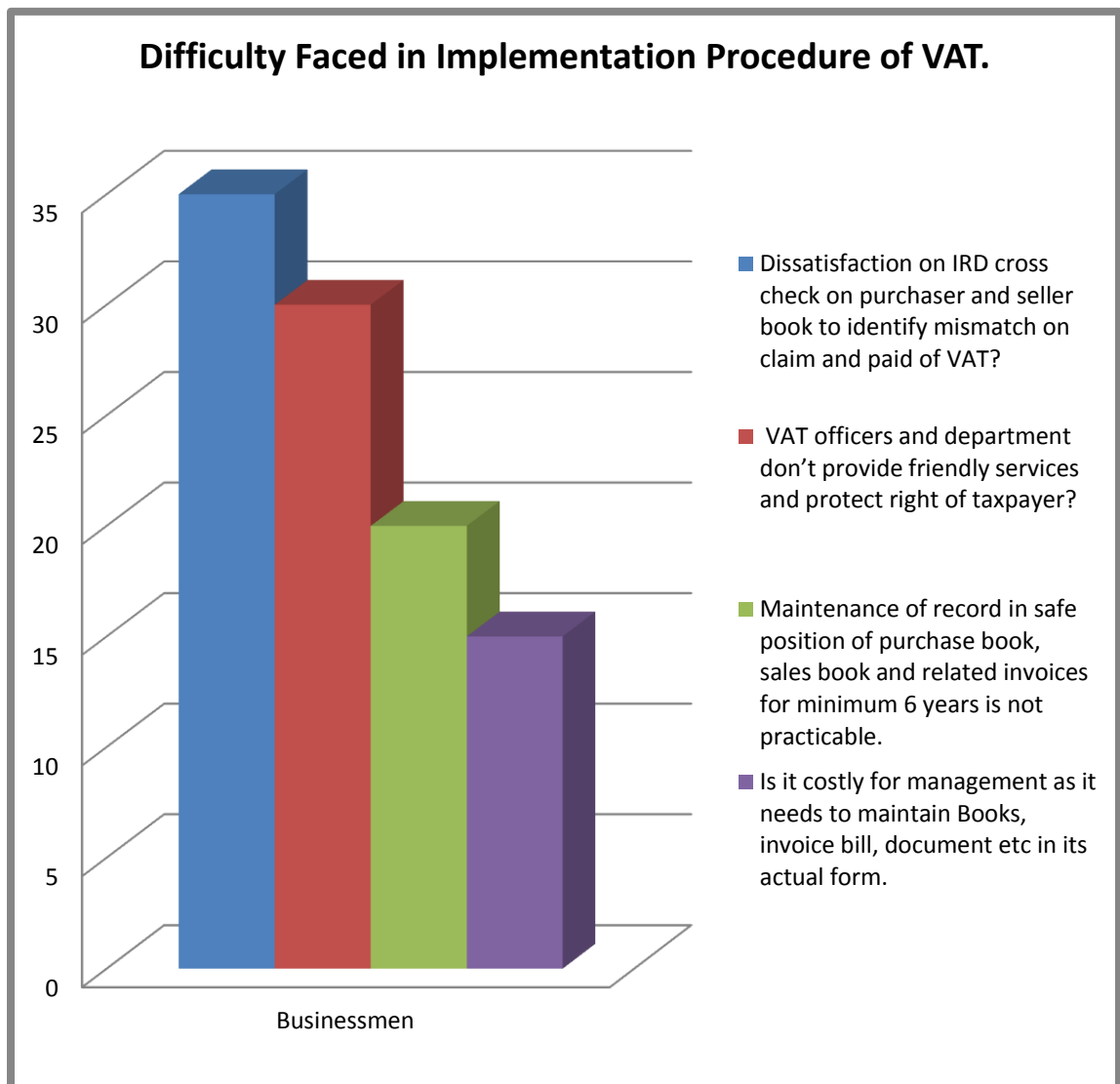
Table 32
Difficulty Faced in Implementation Procedure of VAT.

| Respondent Type | Response | No. of Respondents | % |
|---------------------------------|----------------------------------------------------------------------------------------------------------------------------------|---------------------------|-----------|
| Businessmen No. = 20 | Dissatisfaction on IRD cross check on purchaser and seller book to identify mismatch on claim and paid of VAT? | 7 | 35 |
| | VAT officers and department don't provide friendly services and protect right of taxpayer? | 6 | 30 |
| | Maintenance of record in safe position of purchase book, sales book and related invoices for minimum 6 years is not practicable. | 4 | 20 |
| | Is it costly for management as it needs to maintain Books, invoice bill, document etc in its actual form. | 3 | 15 |

The major difficulties faced in implementation procedure of VAT system are presented below as per the rank made from Businessmen's view.

1. Dissatisfaction on IRD cross check on purchaser and seller book to identify mismatch on claim and paid of VAT?
2. VAT officers and department don't provide friendly services and protect right of taxpayer?
3. Maintenance of record in safe position of purchase book, sales book and related invoices for minimum 6 years is not practicable.
4. Is it costly for management as it needs to maintain Books, invoice bill, document etc in its actual form.

Figure 24



VAT was come into implementation since 2053 B.S. even than in present there are many difficulties faced in the implementation procedure of VAT which make business community unlikely to follow due to 15% think that Is it costly for management as it needs to maintain Books, invoice bill, document and 35% respondent think it make dissatisfaction on IRD cross check on purchaser and seller book to identify mismatch on claim and paid of VAT, and 20% views it is area consuming and hard to Maintenance of record in safe position of purchase book, sales book and related invoices for minimum 6 years is which also not practicable.

4.2.12 Benefit from Registration of More than One VAT Unregistered Business.

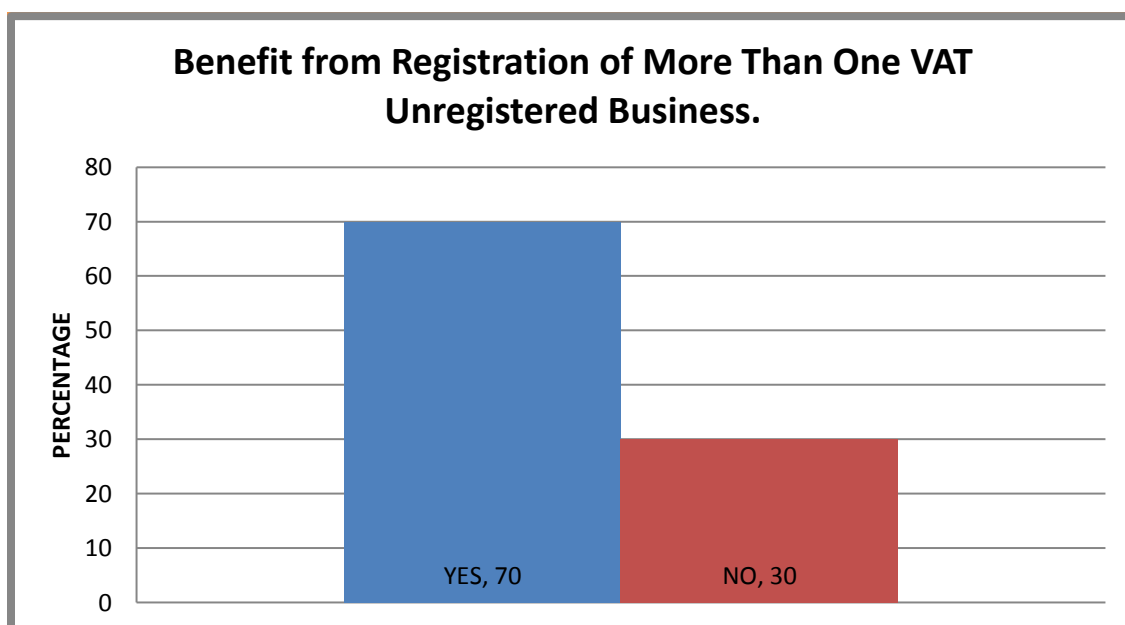
Business community is main sources of revenue generation for government, as VAT provide threshold for registration there may be probability of registration business to get out of VAT mainly by those who purchase from VAT from VAT unregistered but have to issue bill if cross limit of thresh hold.

Table 33
Benefit from Registration of More than One VAT Unregistered Business.

| Respondent Type | Response | No. of Respondent | % |
|------------------------|----------|-------------------|----|
| Businessmen No.= 20 | Yes | 14 | 70 |
| | No | 6 | 30 |

Source: Field Survey,2013

Figure 25



By the above table and figure 70% business agreed that it benefit those businessmen who get more than one business registered to get out of VAT area. Government should apply certain scheme or punishment to such businessmen.

4.2.13 VAT makes no discrimination of rich and poor.

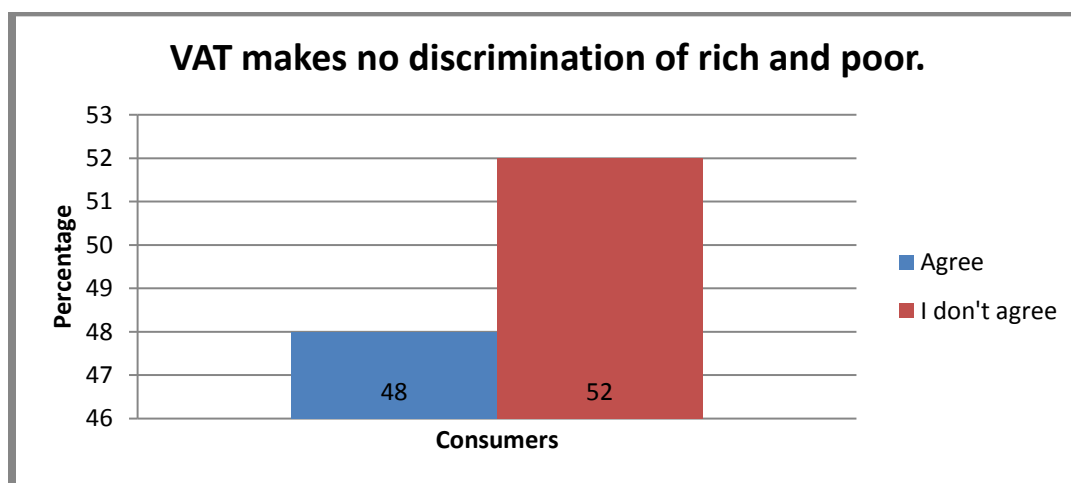
VAT main objective is transparent and no discriminate between poor and rich but it make discriminate to some extent on practical application where businessmen can claim VAT paid but consumer could not in consumption of basic good e.g petroleum and others .

Table 34
VAT makes no discrimination of rich and poor.

| Respondent Type | Response | No. of Respondent | % |
|----------------------|---------------|-------------------|----|
| Consumers No.= 25 | Agree | 12 | 48 |
| | I don't agree | 13 | 52 |

Source: Field Survey, 2013

Figure 26



From the above table 53% don't agree that VAT dissertation on rich and poor but 48% think it discriminate poor and rich.

4.2.14 Reasons of tax office for being unable to extend area and amount of tax collections.

VAT has come of 14 years in Nepal, but it has completed 57 years in the international arena of taxation as it was firstly introduced in France in 1954. VAT in Nepal has witnessed many ups and downs and twists and turns so far. Despite all the odds, it has been able to prove itself as a strong and healthy backbone of the internal revenue by

outstripping custom duties from FY 2002/03 onward and now stands as the largest contributor to the state coffer. Even than tax does not able to extend the area and collect the amount it can.

Table 35
Reason for IRD being unable to extend area and amount of tax collection.

| Respondent Type | Response | Rs. In '000' | |
|----------------------------|-----------------------------------------------------------------------------------------------------|--------------------|-----------|
| | | No. of Respondents | % |
| Expert No. = 10 | Tax Department unable to conduct tax research and applied professional support in policy formation. | 4 | 40 |
| | Problem in VAT registration and deregistration. | 3 | 30 |
| | Inadequacy of manpower to examines the business record and the stock of business. | 2 | 20 |
| | Tax payer's lack of interest on VAT deposit due to difficulty on claim off VAT refunds. | 1 | 10 |

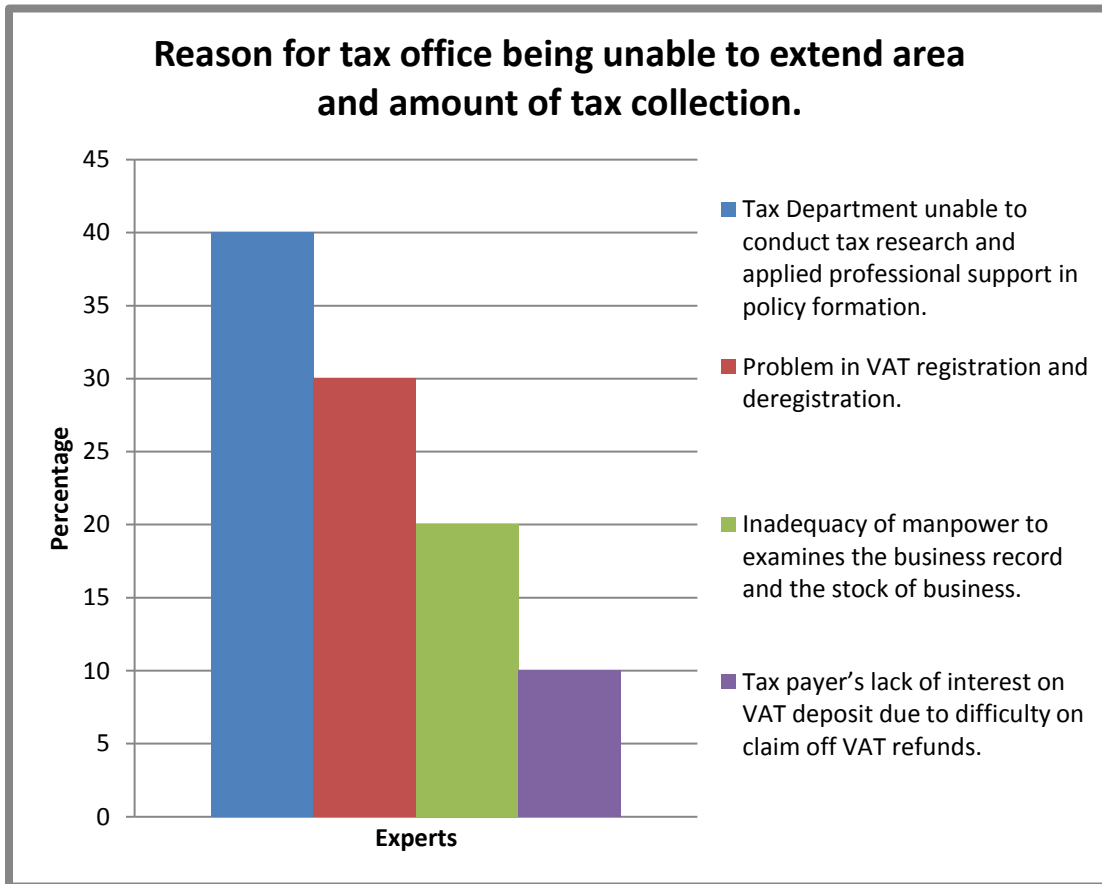
Source: Field Survey, 2013

The major reasons of tax office for being unable to extend area and amount of tax collections as per the rank made from taxpayer's view.

1. Tax Department unable to conduct tax research and applied professional support in policy formation.
2. Problem in VAT registration and deregistration.
3. Inadequacy of manpower to examines the business record and the stock of business.
4. Tax payer's lack of interest on VAT deposit due to difficulty on claim off VAT refunds.

By the finding of above table 40% experts views the reason for unable to extend area and amount of tax collections is due to Tax Department unable to conduct tax research and applied professional support in policy formation in implementation of VAT.

Figure 27



Hence government should make easier in VAT registration and post registration procedure and professional should be hired in full audit of VAT registrants. At the time of its introduction, there were only 2045 taxpayers converted into VAT from the then sales tax regime, but by the end of FY 2010/11, registration toll has reached to almost 97,664, registering a phenomenal annual average growth of 126.42 percent. If IRD has to extend area of VAT it must consider above finding.

4.2.15 Reasons for inability in improvement, maintenance and record books of account as per VAT system.

For knowing how any entity is performing its transaction must be transparent and legal for that proper book of account must be maintain as required by NAS guidelines and relevant authority regulation. As getting the businessmen view on difficulty faced in implementation procedure of VAT, further expert feedback about the reason of inability to make improvement of proficient in maintaining proper books of accounts.

Table 35
Reasons for inability in improvement, maintenance and record
books of account as per VAT system

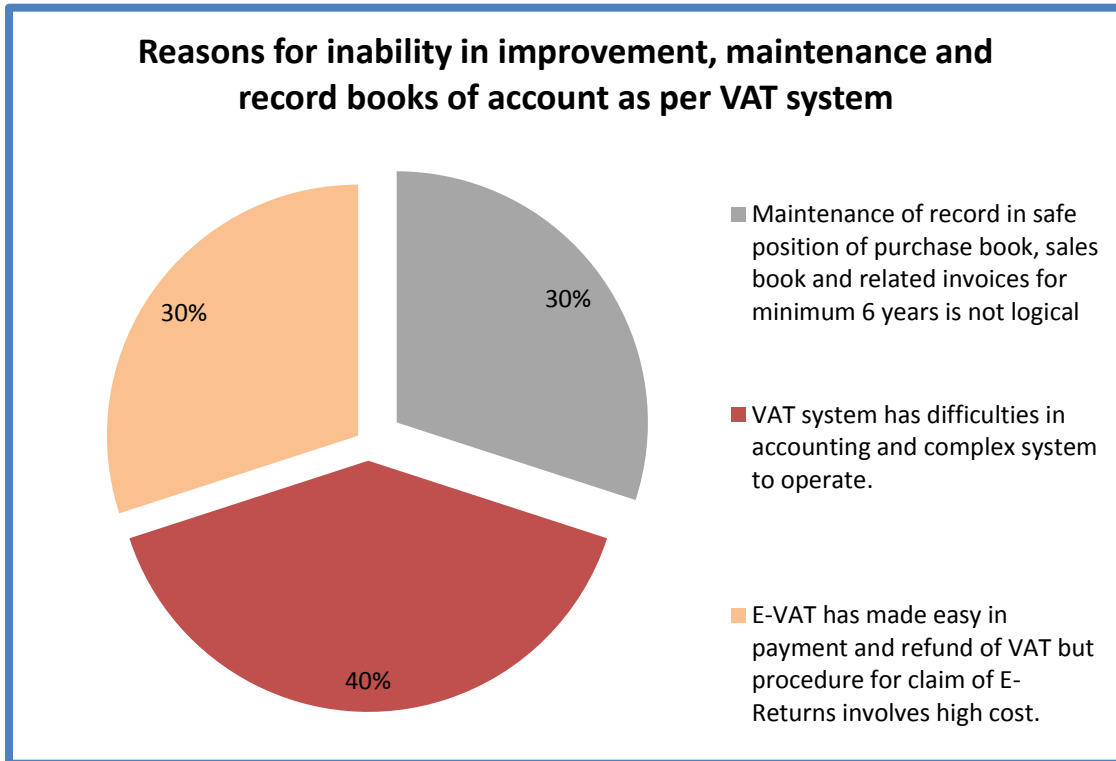
| Respondent Type | Response | No. of Respondents | % |
|-----------------------------|------------------------------------------------------------------------------------------------------------------------------|---------------------------|-----------|
| Experts No. = 10 | VAT system has difficulties in accounting and complex system to operate. | 3 | 30 |
| | Maintenance of record in safe position of purchase book, sales book and related invoices for minimum 6 years is not logical? | 4 | 40 |
| | E-VAT has made easy in payment and refund of VAT but procedure for claim of E- Returns involves high cost. | 3 | 30 |

Source: Field Survey,2013

The major reasons of inability to make improvement of proficient in maintaining proper books of accounts from expert's rank as below:

1. Maintenance of record in safe position of purchase book, sales book and related invoices for minimum 6 years is not logical?
2. VAT system has difficulties in accounting and complex system to operate.
3. E-VAT has made easy in payment and refund of VAT but procedure for claim of E- Returns involves high cost.

Figure 28



Even there is Act, Regulation, Directives on VAT smooth and transparent functioning has not been seen yet as big business house also unable to maintain of record and fall guilty for duplicate VAT invoice , mismatch of book maintain by VAT registrants. 40% experts it is due to hard to maintenance of record in safe position of purchase book, sales book and related invoices for minimum 6 years is not logical base on these cross checking is impossible.

4.2.16 Reason for resistance on implementation of VAT by Business Community.

Value Added Tax is a tax on consumption. Inputs of a firm are not taxed at each point the firm is reimbursed the tax which it has already paid at the time of purchasing the inputs, thus there is no cascading effect. More often in most countries at time of implementation VAT get resistance from business community.

Table 37
Reason for resistance on implementation of VAT by Business Community

Rs. In '000'

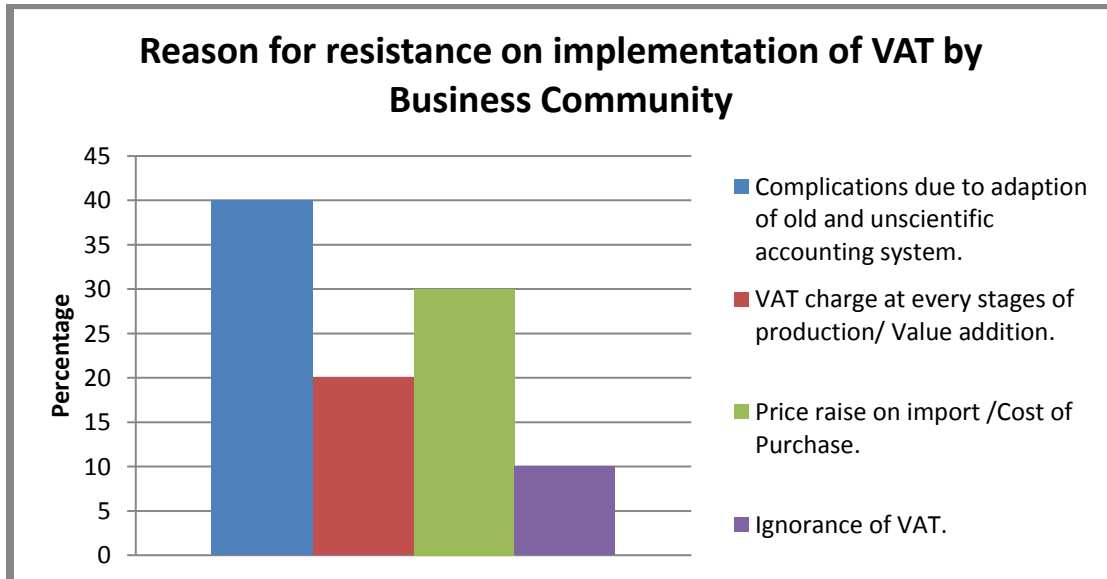
| Respondent Type | Response | No. of Respondents | % |
|----------------------------|--------------------------------------------------------------------------|---------------------------|-----------|
| Expert No. = 10 | Ignorance of VAT. | 1 | 10 |
| | Complications due to adaption of old and unscientific accounting system. | 4 | 40 |
| | Price raise on import \Cost of Purchase. | 3 | 30 |
| | VAT charge at every stages of production\Value addition. | 2 | 20 |

Source: Field Survey, 2013

The major reasons of tax office for being unable to extend area and amount of tax collections as per the rank made from taxpayer's view.

1. Complications due to adaption of old and unscientific accounting system.
2. VAT charge at every stages of production\ Value addition.
3. Price raise on import \Cost of Purchase.
4. Ignorance of VAT.

Figure 29



The respondents are requested to express their perception about resistance of VAT by business community, 40% of experts vies it is due to Complications due to adaption of

old and unscientific accounting system & VAT charge at every stages of production\ Value addition which they thought decrease their competitiveness in international scenario.

4.2.17 How VAT Challenges can be effectively handle in current scenario?

The study challenge revealed on the maintaining transparency in VAT. It is found that equal channel of distribution of VAT is found among Wholesalers, Retailers and Consumers. The tax applicability and e-filing plays a vital role in the VAT system can handle VAT effectively and mutual benefits to the Consumers and Government. Further experts response obtains as below:

Table 38
How challenges can be effectively handle in current scenario?

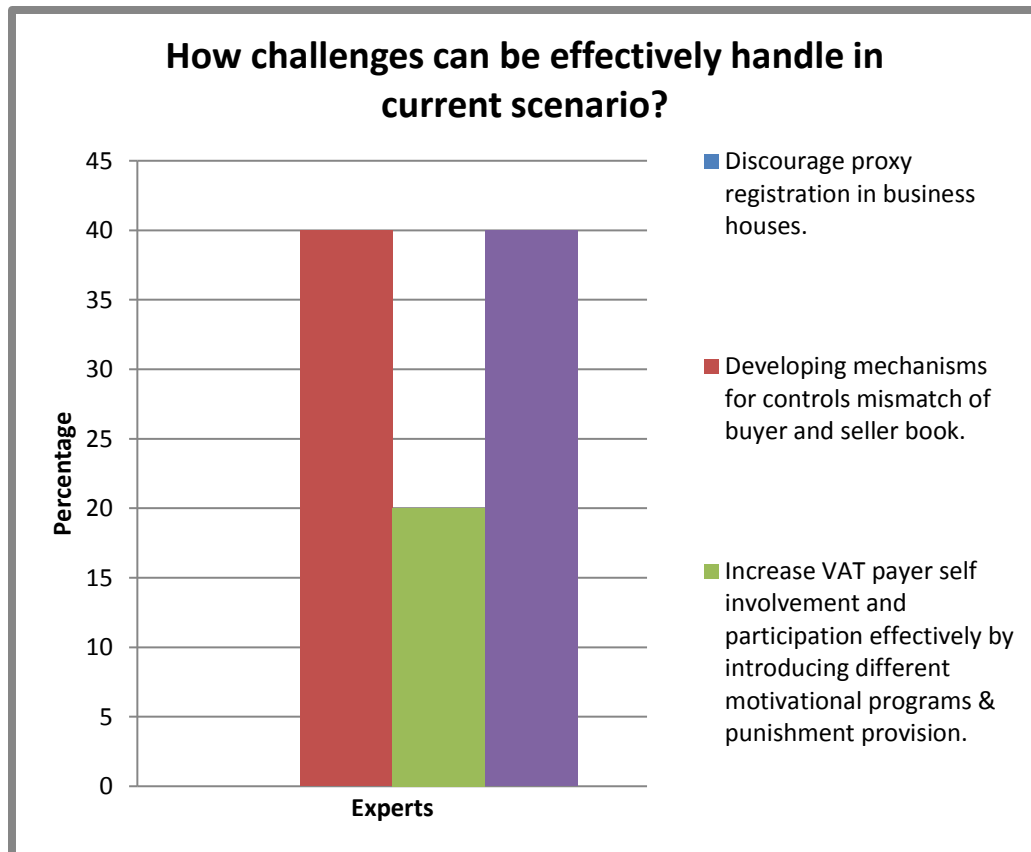
| Respondent Type | Response | No. of Respondent | % |
|----------------------------|------------------------------------------------------------------------------------------------------------------------------------------|--------------------------|-----------|
| Expert No. = 10 | Discourage proxy registration in business houses. | 0 | 0 |
| | Developing mechanisms for controls mismatch of buyer and seller book. | 4 | 40 |
| | Increase VAT payer self involvement and participation effectively by introducing different motiVATional programs & punishment provision. | 2 | 20 |
| | Prompt interpretation of VAT in case of difficulties faced in implementation by Tax Office. | 4 | 40 |

Source: Field Survey,2013

The major reasons of tax office for being unable to extend area and amount of tax collections as per the rank made from taxpayer's view.

- Discourage proxy registration in business houses.
- Developing mechanisms for controls mismatch of buyer and seller book.
- Increase VAT payer self involvement and participation effectively by introducing different motivational programs & punishment provision.
- Prompt interpretation of VAT in case of difficulties faced in implementation by Tax Office.

Figure 30



VAT must be effectively implemented than only IRD can gain belief of society and business community and encourage not get undue advantage from VAT, 40% of experts respond on developing mechanisms for controls mismatch of buyer and seller book and next 40% views on Prompt interpretation of VAT in case of difficulties faced in implementation by Tax Office.

4.3 Major Findings

In order to mobilize more tax revenue, make tax system efficient, simple and transparent. VAT is necessary, for making the system broad based, neutral, stable and more revenue generating, transparent and to eliminate growing fiscal deficits as well as to lower dependency on foreign loans in Nepal. It is found that there is need of 'reforms plan' of IRD must be implemented. Low public awareness as well as taxpayers' ignorance may create problems for implementation of VAT in Nepal

1. Very few people are aware about the VAT system. Those saying they know about VAT system and its impact could not give satisfactory answer. So awareness regarding VAT on general public should be improved. Consumers have fear that VAT increases the price of goods and services they consumed.
2. Major problems associated with VAT system to business houses are account keeping and billing. Weakness of VAT administration are lack of motivation, service minded attitude and dishonesty in VAT officers.
3. It is found from the study that the major problem of VAT's leakages is an unofficial trade from the southern and northern borders. Under valuation of goods is rampant which cause problems from the very initial stage of the VAT. According to VAT, if less tax is paid the tax credit latter will also be less and taxpayers are discouraged from indulging in under invoicing.
4. One of the reasons why VAT is not successful in Nepal is due to vested interest in different layer of administration system. During the survey the researcher found the businessmen pay a large donation during election.
5. The research found that shopkeepers issue invoices in their sales. Even than issue invoices in their sales are mostly fixed priced shop and departmental stores. Therefore we can easily conclude the weakness.
6. VAT is considered as a bored based tax, and potential advantages of it cannot be attained fully, if the tax is not extended through retail level. Nepal has an economy where a large number of retailers are spread over terai to Himalayans without proper accounting habits.VAT should extend right through the retail level after a proper preparation and with moderate threshold.
7. Exemptions on the basic needs and concession on company established special VAT zone would reduce the regressivity of VAT. The study favored moderate VAT rate between 5 percent to 20 percent. In specific cases, a single rate of 13%, supporting by exemption system for basic need and "special VAT zone" for sustain in the competitive environment.
8. Implementing VAT in Nepal faced various challenges. A poor condition of account keeping, VAT implementation largely depend upon taxpayers behavior but they show low level of support and strong voice against VAT, an inefficient tax administration. Making improvement is costly and time taking, since compliance costs are highest under VAT system.

9. Rate structure plays important role for efficiency and the success and failure of tax. Multiple rates seem complex and less effective, since, it reduces progressivity of VAT and single rate proves highly simple to handle VAT in Nepal but tend to high degree of progressivity. A dual rate may prove moderate way to solve both, problems, hence, the survey shows favoring “multi rate” system in Nepal.
10. Existence of small traders in large proportion, lack of accounting records, illiteracy and high compliance cost, open border with Indian market etc which create a question for successful implementation of VAT. Very large number of small tax payers with no record keeping and issuing invoices are major problem facing by Nepalese Tax system.
11. It is very important to understand that VAT comprises 35.92% of total tax revenue in FY 2010/11 and the pictures during the early years of its inception were also near about the same. The VAT/ GDP growth has been increasing marginally from 2.78 % in FY 1997/98 to 4.58% in FY 2010/11 which and having highly positive correlation (+0.9993) is a backbone of current revenue collection portfolio. Its development and improvement will surely be beneficial for the whole nation, no doubt.
12. The type of Customer, Location, Status of the business, Age of business, Educational qualification, Industry, Experience in the field, Awareness, Know about VAT, Annual turnover, Publicity, Implications of VAT Introduction, VAT Implementation system, Tax Rates, VAT Rates, Filling Monthly Return, E-filling, Relaxation/concessions, Computer and Internet Connectivity are essential to understand to implement of VAT system and suggestions for effective Implementation of VAT .

Findings at a Glance

- Custom valuation not being based on actual price
- Lack of tendency of not issuing invoices and not asking for invoices.
- Lack of tendency to execute fair business amongst the businessmen.
- Inability of the revenue administration to make the audit systematic and reliable.
- Corruption is widespread.
- The consumers have feeling that not taking the invoice is saving the cost.

CHAPTER V

SUMMARY, CONCLUSION & RECOMMENDATIONS

5.1 Summary

World experienced a decline in economic growth rate in comparison to 2011 than in 2010. According to International Monetary Fund (IMF) published World Economic Outlook, the world economy that grew by 5.3 percent in 2010 grew only by 3.9 percent in 2011. It directly and indirectly affects Nepalese economy.

VAT is definitely a new and modern tax as compared with other traditional tax systems. Actually, VAT is thought of being the most important tax reform in the 21st century. Of all the indirect taxes that evolved in the past, VAT is by far the best tax system. By contrast, other tax system had never risen into prominence in such a short span of period. Moreover, it is concerned with the present context of liberalization, privatization and globalization. It is easily adaptable with the open economy of present day. It is a tax that is transparent and has an in-built system of self-control. There can be no difference of opinion on the above facts.

It was introduced in 1997 but still many businessmen here in Nepal are not very clear on how this system works. “The major challenges in the revenue mobilization are major share of revenue based on import trade, small contribution of direct tax in revenue, lack of information technology, unfriendly revenue administration, lack of desired amount of revenue collection even at broadening tax base, lack of effective control in revenue leakage, lack of adequate exercise to make tax policy stable and predictable, lack of adequate probe and actions taken to bring all under tax net or showing less participation not complying with tax liability, and also not providing effective encouragement to the people to participate in the tax net”. Three Year Plan (2010/11-2012/13)

Several other countries, which so far have not adopted VAT, are trying to make necessary changes in their fiscal policies and laws to assimilate and accommodate this scientific tax system into their economic set up. Although VAT is out and out a new system as compared to other traditional tax system, its popularity is growing fast. It is a precondition that any European countries must have already adopted VAT to become a member of EEC. This precondition plays a vital role in the popularization 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. The coverage of VAT in Nepal is based on transfer, sales, supply, import

and export of goods and services except some special provisions. It is levied on the value added at each stage of the production or distribution. Every persons or firms or companies who are involved in such transaction liable to pay and collect tax. The actual coverage is structured by the standard and zero rates as well as tax exempted provisions. In other words, tax coverage is guided by tax invoice system. VAT is administered by invoice method. Moreover this system requires proper recording of business transactions, which many firms lack. The existence of open boarder and large amount of unauthorized trade from India to Nepal is a challenge for implementing VAT. While full implementation of the value added tax is one area that may have an immediate pay off, more broad based tax reform are necessary to integrate the VAT with income and customs tax administration to produce a more buoyant and responsive tax system.

In the traditional tax system, each tax was independent by itself. While importing goods from abroad, the customs duty and the income tax to be paid on this basis did not have a straight connection. In other words, the transaction papers used for customs purpose would not be used for income tax. The same was true for all taxes. Due to this there is many possibilities of revenue leakages. It has a special system where a person trying to deceive tax will be caught in either one of the levels. Therefore, the trend of evading taxes would be discouraged.

Despite of all this features of VAT system, it could not be implemented perfectly. The government was not able to effectively enforce the acts and regulations of the tax system and it was not able to take it seriously among the taxpayers and the consumers. The factors such as custom valuation not being based on actual price, lack of tendency of not issuing invoices and not asking invoices, lack of tendency to execute fair business amongst the businessmen, taxpayers not used to paying taxes, inability of the revenue administration to make the audit systematic and reliable, instability and insincerity of the government may be the main reasons for this system not being as successful as in other countries. Lack of awareness regarding this system amongst the taxpayers, tax administration and the general public is another main reason of the problem.

VAT is collected mainly in the city areas. The institutional set-up and the aims of revenue also imply that it has targeted the city areas most. Hence, it appears appropriate to prepare an increase publicity campaigns based on radio, TV, FM programs that are popular in the cities as well as in the whole country. Though the main business centers are located in the city areas, consumers come to a particular shop from the 75 districts of the country. Similarly, immediate campaigns should be undertaken to place attractive hoarding boards in strategic locations of the cities with messages regarding VAT invoices and by placing inspiring messages in the popular newspapers and magazines. Public awareness campaign should be undertaken in such a way that whether a consumer goes,

whether at home or market place, they encounter with VAT messages and remind them to take invoices. The campaign should as much effective as it could stamp on consumers mind that they should not purchase anything without an invoice.

VAT is neutral with respect to the choice of method of production and distribution. Since the tax is levied only on the value, VAT does not interfere with the optimal allocation of means of production, it is considered neutral. All other forms of sales tax are distorted since they bring unnecessary and intended changes in the method of production and distribution. VAT is, thus, superior to other forms of sales tax on the ground of efficiency since this tax is neutral with respect of method of production and distribution. Likewise, VAT does not affect the preference of the consumer. It also avoids probable distortions of the optimum allocation of resources. All other form of sales taxes is not neutral in respect to consumer's choice.

Resource development depends upon countries income. The source of revenue is income tax, custom duties and VAT. The only tax system that is popular worldwide is VAT. All industrialist and traders should register under VAT to increase the revenue source of the country to build our nation ourselves. It is preferred not merely for raising revenue but also its avoiding multiple distortions as created by other forms of sales tax. In the process of economic liberalization and globalization VAT makes the tax system flexible and the bracket widen. All this indicates that the VAT is the tax system of the present day.

In coming days, the government should balance this expenditure through ceiling on general expenditure and especially on security expenditure. To increase security expenditure on unplanned way is to decrease the development expenditure. The cycle of income of general public revenue collection and poverty alleviation also need continuation to development activities.

The business community was strongly against the VAT in the beginning but the gradually withdrew the opposition as they went on being clearer about positive aspects of the VAT and also its simplicity. Government went through many negotiations with business communities before implementing VAT in the Kingdom of Nepal. Taxpayers were opposed to VAT not because of any defect in VAT as a system. Rather they were afraid of frequent contacts with revenue officials who were historically notorious for a behavior that exploited the taxpayers. The success of the VAT is dependent on some prerequisites, such as

- (a) Acceptance of the correct invoice.
- (b) Self-assessment of taxes &
- (c) Refund of the tax amount in a speedy and simple manner when the conditions for a tax refund are met.

As open border to India businessmen importing good without custom duty make false pragapanpatra, bills & use other person PAN for sale and distribution of goods. Importing goods outside custom point to store house and from there distribution to other cities by using same pragapanpatra many times shows that our 40% of transaction are not shown in national economy. Even if government tries to control such activities local people protest against it as they are employed on such activities.

Government by reducing taxes on various commodities has tried to promote import and at the same time has tried to curb the smuggling also. Though at present, it is difficult to deal with the large number of people wanting to be registered into VAT, the government is appointing 'tax helper' using the businessmen to support the government by 'taking and giving' bills of right value?

Local manufacturer also does not show actual transaction detail of their production and raw materials but show stock record as they want is another sector of VAT leakage. The problem is not so much in manufacturing but in trading. The government should aware of it. Unless illegal trading through the open boarder with India is addressed, we cannot adopt a magical solution. The government should have a two tier VAT system. All types of businesses whether small or big should be brought under tax not to increase revenue but for better performance. The government should understand that people's income does not keep on increasing on a constant rate during economic recessions. That may generate less revenue which tax officials failed to understand. Leakage is one of the serious problems inflicting the tax system. The government needs to introduce strong measures for stemming the rot and make sure they are implemented. Due to falling revenues from exports, VAT has become more important. The government, however, should not raise the VAT rate, but concentrate on efficiently implementing it.

5.2 Conclusion

Different aspects are influencing the implementation of tax policies in Nepal. The large informal economy, tax fraud and evasion, insufficient information about the tax system, as well as limited organizational capacities have been identified to impede progress of the tax system and change processes within IRD. At the core of the improvement of tax compliance is the context or the 'environments' in which the tax administration operates.

The ultimate goal of the underdeveloped countries like Nepal is to achieve the economic development and ensure the rapid rate of economic growth. It calls for a huge amount of investment in economic overheads and other development activities for which taxation is undoubtedly a primary source of Inland Revenue for the government. Taxation may be

considered as a basic tool in the path of economic development for the underdeveloped countries. The VAT system is in force for a year now. Apart from its initial resistance, Trade and Industry has welcomed the implementation of VAT as the pros clearly outnumber the cons. However, there are still some areas where businesses feel that much needs to be done.

Recently, developing as well as developed countries in the world have increasingly focused their attention towards reforming the tax system by standardizing and improving the poorly designed tax structure in order to mobilize high volume of resources for the development purposes and make the economy healthy, efficient and self sufficient to a larger extent. In this regard, VAT has become a point of attraction for about 130 countries in the world including Nepal. Existed sales tax along with contract tax, entertainment tax and hotel tax were replaced by VAT since 1997 in Nepal.

Emphasis should be put on the need to maintain the good qualities of VAT (uniformity, a broad base, no cascading, buoyant revenue) by having very few exemption, zero-rating only for export and only one (or at most, two) rate (Tait, 1991). The term 'Value Added' refers to the value added to goods and services by a step in the chain of original purchase, manufacture or other enhancement and retail. Thus Value Added Tax basically means the tax liability to be levied on the Value Added by an organization at each stage of its producing goods and rendering services.

VAT is a self-policing and transparent system of taxation reducing the scope for tax evasion wherein the tax administration is highly automated. Under VAT, the ideology is to allow full credit that is set off taxes paid on purchase. So the manufacturers should not consider any taxes paid in his purchases as part his purchase price, and accordingly while fixing his sale price, no component of tax will get included in the same. This will avoid tax upon tax.

Furthermore, VAT is favorable from the administrative point of view also. VAT is favored on the ground that, as the base of this tax is broad; a relatively low rate can produce the required revenue. Low rate reduce the possibility of tax evasion. Since the tax burden is distributed among a large number of taxpayer under the VAT system, it does not put a heavy burden on a taxpayer and hence avoids the chance of considerable tax evasion. The built-in control nature of VAT makes tax evasion more difficult. VAT is thus, better in this respect than other forms of sales taxes

Further Nepal's taxation system and administration is not conducive to business. There is need to improve attitude and treatment of tax officials, which is a major reason that people hesitate to go to tax offices. The diverse interpretation of laws and regulations

have added extra legal burden on the business community. As a result, the share of tax in national revenue generation has not been able to pick up compared to the contribution of non-tax revenue sources.

Though VAT has been implemented in Nepal in order to generate more revenue, but the efficiency of the Nepalese VAT administration is not satisfactory and not up to the expectation of the general people. More revenue can be generated through VAT by widening its coverage. The small traders which fall on the threshold limit could not have been brought into VAT net yet. They should be registered. The revenue can increase by discouraging tax evasion. There is wide range of practice of evading tax.

Even after one and half decade the most challenging aspect of VAT is to address no-billing, under-billing and not depositing VAT paid by customers malpractices of the vendors head-on. For this, custom administration should enforce the law to buy all the goods being declared on under-valuation and simultaneously the Inland Revenue administration should also purchase under-invoiced goods and should not spare anybody to bring them under the purview of law. The tax administration and business communities, who were once at loggerhead over the introduction of VAT in Nepal, are now on the same boat to sail through the challenging job. Recent years Department makes detail investigation for the business firms for false and duplicate invoice of groups business, contractor, factory, hardware, services, departmental stores and other due to which there is increase in VAT registrants.

The taxpayers are also equally responsible for making the taxation system dynamic and vibrant. Taxpayers tend to avoid segregated information to reduce tax liabilities and evasion is abundant. This is to see in future how far the government programmers of campaign and tax-helper could do in this matter.

Therefore, there is urgent need for taking immediate action by Nepal Government in developing and implementing effective tax reform and policy measures as recommended.

5.3 Recommendations

Nepal has been undergoing through server fiscal crises due to limited sources of revenue and increasing Government expenditures. The trend of past few years shows unbalance revenue expenditure gap. The country is heading toward debt trap situation. The implementation of VAT through tax reform program and Strategic plan could not solve the economic challenge yet. To establish this tax on a completely successful scale and to make it a major part of country's internal resources requires much bigger efforts than what we are doing now.

One of the challenges that the IRD is currently facing is the poor voluntary compliance. Furthermore, it has also been challenged with high compliance cost, narrow tax base and an unpredictable tax environment. Thus, in order to make the taxpayers compliant to the tax laws, IRD needs to eliminate these obstacles by being efficient and effective. This could be achieved through faster dispute resolution and integration of taxpayer-friendly tax administration system, proper audit mechanism, harmonizing legal system and procedures, enforcing the law in a timely manner, improving advance ruling, administrative review and appeal system, educating taxpayers, being responsive to taxpayers and meeting taxpayers' aspirations and honoring taxpayers' rights.

The IRD's mandate to collect taxes denotes a remarkable responsibility to maintain a high level of integrity, fairness and competence. IIRD strives for transparency to craft an environment of trust and cooperation between IRD and taxpayers. The following measures are recommended for successful implementation of VAT and to get the desired result.

A collection strategy needs to be developed and implemented effectively in order to collect the increasing amounts of arrear. To improve billing condition in the market needs regular supervision, audits and investigation.

The tax administration should be fully computerized and ensure faster, simpler and reliable procedures for the taxpayers. Various revenue organizations should unify and make one unit in order to make tax administration simpler, transparent and effective.

Tax helper program should be monitored properly as there is a bad smell even in that young blood too. They should be guided properly. To decrease corruption, strong measures of carrot and stick should be applied.

Perfect billing system should be established. Every trader should be made compulsory to register under VAT and use prescribed computer software so that taxpayers should not be able to delete the transaction once entered in the computer.

The existing long open border is the main cause of smuggling and undervaluation in the border sides. So open borders should be systematized to a greater extent. Threshold and tax refunds are two possible gates for tax evasion. An effective and efficient tax auditing, investigation and monitoring system should be developed.

In the campaign to increase public awareness, institutions that deal with the public should be involved. There are many examples worldwide of such institutions being used to establish VAT.

If implemented properly, VAT would definitely help to increase revenue collection in Nepal. The present situation of VAT shows that the system could be improved by understanding and commitment at different layers of the society with government's commitment towards its political and administrative quality. Therefore the improvements to be made in each layers of the society are specifically presented below.

5.3.1 What should the Administration and Government do?

1. Strong political commitment is the key to the success of VAT. It helps to keep regulations on track.
2. The administration must take a big heart with support by the Finance Act and VAT Act to take legal action to those who break the rules. Evidence based tax fraud and evasion investigation.
3. Full application of HRM policy review of IRD's performance & operationalization of Quality Circles in IRD.
4. Since the Consumers and Retailers are unaware of certain implementation process of Value Added Tax. It is suggested the government should come with transparent norms to enlighten the retailers and consumers.
5. It is strongly recommended that the tax consultant and the government should periodically to monitor the procedure. Adoption of a practical approach to VAT audits of assesses.
6. A transparent approach Rate of Tax, Refund Procedure, Maintaining and improving accounting procedure are the immediate need for an hour.
7. The study ascertained maximum benefit to the government through Value Added Tax system. So it is strongly recommended to have innovative slab system suitable for Wholesalers, Retailers and Consumers.
8. Compulsory application of the cash machine billing system.
9. Making all traders compulsory to register on VAT net. So that the vendor could not misuse the facility given by threshold limit.
10. Businessmen want the government to introduce multiple tax rates to make it more progressive and comprehensive. But, wrangling over multiple rates is neither

distortion-free nor is it administratively feasible for both taxpayers and tax administration.

5.3.2 What Should The Businessmen Do?

The main backbone of the economic system is business community. It can change the whole system if become honest and responsible for the benefit and development of the country. The following are the few points we should do now.

1. Businessmen should maintain their account as per the Act, Regulation & Directives issued by government.
2. Be honest from today to the consumers, to the business ethics and to the country.
3. A notice saying “please do not forget to take your invoice” can be posted as the cash counter.
4. Do not offer bribe to the corrupt employees for the immediate benefit.
5. Start giving invoices that denote correct price and the correct transaction and force the buyer to take invoice.

5.3.3 What Should The Consumers Do?

As a good citizen it is our responsibility to develop a good system for financial reform. We could not make such policies in this context but we could contribute a lot to make a civilized society. Let us build a habit of taking invoices and make the best use of our hard-earned money. Stop being cheated.

1. By not taking the invoice we are not free from the liability of paying VAT. There will be another huge tax waiting for us to pay in future.
2. Appropriate goods can only be found after taking the invoice. If an invoice is requested, the seller is afraid and he/she will not be able to lie.
3. Try to know whatever we can grasp with our knowledge. Ask to those who are professional in this subject.

With the above analysis it is clear that the problem of discussed subject could not be solved with only one effort. A community is made up of groups of people and if you and I start developing this habit at a personal level, the trend will develop automatically. The combined effort of all businessmen, consumers, civil society and the government is equally important. For this purpose, various suggestions have been recommended which are concerned with various communities of our society. The list of suggestion is only a short list for immediate action. The continuous and long term effort is necessary for the complete solution of the deep rooted problem. There is always room for improvements in an open society and market economy. Therefore, there are possibilities for future improvements learned through our mistakes.

We cannot blame for others for our own mistake and weaknesses. Until and unless a system of issuing bills/invoices in a correct manner can be established in the market, the collection of VAT and the entire revenue collection will be at risk. Revenue policies are not only implemented for immediate revenue collection but are also directed towards long-term well being and development of the economy. In this context, our duty is to be fully committed towards developing a self- generated system of the process of giving and taking invoices. If we cannot fulfill this responsibility from this day, we will not only be unsuccessful but the future of our economy would be in great danger.

BIBLIOGRAPHY

Books

- Adhikari, C. (2060). *Modern Taxation in Nepal*. Kathmandu: Pairavi Prakashan.
- Amatya, S.K , Pokharel, B.B. & Dhakal, R.K. (2004). *Taxation in Nepal (Income Tax, Property Tax & Value Added Tax)*. Kathmandu: M.K. Publishers and Distributors.
- Bhatia, H.L. (1976). *Public Finance*. New Delhi: Vikas Publishing House.
- Bhattarai, I. & Koirala, G.P. (2006). *Taxation in Nepal with Tax Planning and VAT*. Kathmandu: Asmita Prakashan
- Clara, K.S. (1965). *The Tax on Value Added*. New York: Colombia University Press.
- Dahal, C.N. (2007). *Tax Auditing System in Nepal*. Kathmandu: NPTC Limited, Press
- Dhakal, K.D. (2059). *Income Tax and House- Land Tax: Law and Accounting*. Kathmandu: Kamal Prakasan.
- Gupta, S.C. (2004). *Fundamental of Statistics*. Mumbai: Himalayan Publishing House.
- Jenkins and Kuo (2010). *A VAT Revenue Simulation Model for Tax Reform in Developing Countries: A Case Study of Nepal*.
- Khadka, R.B. (2000). *The Nepalese Tax System*: Kathmandu: Shaja Prakashan.
- Lyons, S. (1996). *International Tax Glossary*. Nederland: IBFD, Publications BV.
- Osborne, D. & Gaebler, T. ((1992). *Reinventing Government*. New Delhi: Prentice Hall India.
- Shade, S.N. (2003). *Mobilizing the state's Financial Resources for Developing, Topic in Reinventing Government for Twenty First Centuries*. U.S.A: Kumarian, Press.
- Silwal, N.P. (2000). *Value Added Tax: A Nepalese Experience*. Kathmandu: Indu Silwal,Sheela Printers.
- Subedi, B.R. (1998). *Value Added Tax and Its Applicability in Nepal*. Kathmandu: Bhrikuti Academic Publications.
- Terre, Ben J.M. (1990). *System of Levying Sales*. Netherlands: Tax International Bureaus of Fiscal Documentation.

Journals / Articles and Reports /Publications

Annual Report (2063/64 to 2067/68). Inland Revenue Department. Ministry of Finance, Government of Nepal.

Budget Speech, (2066, 2067 & 2068). Ministry of Finance, Government of Nepal Nepal.

Economic Survey (2066, 2067 & 2068). Ministry of Finance. Government of Nepal Nepal.

Kandel, P. (2005). *Implementation of VAT in Nepal: Success or Failure*. Kathmandu: The Nepal Chartered Accountant Magazine.

Keen and lock wood (2010). *Value Added Tax, it's Causes and Consequences*.

Khadka, R.B. (1994). *Evolution of VAT*. Kathmandu: The Rising Nepal.

Khadka, R.B. (2001). *Value Added Tax: The Concept, International Experiences and its Application in Nepal, Value Added Tax Four Years of Implementation*. Kathmandu: Inland Revenue Department and Value Added Tax Project.

Ministry of Law and Justice, (2052). *The Value Added Tax Act*. Kathmandu: Government of Nepal.

Ministry of Law and Justice, (2058). *The Income Tax Act*. Kathmandu: Government of Nepal.

Nepal Chamber of Commerce (1997). *Study on Possible effects of Value Added Tax on Different Areas (Nepali)*. Kathmandu: Nepal Chamber of Commerce.

Publications of FNCCI and Nepal Chamber of Commerce

Reform Plan (2012/13 – 2014/15). *Inland Revenue Department*. Ministry of Finance, and Government of Nepal.

Strategic Plan (2012/13 – 2016/17). *Inland Revenue Department*. Ministry of Finance, Government of Nepal.

Study on Taxpayers' Satisfaction level in Nepal, (2010). Revenue Administration Support Project (RAS). A Joint of the Inland Revenue Department (IRD)- Ministry of Finance and the German Technical Cooperation (GTZ).

Tait, A.A. (1991). *VAT Policy Issue: Structure, tegressivity, Inflation, and export. Value Added Tax: Administration and Policy Issue (edited by Alan A Tait)*. Occasional paper 88, International Monetary Fund Washington D.C.

The Auditor General (2068). *Audit- Report*. Kathmandu.

Thesis

Chaudhari, A. (2001). *VAT in Nepal: An Analysis of its Problems and Prospects*. Kathmandu: Central Department of Management, T.U.

Dhakal, S. (2000). *Nepalese Tax Structure*. Kathmandu: Central Department of Management, T.U.

Karki, D. (2003). *Revenue Mobilization through Value Added Tax in Nepal*. Kathmandu: Central Department of Management, T.U.

Neupane, P. (2006). *Resource Mobilization through VAT in Nepal*. Kathmandu: Shanker Dev Campus, T.U.

Rawal, T.R. (2010). *Value Added Tax in Nepal: A Study of Achievement and Challenges*. Kathmandu: Central Department of Management, T.U.

Wagle, S. (2010). *A Study on Contemporary Issued on VAT System of Nepal*. Kathmandu: Central Department of Management, T.U.

Wikipedia, the free Encyclopedia-Value Added Tax

www.ird.gov.np (Official website of Inland Revenue Department, Nepal)

www.mof.gov.np (Official website of Ministry of Finance, Nepal)

www.nrb.org.np (Official website of Nepal Rastra Bank-Central Bank of Nepal)

ANNEXURE

Annex -1

Questionnaire for Consumers

Date:

A. General Information:

Questionnaire Number:

B. Information of Respondent:

Name of the consumer:

Education:

Address:

1. As a customer you ask & receive tax invoice from businessmen at the time of purchasing?

- Yes.
- No.
If No, (Select any one option)
- VAT bill increase the price of commodity.
- Sellers don't give/I don't need.
- Seller don't make bill equal to amount we pay.

2. Does Shopkeeper use V AT Bill on every Purchase and Sale?

- Yes.
- No.

3. Does VAT Increase Price Of Commodities Compared To Earlier Tax System?

- Yes.
- No.

4. Is The Demand Of Different VAT Rate Is Appropriate?

- Yes.
- No.
(If yes, what the government should do?)
- Government should categories different rates among luxurious and inferior goods.

- Government should take a step on making Special VAT Zone for geographically inaccessible and backward areas to reduce value added. (Social equality).
- Government should emphasize business entrepreneurs to sustain in the competitive globalised environment.

5. VAT makes no discrimination of rich and poor?

- Agreed.
- I don't agree.

6. What Should Government do for Effective Implementation of VAT?

- Discover corruption by making strong rules against sources unidentified income.
- Increase public awareness through various programs.
- Monitoring the effectiveness of VAT should be improved.
- Control custom point for low valuation of goods.
- Make every trader compulsory on VAT registration.

Thank You for Your Valuable Time.

Annex -2

Questionnaire for Tax officer / Expert/Consultant

A. General Information:

Questionnaire Number:

Date

B. Information of Respondent:

Name of the respondent:

Position:

1. Reason for IRD being unable to extend area and amount of tax collection?

- Tax Department unable to conduct tax research and applied professional support in policy formation.
- Problem in VAT registration and deregistration.
- Inadequacy of manpower to examines the business record and the stock of business.
- Tax payer's lack of interest on VAT deposit due to difficulty on claim off VAT refunds.

2. Reasons for inability in improvement, maintenance and record books of account as per VAT system?

- VAT system has difficulties in accounting and complex system to operate.
- Maintenance of record in safe position of purchase book, sales book and related invoices for minimum 6 years is not logical?
- E-VAT has made easy in payment and refund of VAT but procedure for claim of E>Returns involves high cost.

3. Is The Demand For Different VAT Rate Appropriate?

- Yes
- No
- I don't know
(If yes, what the government should do?)
- Government should categories different rates among luxurious and inferior goods.
- Government should take a step on making Special VAT Zone for geographically inaccessible and backward areas to reduce value added. (Social equality).
- Government should emphasize business entrepreneurs to sustain in the competitive globalised environment.

4. What Should Government do for Effective Implementation of VAT?

- Discover corruption by making strong rules against sources unidentified income.
- Increase public awareness through various programs.
- Monitoring the effectiveness of VAT should be improved.
- Control custom point for low valuation of goods.
- Make every trader compulsory on VAT registration.

5. What Is Possible Loopholes of VAT? (Tick Any One)

- Misuse of debit note and credit note
- Direct posting of tax return without account keeping
- Weak communication channel in government system.
- VAT implementation largely depends upon taxpayer's behavior.

6. Reason for resistance on implementation of VAT by Business Community ?

- Ignorance of VAT.
- Complications due to adaption of old and unscientific accounting system.
- Price raise on import \Cost of Purchase.
- VAT charge at every stages of production/ Value addition.

7. How VAT Challenges Can Be Effectively Handle In Current Scenario? (Tick Any One)

- Discourage proxy registration in business houses.
- Developing mechanisms for controls mismatch of buyer and seller book.
- Increase VAT payer self involvement and participation effectively by introducing different motivational programs & punishment provision.
- Prompt interpretation of VAT in case of difficulties faced in implementation by Tax Office.

Thank You for Your Valuable Time.

Annex-3

Questionnaire for Businessmen/professional

A. General Information:

Questionnaire Number:

Date

B. Information of Respondent:

Name of the respondent:

Education:

Address:

Business Type:

| | | | | |
|-------------|------------|----------------|-------|------------------|
| Distributor | Wholesaler | Retail Stores | Hotel | Travel & Tourism |
| Producing | Company | Other Specific | | |

1. Why Do Businessmen Get Registered in VAT? (Tick Any One)

- As compulsory by law.
- To increase/expand the market share.
- To help the government in revenue collection.

2. Problem in VAT Registration and Deregistration?

- The rules and regulations are not clear.
- Tax office does not provide the required assistance and support.
- Cost of maintaining specified accounting system is high.
- Other if specific.

3. Demand By Different VAT Rate Is Appropriate?

- Yes
 - No
- If yes, what the government should do?
- Government should categories different rates among luxurious and inferior goods.
 - Government should take a step on making Special VAT Zone for geographically inaccessible and backward areas to reduce value added. (Social equality).
 - Government should emphasize business entrepreneurs to sustain in the competitive globalised environment.

4. VAT System has Practical Difficulties in Accounting and Hard System to Apply?

- Yes
- No

5. Difficulty Faced In Implementation Procedure of VAT?

- Maintenance of record in safe position of purchase book, sales book and related for minimum 6 years is not practicable.
- VAT officers and department don't provide friendly services and protect right of taxpayer?
- Dissatisfaction on IRD cross check on purchaser and seller book to identify mismatch on claim and paid of VAT?
- Is it costly for management as it needs to maintain Books, invoice bill, document etc in its actual form.

6. What Should Government do for Effective Implementation of VAT?

- Discover corruption by making strong rules against sources unidentified income.
- Increase public awareness through various programs.
- Monitoring the effectiveness of VAT should be improved.
- Control custom point for low valuation of goods.
- Make every trader compulsory on VAT registration.

7. Benefit from Registration of More than One VAT Unregistered Business?

- Yes
- No

Thank You for Your Valuable Time.

Annex:.....

Large Businesses Robbing Nepal of its Due Revenue

By [ravirose](#) | Posted May 10, 2011 | Kathmandu, Nepal

The biggest fiscal or 'white' crime in Nepal's history

After resigning from the position of Finance Secretary, Rameshwor Khanal wrote a brief note on his Facebook account – “I came across people with greed for power and money each day for the last eight years.” So who are those people who are only running after money and power?

We have obtained a confidential list of large corporate houses involved in fake Value Added Tax (VAT) bills scam for their greed of money and then lobbying for power to clean up their mess through political channels.

The list of those involved in the biggest fiscal or ‘white’ crime in Nepal’s history so far includes even the earliest Nepalese conglomerate that also claims itself as the first multinational of the country. The companies of two parliamentarians representing from the quota of businessmen and industrialists in the Constituent Assembly to write an inclusive constitution for the newest republic are also enmeshed in the fraud. Read further below to find out who they are.

The Frauds

Thirty-one out of fifty-two companies under investigation of Inland Revenue Department (IRD) have been found to evade tax using fake VAT bills. Among those, twenty-four companies had evaded 2.7 billion Nepalese Rupees in VAT and income tax through transactions in fake bills while they had taken back VAT amount of 890 million Nepalese Rupees by submitting fraudulent certification of payments.

The VAT scam involves large conglomerates such as Chaudhary Group, Golchha Organisation, Vishal Group, Shanker Group, Varun Developers, all owned by trading community from India called Marwaris, plus Bhatbhateni Supermarket of a native Nepalese and even the Chinese contractor of Chameliya Hydroelectricity Project. These include the firms of two sitting parliamentarians of Nepal’s Constituent Assembly – Binod Chaudhary, Chairperson of Chaudhary Group and Diwakar Golchha of Golchha Organisation. UML, the third largest political party had nominated Chaudhary and Diwakar Golchha was nominated by Nepali Congress, the second largest party in the Assembly.

Shanker Group

Among the 31 firms investigated under the scam, most fake bills have been found in the name of Jagadamba Steels amounting to 800 million Nepalese Rupees, according to the source in the Inland Revenue Department (IRD).

The fair payment of VAT would have only been 38% of total amount; however, after investigation, the tax amount has been fixed to 600 million Nepalese Rupees. Tax evasion implies 13% VAT, 25% income tax and fine of the same amount plus interest at 15% per annum payable to the government that makes 75% of the 800 million Nepalese Rupees i.e. 600 million Nepalese Rupees, informed the source. President of the group, Shankar Lal Golyan who came to Nepal without a penny from India 40 years ago now owns 18 industries. Jagadamba Steels is the largest company of the group. Shanker Group's annual transactions come around 26 billion Nepalese Rupees, claims Golyan in his website. After investigation of 52 firms under the scam, the second list of tax defaulters of 480 firms also include other companies of the group. Pawan Kumar Golyan of the same group is also the chairperson of NMB Bank, Nepal's first commercial bank.

Chaudhary Group

Under this group, three companies headed by the group's President Binod Chaudhary and one headed by Arun Chaudhary are also involved in the scam. Fake VAT bills worth 60 million Nepalese Rupees have been found from CG Impex and CG Electronics of the group. CG Foods of the same group is also involved in the fraud. It is one of the five companies in the final list in course of investigation that has evaded tens of millions Nepalese Rupees through fake bills, informed the source in the IRD. Chaudhary Group, that recently grabbed international headlines with its decision to open dozens of hotels outside Nepal, sells LG and CG electronic appliances in Nepal through GC Impex and CG Electronics. CG Foods produces Wai Wai Instant Noodles in Nepal and India, with collaboration of Thai Foods Industries, which has gained popularity in Asia and Europe.

Fake VAT bills worth 160 million Nepalese Rupees have also been found from Arun Intercontinental of Arun Chaudhary, lawmaker Chaudhary's sibling. The IRD had investigated eight wholesale traders of automobiles that evaded 200 million Nepalese Rupees in VAT among them. Arun Intercontinental is the largest defaulter, stated the source in the IRD.

Golchha Organisation

The IRD investigation also found fake VAT bills amounting 60 million Nepalese Rupees of Him Electronics under Golchha Organisation headed by parliamentarian Diwakar Golchha. Him Electronics itself is directed by rising 'major entrepreneur' Shekhar Golchha.

Last year, another firm owned by the group, Neoteric Nepal, distributor of information technology, communications and entertainment products such as Nokia, HP and the likes, was also found guilty in previous IRD investigation. The company had come under scanner after it issued VAT bills in advance dates. Since then, the IRD had speculated of transactions in fake VAT bills from the company. However, the biggest tax investigation had been started after fake VAT bills of more than 200 companies were found in a raid of a firm in southeast Kathmandu.

Vishal Group

Not so popular but another large conglomerate, Vishal Group's United Distributors is also involved in the VAT fraud. Listed under multinational companies in the course of the IRD investigation, the company has evaded 100 million Nepalese Rupees through fake bills.

United Distributors deals in cosmetic and daily consumer goods imported from India and other countries. With strong political access to the level of Finance Minister, this group has investments in banks and other financial institution, insurance companies and trading houses.

The chairperson of Vishal Group JP Agrawal also chairs the board of NIC Bank while the group's vice-chairs TR Agrawal and Nirmal Agrawal are members of the bank's board too. NIC Bank is the first bank in Nepal to be provided a line of credit by International Finance Corporation (IFC), an arm of World Bank Group under its Global Trade Finance Program. In addition, another deputy of Vishal Group Trilok Chandra Agrawal is the chairperson of newly formed Bank of Asia and Anuj Agrawal is board member of the bank. According to the source, the second list of 480 companies for investigation of fake VAT bills fraud also includes other firms of the group.

Bhatbhateni Supermarket

Owned by Min Bahadur Gurung, who has recently imported a Mercedes Benz car through 'air cargo' spending tens of millions Nepalese Rupees, one of the biggest supermarkets of Kathmandu is also involved in the VAT fraud. The investigation found fake bills worth 80 million Nepalese Rupees from the Bhatbhateni Supermarket that runs two super stores in Kathmandu.

Bhatbhateni Supermarket is one of the five companies currently under investigation that are yet to be confirmed for their tax evasion amount, informed the source. It is also liable to pay 75% of the total worth of fake VAT bills, stated the source. Most companies involved in the scam are owned by Marwaris, the trading community from India, it is a surprise how Bhatbhateni Supermarket also got enmeshed in the fraud, one of the IRD officials noted.

Varun Developers

Another tax defaulter is Varun Developers owned by Indian investor Ravi Jajpuria's company RJ Corp that rose to fame last year with introduction of international fast food chain KFC and Pizza Hut in Kathmandu. Besides KFC and Pizza Hut, the parent company has also invested in Varun Beverages, the producer of popular drink Pepsi in Nepal.

Varun Developers sells super-luxurious condominiums named Park View Horizons it built in northeast Kathmandu. The company that has put up for sale a single bungalow for 11.9 million to 25.3 million Nepalese Rupees has been found to evade 150 million Nepalese Rupees through fake VAT bills. The tax payable for the company has been decided to be more than 110 million Nepalese Rupees.

Chameliya Hydropower

China Gezhouba (Group) Corporation (CGGC), the Chinese contractor for civil construction of Chameliya Hydropower Station in Nepal is also enmeshed in the VAT fraud. The CGGC had bought fake bills to increase its variation that amounts to 600 million Nepalese Rupees, stated the source for which the VAT payment of the payment could not be found in books