

# **CONTRIBUTION OF VALUE ADDED TAX IN NEPALESE GROSS DOMESTIC PRODUCT**

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In partial fulfillment of the requirement for the  
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# RECOMMENDATION

This is to certify that the thesis

Submitted by  
**Janak Singh Saud**

Entitled  
**CONTRIBUTION OF VALUE ADDED TAX IN  
NEPALESE GROSS DOMESTIC PRODUCT**

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

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# VIVA- VOCE SHEET

We have conducted the viva-voce of thesis

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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 Degree of Master in Business Studies (M.B.S.)

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## DECLARATION

I hereby declare that this thesis entitled **Contribution of Value Added Tax in Nepalese Gross Domestic Product** submitted to the Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement of the Degree of Master's of Business Studies (M.B.S) under the guidance and supervision of Dinesh Man Malego, Head of Research Department of Patan Multiple Campus.

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This thesis entitled Contribution of Value Added Tax in Nepalese Gross Domestic Product has been prepared in partial fulfillment for Degree of Master's of Business Studies (M.B.S). This specially focused on the contribution of VAT to uplift the overall national revenue of the country. I hope this thesis is helpful to those who are directly and indirectly concerned with economic growth of the country.

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Janak Singh Saud  
Patan Multiple Campus

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## **ABBREVIATIONS**

CBS	: Central Bureau of Statistics
FY	: Fiscal Year
GDP	: Gross Domestic Product
Govt.	: Government
IMF	: International Monetary Fund
IRD	: Inland Revenue Department
IRO	: Inland Revenue Office
MODVAT	: Modified Value Added Tax
MOF	: Ministry of Finance
NG	: Nepal Government
No.	: Number
Rs.	: Rupees
SAARC	: South Association for Regional Cooperation
TTR	: Total Tax Revenue
VAT	: Value Added Tax
Vol.	: Volume
WTO	: World Trade Organization

# **CHAPTER I**

## **INTRODUCTION**

### 1.2 Background of the Study

Taxation is the biggest source of public revenue of the modern governments. Tax is a kind of payment to government of which it is the legal duty of every citizen of a country to pay honestly. In the present day, a government has to spend a lot of money to fulfill its responsibility towards its people. The main objectives of every government of developing country are to raise the living standard of the people, accelerate economic growth rate, alleviate absolute poverty, reduce inequality, and create more productive employment opportunities without affecting the ecological balances. To meet the growing public expenditure, the government has to manage its funds from internal as well as external sources. External source of funds are foreign loans and grants, which are uncertain, inconvenient, and not good for healthy development. Therefore, it is better to mobilize internal sources rather than expecting from the donors. Taxation has become a main internal source of resource mobilization to meet the financial requirements of the government. Income generated by the private sector should be extracted with the intention to reduce the gap between the rich and the poor. For the economic development of a country, taxation remains the most effective way of mobilizing internal sources. The objectives of any tax system are to make funds available for economic development, to maintain reasonable economic stability in the face of long-term inflationary pressure and short-term internal price movements, to reduce inequalities that bring productive efficiency and bring about justice and political instability in a developed country.

The tax revenue includes two types of taxes: direct and indirect. Direct taxes are more familiar and have a dominant role in the developed countries rather than in developing countries. Direct taxes are the means and tools of generating

savings and promoting capital formation. Direct taxes are income tax, property tax, business profit tax, land revenue, etc.

Indirect taxes have a dominant role in the whole tax structure of developing countries like Nepal. Most of the revenue has been raised from indirect taxes, as it is easy, less expensive, and convenient method for a developing economy. Indirect taxes are excise duty, import and export tax or custom duty, VAT, sales tax, entertainment tax, air flight tax, vehicle tax, etc. In any developing economy, indirect taxes occupy the most important means to finance. Among the indirect taxes VAT is the pivotal one.

The VAT is comparatively a new tax. Wilhelm Von Siemens first recommended this tax in 1919 for Germany to replace multistage sales tax in order to avoid the undesirable effects particularly cascading and vertical integration of the sales tax.

The VAT is similar to the national sales tax. However, instead of implementing one tax of a certain percentage at the time of retail sale, there is a smaller tax added each time the product is resold or when value has been added. The VAT is levied on the value added by each firm through its production and distribution activities. Value added for a firm is the value it adds to its purchases of inputs from other firms before selling them to others.

In the production and distribution process, a firm buys inputs such as raw materials, chemical, electricity, and capital goods from other firms. The firm adds value to these materials by processing or handling them with the help of its own factors of production such as land, labor, capital, etc. This increase in the value of output over input is the value added by a firm. In other words, value added by a firm is the sum total of expenses paid out by the firm to factors employed. This means the value added by a firm is equivalent to its payment of wages, rent, and interest plus profit, and this value added is the

base of VAT. The VAT, therefore, is a net turnover tax that is levied on value added at each stage in the production and distribution processes. It is a broad-based tax, which is levied on a large range of goods and services.

The directions and lessons of tax reform in developing countries established that, among other things, the VAT is the most important choice and ingredient of tax reform. As VAT is less distortive and more revenue productive, it has been spreading all over the world. By 2009 about 130 countries have adopted VAT and it is under consideration in many others countries for its implementation.

### 1.2 Statement of the Problem

As the government wants to fulfill the growing aspirations and demand of the people huge capital is needed by efficient mobilization of internal resources. The capital is collected either from the internal sources (i.e. financial institutions, general public/entrepreneurs) or from external sources (foreign grants and loans). Dependency on the foreign grants and loans can never be a fruitful and effective way to collect the capital as required by the nation's development program.

To reduce the economy's dependence on foreign assistance for development expenditures, the government needs to continue its efforts to mobilize domestic resources. Full implementation of the VAT is one area that may have an immediate payoff, more broad-based tax reforms are necessary to integrate the VAT with income and customs tax administration to produce a more systematic and responsive tax system.

After the restoration of democracy in 1990, Nepalese Governments adopted ambitious development expenditure and revenue targets, which also continued in the recent year. Development expenditures are also growing at a faster rate as compared to revenue collection. Effective implementation of VAT can be

the major way in front of the government to meet the growing development expenditures. But the government has not been able to collect the expected revenue, which can be regarded only as the consequence of ineffective implementation. Actual revenue performance will depend on the effective implementation of the VAT. VAT Act, 1995 and VAT Regulation, 1996 have not been able to bring more business organizations into the tax net. The evasion of VAT has been in the increasing rate since the beginning of its implementation.

The easy way for the increment of VAT revenue can be either by increasing the rate of VAT or decreasing its ceiling. The increment in the rate of VAT might affect the production and consumption. It might affect the economic interest of the general public. And it might also bring the instability in the political, legal, and business grounds of the nation. On the other hand, decreasing the ceiling of VAT might bring a hazardous situation in the VAT administration. Both ways can neither be too easy nor effective way. Increasing the rate or decreasing the ceiling, just on the basis of some years of implementation cannot be an effective way for increasing the VAT revenue. In this context, the effective implementation of VAT is challenging.

VAT was implemented to replace the sales, contract, hotel and entertainment tax. Therefore, the VAT should have been able to successfully displace the revenue that these sectors had been paying in the past. In other words, the revenue collection from these sectors should have increased manifolds compared to the revenue collection in the past. Otherwise, there was no need to bring in a new tax system by abolishing the old ones. Whether VAT has been beneficial or not can be clear by comparing the total revenue collected from the four old taxes with the revenue collected from VAT. This proves that only a scientific and modern tax system is not sufficient to increase revenue collection. Otherwise, VAT would have definitely increased the revenue collection of Nepal.

The present situation of VAT shows the motivated tax administration, serious study of the negative aspects of the tax system and honest, earnest attempts and environment to tackle them in order to make any tax system revenue productive. These aspects were not given any consideration due to political instability and the opposition of united taxpayers while implementing VAT in the manner that it had planned.

### 1.3 Objectives of the Study

The general objective of this study is to examine the contribution of VAT to Nepalese GDP. The study also aims at considering VAT in Nepal in terms of its desirability, applicability, revenue potentiality and its effects on various economic sectors. However, specific objectives of this study are:

- i) To assess the contribution of VAT to Nepalese GDP.
- ii) To show the relationship between the VAT with GDP.
- iii) To recommend the concerned authorities and all the stakeholders about the effective implementation of VAT.

### 1.4 Significance of the Study

Various studies have been conducted with regard to indirect taxation system of Nepal and various reports about the indirect taxation system are available. But limited studies have been conducted in the VAT system and its consequences. In recent years, no any empirical study has been conducted on the contribution of VAT to Nepalese GDP. This is the basic reason to undertake this study.

In addition, majority of the people who pay VAT feel exploited due to the introduction of VAT. In such a situation, it is believed that such a study would necessary be helpful for understanding the essence of VAT. And also there is a lack of taxpaying habits and tax consciousness in various classes of people. The tax evasion habit of the people is increasing. So, this study necessitates to find out the loopholes of VAT regulation and administration and to make the sound VAT administration.

This study gives the present scenario of contribution of VAT to Nepalese GDP. Moreover we can also see the direct relationship of VAT with GDP.

This study would be helpful to those persons who are interested to know about the VAT and to work on similar ground and more for the government to formulate an effective VAT policy in compatible to its tax objectives.

Besides, the study will directly be beneficial for the policy makers, private sectors, researchers, and other interested individuals. It could be instrumental to those who are interested to understand more about the VAT system. Similarly, it will help researchers carry out their research about VAT.

#### 1.5 Scope of the Study

This study is basically concerned with the contribution of VAT to Nepalese GDP including the personnel management aspects of VAT administration and present legal aspects of VAT regulation. This study also tried to figure out the position of revenue collected from VAT in the whole tax revenue structure of the country. So, VAT has only been considered as its scope of study.

In addition, this study is concerned with the problem of VAT collection, the causes of evasion and loopholes of VAT administration. Finally, some policy implications would be raised for sound tax administration.

#### 1.6 Limitations of the Study

This study would confine its scope within VAT in Nepal. Generally, revenues are collected through different sources, but it will cover only the management of sales tax, contract tax, hotel tax, entertainment tax and air flight tax that were replaced by VAT. This study is merely based on the published secondary data.

### 1.7 Organization of the study

This study has been organized into five chapters, each devoted to some aspect of study on VAT and its contribution to GDP. Chapter one consists of introductory part of the study. The chapter consists of background, statement of problem, objective of the study, significance of the study, limitation of study and organization of study. Chapter two includes the brief review of available literature on related topic. It includes a discussion on the conceptual framework and review of major studies. Chapter three includes the research methodology employed in the study. This chapter deals with the nature and serious of data research design, population and sample, data collection procedure and method of analysis. Chapter four deals with the presentation and analysis of relevant data with the help of various financial and statistical tool and techniques and major findings. Finally, chapter five incorporates summary, conclusion & recommendations of the study which are the important aspects to solve the problems associated to the present analysis and offers recommendation for the improvement in future.

## **CHAPTER II**

### **REVIEW OF LITERATURE**

#### 2.1 Conceptual Review

VAT is an indirect tax. It is an improved and modified form of sales tax. It is levied on value added of goods and services of each stage in the process of production & distribution chain. These stages can be import, manufacturing, wholesale and retail. The value added can be obtained by adding payment to factors of production (wages, rent, interest & profit). Although VAT is eventually born by the final customer, it is collected at each stage of production & distribution chain.

##### 2.1.1 Origin and Development of VAT

VAT is the most recent innovation in the field of taxation. The concept of VAT was developed for the first time by Dr. Wilhelm V. Siemens in Germany in 1919. The concept of VAT was developed further in 1949 by a tax mission of Japan headed by Prof. Carl. S. Shoup. The tax however remained as only a topic of academic interest until 1953. In 1954, France introduced a VAT covering the industrial sector. The tax was, however, limited up to the wholesale level. By the end of 1960s, only eight countries including France, Brazil, Germany, the Netherland, Sweden, etc. had introduced VAT. Since, then VAT has been introduced by at least one country each year and now it has been adopted by more than 130 countries.

Vietnam ventured VAT for the first time in Asia in 1973 but it was repealed in sort period. South Korea adopted VAT in 1977 and is continuing till this time. Therefore, it is the leading country in Asian continent. In south Asia, Pakistan is the first country introducing VAT in 1990. Bangladesh and Srilanka started VAT in 1992 and 1995 respectively. India had introduced modified VAT (MOD-VAT) in 1986 for manufacturing products. Full Vat has been

implemented there with effect from 1<sup>st</sup> April, 2003. Nepal also has implemented VAT system since 1995

### 2.1.2 VAT in Nepal

Sales tax was criticized by cumulative system, as it was consumption oriented and one-sided, not neutral in saving and investment lack of credit system. Traditional income and sales tax had met only public regular expenditure and the new VAT providence, systematic revenue base, typically yielding more than initial estimates of revenue in various countries such as Korea, New Zealand.

Value Added Tax (VAT) is an indirect tax on consumption that is assessed on the increased value of goods at each point in the chain of production and distribution, from the raw material stage to final consumption. It is levied on the difference between the sale prices of the goods or services (outputs) to which the tax is applied and the cost of goods and services (inputs) bought in for use in its production.

VAT was introduced in Nepal in November 16, 1997 in replacement of four taxes: Sales Tax, Entertainment Tax, Hotel Tax and Contract Tax. For the first time, Eighth Plan (1992/93-1996/97) announced a policy of adopting VAT. Prior to this, the idea of a VAT appeared in a few articles and in the IMF mission reports in the 1980s. Ultimately, although it took a little bit longer time than mentioned in the Eighth Plan to make enough study and discussion before implementing it, VAT was successfully implemented in 1997.

To implement VAT, there are separate act and rule: VAT Act, 1996 and VAT Rules, 1997. Although there will be some changes in this act and rules every year by Annual Financial Act, the basic principles and provisions are the same from the very beginning.

At the beginning, Sales Department was changed to VAT Department to implement VAT in Nepal. But later, in 2001, Income Tax Department and VAT Department were merged to a single one named IRD. Now, under this department, there are 22 field offices to administer VAT along with income tax and excise duty.

#### 2.1.2.1 Basic Provision on VAT

##### Registration

According to the Nepalese VAT Act and Rules, any individual, partnership, company or whatever who wishing to engage into a taxable (VAT-able) transaction shall apply to a tax officer in the prescribed form for registration before beginning to engage in such transactions and tax officer shall register those individual under VAT system. After registering, taxpayer will be assigned a Permanent Account Number (PAN) or commonly known as Tax Payer's Identification Number that consists of 9 digit numerals throughout the country.

There are two types of registration under VAT system:

- (1) Compulsory Registration; and
- (2) Voluntary Registration.

Anyone having annual business transaction of taxable goods and services of more than or equal to the threshold level (Rs. 2 million) are subject to compulsory registration. Furthermore, person doing given business and within the prescribed area must register under compulsory registration system. If the annual turnover of taxable goods and services is less than the threshold level, the person should not need to register under the VAT system, but still they may register their business under voluntary registration system. However, any business who import more than NRs.10 thousands at a time must register.

## Scope of VAT

VAT is based on the destination principle. It is levied on the goods and services where the place of supply is in Nepal and importation of goods and services into Nepal. Exports of goods and services are zero-rated. This means that the tax base is domestic consumption.

VAT is broad-based tax, which applies to all business turnovers through to the retail stages, with a few exceptions. It is levied on a large number of goods and services other than those specifically exempt by law, particularly on administrative and social grounds. Exempted goods and services are mentioned by VAT act, which can be changed by the government by Financial Act and does not require parliamentary approval.

Under exempted category, there are such a commodities comprising of natural and unprocessed products in unorganized sector, basic agricultural products, goods of basic needs, live animals and animal products, medicines, medical and health services, educational services, books, newspapers, artistic and cultural goods and services, transportation services.

## How is it Charged?

The VAT due on any sale is a percentage of the sale price but from this the taxable person is entitled to deduct all the tax already paid at the preceding stage. Therefore, double taxation is avoided and tax is paid only on the value added at each stage of production and distribution. In this way, as the final price of the product is equal to the sum of the values added at each preceding stage, the final VAT paid is made up of the sum of the VAT paid at each stage.

Registered VAT traders who are given a number called PAN (Permanent Account Number) have to show this number to charge VAT from the customers. The customer, if he is a registered trader, knows how much he can deduct in turn and the consumer knows how much tax he has paid on the final

product. In this way the correct VAT is paid in stages and to a degree the system is self-policing.

### 2.1.3 Types of VAT

VAT has been classified on several bases. The most important base of the classification of VAT is on the base of treatment to capital goods. Capital goods are such goods which are used more than a year in own to serve on purchased revenue goods. VAT can be classified in three categories according to the capital goods are treated. They are:

#### 2.1.3.1 Consumption Type VAT

Under consumption type of VAT, all capital goods purchased from other firm, in the year of purchase, are excluded from the tax base while depreciation is not deducted from the tax base in subsequent years. The tax base is consumption since investment is relieved from tax while imports are taxed; the base of this becomes identical to the base of sales tax on consumer goods services.

Consumption type VAT = gross domestic product - cost of intermediate goods - cost of capital goods.

#### 2.1.3.2 Income Type VAT

The income type VAT does not exclude capital goods purchased from other firms from the tax base in the year of purchases. This type, however, excludes depreciation from 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.

Income type VAT = goods receipt - cost of intermediate goods - depreciation

#### 2.1.3.3 GNP Type VAT

Under this type, capital goods purchased from other firm 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. The tax is levied on consumption and goods investment. The tax base of this type is goods domestic product.

Consumption type VAT is widely used. So, by the firm VAT we basically mean the consumption type VAT.

GDP type VAT = goods receipt- cost of intermediate goods.

#### 2.1.4 Methods of Calculating VAT

There are three methods of computing VAT:

2.1.4.1 Addition method: Under this method, tax base is obtained by adding the payment made by the firm to the factors of production employed in the production process such as wages, rent, interest and profit. This method is suitable for the income type VAT.

$$T=f(\text{wages} + \text{rent} + \text{interest} + \text{profit}) = f(W+R+I+P)$$

2.1.4.2 Subtraction method: Under this method, value added is determined as net turnover. The net turnover is obtained by subtracting the cost of materials from sales proceeds. Thus, the VAT is levied on the amount which is derived by subtracting purchase from sales. This method is suitable for consumption type VAT.

$$T=f(\text{outputs} - \text{inputs})$$

2.1.4.3 Tax credit method: Under this method, tax imposed on total value of sales and taxpayers are allowed to deduct from their goods taxes already paid by their suppliers. As compared to subtraction method, which deducts purchases from sales and levies tax on the difference, tax on sales under this method? This method is also known as invoice method. Out of these methods

of computing VAT, tax credit method is widely used. In most of the country including Nepal, tax credit has been adopted.

$T = f(\text{output}) - f(\text{input})$ .

#### 2.1.5 Principles of VAT

The following are the principles which govern VAT:

##### Principle of Transparency

VAT is a transparent tax. It is an account based tax system. VAT has made tax system transparent. Tax evasion is not pervasive where account system is transparent.

##### Principle of Removing Cascading Effect

VAT removes cascading effect. Cascading effect means tax on tax i.e., tax is charged on 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 sales tax system, sales tax paid at one stage is included in the cost price for another stage.

##### Principle of Neutrality

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

##### 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 zero rate (i.e. the tax payers get refund of VAT earlier paid in purchasing raw materials and interrelated goods but he should not pay tax on added value).

### 2.1.6 Importance of VAT

VAT is an efficient Tax system

VAT system is considered as an efficient tax system than rest other product base tax system. Its application is found to be beneficial from many angles. The system is advantageous to the tax authorities, because it ensures collection of more and more revenue to the government in a perennial way. It is beneficial to the public because it helps to restrict price rise in market by eliminating inefficiencies of product base tax system and helps to decrease burden of tax and market price. It is good from the businessmen's point of view as well capital in one hand and on the other hand their income tax matter will be streamlined.

VAT restricts price rise

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

VAT discourages business firms to understate their income statement:

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

VAT helps to control unauthorized trade

Application of the system allows registered vendors to offset tax pay on their purchase or import of taxable goods and services. But people involved in unauthorized trade will be required to treat the tax they pay as cost of their product since they are not permitted to offset the tax they pay on their purchase or import. Application of VAT system encourages businessmen to be registered with the concerned authority and conduct their commercial activities in an authorized way, people involved in unauthorized trade cannot produce authentic documents of their commercial transaction which are required under VAT arrangement. So vendors involved in unauthorized trade shall find themselves in an advantageous position if they quit from conducting unauthorized trade.

VAT improves mobilization of internal resources

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

#### 2.1.7 Special Features of VAT in Nepal

The type of VAT adopted by Nepal is conventional similar to that implemented over 130 countries around the world, it has injected some special features into the VAT system to make it uniquely Nepalese. The following are the main features of the Nepalese VAT system: The adoption of consumption type of VAT because VAT is finally borne by the consumer.

#### 2.1.7.1 Input Tax Credit

Registered businessmen are obliged to collect and remit VAT on their taxable transactions. These registrants are entitled to recover the tax paid on their purchases. This recovery or refund is known as an input tax credit. The Input Tax Credit is the total of the tax paid or payable on taxable goods and services purchased in Nepal and tax paid on taxable goods imported into Nepal. Where VAT is paid or payable by a registrant on a purchase or on imports. The registrant is allowed to claim an input tax credit for those purchases used in the registrants' commercial activity.

However, even though the purchase of goods or services may relate in part to a commercial activity, in certain circumstances the purchases may not generate an input tax credit entitlement when he sells goods or services, which are tax-exempt.

Most registrants are entitled to claim inputs tax credits for the tax paid acquisitions of capital goods for use primarily in commercial activities. Unlike the income tax deduction rules, the input tax credit for any VAT paid on capital goods is not amortized over the life of the assets. It can be claimed in full in the period in which it is acquired. If the capital goods are later put to a non-commercial use, special change-of-use rules will apply. Tax payers whose exports is more than 50% of total sales or those who are continuously on 6 months credit may claim for refund. Refund shall be paid back within 30 days from the receipt of refund claim.

#### Taxable and Non- Taxable Goods

VAT divides all goods and services into two basic categories, taxable and tax-exempt.

Goods and services are either taxed at the standard rate of 13 percent or they are taxed at 0 percent. Those taxed at the standard rate include all goods and services except those which are specified as taxed at 0 percent or tax- exempt.

### Tax Exemption

The purchaser will not pay VAT on tax exempt following goods and services :

- A) Goods and services of basic needs which include rice, pulses flour, fresh fish, meat, eggs, flowers, edible oils, piped water, food fuel.
- B) Basic agricultural products are also tax exempt, for example, paddy, wheat, millet, cereals, and vegetables.
- C) The expense of buying goods and services required to grow basic agricultural products are tax exempt. This includes live animal, agricultural inputs including machinery, fertilizer, seeds and pesticides.
- D) Social welfare services including medicine, medical services, veterinary services and educational services.
- E) Goods made for the use of the disabled persons.
- F) Air transport.
- G) Educational and cultural goods and services such as books and other printed material, radio and television transmission, artistic goods, cultural programme, non- professional sporting events and admissions to educational and cultural facilities.
- H) Personal services are also tax exempt. These are services provided, for example, by actors and other entertainments, sportsmen, writers, translators and manpower supplies agents.
- I) Exemption from VAT is also extended to the purchase and renting of land and building.
- J) Financial and insurance services.
- K) Postage and revenue stamps, bank notes, cheque books.
- L) Taxation on import

The VAT Act, schedule I list imports which are tax-exempt. Some of these include prescription drugs, basic groceries, medical devices and agricultural products.

Most imports, however, are fully taxable at custom point. Thereafter these are treated on the same basis as domestically produced goods.

The VAT on imported goods is collected by customs. It is calculated on the dutiable value of the goods, in other words, on the value of the goods including transportation, insurance, freight and commission plus any duty or other taxes (other than VAT) payable on the goods.

The value for the duty of the goods is determined in accordance with the valuation provisions contained in the Custom Act.

Registrant may claim input tax credit for the VAT paid on imported goods used in their commercial activities.

M) Taxation on Export VAT is applicable only to the consumption of goods and services in Nepal. However, supplies made in Nepal that are exported are taxable at 0%.

Exporters are allowed to claim input tax credits for VAT paid on payable on purchase of goods and services relating to their commercial activities. Exports taxed at 0% include exports of both goods and services.

N) VAT registration

Registration is required for any business:

- ) With an annual turnover of more than 2 million rupees.
- ) Belonging to a conglomerate which has an aggregate annual taxable turnover exceeding 2 million rupees.

O) Obligation of VAT registrants

VAT registrants are required to:

Submit VAT return and pay tax within the 25<sup>th</sup> day of the following month.

Provide their customers with a tax invoice

Maintain purchase book, sales book, VAT account

Keep their VAT records for a period of 6 years.

Inform the Inland Revenue Office (IRO) of changes to the business including new address, telephone number or a Registration in the premises where customers may easily see and read it.

Allow tax officers to enter the business to examine the business record and the stock on hand.

## 2.2 Review of Previous Study

Since the period of study on VAT, many individuals as well as some institutions have made efforts on study of taxation for finding the ways for the improvement of VAT. Many books, research reports and articles have been written and published in this respect. The researcher had consulted books, theses and some articles concerning with VAT during the thesis writing. Some of them are presented in brief below.

### 2.2.1 Review of Books

The Value Added Tax does not have a long history even in the global context, admittedly, there are not as much literatures available on this topic as other forms of tax system. So in other words, very few studies have been done on this particular topic with special reference to Nepal. An attempt, thereby, has been made to review the theory of tax reform as well as the recent literature on VAT.

Khadka (2055), published a text book entitled “Nepalma Mulya Abhibridhhi Kar: Siddhanta ra Byabahaar” is collection of different articles published in various newspapers and written during 2051/54. The main objective of this book is to bring public awareness regarding the implementation of VAT. It cites the examples of India, China and Bangladesh where Vat had been already introduced. It has made an attempt to justify the rational for introducing VAT in Nepal. The legal, procedural and structural aspects of VAT are also covered in the book. The success story of Singapore and the failure story of Ghana and implication to Nepal are delineated in the study.

Pandit (2053) published a text book entitled “Kardatako Guide” gives the glimpses of different forms of taxes and their provision. He tries to make aware about the general terminology of Vat and its application in Nepal. He clearly defines the every term of Vat that is associated with VAT system and the procedure that business community has to follow if falls under the threshold.

Silwal(1998) published a text book entitled “Value Added Tax: A Nepalese Experience” discloses the empirical finding of VAT after its implication. He was actively associated in VAT administration from the very beginning. He regarded sales tax system as.

- Narrow tax base and low rate.
- Low elasticity and buoyancy.
- Parochial administration
- Abundance of tax but lot of evasion.

Taxpayers were initially scheduled to register in VAT from the July 17, 1997 and VAT was scheduled to effect from the beginning of F/Y 1996-97. At the time of its announcement he realizes that the reparatory work was not complete. In his own words,

- The computer system was not ready.
- The staffing was not complete.
- The manuals were not approved.
- The business community strongly resisted the introduction.

He further added “taking into account all these factors, it was quite reasonable to postpone the scheduled date from April 16 to November 16, 1997 because the VAT being a modern a voluntary tax had to rely on the computerized information system as well as the cooperation of the business community” Tax base, rate structure, exemption and the threshold issues were major factors affecting VAT design in Nepal. According to his study staff recruitment, issue

of retention and issue of attitudes of staff are crucial problems in administration front.

Adhikari(2003) published a text book entitled “VAT in Nepal: Theory and Practice” which comprises of three chapters the first chapter deals with theoretical concept of VAT which includes historical background, objectives, merit and demerit of VAT. The second chapter comprises practice of Nepalese VAT which deals with introduction of VAT system in Nepal, different terminologies associated with VAT, Tax administration system and legal provision made for the VAT implementation in Nepal. The third chapter consists of different model question of TU on VAT, specimen of VAT related forms and Accounts and VAT Rule 1997 and VAT Act 1996.

Kandel (2008) published a text book entitled “Tax Laws & Tax Planning in Nepal” in 2004. The book was designed to fulfill the needs of MBS and BBS levels under T.U. This book was very useful to the students and teachers to know the legal provisions of Income Tax Act 2058. The book has attached unofficial translation of the tax laws – both Acts and Rules – related to VAT and income tax. This book was more informative rather than analytical.

Amatya, Pokharel and Dahal (2004) published a text book entitled “Taxation in Nepal (Income Tax, Property Tax & Value Added Tax)”. This book has exclusively been designed for the subject “Taxation in Nepal” as per the syllabus prescribed by the Faculty of Management, Tribhuvan University for 3rd year of Bachelor of Business Studies (BBS). Unlike other books available on this subject, 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 those students who are studying taxation as a concentration/elective subject at BBS 3rd year. This book was very useful to know the legal provisions of Income Tax Act 2058 and VAT Act 2052. Theoretical aspects as well as numerical problems of income tax and VAT are shrewdly presented in this

book. However the book was failed to analyze legal provisions with numerical examples on the topic of income taxation of insurance business.

Bhattarai and Koirala (2011) published a text book entitled “Tax Laws and Tax Planning” described the income tax system in depth. This book includes the separate chapter on Value Added Tax. It describes VAT practices in Nepal with several theoretical aspects and numerical examples. This book was specifically designed for the students of MBS 2nd years under Tribhuvan University. However, the book was failed to mention legal provisions with examples regarding taxation of income from insurance business in detail.

### 2.3.2 Review of Journals and Articles

VAT: Analysis and Suggestion (Jyoti, New Business Age: 2002) - New Business Age, Feb 2002 issue contains this article by famous industrialist and intellectual personality called Dr. Roop Jyoti. According to him VAT was introduced in Nepal in response to realization that a fundamental change was necessary in the country’s revenue policy. 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:

- Acceptance of the correct in voice.
- Self-assessment of taxes
- Refund of the tax amount speedy and simple manner when the conditions for a tax refund are met.

VAT is useful in the context of Nepal too because of these reasons:

- Limited scope for revenue officials to use discretion
- Honest taxpayers have practically no need to have contacts with the tax officials
- Due to the self-enforcing mechanism of VAT, the tax payers are forced to become honest.

According to him VAT system will fail not because of any defect in it but because of these reasons:

- Inadequate and incorrect step taken to ensure billing and /or billing at the correct prices.
- Failure to enforce VAT threshold on an effective way.

VAT Refund System (The Kathmandu Post: 2002) - The article published in the November 15, 2002 issue made a point that Nepalese industrialist and business did not have any faith in the VAT refund system before four or five years. Most of them used to say that it would be impossible to institutionalize a refund system in Nepal. While refund is one of the important features of Vat system, it was a big challenge for those who were involved in designing the Nepalese VAT system to create a refund mechanism that can be implemented smoothly under the Nepalese circumstances. The possibility of refund arises when the tax paid by a taxpayer on his purchase/imports exceeds the tax collected on his output. Tax refund is granted after verifying the export declaration forms, letter of credits/bills of entry and proof of payment to authenticate the export and the import declaration forms or purchase invoices to authenticate the tax paid on inputs. In the absence of these conditions, refund mechanism is likely to be grossly misused by the taxpayers, which does not become sustainable. International experience indicates that provided refund without verification of export and payment of input tax. So, these countries later on stopped granting refunds even to the genuine exporters. In order to avoid such situation, the system of verification has been introduced in Nepal.

On the other hand, refund mechanism has been misused by the tax official in those countries which made full audit mandatory for the refund. This is because resources allocated for audit generally limited. But in case of Nepal problem of allocating budget and realizing the long term process of budget and approving refund , a system of refund directly through the VAT revenue collected on imports has been introduced. It was a dream of the designers of the refund system to implement it in a proper and effective manner in real life. In the first year of introduction of VAT, no one claimed for the refund.

After publicity regarding the tax refund system the trust of taxpayers gradually increased and claimed for refund. VAT refund figure indicated that the refund system is becoming increasingly effective in real life but there is still long way to go.

Tax System and Its Reform in Nepal (Thapa, Business Age: 2003) - An article entitled “Tax System and Its Reforms in Nepal” written by Dr. Gobinda Bd. Thapa, was published in the Business Age in Dec 2003 views that VAT as an important element of tax return program .

VAT and Its Legal Scrutiny (Dhungana, Business Age: 2003) Dhungana has scrutinized the legal aspects of and Its Legal Scrutiny. He concludes that as other areas of economy that are heavily influenced by political instability, corruption, bad governance, frequent change in government and Moist revolution. VAT also witnesses weak implementation owing to these hurdles.

United Nation (2009) published a journal on public finance entitled, “Guidelines for improving tax administration in developing countries”. The study was divided into four separate parts. Among them reforming the structural organization of the tax administration and explained in two separate sub topics i.e. guidelines for appropriate initiatives and underlying consideration and explanatory. Functions of tax administration are

identification and registration of taxpayer's education, information provider and assistance etc. The study had explained these two functions and the study had recommended some valuable suggestion to the developing countries.

Nepal (2010) has analyzed existing position, problems and prospects of income tax in her dissertation “A Study on Problems and Prospects of Income tax in Nepal”. She has indicated the major problems in Nepalese tax system that are inefficient income tax administration, mass poverty, lack of tax co-operation between tax payers and tax administration, assessment deficiency etc. Her suggestion is towards the improvement on those specified problems.

Pant (2010) has tried to show the income tax system and its role in National economy in his dissertation “A Study on Identified Various Problems of Income Tax Management in Nepal” .He has shown the problem as lack of effective personnel management, lack of reward and punishment system, lack of managerial efficiency, poor income tax procedure, poor tax information system, lack of tax payer’s education etc.

Pant (2011) wrote an article entitled, “Problem in Tax Administration and Their Remedies” published in journal of finance and development ‘Rajaswa, 2011, April vol.4. He had comprehensively explained about the problem and their remedies related with tax revenue and major types of practical problems and challenges, in tax administration. He had maintained in his article where showing limited amount of transaction showing low selling price , less of issuing in taking bills, lack of showing the real factory cost, commercial fraud, lack of co-operation in tax auditing , legal ambiguity and complexity in implementation and lack of co-ordination between IRD and revenue investigation unit . Meanwhile, he had recommended some valuable suggestion to solve the problems and to overcome the challenges. They were statistical and in formation system should be properly managed, fixed norms and standards should be used to assess selling price and factory cost, the billing system

should be made compulsory, co-ordination between Inland Revenue office with various entities of NG, revenue investigation and its related unit should play the important role.

Siwakoti (2012) has examined various factors related in the field of income tax in his dissertation “An Analytical Study of income tax in Nepal”. The major problems identified by him are tax evasion, delay in assessment, and lack of public information, complicated acts and other defects in the income tax act. He has suggested for progressive, separate research units efficient administration, separate research units in tax offices and penalties to tax payers who do not maintain accounts.

### 2.3.3 Review of Previous Researches and Dissertations

There are quite a few dissertations relating to VAT Nepal undertaken by various individuals and some institutions. Some of them are reviewed below:

Subedi, (1997) in his research study concludes that existing Nepalese sales tax system is not efficient, it generates less of the potential amount of revenue and it is far from equity norms. Cascading and pyramiding are overall problems making room for vertical integration, distortions and tax evasion. To reduce such inefficiencies, it is necessary to move towards VAT system and initiate administration reforms. VAT necessary for maintaining the system broad based , neutral , stable and more revenue generating , transparent and to eliminate growing fiscal deficit as well as to lower dependency on foreign loans in Nepal. But low awareness as well as tax payers ignorance may create problems for the implementation of VAT in Nepal.

Chaudhari (2001), in his dissertation, VAT in Nepal: An Analysis of its problems and prospects, having the objective to review historical background of VAT, to examine the 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.

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

The unpublished dissertation entitled Resource Mobilization Through VAT in Nepal undertaken by Neupane (2006) has the basic objective to examine historical background of VAT and to analyze mobilization of revenue through VAT. Mr. Neupane also provided the bird eye view of the practicing scenario of VAT in the foreign countries. He conducted a research applying secondary data to analyze simple ratio and also use of observation method. He concluded that VAT 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 to control tax evasion so that the number of the taxpayers would increase and hence the revenue collection would also increase exponentially. According to him, after the implementation of VAT, attempt was made to inform the public about some non-VAT including commodities through the public means of communications like radio, television and newspapers, but it could not prove effective.

As a result, the consumers are on the other hand, as he argues, the businessmen opposing the VAT had raised the prices of daily consumption goods like rice, vegetable etc, which had added future burden to the consumers. The government, he observed, could neither reduce the price nor punish those businessmen against such act. Instead, the government compromised with those businessmen. These are some of the grievances articulated by Neupane in the conclusion of the thesis, but he also gives some recommendations. His constructive recommendations were the boundary of VAT should be increased instead of increasing the rate of VAT in order to increase the tax amount under VAT, 2. The concentration must be given to bring the use of billing in all trading concern, 3. the most important one, the consumer should be comprehensively educated about the nature and beneficial aspects of VAT.

Basnet (2002), in his dissertation, VAT present status and future prospects in Nepal, by using the analytical and explanatory research design and having the objective to the present status and future prospect of VAT and its effects on various aspects of economy, has concluded that the implementation of VAT in Nepal would have very poor results than expected due to poor planning and poor implementation. But VAT implementation has been becoming more and more effective and VAT net has been spreading and revenue collection is on the constant rise establishing it firmly in Nepal. It is expected that positive impact can be seen

in tax collection as code of conduct announced recently includes all the required ingredients, such as, utilization of tax revenue, respecting the taxpayers, simplification in the service and improvement in the behaviour of the tax administrators. Moreover, he recommended that tax related newspapers, pamphlets, radio, television etc. Interview programs with professors, researchers, tax experts, and economists should be conducted and published through advertising media. Similarly the students at school campus level curriculum should include tax education and social obligation of paying tax. Border should be effectively controlled to prevent the illegal trade. There should be a broader tax adjustment checking and highway checking should be practical effectively to prevent any kind of illegal trade. The accounting should be transparent and VAT officers should control auditing as far as possible.

Paudel (2004), in his dissertation, A Study on VAT: Implementation, Problems and its Effectiveness in the Nepalese Economy, by using the analytical and explanatory research design and having the objective to examine the historical background of VAT in general, to examine the implementation, problems, effectiveness of the VAT in Nepal concluded after using different statistical and financial tools that the revenue collection from VAT is lower in Nepal than expected due to various problems related to VAT. In his findings, Nepalese VAT law is inappropriate and the administration is worse. He suggests the VAT laws and administration in Nepal be deeply scrutinized. There is shortcoming in the implementation. For the efficiency of tax system, in his view, there must be strong commitment, manpower development planning within the administration. Apart from them, Tax education packages are to be made and initiated hence, tax administration and tax compliance could be improved.

He is too optimistic about the prospect of revenue collection from VAT if the problems relating to VAT system in Nepal can be solved and resources fully

and effectively utilized For this, as he recommends, Tax related information should be published regularly through journals, magazines, newspapers pamphlets, radios, television, and cinema. Interview programs with professors, researchers, tax experts and economists should be conducted and published through media. Timely revision should be made in the matter of VAT policy. The most important thing, the members involved in formulating VAT policies must have deep knowledge about VAT.

Dhakal, (2004) submitted his MBS thesis on A Study on Practices of VAT in Nepal. His thesis was guided by the primary objectives like reviewing Nepal's overall tax structure for the period 1990/91 to 2001/2002, examining the theoretical background of VAT, analyzing the existing VAT system of Nepal with special emphasis on revenue mobilization and identifying the major problems of VAT in Nepal. His study is also chiefly based on the secondary sources and the research design descriptive in nature with the use of figures, ratios, percentages, tables and graphs whenever and wherever necessary. He also concluded that the implementation of VAT system has a greater significance in Nepal. However he comments that the VAT system in Nepal from its inception has been facing innumerable problems, which curtail its merits and effectiveness.

According to him, its progress has been slow, initially due to opposition from the business community. He also admits there do exist the immense administrative problems. Even after its full-fledged implementation in 1999, the system has not been taking a considerable place due to administrative inefficiency. VAT regime is extremely challenging in a developing economy like Nepal where, with long open border, a large segment of the economy is yet to be mobilized. Resistance from the business community, ignorance of general people and the lack of full support and commitment from the politicians and government officials forced the authority responsible for implementation VAT to make compromises on various aspects of VAT which has weakened the process of implementation right from the beginning.

To overcome these problems he put forth his recommendation which include the establishment of proper co-ordination between Inland Revenue Department and Ministry of Finance, the amendment of Unpractical acts, rules and regulations, the need to review the VAT laws on the basis of experience gained so far, cutting down of the existing status of VAT exemption, adoption of dual rate VAT system: a lower rate of tax on the goods and services of general consumption and higher rate on luxurious goods & services, installation of computer and networking system and so on.

Keen (2007) has explored the implications of a distinctive feature of the VAT that is stressed by practitioners but has been ignored or dismissed by theorists: that it functions, in part, as tax on the purchases that informal operators makes from formal sector businesses and, not least, on their imports. Recognizing this is key, for example, to understanding the comparative effects and roles of the VAT and import tariffs, and so also to addressing the difficulties that developing countries may face in replacing the revenue loss from prospective trade liberalization.

The study has addressed two of the key challenges for tax design that currently face almost all developing countries. The first is that of dealing with a large informal sector. Hard to measure, but recently put by Schneider (2002) at an average of around 40 percent of gross national income in these countries, informality represents both a costly narrowing of the tax base and a potentially serious distortion of economic activity. The second challenge is that of determining the proper degree of reliance on trade taxes. These still account for 20 percent or (often) more of all tax revenue in many developing countries, so that continuing pressures towards further trade liberalization, combined with pressing revenue needs, raise the question of how reduced trade tax revenue can be replaced from domestic sources.

Shakya (2008) in his dissertation “Tax Reform in Nepal: A Study on Nepalese VAT System” has concluded that theoretically, VAT is the alternative of sales tax on the ground of economic growth that VAT has high revenue potential power. The board coverage of VAT would generate more revenue without addressing the equity norms. Practically, it is found that the VAT is going to become the hot milk in mouth due to inefficient tax administration. The analysis of elasticity coefficients of overall selected taxes is less than unity, means inelastic in nature, his recommendation for better implementation of VAT is that the concentration must be given to bring the use of billing in all trading concern, making tax officers more responsible, accountable as well as competent and honest instead of powerful authorization by balancing the rights and duties mentioned in acts. There is no definite course about the degree of tax reform. Thus, the implementation of VAT by super sending sales, hotel, and entertainment and contract taxes is only the partial reform that cannot address the equity respects. Therefore, VAT should be extended into excise and non-tax portions.

Shrestha, (2008) presented a dissertation entitled of “A Study on The Problems and Prospects of VAT in Nepal”. She had mentioned problems in the implementation of VAT in Nepal and effectiveness of VAT. She had also mentioned sales tax, superiority of VAT over sales tax. She had suggested for effective implementation of VAT in Nepal were Follows:

VAT refund mechanism should be simplified, so that the refund can be made without deals and the taxpayer’s have confidence in the system.

As most of the taxpayers are still ignorant about account keeping under VAT and who get this job by paying other people, taxpayer’s education program should be continued. Extensive taxpayer’s education should be conduct from time to time familiarize the potential taxpayers and others with various aspects of VAT.

Ghimire (2008) submitted the thesis on “Contribution of VAT to National Income”

Ghimire cited the following findings;

- i) The trend of VAT registrant in IRO of Kathmandu is increasing trend which shows that people are being quote aware regarding VAT system and its advantage.
- ii) Revenue is in increasing trend so it is expected to generate more VAT revenue in future and in the long run VAT will be an integral part of Nepalese tax structure but the revenue have not increased to meet in increasing Government expenditure as expected.
- iii) The share of tax revenue is greater than the share of non-tax revenue and the share of VAT is very low in national GDP as compared to other developed countries.
- iv) VAT system will help government to curb illegal activities.
- v) Difficulties in business registration procedure, accounting keeping system and cost record keeping are the major problem in business sector.

Bhattarai (2009) in the dissertation “VAT in Nepal: A Cross- Check Analysis” has concluded that the prospect of VAT entirely depends on its implementation aspect. VAT has bright prospects in Nepal only when it can be implemented in a successful way. Further, the successful implementation depends on the strong fair and capable administration, strong political commitment, co -operation between the custom offices and Inland Revenue offices, co-operation between private sector and the government bodies systematization of open boarder, high public consciousness level, transparency and improvement of rules and regulation accordingly over time. Thus, VAT can be entrenched as an integral part of the Nepalese tax structure in the long run if the issues mentioned above are taken seriously and solved accordingly. Then, Nepal also will not be a country of exception in the line of successful VAT implemented countries in the world.

Wawire, (2011) applied Paul Samuelson's fundamental general equilibrium analysis (1955) of the public sector to assess responsiveness of tax revenues to changes in GDP in Kenya. The study uses the demand function for the public good was derived from a constrained model of utility-maximization. In the same vein, tax revenues were taken as functions of household incomes, which paved the way for the estimation of Engel curves for public goods. The study has found a positive relationship between tax revenues and GDP as the growth elasticity's for VAT are all greater than one. The estimation results show that total GDP elasticity of VAT revenues is less than the elasticities with respect to monetary GDP, suggesting the existence of an underground economy in Kenya over the period of analysis. It is found that VAT revenues respond with substantial lags to changes in its determinants and that VAT revenues are sensitive to unusual circumstances. The study concludes that Kenya's VAT revenue is very responsive to changes in their determinants especially international trade. There is therefore the challenge of creating a stable VAT system so that tax revenues can increase rapidly as the economy grows.

### 2.3 Research Gap

Above all researchers have conducted in different sense either in worldwide coverage or in particular case of any countries has not been evaluated. This research has tried to elaborate the actual contribution of VAT to the Nepalese GDP by conducting comparative analysis with different parameters.

## **CHAPTER III**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

Research Methodology is the way to solve the research problem systematically it facilitates the research work, provides reliability and validity. The study also confines formulation and acceptance of goals, objectives strategies and other operational planning and their relationship between performance and management system to achieve the formulated objectives. The basic objective of the study is to highlight the contribution of VAT on GDP. The study has been made mainly on secondary data. In the course of the study the following process has been considered.

#### **3.2 Research Design**

Research Design is the arrangement of condition for the collection and analysis of data in a manner that aims to combine relevance to the research purpose. Research design is the plan, structure and strategy of investigation conceived as to obtain answer to research question and to control variance. The plan is the overall scheme or program of the research. It will do from writing the hypothesis and their operational implication to the final analysis of the data. The structure of the research is more specific. It is the outline, the scheme and the example of the operation of the variable. Strategy as used here, is also more specific the plan. In other words, strategy implies how the research objectives will be reached and how the problem encountered in the research will be tackled.

Basically, the research design has two purposes. The first is to answer the research question and second is to control variance. The research design asks what approach to the problem should be taken. What method will be used? What strategies will be most effective? Identification may be considered as the

planning stage of a research. The remaining activities refer to design, operation and completion of research study.

To achieve the stated objectives of the study both descriptive and analytical research has been carried out.

### 3.3 Nature and Sources of Data

Only the secondary sources of data have been used. Secondary sources of data have been collected in order to achieve the result from this research. All the available data has been collected.

Economic Survey, Annual Report, publications of IRD, Central Bureau of Statistics, National Planning Commission, Financial Comptroller General's Office and concerned authorities have also been used including books, reports, articles leaflets, magazines, websites and dissertations etc. are the sources of secondary data. The collected data through above sources are tabulated in different ways according to the requirement of the study.

### 3.4 Data Processing and tools for analysis

In this study, secondary sources have been used. The collected data have been classified, edited, and presented in the appropriate tables and graphs for proper analysis and interpretation, and made up-to-date. The share of important VAT in GDP has also been calculated.

Data collected from secondary sources are managed, analyzed and presented in proper format and are interpreted and explained wherever necessary. The data of 8 years since 2003-04 to 2010-11 are taken for the analysis purpose.

For analyzing and interpreting the data collected through different sources in the process of presentation and analysis, both the qualitative and quantitative parameters have been used. The tables, graphs and diagrams are presented and

analyzed as statistical tools. The following econometrics tools and technique are applied.

$$\text{Goods VAT} = \alpha + \beta \text{GDP} + u_t$$

$$\text{Domestic VAT} = \alpha + \beta \text{GDP} + u_t$$

$$\text{Production VAT} = \alpha + \beta \text{GDP} + u_t$$

$$\text{Sales and Distribution VAT} = \alpha + \beta \text{GDP} + u_t$$

$$\text{VAT on import} = \alpha + \beta \text{GDP} + u_t$$

Where,  $\alpha$  = constant       $\beta$  = coefficient       $u$  = error term

## CHAPTER IV

### PRESENTATION AND ANALYSIS OF DATA

#### 4.1 Trend of Revenue Collection from VAT

VAT is the best form of the sales tax and it is very helpful method of more revenue collection because of its broad coverage, neutrality, transparency and fairness. VAT will generate more revenue with less distortion. The revenue collection from VAT in different fiscal since the fiscal year 2003-04 to 2010-11 is presented in table below. In an average VAT contribute 3.157 percent of GDP.

Table 4.1  
Contribution of Total VAT to GDP, 2003-04 to 2010-11

Fiscal year	Total VAT	GDP	Total VAT as % of GDP
2003-04	13030.05	492231.3	2.647
2004-05	15203.5	536748.9	2.832
2005-06	15801.49	589412.6	2.680
2006-07	22450	654084	3.432
2007-08	25398.03	727827	3.489
2008-09	28762	815658	3.526
2009-10	39700.9	988053	4.018
2010-11	54920.9	1171905	4.686

*Rs in million*

*Source: Economic Survey, 2010/11, MOF, Nepal Government*

Table 4.1 gives the clear view of contribution of VAT to GDP of period of 8 years since 2003-04 to 2010-11. The amount of total Vat is in increasing trend which shows that the contribution of GDP is increasing. Higher the GDP higher the collections VAT. In the period first, the contribution of GDP to the VAT was 2.647 percent. Since 2003-04 to 2005-06, its contribution was in around more than 2 percent except in the fiscal year 2003-04. Similarly, since 2006-07 to 2008-09 the contribution was in the line of 3 percent. From the fiscal year 2009-10 till 2010-11 the contribution rate is in the line of 4 percent. So, we can expect the higher result in the days to come.

The above mentioned table is presented in the graph below which contains fiscal year in the x-axis and Total VAT and GDP in the y-axis.

Figure 4.1

Contribution of Total VAT to GDP, 2003-04 to 2010-11

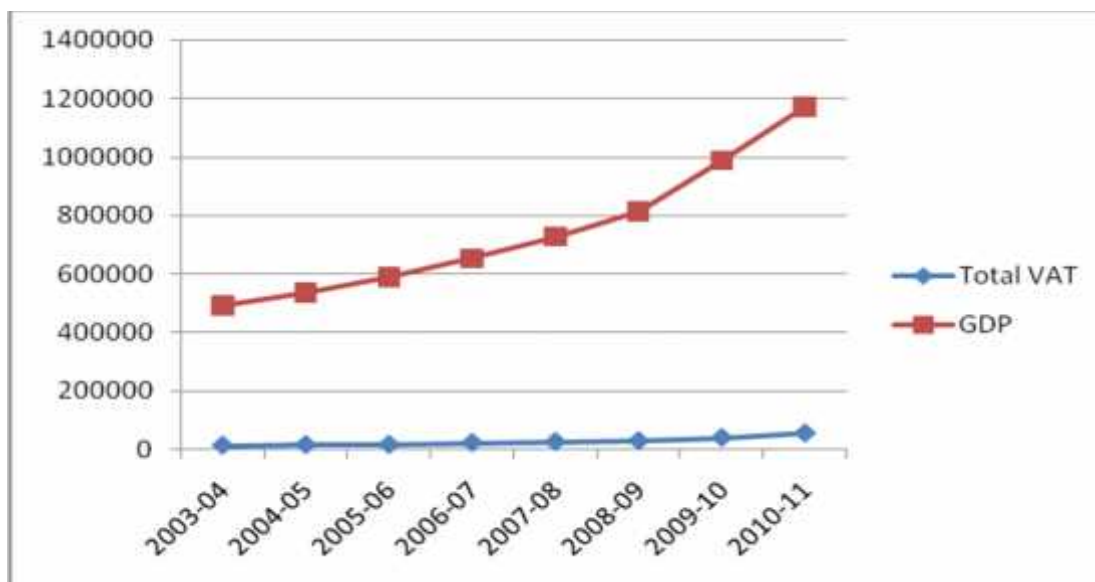


Table 4.1 is presented in the figure. GDP is indicated by dotted line and total VAT is denoted by a straight line. The curve of GDP is moving upwards which indicates that, GDP is increasing in every fiscal year. The curve of total VAT is nearly slopping to the x-axis. it is because the figure of VAT is too small than the figure of GDP. Though the figures of VAT are too small compared to GDP but it started rising, which we can see in the figure.

Table 4.2  
Results of Regression between Total VAT and GDP

Variables		
Dependent	Independent	
Dependent Variable: TOTAL VAT	C	GDP
Coefficient	-10991.56	0.052024
Std. Error	2029.308	0.00309
t-Statistic	-5.41641	16.83754
Prob.	0.0002	0

*Source: Economic Survey, 2010/11, MOF, Nepal Government*

Using the least square method and t-test we obtained the above mentioned result. Here, VAT is a dependent variable and GDP in an independent variable. As the GDP increases the total VAT also increases. T- Test is used because the number of observation is less than 30 i.e. 08. GDP and Total VAT are directly proportional, which means as the GDP increases Total VAT also increases. The regression result shows that the GDP and total VAT have a close relationship having 0.052 coefficients which is significant at 1 percent critical t-value.

#### 4.2 Contribution of VAT on Total Revenue

Total revenue includes both tax revenue and non tax revenue. VAT is a one of the component of indirect tax revenue. Here we analysis the contribution of VAT in total revenue of different fiscal year. VAT occupies 26.614 percent of total revenue of the country.

Table 4.3  
Contribution of VAT on Total Revenue, 2003-04 to 2010-11

*Rs. in million*

Fiscal Year	Total VAT	Total Revenue	Total VAT as % of Total Revenue
2003-04	13030.05	54538.9	23.891
2004-05	15203.5	62332	24.391
2005-06	15801.49	70122.7	22.534
2006-07	22450	72281.9	31.058
2007-08	25398.03	87712.1	28.956
2008-09	28762	107622.5	26.724
2009-10	39700.9	143480.5	27.669
2010-11	54920.9	179945.8	30.520

*Source: Economic Survey, 2010/11, MOF, Nepal Government*

Table 4.3 gives the detail view of contribution of total revenue to Total VAT. The amount of total revenue is in increasing trend. As the total revenue increases the total VAT also increases. The contribution of total revenue to Total VAT is seems to be fluctuating. In the first period it was 23.891 percent. This percent decreased till 2005-06. In the fiscal year 2006-07 its contribution reached to 31.058 percent which is the highest till now. Again the percentage decreases and in the fiscal year 2010-11 it was in the line of 30 percent.

Figure 4.2

Contribution of VAT on Total Revenue, 2003-04 to 2010-11

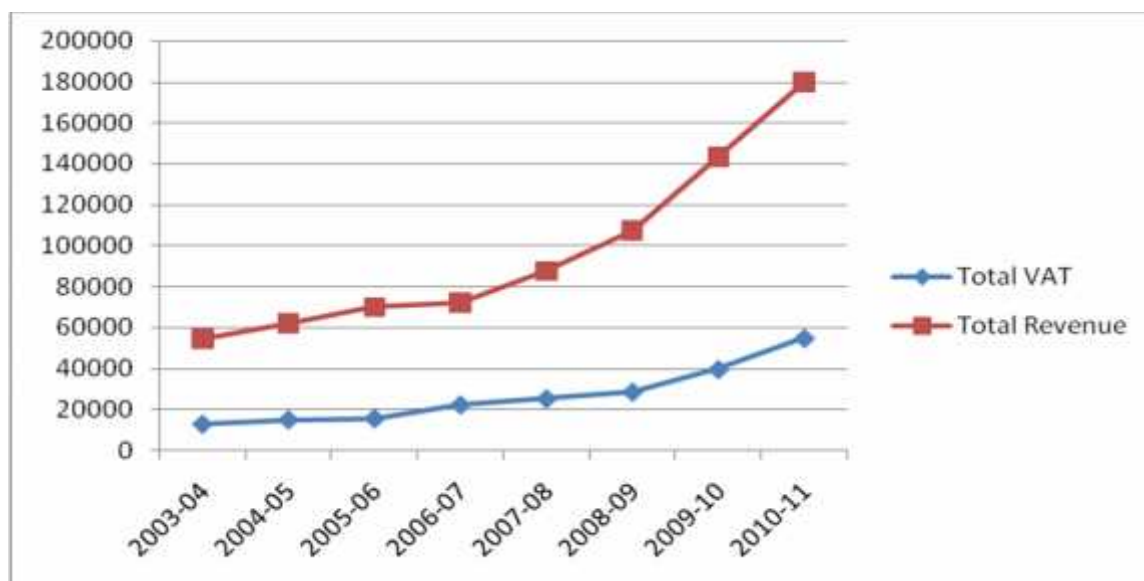


Figure 4.2 shows the total revenue is denoted by the dotted line and total VAT is denoted by the straight line. Total revenue curve is moving upwards and total VAT curve is following to the total revenue curve. Total revenue and VAT amount has the positive relation between them. As the total revenue which includes tax revenue and non tax revenue increases automatically its contribution to Vat also increases.

#### 4.3 Contribution of Total VAT on Total tax Revenue

As we know that VAT is a major component of tax revenue. As we analyze previously here also we analyze the contribution of VAT only on tax revenue. VAT occupies the large share of tax revenue. In an average it occupies 33.635 percent of total tax revenue. Here the data of 8 years are presented, since 2003-04 to 2010-11 for the analysis purpose.

Table 4.4

Contribution of Total VAT on Total Tax Revenue, 2003-04 to 2010-11

*Rs. in million*

Fiscal Year	Total VAT	Total Tax Revenue	Total VAT as % of Total Tax Revenue
2003-04	13030.05	42586.94	30.596
2004-05	15203.5	48173	31.560
2005-06	15801.49	54104.7	29.205
2006-07	22450	57430.4	39.090
2007-08	25398.03	71126.7	35.708
2008-09	28762	85155.5	33.775
2009-10	39700.9	117051.9	32.823
2010-11	54920.9	156294.9	35.139

*Source: Economic Survey, 2010-11, MOF, Nepal Government*

Table 4.4 gives the detail view of contribution of total tax revenue to the total VAT. In the first period 2003-04 its contribution was 30.596 percent which. It

raised in the line of 30 percent for next three years till 2004-05. However its contribution has been increasing in fiscal year 2006-07 it became 39.090 percent which is the highest till 2010-11. Though it fluctuates sometimes but the contribution has been in increasing trend.

Figure 4.3

Contribution of Total VAT on Total Tax Revenue, 2003-04 to 2010-11

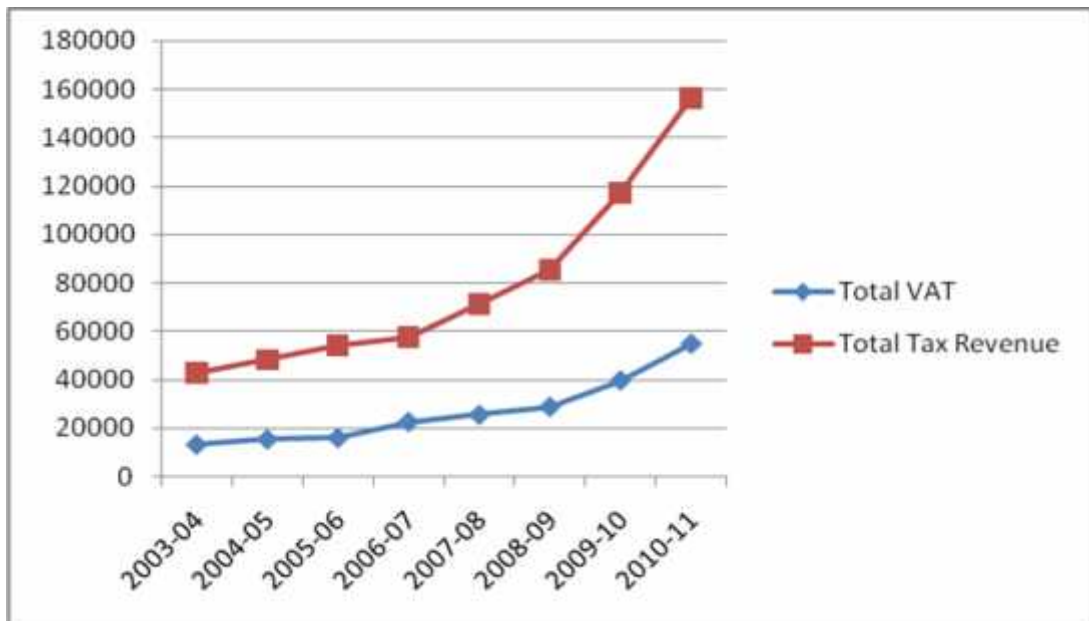


Table 4.4 is presented in the figure. Total tax revenue is denoted by the dotted line and the total VAT is denoted by the straight line curve. As the total revenue increases the amount of VAT also increases. The amount of total tax revenue curve is sloping upwards and total VAT curve is following it.

#### 4.4 Composition and Contribution of Value Added Tax

The composite picture of the VAT structures in Nepal has been analyzed with the contribution of different composition of the VAT to the total revenue. The major trends of the individual component and group of the VAT are examined separately. Ministry of Finance (2002) classified the VAT into six categories i.e. production, imports, sales and distribution, contract and consultancy, tourism industries, and other services under new regime.

On the basis of the table presented by Ministry of Finance, some assumptions were made to classify the data into various groups. The total VAT classified into two groups such as goods VAT and total services. The goods VAT (old sales tax) cover domestic VAT (collected internally from production, and sales and distribution) and imports. Finally, total services VAT has assumed to be collected in services such as contract and consultancy, tourism industries, and other services. The highest contribution of import VAT has followed by production, other services, sales and distribution, contract and consultancy, and tourism industries under the new regime.

Here each type of VAT and their contribution are presented in table, figure and through running regression under least square method.

#### 4.4.1 VAT on goods

The components of VAT on Goods include Production, Imports and Sales and Distribution. The table below gives the clear view of contribution of VAT on goods to the GDP of different fiscal years since 2003-04 to 2010-11. In an average Goods VAT contribute 2.595 percent of GDP.

Table 4.5  
Contribution of Goods VAT, 2003-04 to 2010-11

<i>Rs. in million</i>			
Fiscal year	Goods VAT	GDP amount	Goods VAT As % of GDP
2003-04	11170	492231.3	2.269
2004-05	12597.3	536748.9	2.346
2005-06	12637.7	589412.6	2.144
2006-07	18390	654084	2.811
2007-08	20411.65	727827	2.804
2008-09	23388.1	815658	2.867
2009-10	32283.2	988053	3.267
2010-11	44659.3	1171905	3.810

*Source: Ministry of Finance (various years) Budget Speeches, Nepal*

Table 4.5 gives the clear view of contribution of goods VAT to the GDP. In first period say in fiscal year 2003-04 its contribution was 2.269 percent of GDP. However since 2003-04 to 2008-09 its contribution was in the line of 2

percent. Since 2009-10 its contribution was increased to 3 percent and more. In an average its contribution to GDP is about Rs. 16874.8 million per year.

Figure 4.4

Contribution of Goods VAT, 2003-04 to 2010-11

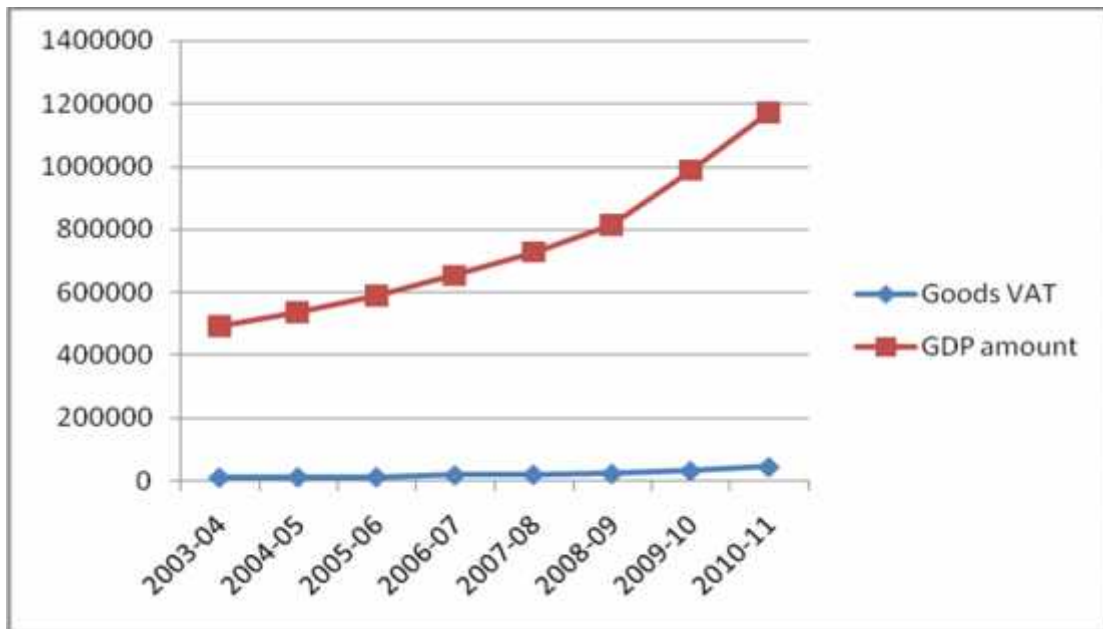


Figure 4.4 shows the GDP is denoted by the straight line and Goods VAT is denoted by the dotted line. GDP curve is sloping upwards and Goods VAT curve following it. However it seems to be lying in the x-axis because amount collected from Goods VAT is very smaller figure than compared to the GDP amount.

Table 4.6  
Result of Regression between Goods VAT and GDP

Variables		
Dependent	Independent	
Dependent Variable: GOODS VAT	C	GDP
Coefficient	-8604.83	0.041932
Std. Error	1690.347	0.002574
t-Statistic	-5.090571	16.29293
Prob.	0.0003	0

*Source: Economic Survey, 2010/11, MOF, Nepal Government*

Using the least square method and t-test we obtained the above mentioned result. Here, Goods VAT is a dependent variable and GDP in an independent variable. GDP and Goods VAT are directly proportional which means as the GDP increases the Goods VAT also increases. The regression result shows that the GDP and Goods VAT have a close relationship having 0.041 coefficient which is significant at 1 percent critical t-value.

#### 4.4.1.1 Production VAT

Production VAT includes the VAT levied on producer and manufacturer level. The table below presents the total VAT collected in different fiscal years relating to the VAT levied at the manufacturer level and its contribution to the total Nepalese GDP. In an average production VAT contribute about 0.403 percent of GDP.

Table 4.7  
Contribution of Production VAT, 2003-04 to 2010-11

*Rs in million*

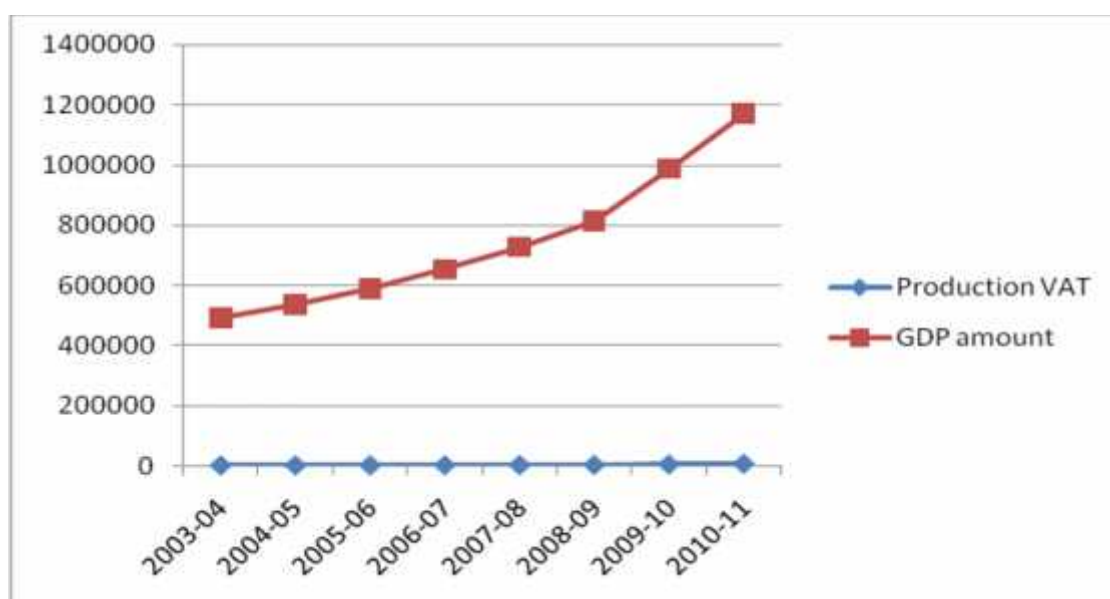
Fiscal Year	Production VAT	GDP amount	Production VAT as % of GDP
2003-04	1950	492231.3	0.396
2004-05	1963.3	536748.9	0.365
2005-06	2024	589412.6	0.343
2006-07	2745	654084	0.419
2007-08	3016.73	727827	0.414
2008-09	3617.8	815658	0.443
2009-10	4993.7	988053	0.505
2010-11	6908.2	1171905	0.589

*Source: Ministry of Finance (various years) Budget Speeches, Nepal*

Table 4.7 gives the clear view of contribution of Production VAT to the GDP. The amount collected from the production VAT is very small. Since fiscal year 2003-04 to 2005-06 its contribution was around 0.3 percent. Since fiscal year 2006-07 to 2008-09 it was around 0.4 percent. Then in last two fiscal years it has been increased to around 0.5 percent. In an average its contribution is about Rs.2616.51 million per year.

Figure 4.5

Contribution of Production VAT, 2003-04 to 2010-11



In above mentioned figure GDP is denoted by the straight line and Production VAT is denoted by the dotted line. GDP curve is slopping upwards and curve denoting Production VAT seems to be lying in the x- axis because amount collected from Production VAT is very smaller figure than compared to the GDP amount. Due to the various obstacles and problem in the country the production was not enough, almost all the factories and industries were about to close in that period.

Table 4.8  
Result of Regression between Production VAT and GDP

Variables		
Dependent	Independent	
Dependent Variable: PRODUCTION VAT	C	GDP
Coefficient	-1286.986	0.006424
Std. Error	263.2774	0.000401
t-Statistic	-4.888326	16.02592
Prob.	0.0005	0

*Source: Economic Survey, 2010/11, MOF, Nepal Government*

Using least square method and T-Test we obtained the above result. Production VAT is a dependent variable and GDP is an independent variable. As we know Production VAT and GDP are directly proportional to each other which means as the GDP increases Production VAT also increases. The regression result shows that the GDP and Production VAT have a close relationship having 0.006 coefficient which is significant at 1 percent critical t-value.

#### 4.4.1.2 Sales and Distribution VAT

Sales and Distribution VAT includes the VAT levied in wholesaler or retailer level. As similar to the Production VAT it occupies 0.194 percent of GDP. The following table gives the clear view of Selling and Distribution VAT collected and its contribution to GDP, since 2003-04 to 2010-11.

Table 4.9  
Contribution of Sales and Distribution VAT, 2003-04 to 2010-11

Fiscal year	Sales and Distribution VAT	GDP	<i>Rs. in million</i> Sales VAT As % of GDP
2003-04	1120	492231.3	0.227
2004-05	784	536748.9	0.146
2005-06	901.54	589412.6	0.152
2006-07	1445	654084	0.220
2007-08	1654.44	727827	0.227
2008-09	1869.8	815658	0.229
2009-10	2580.93	988053	0.261
2010-11	3570.37	1171905	0.304

*Source: Ministry of Finance (various years) Budget Speeches, Nepal*

Table 4.9 gives the clear view of contribution of sales and Distribution VAT to the GDP. As the production VAT is very minimal in the same way contribution of sales and distribution VAT is also minimal. Collection from Sales VAT in an average since 2003-04 to 2010-11 is Rs. 1306.544 million per year .Sales VAT as percentage of GDP is increasing in every fiscal year except 2004-05 to 2005-06.

Figure 4.6  
Contribution of Sales and Distribution VAT, 2003-04 to 2010-11

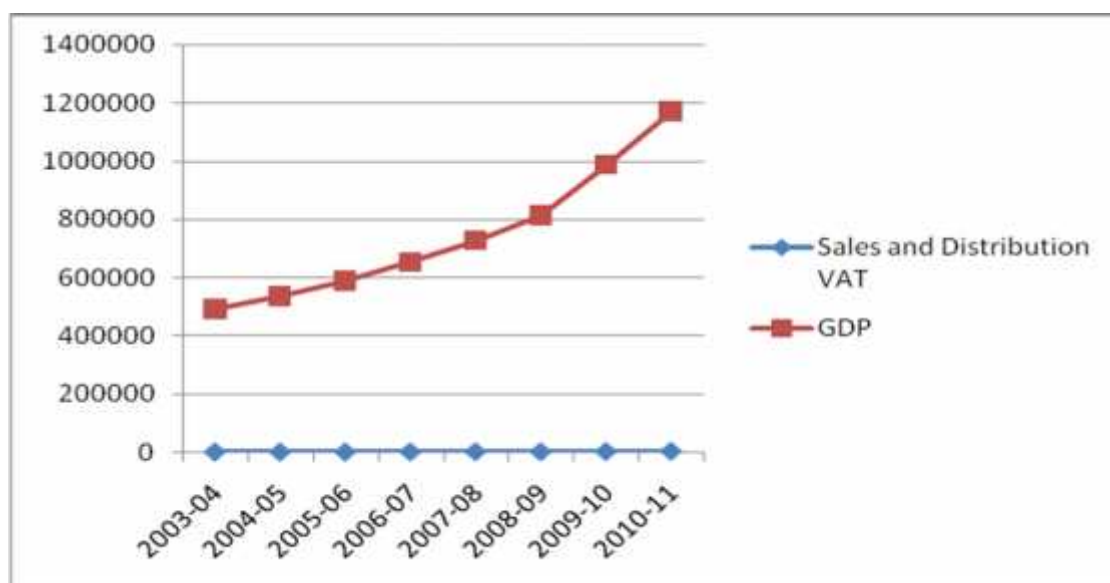


Figure 4.6 shows the GDP is denoted by the straight line and Sales VAT is denoted by the dotted line. GDP curve is sloping upwards and curve denoting Sales VAT seems to be lying in the x- axis because amount collected from Sales VAT is very smaller figure than compared to the GDP amount. Due to the various obstacles and problem in the country the production was not enough, almost all the factories and industries were about to close in that period. In the same way Sales were also not so high as a result VAT from sales is very little.

Table 4.10  
Result of Regression between Sales VAT and GDP

Variables		
Dependent	Independent	
Dependent Variable: SALES VAT	C	GDP
Coefficient	-830.644	0.003517
Std. Error	151.1226	0.00023
t-Statistic	-5.496492	15.28606
Prob.	0.0002	0

*Source: Economic Survey, 2010/11, MOF, Nepal Government*

Using least square method and T-Test we obtained the above result. Sales VAT is a dependent variable and GDP is an independent variable. As we know Sales VAT and GDP are directly proportional to each other which means as the GDP increases Sales VAT also increases. The regression result shows that the GDP and Sales VAT have a close relationship having 0.003 coefficient which is significant at 1 percent critical t-value.

#### 4.4.1.3 Imports VAT

The components of imports VAT includes the VAT levied at custom point. Similar to the above table this given below table present the clear picture that the total import VAT collected in different custom point in different fiscal year and its contribution to the GDP. In an average the contribution of Imports VAT to GDP is 2.054 percent.

Table 4.11  
Contribution of Imports VAT, 2003-04 to 2010-11

Fiscal Year	<i>Rs. in million</i>		
	Import VAT	GDP	Import VAT as % of GDP
2003-04	8100	492231.3	1.645
2004-05	9850	536748.9	1.835
2005-06	9712.15	589412.6	1.647
2006-07	14200	654084	2.170
2007-08	15740.48	727827	2.162
2008-09	17900.5	815658	2.945
2009-10	24708.5	988053	2.500
2010-11	34180.91	1171905	2.916

*Source: Ministry of Finance (various years) Budget Speeches, Nepal*

Table 4.11 gives the clear view of contribution of Import VAT to the GDP. In the first period its contribution was 1.645 percent then since 2003-04 to 2005-06 its contribution was decrease to the line of 1 percent. Again, after the fiscal year 2006-07 to 2010-11 it has been in the process to rise. In an average the collection from Imports VAT is Rs. 12951.73 million per year.

Figure 4.7

Contribution of Imports VAT, 2003-04 to 2010-11

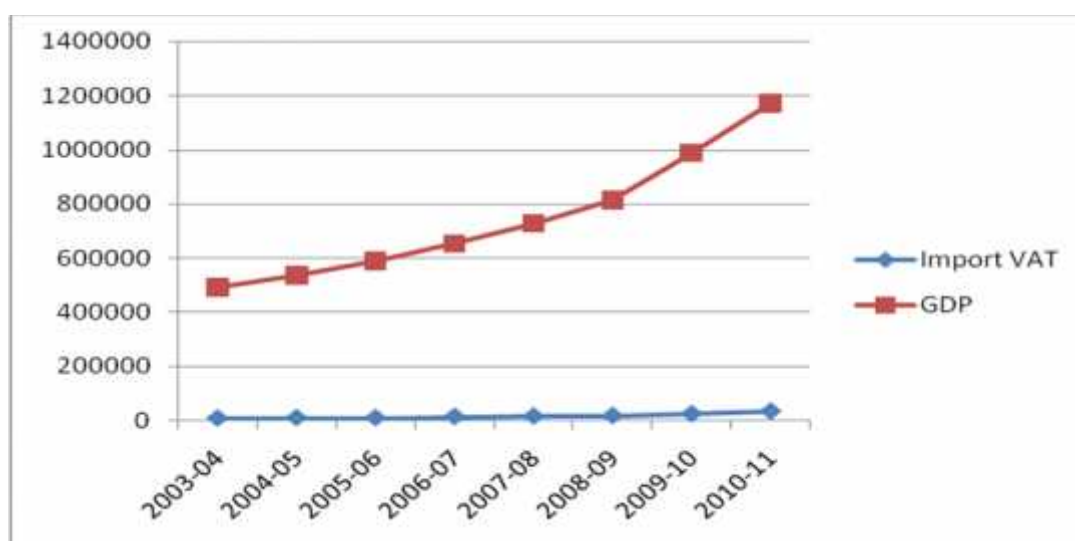


Figure 4.7 shows the GDP is denoted by the straight line and Sales VAT is denoted by the dotted line. GDP curve is slopping upwards and curve denoting Import VAT seems to be lying in the x- axis because amount collected from Import VAT is very smaller figure than compared to the GDP amount.

Table 4.12  
Result of Regression between Imports VAT and GDP

Variables		
Dependent	Independent	
Dependent Variable: IMPORTS VAT	C	GDP
Coefficient	-6487.2	0.031991
Std. Error	1340.803	0.002041
t-Statistic	-4.838295	15.67074
Prob.	0.0005	0

*Source: Economic Survey, 2010/11, MOF, Nepal Government*

Using least square method and T-Test we obtained the above result. Imports VAT are a dependent variable and GDP is an independent variable. As we know Imports VAT and GDP are directly proportional to each other which means as the GDP increases Imports VAT also increases. The regression result shows that the GDP and Imports VAT have a close relationship having 0.031 coefficient which is significant at 1 percent critical t-value.

#### 4.4.2 Total Services Value Added Tax

The contractor, hotel business, entertaining business such as cinema hall, and airlines are service motive business so VAT levied on contract and consultancy, tourism industries, and other services comes under the purview of total services VAT. Ministry of Finance (2002) classified existing contract and consultancy as of earlier contract tax; tourism industry VAT from hotel tax; and other services VAT from the total of entertainment, and air flight tax. Given below table contains the data since 2003-04 to 2010-11 for analysis purpose. In an average total service VAT contributes 0.562 percent of GDP.

Table 4.13  
Contribution of Total Service Value Added Tax, 2003-04 to 2010-11

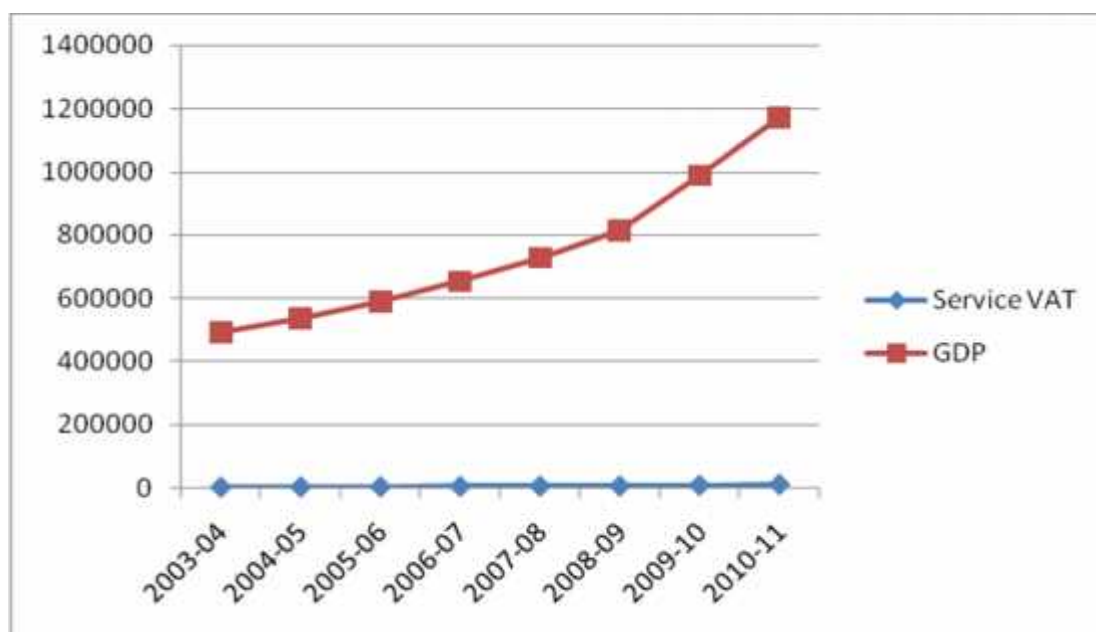
<i>Rs in million</i>			
Fiscal Year	Service VAT	GDP	Service VAT as % of GDP
2003-04	1860.05	492231.3	0.377
2004-05	2606.2	536748.9	0.485
2005-06	3136.8	589412.6	0.532
2006-07	4060	654084	0.620
2007-08	4986.38	727827	0.685
2008-09	5373.9	815658	0.658
2009-10	7417.73	988053	0.750
2010-11	10261.44	1171905	0.875

*Source: Ministry of Finance (various years) Budget Speeches, Nepal*

Table 4.13 gives the clear view of contribution of Service VAT to the GDP. As similar to the VAT collection from the other VAT it is also in small figure. Amount collection from service VAT as percentage of GDP is not so high but it is in increasing trend. After fiscal year 2005-06 it has been increasing in a remarkable manner. In an average the collection from the Total Service VAT is Rs.3743.025 million per year.

Figure 4.8

Contribution of Total Service Value Added Tax, 2003-04 to 2010-11



In above mentioned figure GDP is denoted by the straight line and Total Service VAT is denoted by the dotted line. GDP curve is slopping upwards and curve denoting total service VAT seems to be lying in the x- axis because amount collected from total service VAT is very smaller figure than compared to the GDP amount but it is increasing after fiscal year 2005-06.

Table 4.14  
Result of Regression between Service VAT and GDP

Variables		
Dependent	Independent	
Dependent Variable: SERVICE VAT	C	GDP
Coefficient	-2386.732	0.010091
Std. Error	385.0469	0.000586
t-Statistic	-6.198548	17.21308
Prob.	0.0001	0

*Source: Economic Survey, 2010/11, MOF, Nepal Government*

Using least square method and T-Test we obtained the above result. Service VAT is an dependent variable and GDP is an independent variable. As we know Services VAT and GDP are directly proportional to each other which means as the GDP increases Service VAT also increases. The regression result shows that the GDP and Services VAT have a close relationship having 0.010 coefficient which is significant at 1 percent critical t-value.

#### 4.4.2.1 Contract and Consultancy Value Added Tax

Ministry of Finance (2002) classified existing contract and consultancy as of earlier contract tax. Given below table contains the data since 2003-04 to 2010-11 for analysis purpose. In an average Contract and Consultancy VAT contributes 0.184 percent of GDP. The table gives a cursory view of the size and contribution of contract and consultancy in the Nepal's tax structure.

Table 4.15  
Contribution of Contract and Consultancy VAT, 2003-04 to 2010-11

*Rs. in million*

Fiscal Year	Contract VAT	GDP	Contract VAT as % of GDP
2003-04	870	492231.3	0.176
2004-05	967.7	536748.9	0.180
2005-06	838.5	589412.6	0.142
2006-07	1195	654084	0.182
2007-08	1399.58	727827	0.192
2008-09	1406.6	815658	0.172
2009-10	1941.56	988053	0.196
2010-11	2685.89	1171905	0.229

*Source: Ministry of Finance (various years) Budget Speeches, Nepal*

Table 4.15 also gives the clear view of contribution of contract VAT to the GDP. As similar to the other types of VAT, here also in the first period its contribution was high i. e. 0.236 percent and then this percent decreased to the line of 1 percent till fiscal year 2009-10. In the last year however it has been increased to 0.229 percent. The VAT collection from contract VAT has been in increasing rate. In an average the VAT collection from the Contract VAT is Rs. 140.353 million per year.

Figure 4.9

Contribution of Contract and Consultancy VAT, 2003-04 to 2010-11

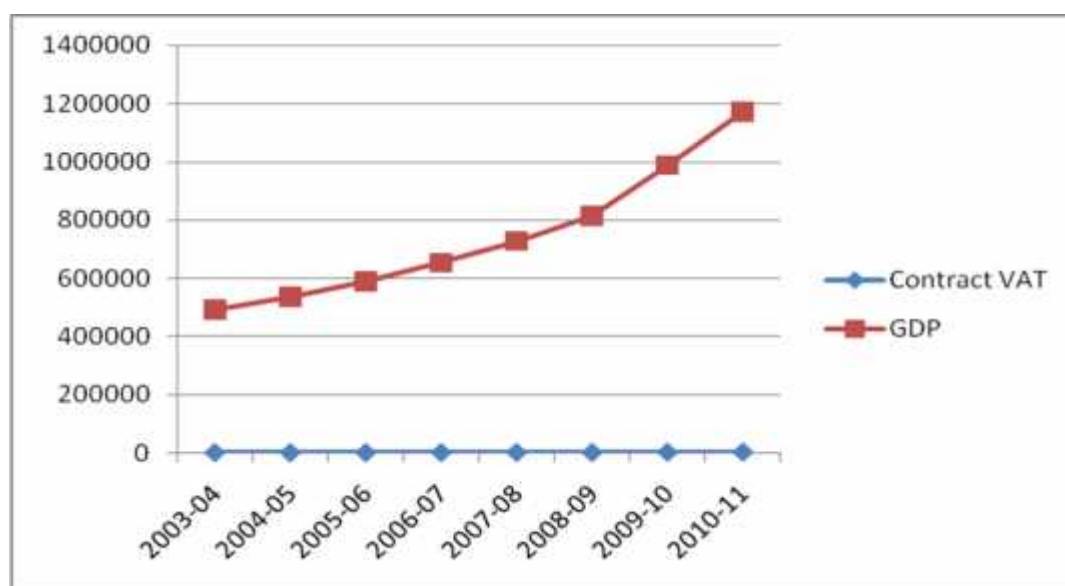


Figure 4.9 shows the GDP is denoted by the straight line and Contract and Consultancy VAT is denoted by the dotted line. GDP curve is slopping upwards and curve denoting contract and consultancy VAT seems to be lying in the x- axis because amount collected from contract and consultancy VAT is very smaller figure than compared to the GDP amount.

Table 4.16  
Result of Regression between Contract VAT and GDP

Variables		
Dependent	Independent	
Dependent Variable: CONTRACT VAT	C	GDP
Coefficient	-235.5166	0.002264
Std. Error	115.4234	0.000176
t-Statistic	-2.040459	12.88446
Prob.	0.0661	0

*Source: Economic Survey, 2010/11, MOF, Nepal Government*

Using least square method and T-Test we obtained the above result. Contract VAT is a dependent variable and GDP is an independent variable. As we know Contract VAT and GDP are directly proportional to each other which means as the GDP increases Contract VAT also increases. The regression result shows that the GDP and Contract VAT have a close relationship having 0.002 coefficient which is significant at 1 percent critical t-value.

#### 4.4.2.2 Tourism Industries

Tourism industry is very important industry having a great potentiality in context of Nepal because of its natural beauty. Tourism industry is in process to develop. The components of Tourism Industries include VAT levied on Hotel and Tourism Sector and old Hotel Tax also included under this head. VAT collection from tourism industry is also in process of increment. In an average tourism industry VAT occupies 0.073 percent of GDP. The given below table gives a cursory view of the size and contribution of tourism industry in the Nepal's tax structure.

Table 4.17  
Contribution of Tourism Industries VAT, 2003-04 to 2010-11

*Rs. in million*

Fiscal Year	Tourism VAT	GDP	Tourism VAT as % of GDP
2003-04	350	492231.3	0.071
2004-05	324.8	536748.9	0.060
2005-06	365	589412.6	0.061
2006-07	490	654084	0.074
2007-08	553.97	727827	0.076
2008-09	621.5	815658	0.076
2009-10	857.87	988053	0.086
2010-11	1186.75	1171905	0.101

*Source: Ministry of Finance (various years) Budget Speeches, Nepal*

Table 4.17 gives the clear view of contribution of tourism VAT to the GDP. The amount collection from tourism VAT was not so satisfactory till 2006-07. However, after the fiscal year 2007-08 its contribution has been increasing satisfactorily. The amount of VAT collected from the Tourism sector in an average is Rs. 473.304 million per year. In the past few years the tourism industries has been expected to be flourished due to the establishment of peace in the country.

Figure 4.10

Contributions of Tourism Industries VAT, 2003-04 to 2010-11

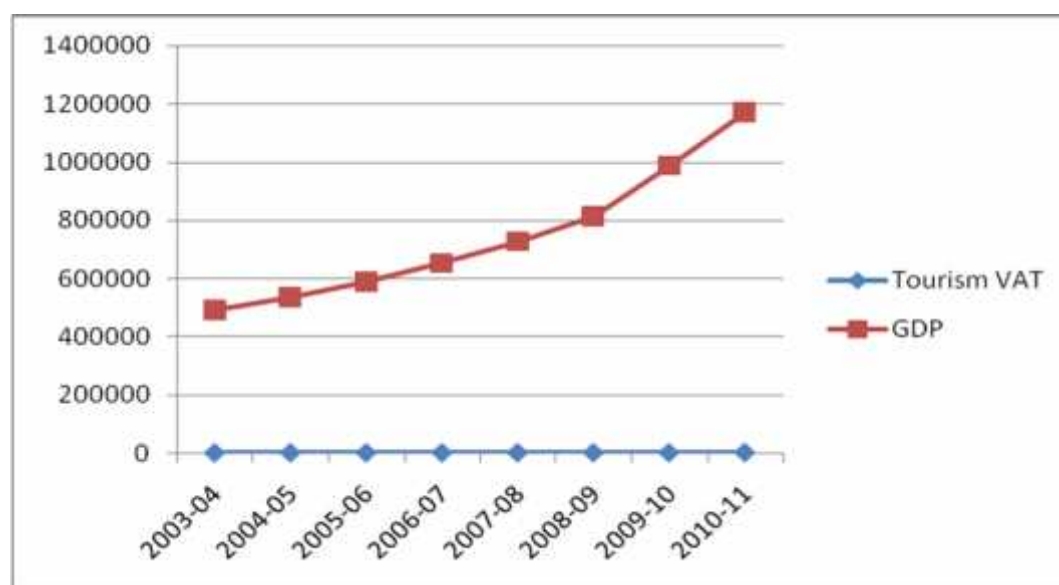


Figure 4.10 GDP is denoted by the straight line and Tourism VAT is denoted by the dotted line. GDP curve is slopping upwards and curve denoting Tourism VAT seems to be lying in the x- axis because amount collected from Tourism VAT is very smaller figure than compared to the GDP amount. However, it has been increasing since few years.

Table 4.18  
Result of Regression between Tourism VAT and GDP

Variables		
Dependent	Independent	
Dependent Variable: TOURISM VAT	C	GDP
Coefficient	-179.0588	0.001074
Std. Error	59.51339	0.0000906
t-Statistic	-3.008714	11.84833
Prob.	0.0119	0

*Source: Economic Survey, 2010/11, MOF, Nepal Government*

Using least square method and T-Test we obtained the above result. Tourism VAT is a dependent variable and GDP is an independent variable. As we know Tourism VAT and GDP are directly proportional to each other which means as the GDP increases Tourism VAT also increases. The regression result shows that the GDP and Tourism VAT have a close relationship having 0.001 coefficients which is significant at 1 percent critical t-value.

#### 4.4.2.3 Other Services

The components of Other Services include VAT levied on services other than Contract and Tourism and old Entertainment and Air Flight Tax also included under this head. Among the component of total services (entertainment and air flight tax), the highest size and contribution of other services presented in table gives a cursory view. In average other services VAT occupies 0.306 percent of GDP.

Table 4.19  
Contribution of Other Services VAT, 2003-04 to 2010-11

<i>Rs. in million</i>			
Fiscal Year	Other Services VAT	GDP	Other Services VAT as % of GDP
2003-04	640.05	492231.3	0.130
2004-05	1313.7	536748.9	0.244
2005-06	1960.3	589412.6	0.332
2006-07	2375	654084	0.363
2007-08	3032.83	727827	0.417
2008-09	3345.8	815658	0.410
2009-10	4618.29	988053	0.467
2010-11	6388.79	1171905	0.545

*Source: Ministry of Finance (various years) Budget Speeches, Nepal*

Table 4.19 gives a cursory view of the size and contribution of other services VAT to the GDP. In the first second year its contribution was high. Again it decreases and also it fluctuates. Since fiscal year 2004-05 the contribution of other services VAT as percentage of GDP has been increasing and it became 0.545 percent. The VAT amount collected from the other services in average is Rs.2136.058 million per year.

Figure 4.11  
Contribution of Other Services VAT, 1998-99 to 2010-11

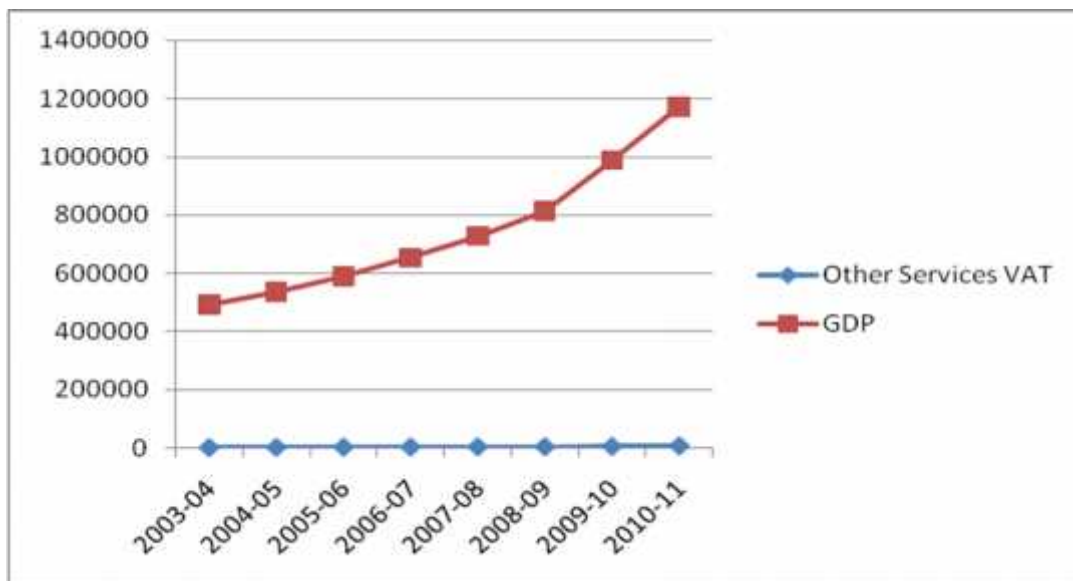


Figure 4.11 shows the mentioned graph GDP is denoted by the straight line and other services VAT is denoted by the dotted line. GDP curve is sloping upwards and curve denoting other services VAT seems to be lying in the x-axis because amount collected from other services VAT is very smaller figure than compared to the GDP amount. However, it has been increasing since few years. Since 2005-06 its contribution is raising.

Table 4.20  
Result of Regression between Others VAT and GDP

Variables		
Dependent	Independent	
Dependent Variable: OTHRES VAT	C	GDP
Coefficient	-1972.154	0.006753
Std. Error	283.0087	0.000431
t-Statistic	-6.968527	15.67281
Prob.	0	0

*Source: Economic Survey, 2010/11, MOF, Nepal Government*

Using least square method and T-Test we obtained the above result. Others VAT is a dependent variable and GDP is an independent variable. As we know Other VAT and GDP are directly proportional to each other which means as the GDP increases Others VAT also increases. The regression result shows that the GDP and Others VAT have a close relationship having 0.006 coefficients which is significant at 1 percent critical t-value.

#### 4.5 Major Findings of the Study

**Goods VAT:** As compared to the other types of VAT the highest revenue collected from the VAT is the Goods VAT. In an average per year Rs.16874.8 million is collected from the Goods VAT having 0.041 coefficient which is significant at 1 percent critical t-value. .

**Production VAT:** Production VAT is one of the components of Goods VAT. Its collection is definitely lower than the Goods VAT. In an average, amount

collected from the Production VAT is Rs. 2616.51 million per year having 0.006 coefficient which is significant at 1 percent critical t-value.

Sales and Distribution VAT: Being one of the components of Goods VAT its contribution is also measurable in the revenue collection. In an average the revenue generated from the Sales and Distribution VAT is Rs. 1306.544 million per year having 0.003 coefficient which is significant at 1 percent critical t-value.

Imports VAT: Another major element from which huge amount of VAT can be collected is Imports VAT. After the goods VAT it comes in the second rank for the VAT collection. Rs. 12951.73 million per year is collected in an average from the Imports VAT having 0.031 coefficient which is significant at 1 percent critical t-value.

Service VAT: It includes contract and consultancy VAT, Tourism VAT and other services VAT. The VAT collection by rendering Services in an average is Rs. 2136.058 million per year having 0.010 coefficient which is significant at 1 percent critical t-value.

Contract VAT: Its contribution to service VAT falls in the second rank after the other services VAT. In an average its collection is about Rs. 1140.353 million per year having 0.002 coefficient which is significant at 1 percent critical t-value.

Tourism VAT: Tourism industry is one of the vital industry from which we can earn a huge amount of foreign currency if this sector developed. But due to the various internal and external causes this sector is not being flourished as it is to be. As a result the VAT collection from the tourism sector is Rs. 473.304 million per year having 0.001 coefficient which is significant at 1 percent critical t-value.

Other services VAT: The other services include the service sector except the contract and consultancy and tourism sector. Normally in an average about Rs. 2136.08 million per year is collected as a VAT from the other services having 0.006 coefficient which is significant at 1 percent critical t-value.

## **CHAPTER V**

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

#### 5.1 Summary

This chapter presents a composite synthesis of the findings with short-run as well as long run implications of Nepal's tax structure. A policy framework has been designed for an optimal structural reorganization of taxation for Nepal so as to make the VAT and overall tax system more productive and equitable. Apart from this, a brief evaluation of the recommendations of the IMF and Economic Commission, Government of Nepal has also been made. Finally, specific conclusion and suggestions have been put forward to deal with the master bottlenecks, thereby attempting to refurbish the overall tax system of Nepal.

#### Contribution of the Value Added Tax

As we all know that VAT is one of the components of the indirect taxation in Nepal. VAT has a significant contribution in the total revenue which includes the tax revenue. There are different types of VAT contributing to the national revenue, which are given in detail below as follows:

As compared to the other types of VAT the highest revenue collected from the VAT is the Goods VAT. In an average per year Rs.16874.8 million is collected from the Goods VAT and in average it occupies 2.595 percent of GDP.

Production VAT is one of the components of Goods VAT. Its collection is definitely lower than the Goods VAT. In an average, amount collected from the Production VAT is Rs. 2616.51 million per year and it occupies 0.403 percent of GDP.

Being one of the components of Goods VAT its contribution is also measureable in the revenue collection. In an average the revenue generated from the Sales and Distribution VAT is Rs. 1306.544 million per year and in an average it occupies 0.194 percent of GDP.

Another major element from which huge amount of VAT can be collected is Imports VAT. After the goods VAT it comes in the second rank for the VAT collection. Rs. 12951.73 million per year is collected in an average from the Imports VAT and it occupies 2.054 percent of GDP.

It includes contract and consultancy VAT, Tourism VAT and other services VAT. The VAT collection by rendering Services in an average is Rs. 2136.058 million per year and it occupies 0.562 percent of GDP in an average.

Its contribution to service VAT falls in the second rank after the other services VAT. In an average its collection is about Rs. 1140.353 million per year and it occupies 0.184 percent of GDP in an average.

Tourism industry is one of the vital industry from which we can earn a huge amount of foreign currency if this sector developed. But due to the various internal and external causes this sector is not being flourished as it is to be. As a result the VAT collection from the tourism sector is Rs. 473.304 million per year also it occupies 0.073 percent of GDP in an average.

The other services include the service sector except the contract and consultancy and tourism sector. Normally in an average about Rs. 2136.08 million per year is collected as a VAT from the other services and its average growth rate is 0.306 percent per year.

## 5.2 Conclusion

In the process of economic and social development, the governments in a majority of developing countries have not only assumed the principal responsibility for the control and direction of the growth of their economies but have also increased direct participation in the development process. As a result, public expenditures- current and investment- have grown rapidly. Since a substantial part of government revenue is derived from taxation and other compulsory levies, taxation has to provide funds not only for the financing of non-revenue yielding services but also a large part of the savings for capital formation.

The success of any taxation system lies in creating conducive atmosphere where taxpayers come forth voluntarily to discharge their duties as dignified citizens, and the state recognizes and appreciates such action. It must also be understood, that no matter how good a system is, there will always be exceptions on the other side of the coin. Any action or regulations, based on controlling the exception will seldom achieve the stated output. This would perhaps, require a complete turnaround in our attitude, which definitely will be hard to digest. The time is now right to give taxpayers such a break. It will no doubt produce results beyond the expectation of anyone's mental horizon.

When VAT was finally implemented in November 1997 it gradually dispelled the doubts and uncertainty. All industrialists and traders should register under VAT and help increase the revenue source of the country to build our nation ourselves. Why should we always depend on foreign aid and spread our hands and ask for donation? It is drop by drop that a jar get filled and hence let us all get together and do what we can to make our nation self-dependent. The businessman can make a major contribution by just issuing invoices each time and keeping accurate and proper accounts and the consumers should be more alert and demanding in terms of asking for and taking invoices. In all transactions that are transparent and legal the VAT offices should provide help

by maintaining a supportive attitude. Integrating the efforts of all concerned at this moment of time would definitely push us towards success and this is what lacking behind the successful implementation of VAT.

Therefore, until and unless the entire citizen whether businessman or general public, feel themselves as dignified citizens, tax revenue cannot be increase, no matter whatever the policy or reforms made. Businessman or general public do not feel themselves as dignified citizens unless they are ensured that the taxes they paid in the various tax heads are properly utilized for the nation and for the people of the nation as a whole.

### 5.3 Recommendations

The following are some specific tax policy options for Nepal suggested in this study. Since the implementation of VAT it is unable to get the real pace of revenue generation. On the basis of major finding and conclusion, following recommendation have been made to make the VAT more effective in the future, which could be useful to concerned authorities relating to VAT while reforming Nepal's VAT system.

- 1 It is necessary to improve the VAT in order to eliminate the cascading effect of the turnover taxes, mitigate distortions like vertical integration, increase revenue productivity, and to introduce an element of progression.
- 2 It is also equally urgent and important to develop the taxpaying habit and consciousness among the people. This can be done by introducing effective education program for people to make understand the need and importance of invoice, publishing price list of major products, providing tax credit facility, and penalizing the tax evaders.
- 3 The most serious problem for implementing VAT in Nepal is the administrative inefficiency. Qualified, competent, knowledgeable and well-trained manpower is necessary to investigate and audit the business transactions. For a successful and effective operation of a tax system in

an economy, a dynamic tax administration, is required in which a large number of trained personnel have to play an important role in the proper functioning of tax system. Government should import short and long term training facilities to its staff. As Nepal is perennially lacking in high quality performance oriented human resource, recruitments to deal with the VAT seems urgent.

- 4 VAT related laws should be implemented in its right form; an environment for the taxpayers to easily and simply fulfill the formalities regarding this tax should be created.
- 5 The geographical condition of the country is also a great challenging factor of effective implementation of VAT. Exemption or exclude some transaction from the VAT base depends upon the inequitable and cost benefit factor of different geographical area also. The exemptions mean the exclusion of certain goods and services from the tax jurisdiction while zero percent tax rate on goods and services simply means zero rating. The objective of zero rating is to relieve some selected goods and services completely from taxation; as such items technically remain within the tax net, so, the items of exemption and zero rating should be minimized as much as possible.
- 6 It is necessary to expand audit and investigation activities in order to clean artificial credit that might be intentional or unintentional. All large and medium manufacturing industries should be subjected to cost audit to determine the cost of products. Independent registered auditors should conduct such audits. This provides not only fair value of production, but also information on utilization of raw materials and information for excise and other regulatory purposes.
- 7 It is equally important to re-orient the tax administration in the light of modern tax. Tax investigations and audits should be effective in order to make taxpayers more careful in fulfilling their duties. It is equally necessary to teach the basics of VAT to officials working in various organizations which are also involved in the VAT administration in one

way or another. It must be remembered that in the case of a tax based on self-assessment, a service-minded attitude of tax officers is very important. Moreover, the commitment of staff to solve all problems must be increased significantly.

- 8 Open boarder and barter system are the two obstacle observed in surface in implementation of VAT principle fully so could not achieve effective results from VAT. The long open border of Nepal with India and China has created many problems on tax system which the government has not established the effective mechanism to control free movement of people and large amount of smuggling business. The trade between Nepal and Tibet is based on barter system. There are no invoice systems in purchase and sale of goods keeps transactions out of the tax net. It reduces the tax base so include such transaction to avoid difficulties of VAT, some provisions have made.
- 9 Surprise and spot-checking of book of account, inventories and billing are not being effective due to the pressure from business community. Businessmen and traders tend to shut down their office and call for strikes in response of surprise and spot-check and sometimes hire fighters against tax officials. The government could not solve such matters due to corrupt tax officials and political support to these wrong practices.
- 10 The vendor, only whose annual turnover is equal to or above the threshold Rs. 2 millions needs to register compulsorily in the VAT department, assumed to be well established so can afford computer. But compulsory registrants are needed to be encouraged to use of computerized billing system or automatic cash registers. The steps must be taken for effective implementation of the threshold. Group registration systems implement effectively in which companies with in a group registered separately. Registered companies are required to levy VAT on intercompany transactions and fulfill all VAT requirements, leading to increase compliance.

11 Detail information should be collected such as name, quantity, brand, and expected selling price at the time of opening letter of credit. Importer should mention clearly that the distribution channel and the tentative selling price at the different stages of sales. Whether such information is unavailable or supposed to be false, the tentative price should be informed to the rival importers. Such information from the importer should be compulsory submitted a month prior to the concerned office. Such provision will reduce the under invoicing problems

Appendix-1

1	Regression between Goods VAT and GDP				
	Dependent Variable: GOODSVAT				
	Method: Least Squares				
	Date: 03/04/12 Time: 22:06				
	Sample: 2004-2011				
	Included observations: 08				
	Variable	Coefficient	Std. Error	t-Statistic	Prob.
	GDP	0.041932	0.002574	16.29293	0
	C	-8604.83	1690.347	-5.09057	0.0003
	R-squared	0.960211	Mean dependent var	16874.8	
	Adjusted R-squared	0.956594	S.D. dependent var	11103.66	
	S.E. of regression	2313.347	Akaike info criterion	18.47142	
	Sum squared resid	58867340	Schwarz criterion	18.55833	
	Log likelihood	-118.064	F-statistic	265.4597	
	Durbin-Watson stat	0.999561	Prob(F-statistic)	0	

Appendix-2

2	Regression between Production VAT and GDP				
	Dependent Variable: PRODNVAT				
	Method: Least Squares				
	Date: 03/05/12 Time: 02:02				
	Sample: 2004-2011				
	Included observations: 08				
	Variable	Coefficient	Std. Error	t-Statistic	Prob.
	GDP	0.006424	0.000401	16.02592	0
	C	-1286.99	263.2774	-4.88833	0.0005
	R-squared	0.958929	Mean dependent var	2616.518	
	Adjusted R-squared	0.955195	S.D. dependent var	1702.229	
	S.E. of regression	360.312	Akaike info criterion	14.75246	
	Sum squared resid	1428072	Schwarz criterion	14.83937	
	Log likelihood	-93.891	Hannan-Quinn criter.	14.73459	
	F-statistic	256.8302	Durbin-Watson stat	1.034347	
	Prob(F-statistic)	0			

Appendix-3

3	Regression between Sales VAT and GDP				
	Dependent Variable: SALESVAT				
	Method: Least Squares				
	Date: 03/05/12 Time: 02:04				
	Sample: 2004-2011				
	Included observations: 08				
	Variable	Coefficient	Std. Error	t-Statistic	Prob.
	GDP	0.003517	0.00023	15.28606	0
	C	-830.644	151.1226	-5.49649	0.0002
	R-squared	0.95504	Mean dependent var	1306.545	
	Adjusted R-squared	0.950953	S.D. dependent var	933.8746	
	S.E. of regression	206.8209	Akaike info criterion	13.64222	
	Sum squared resid	470523.9	Schwarz criterion	13.72914	
	Log likelihood	-86.6744	Hannan-Quinn criter.	13.62436	
	F-statistic	233.6636	Durbin-Watson stat	1.336971	
	Prob(F-statistic)	0			

Appendix-4

4	Regression between Import VAT and GDP				
	Dependent Variable: IMPORTSVAT				
	Method: Least Squares				
	Date: 03/05/12 Time: 02:10				
	Sample: 2004-2011				
	Included observations: 08				
	Variable	Coefficient	Std. Error	t-Statistic	Prob.
	GDP	0.031991	0.002041	15.67074	0
	C	-6487.2	1340.803	-4.8383	0.0005
	R-squared	0.957127	Mean dependent var	12951.73	
	Adjusted R-squared	0.95323	S.D. dependent var	8484.849	
	S.E. of regression	1834.974	Akaike info criterion	18.00809	
	Sum squared resid	37038440	Schwarz criterion	18.095	
	Log likelihood	-115.053	Hannan-Quinn criter.	17.99022	
	F-statistic	245.5721	Durbin-Watson stat	1.020365	
	Prob(F-statistic)	0			

Appendix-5

5	Regression between Service VAT and GDP				
	Dependent Variable: SERVICEVAT				
	Method: Least Squares				
	Date: 03/05/12 Time: 02:12				
	Sample: 2004-2011				
	Included observations: 08				
	Variable	Coefficient	Std. Error	t-Statistic	Prob.
	GDP	0.010091	0.000586	17.21308	0
	C	-2386.73	385.0469	-6.19855	0.0001
	R-squared	0.964203	Mean dependent var	3745.102	
	Adjusted R-squared	0.960949	S.D. dependent var	2666.629	
	S.E. of regression	526.9614	Akaike info criterion	15.51277	
	Sum squared resid	3054571	Schwarz criterion	15.59969	
	Log likelihood	-98.833	Hannan-Quinn criter.	15.4949	
	F-statistic	296.2902	Durbin-Watson stat	0.930273	
	Prob(F-statistic)	0			

Appendix-6

6	Regression between Contract VAT and GDP				
	Dependent Variable: CONTRACTVAT				
	Method: Least Squares				
	Date: 03/05/12 Time: 02:17				
	Sample: 2004-2011				
	Included observations: 08				
	Variable	Coefficient	Std. Error	t-Statistic	Prob.
	GDP	0.002264	0.000176	12.88446	0
	C	-235.517	115.4234	-2.04046	0.0661
	R-squared	0.937856	Mean dependent var	1140.355	
	Adjusted R-squared	0.932207	S.D. dependent var	606.689	
	S.E. of regression	157.9642	Akaike info criterion	13.10325	
	Sum squared resid	274479.7	Schwarz criterion	13.19017	
	Log likelihood	-83.1711	Hannan-Quinn criter.	13.08539	
	F-statistic	166.0092	Durbin-Watson stat	1.478505	
	Prob(F-statistic)	0			

Appendix-7

7	Regression between Tourism VAT and GDP				
	Dependent Variable: TOURVAT				
	Method: Least Squares				
	Date: 03/05/12 Time: 02:19				
	Sample: 2004-2011				
	Included observations: 08				
	Variable	Coefficient	Std. Error	t-Statistic	Prob.
	GDP	0.001074	9.06E-05	11.84833	0
	C	-179.059	59.51339	-3.00871	0.0119
	R-squared	0.927337	Mean dependent var	473.3048	
	Adjusted R-squared	0.920731	S.D. dependent var	289.2861	
	S.E. of regression	81.44788	Akaike info criterion	11.77844	
	Sum squared resid	72971.33	Schwarz criterion	11.86536	
	Log likelihood	-74.5599	Hannan-Quinn criter.	11.76058	
	F-statistic	140.3829	Durbin-Watson stat	1.041653	
	Prob(F-statistic)	0			

Appendix-8

8	Regression between Other VAT and GDP				
	Dependent Variable: OTHVAT				
	Method: Least Squares				
	Date: 03/05/12 Time: 02:23				
	Sample: 2004-2011				
	Included observations: 08				
	Variable	Coefficient	Std. Error	t-Statistic	Prob.
	GDP	0.006753	0.000431	15.67281	0
	C	-1972.15	283.0087	-6.96853	0
	R-squared	0.957138	Mean dependent var		2131.443
	Adjusted R-squared	0.953241	S.D. dependent var		1791.158
	S.E. of regression	387.3155	Akaike info criterion		14.89699
	Sum squared resid	1650146	Schwarz criterion		14.98391
	Log likelihood	-94.8305	Hannan-Quinn criter.		14.87913
	F-statistic	245.637	Durbin-Watson stat		0.786122
	Prob(F-statistic)	0			

Appendix-9

9	Regression between Total VAT and GDP				
	Dependent Variable: TOTVAT				
	Method: Least Squares				
	Date: 03/05/12 Time: 02:25				
	Sample: 2004-2011				
	Included observations: 08				
	Variable	Coefficient	Std. Error	t-Statistic	Prob.
	GDP	0.052024	0.00309	16.83754	0
	C	-10991.6	2029.308	-5.41641	0.0002
	R-squared	0.962649	Mean dependent var		20619.9
	Adjusted R-squared	0.959253	S.D. dependent var		13758.37
	S.E. of regression	2777.237	Akaike info criterion		18.83694
	Sum squared resid	84843524	Schwarz criterion		18.92385
	Log likelihood	-120.44	Hannan-Quinn criter.		18.81907
	F-statistic	283.5028	Durbin-Watson stat		0.938948
	Prob(F-statistic)	0			

Appendix 10  
Data of VAT on Goods

	VAT on Goods				
Year	Total	Domestic VAT			Imports
		Total	Production	Sales	
2003-04	11170	3070	1950	1120	8100
2004-05	12597.3	2747.3	1963.3	784	9850
2005-06	12637.69	2925.54	2024	901.54	9712.15
2006-07	18390	4190	2745	1445	14200
2007-08	20411.65	4671.17	3016.73	1654.44	15740.48
2008-09	23388.1	5487.6	3617.8	1869.8	17900.5
2009-10	32283.1721	7574.66982	4993.7387	2580.9311	24708.502
2010-11	44659.462	10478.5452	6908.1713	3570.3739	34180.917

Appendix 11  
Data of VAT on Services

	Services				Total VAT
	Total	Tourism	Production	Other	
2003-04	1860.05	870	350	640.05	13030.05
2004-05	2606.2	967.7	324.8	1313.7	15203.5
2005-06	3163.8	838.5	365	1960.3	15801.49
2006-07	4060	1195	490	2375	22450
2007-08	4986.38	1399.58	553.97	3032.83	25398.03
2008-09	5373.9	1406.6	621.5	3345.8	28762
2009-10	7417.7269	1941.5647	857.8718	4618.2904	39700.9
2010-11	10261.436	2685.8958	1186.7512	6388.7887	54920.9

Appendix 12  
Data of Total Tax Revenue and GDP

Fiscal Year	Total Tax Revenue	GDP
2003/04	42586.935	4922313
2004-05	48173	536748.9
2005-06	54104.7	589411.6
2006-07	57430.4	654084
2007-08	71126.7	727827
2008-09	85155.5	815658
2009-10	117051.9	988053
2010-11	156294.9	1171905

Appendix 13  
Classification of Internal Commodity and VAT

Head/ Subhead	Particular	Explanation of Classification
1-1-2-00	Internal Commodity Tax based on Goods and Services	It's main heading so tax can't be deposited under this heading.
1-1-2-10	VAT	VAT collected on sale of Production, Imports, Sales and Distribution, Contract and consultancy, Tourism Industries and Other Services falls under this head. Tax can't be deposited under this heading.
1-1-2-11	Production	VAT and its related Additional Charges, Interest, and Fine and Penalties deposited by manufacturer levied on sale of goods falls under this head.
1-1-2-12	Imports	VAT and its related Additional Charges, Interest, and Fine and Penalties deposited by importer at custom point (i.e., International Airport and Boarder Custom Point) levied on imported goods falls under this head.
1-1-2-13	Sales and Distribution	VAT and its related Additional Charges, Interest, and Fine and Penalties deposited by wholesaler and retailer falls under this head.
1-1-2-14	Contract and Consultancy	VAT and its related Additional Charges, Interest, and Fine and Penalties levied on Contract and consultancy falls under this head. It also includes Collection of Contract Tax due before implementing VAT.
1-1-2-15	Tourism Industries	VAT and its related Additional Charges, Interest, and Fine and Penalties levied on Tourism Industries related Hotel, Travel Agency, Trekking, Rafting etc. business falls under this head. It also includes Collection of Hotel Tax due before implementing VAT.
1-1-2-19	Other Services	VAT and its related Fine and Penalties, and Interest levied on sales of Services as Telephone and Insurance etc. falls under this head. It also includes Collection of Entertainment and Air Flight Tax due before implementing VAT.
1-1-2-20	Excise Duties	Excise Duties and its related Other Charges levied on internal production falls under this head. Tax can't be deposited under this heading.

Source: Ministry of Finance (2002) Classification and Explanation of Expenditure and Revenue Head, Ministry of Finance, Bagdurbar (part of table).

Appendix 14  
List of VAT Exempt Goods and Services

1. Basic Agricultural Products
  - (a) Paddy, rice, wheat, maize, barley, millet, pulses, flour, and similar basic food materials of unprocessed agriculture products and its residuals.
  - (b) Green and fresh vegetable, fresh fruits, fresh flowers and similar products (except used in hotels, restaurants, bars, guest houses, cafeteria and other similar organizations)
  - (c) Unprocessed cereals, (such as sugarcane, cotton, cardamom, ginger, jute, unprocessed tobacco, tealeaf, orthodox tea, tea chest, coffee seeds, soybean, almond and oil-seed cake)
  - (d) Herbs
2. Goods of Basic Needs
  - (a) Drinking water supplied by pipe or tankers
  - (b) Fuel wood and coal
  - (c) Salt
  - (d) Kerosene
3. Live Animals and its products
  - (a) He goat, sheep, yak, he buffalo, bore, pigs, rabbit, and similar other animals; their fresh milk, and uncooked/unprocessed varieties
  - (b) Cows, she buffalo and she goat
  - (c) Ducks, hens, cocks, turkey and similar other birds, and their fresh meat, eggs, and similar uncooked varieties.
  - (d) Fresh or dried fish (other than packed)
4. Agricultural inputs
  - (a) Seeds of any plants listed in Group 1
  - (b) Manure, fertilizer and soil conditioners
  - (c) Agriculture hand implements,
  - (d) Pesticides, made mainly for use of crops
  - (e) Agriculture equipment, including tractors,
  - (f) Pots to provide water to chicken in poultry firm, box to keep chicken and crates
  - (f) Birds and Animal feed
5. Medicine, Medical and Similar Health services
  - (a) Medical or surgical services provided by Government Institutions
  - (b) Human blood and products derived from human blood
  - (c) Human or animal organs or tissue for medical research
  - (d) The supply of services by persons on the register of veterinary surgeons and veterinary doctors
  - (e) The supply of goods made for, and suitable only for the use of, disabled persons.
  - (f) X-ray film and oxygen gas to be used for treatment
  - (g) Raw materials purchased or imported by the drug industries to the extent approved by the Department of Drug Management.

6. Education
  - (a) The provision of research in a school or university
  - (b) The provision, otherwise than for profit, of professional or vocational training or refresher training
  - (c) The provision of education in a school or university and supply of goods made in connection with such services
7. Books, Newspapers etc.
  - (a) Books, newspapers, newsletters and periodicals
  - (b) Newsprint
8. Artistic and cultural goods and services, carving services
  - (a) Painting, handicrafts, carving and related services.
  - (b) Cultural programme
  - (c) Admission to libraries, archaeology, museums, zoos and botanical gardens.
9. Passengers and goods transportation services  
Air transport, non-tourist passenger transportation (except cabal car) and goods carrier (except transportation related to supply)
10. Personal or Professional service  
Personal services rendered by artists, sportsmen, authors, writers, designers, translators and interpreters institutionally or individually.
11. Other goods or services
  - (1) Postal services (provided by HMG only)
    - (a) The service of conveyance of letters, money and postal packets by the Post office
    - (b) The supply by the post office of any service in connection with the conveyance of letters, money and postal packets
    - (c) Age stamps,
  - (2) Excise tickets
  - (3) Financial and insurance services.
  - (4) Bank notes and chequebooks.
    - (a) The printing and issue of bank notes
    - (b) The supply of bank notes from outside the Kingdom of Nepal to the Kingdom of Nepal.
    - (c) Cheque book
  - (5) Gold and silver
    - (a) Gold, gold coins and gold ornaments
    - (b) Silver and silver coins (other than ornaments and goods made of silver)
  - (6) Electricity,
  - (7) Raw wool,
  - (8) Battery operated tempo, their chassis and battery
  - (9) Bio-gas, solar power and wind power operated power generation plant and their main parts on he recommendation of the Alternative Energy Centre.

- (10)Aeroplane, Helicopter, Fire Brigade and Ambulance
  - (11)Jute goods
  - (12)Industrial machinery included in section 84 of customs tariff and subject to 5% tariff
  - (13)Woollen carpet & woollen carpet weaving, dying, washing, knitting
  - (14)Cotton and other synthetic sari, Lungi, Dhoti, Gamchha
  - (15)Cotton yarn
  - (16)Woollen yarn to be used in hand knitting sweater (except artificial & acrylic) domestically
  - (17)Donated goods received for calamities or philanthropic purpose approved by Ministry of Finance.
  - (18)Personal goods imported which if free of tariff due to personal belongings, the value added tax paid by cotton and match factory and industries producing rod and ingot using iron scrap as raw materials will be refunded.  
However, to those industries, which use 100 percent iron scrap as raw materials, will be refunded only 50 percent of the VAT paid.
12. Land and Building  
Purchase and rent of land and buildings (except the rental service provided by hotels, guest houses or similar organization)
13. Betting, casinos, lotteries
- (a) The provision of any facilities for the placing of bets or the playing of games of chance
  - (b) Lottery
- Note: The explanation of tax exempted goods and specifying harmonized code of the goods and services will be done by the Department.  
Source: Value Added Tax Act, 1995 Schedule 1: List of VAT Exempt Goods and Services