

**AN ANALYSIS OF STRUCTURE AND CHALLENGES
OF VALUE ADDED TAX IN NEPAL**

A Thesis

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of the Requirements of the Degree of
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LETTER OF RECOMMENDATION

This thesis entitled “Analysis of Structure And Challenges of Value Added Tax in Nepal “has been prepared by Arati Bhusal under my supervision. I hereby recommend this thesis for examination by the Thesis Committee as a partial fulfillment of the requirements for the Degree of MASTER OF ARTS in ECONOMICS.

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LETTER OF APPROVAL

We certify that this entitled” Analysis of Structure And Challenges of Value Added Tax in Nepal ” submitted by Mrs. Arati Bhusal to the Central Department of Economics, Faculty of Humanities and Social Sciences, Tribhuvan University, in partial fulfillment of the requirements for the Degree ARTS in ECONOMICS has been found satisfactory in scope and quality. Therefore, we accept this thesis as a part of the said degree.

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ABBREVIATION

etc.	Excreta
FY	Fiscal Year
GDP	Gross Domestic Product
i.e.	That is
IMF	International Monetary Fund
IRD	Inland Revenue Department
MOF	Ministry of Finance
Rs.	Rupees
SAARC	South Asian Association for Regional Cooperation
SAPTA	SAARCE Preferential Training Agreement
TU	Tribhuvan University
VAT	Value Added Tax
WTO	World Level Sales Tax

CHAPTER – I

INTRODUCTION

1.1 Background of the Study

The prime concern of every nation of the world is to make rapid economic development and Nepal is no exception to this ever-continuing process. Nepal aimed for self-reliant economic system to upgrade the living standard of people. Thus, a lot of money has to be spent to achieve maximum national objectives.

In the present context the government has to spend a lot of money to fulfill its responsibility towards its people. The responsibility may be either for security or for health, education or other development activities. Every nation wants to improve its current status through proper utilization of resources. The government receipts may take a form of taxes, charges as an internal sources and borrowings, grant and loans as an external source. Those collected huge amounts of fund are spending in maintaining peace and security in the country. It includes the maintenance of fulfilling the basic needs of the people, such as health, education, communication, drinking water and other public utility and facilities etc. Similarly, the government has to spend on development of socio-economic infrastructure, which facilitates to promote the private sectors. All round prosperity of the nation can be achieved through the equal participation of private sectors. All round prosperity of the nation can be achieved through the equal participation of private sectors in development activities, industry and commerce as well.

The Nepalese economy is quite dynamic with favorable economic indicators, viz. Stable prices, surplus balance of payments position and average annual economic growth of more than 4 percent during the decade of the 1990. These descriptions, however, hide the fact that Nepal is in LDCs with widespread poverty and low gross national per capita income. Either to pay regular expenditure or to do development works the government collect revenue. The source of the government revenue can be classified into external and internal sources. External sources of the government revenue are foreign loans, grant, external borrowing etc. External sources are uncertain, inconvenient and good for healthy development of nation because they

have to pay after a certain time with interest. So, it is better to mobilize internal sources rather than external source.

Internal source, another source of government revenue contains tax and non-tax revenues. The examples of non-tax revenue are fees, royalties, administrative and business incomes etc. Taxes are the main sources of revenue for the government. The source of tax revenue and the relative contribution of these sources and determined by government policy, choice about where and how to impose taxes by changes in the structure of the economy. Taxes influence the incentives and thus the behaviors of economic actors and the economy's competitiveness. Taxation is regarded as an effective instrument to monitor various economic activities in a country. Income tax, value added tax, customs duties, excise duty are the example of the sources of tax revenue. The government collects revenue through taxation with major objectives of economic development and economic stability. The contribution of tax revenue and non-tax revenue on total revenue is 87 percent and 13 percent in FY 2012/2013(economic survey, 2012/2013).

It is clear that tax is compulsory levy and those who are taxed has to pay it without getting corresponding benefit of services or goods from the government. The tax payer does not have any right to receive direct benefit from the tax paid. The tax payer can't receive equivalent benefit from the government. Tax is paid to the government for its running. Amount collected through taxation is spent for common interest of the people.

Value Added Tax is based on the principle that each producer and distributor adds value, in some way to the materials they have purchased and it is this added value that is taxed at each stage of the production and distribution chain. VAT is shifted forward completely to the consumer. The VAT is imposed as a neutral tax for substantial revenues without reducing the effectiveness and efficiency of the market system. The VAT is believed to be improvement over the types of indirect taxes. Prior to the introduction of VAT; there were several independent domestic taxes on goods and services. Some major were sales tax, hotel tax, contract tax and entertainment tax.

Some major advantages claimed by its supporter are as follows:

-) It reduces the distortion of trade and consumption due to the broad base and uniform basis of taxation.

-) It is a better instrument for managing the economy.
-) It helps to promote exports and improving the balance of payments.
-) It places an equal burden on both imports and domestic products.
-) It places a proportional burden of tax for both production levels to retail level.

There are also some draw backs which are as follows:

-) It creates dual economy due to the thresholds concept.
-) It increases the price for final consumer. It is not simple in practice as advocated in theory.
-) The administrative cost is relatively high.
-) The final consumer feels higher burden of tax.
-) The bill enforcement of the VAT is not easy as advocated by the VAT experts.
-) It is regarded as regressive nature of tax.
-) It creates a host of problems in practice.

VAT was first implemented at national level in France in 1954. In March 1996, the government of Nepal passed legislation to introduce VAT in Nepal. It was introduced from 16 November 1997 as a reform designed to replace sales tax, hotel tax, contract tax and entertainment tax. VAT is launched in Nepal with an expectation of broadening the tax base, elimination tax cascading and creating an investment friendly tax system. The main objective of VAT is to develop simple and modern tax system with an exemption of export and basic goods from taxation and finally to increase revenue. VAT is a tax imposed on the value added to goods and services consumed in Nepal or exported outside.

In the VAT system, producers, distributors and people providing services raise VAT on the products or services sold or provided. The difference between the VAT collected on sales and the VAT charged on purchases determines the amount, a registrant must remit or the amount that maybe claimed as a refund. At the beginning, VAT rate was fixed at 10 percent, but from mid January 2005 an upward adjustment was made in VAT rate by 3 percentage points. Therefore, at present VAT rate is 13 percent, collected at every stage of selling goods and services but there is pressure from

the business community to apply the multiple rates. They recommended it can be increased from 13 percent to 15 percent flat rate for specific luxurious items. Recently, the committee on VAT multi rates constituted by MOF/GON recommended four rates viz. 0 percent, 1 percent, 4 percent and 13 percent respectively.

Business with annual turnover of less than Rs. 2 million are not required to register for VAT, but those who import goods worth more than Rs. 10000 at a time must register. Goods exempted for VAT include primary agriculture products, goods of primary needs, live stocks and their products agricultural materials, medicine, health services, education, paper and cultural services. VAT is not levied on goods for export raw materials imported by an export promotion industry.

The direction and lessons of tax reforms in developing countries like Nepal established that excise duty is the most important choice and ingredient of tax reform. It may be adopted by a developing country with no difficulty and is an important instrument for the mobilization of internal resources and the pressure of excise duty on economic activities is minimal or not at all. The tax reform and adoption of an excise duty is therefore essentially connected with the efforts of many under developed countries to achieve the goal of country's economic development.

1.2 Statement of the problem

Tax as a major instrument and important policy tools have an important role towards increasing the rate of capital formation and thereby achieving a high rate in economic growth. The role of taxation in economic development lies in its function as raising a maximum volume of revenue. As Nepal is also a member of WTO, SAFTA, BIMSTEC networks, the collection of custom revenue as a major source of revenue is low. On the other hand, there is less possibility of collecting a huge amount of income tax because of the low per-capita income of the Nepalese people. Agriculture and export income are not taxed. Many other incomes could not be brought under the tax nets. This is the major challenge to Nepal's tax system in the connection of reform in Nepal's tax system.

In such circumstances, VAT was introduced in November 1997 as a reform designed to replace the sales tax, hotel tax, contract tax, and entertainment tax, for strengthening internal resource mobilization. Theoretically, VAT is considered as the best form of the sales tax. However, success of VAT in any developing country

largely depends on its implementation, mainly the previous experiences with multistage taxes or general sales taxes; the nature of the taxes that the VAT will replace the rate structure and exemptions, including provisions for small taxpayers. So it is a time to evaluate the Nepalese VAT as a major instrument of resources mobilization.

Value added tax is the most important and effective techniques to collect more revenue for economic development. However the introduction VAT, planned in Nepal has a hot debate among the businessmen, government and academic regarding its good and bad effect in Nepalese economy. Many questions remain unanswered and sometimes, are thrown into doubt. Various issues have been raised regarding to VAT system in Nepal. Many problems are arising successively implementation VAT system in Nepal. These problems are as follows:

-) Lack of suitable management policy of the government.
-) Problem in billing system
-) Increasing gap between revenue estimated and collection.
-) Wide-spread contradiction and non-cooperation by traders.
-) The existence of open boarder and large amount of unauthorized trade from India to Nepal.
-) Unnecessary price hike in name of VAT.
-) Lack of the coordination of VAT department and traders.

1.3 Objectives of the study

The main objective of the study is to analysis the effectiveness and contribution of value added tax on the Government revenue of Nepal. Other specific objectives of the study are listed bellow;

- i. To examine the trend and structure of VAT in the government revenue in Nepal.
- ii. To identity the factors of challenges on VAT implementation in Nepal.

1.4 Rational of the study

VAT is the most popular idea to collect the revenue for the countries. Evidence shows that VAT was used in most of the countries in short time. There are a lot of researches on VAT in abroad but very few of these are concerned about like Nepal. And also most of the efforts on VAT were held only on the theoretical background. Fifteen years have just been passed since VAT became effective. To meet the acute resource gap, VAT maybe instrumental for mobilizing internal resource more effectively. This study is focused on trend, contribution and effectiveness of VAT on Nepalese tax system.

VAT is expected to occupy an important part of Nepal's revenue. In a country with a narrow, basis for revenue to assume this tax which is based on consumption and imposed at all level of production, import, export, wholesales, and retail would include value addition in the distribution process including services within its spare, get the tax payers who are to paying tax within tax net, reduce the possibility of tax evasion due to catch-up self policing feature, improve the valuation of goods and make good implementation of income tax import duty and excise duty more effective.

This study is useful for the readers interested in the field of taxation, policy makers, researchers, tax officials and especially the student of master's degree engaged in the research work on value added tax as well as in the field of Nepalese tax system as a whole. This study provides a clear idea and knowledge those people who are interested to know more about VAT system in Nepal and who are confused about the VAT system.

1.5 Limitations of the study

-) The study is fully representing Nepal as a whole.
-) Basically, the data used in the study from secondary sources.
-) The study is limited up to availability of data and sufficient literature.
-) The research has carried out within limited time and financial resources.

CHAPTER - II

CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE

2.1 Conceptual Framework

The tax on value added in each production and services is called VAT. It is also called Consumption-based tax, the traders, businessmen, producers and service providers collect the tax from the consumers and pay it to the government.

Value added tax (VAT) is similar to a sales tax. It is a tax on the estimated market value added to a product or material at each stage of its manufacture or distribution, ultimately passed on to the consumer. Maurice Lauré, Joint Director of the French Tax Authority, the *Direction générale des impôts*, was first to introduce VAT on April 10, 1954, although German industrialist Dr. Wilhelm von Siemens proposed the concept in 1919. Initially directed at large businesses, it was extended over time to include all business sectors. In France, it is the most important source of state finance, accounting for nearly 50 % of state revenues.

Indirect tax on the domestic consumption of goods and services, except those that are zero-rated (such as food and essential drugs) or are otherwise exempt (such as exports). It is levied at each stage in the chain of production and distribution from raw materials to the final sale based on the value (price) added at each stage. It is not a cost to the producer or the distribution chain members, and whereas its full brunt is borne by the end consumer, it avoids the double taxation (tax on tax) of a direct sales tax. (<http://www.businessdictionary.com/>).

A value-added tax (VAT) is a form of consumption tax. From the perspective of the buyer, it is a tax on the purchase price. From that of the seller, it is a tax only on the value added to a product, material, or service, from an accounting point of view, by this stage of its manufacture or distribution. The manufacturer remits to the government the difference between these two amounts, and retains the rest for themselves to offset the taxes they had previously paid on the inputs. ([wikipedia.org/wiki/Value-added tax](http://wikipedia.org/wiki/Value-added_tax)).

VAT implies a form of indirect taxation. It is an improved and modified form of sales tax. It is levied on value added of goods and service at each stage in the process of production and distribution chain. These stages can be import, manufacturing, wholesale and retail. Value added for a firm is sales value minus all expenditures on goods and services purchased from other firms plus profit. The value added can be obtained by adding payments to factors of production(wages, salaries, rent, interest and profit) this value added is the base of VAT. Although VAT is eventually borne by the final consumer, it is collected at each stage of production and distribution chain (Bhattarai and Koirala, 2004: 18.3).

Personal end-consumers of products and services cannot recover VAT on purchases, but businesses are able to recover VAT (input tax) on the products and services that they buy in order to produce further goods or services that will be sold to yet another business in the supply Chain or directly to a final consumer. In this way, the total tax levied at each stage in the Economic chain of supply is a constant fraction of the value added by a business to its products, and most of the cost of collecting the tax is borne by business, rather than by the state. VAT was invented because very high sales taxes and tariffs encourage cheating and smuggling. Critics point out that it disproportionately raises taxes on middle- and low-income homes. Value Added Tax (VAT) is tax on exchanges. It is levied on the value added that results from each exchange. It differs from a sales tax because a sales tax is levied on the total value of the exchange. For this reason, a VAT is neutral with respect to the number of passages that there are between the producer and the final consumer. A VAT is an indirect tax, in that the tax is collected from someone other than the person who actually bears the cost of the tax (namely the seller rather than the consumer). To avoid double taxation on final consumption, exports are usually not subject to VAT, which led to such consequences, is refunded. Nowadays VAT has become the major source of government revenue, its contribution to total government revenue is significant and increasing. VAT has replaced sales tax, hotel tax, contract tax, and entertainment tax in Nepal. So, VAT is a very good tax system although there are so many complication regards to this system. The successful execution of the system depends upon appropriate government policy and awareness in people.

VAT system is the major source of government revenue. In context of Nepal, external source of revenue generation is dominant which ultimately enhance the foreign dependency. Therefore effective mobilization of internal sources is necessary. Thus the study has major focus on the following points:

1. VAT could be an effective and successful to internal resource mobilization, study on the implementation has been made.
2. While conducting a research on VAT implementation, first it is better to study the legal Provisions and consideration of VAT system. So, the different legal provisions of "Value-added Tax Act, 2052" have been explained.
3. VAT system has an important feature of tax refund. The procedure of tax refund and Judicial trend in tax refund is studied well and analyzed.
4. The study is focus on the contribution of VAT to government revenue.

2.1.1 Basic Features of the Nepalese VAT System

The following are the main features of VAT:

-) Self-policing;
-) No cascading of pyramiding effect;
-) Tax liability on transaction;
-) Good audit trial/invoice trial;
-) Catch up effect;
-) Neutrality on tax;
-) Single rate and multiple rate can be applied;
-) Self-assessment system;
-) Tax credit system;
-) Wide scope

While Nepal has adopted a conventional VAT similar to that implemented over 125 countries around the world, it has injected some special features into VAT system to make it uniquely Nepalese.

Some of them are as follows (K.C., 2007).

1. The adoption of consumption type of VAT
2. The consumption of VAT through tax credit method.
3. The principle of destination.
4. The provision of exemption and zero are goods and services.
5. The application of VAT to all business turnovers through the retail stages i.e. broad base.
6. The allowance of tax credit for taxable supplies including the zero rate supply.
7. The facilities of tax refunds.
8. The use of single positive rate of 13%
9. The level of thresholds of RS 2 millions

Nepalese VAT is subjected to a standard rate of 13%, however a few transactions of goods and services are zero rated and some are exemption and threshold form VAT.

2.1.2 VAT as a Substitute of Sales Tax

VAT is an improved form of sales tax. It is a substitute for sales tax, hotel tax, contract tax and entertainment tax. It is not a genuinely new form of taxation but merely a sales tax administrated in different form. The prices to be charged under VAT and sales tax do not differ. Under the VAT system, consumers know the amount they are paying in form of VAT but under sales tax system, it was not shown separately in the bill. Though both taxes are collected finally from the consumers, VAT is more transparent then sales tax VAT is levied at each stage from production to sales but sales tax is levied on only certain level of sales (Bhattarai and Koirala, 2004: 18.6).

2.1.3 Types of VAT

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

1. GNP type VAT;
2. Income type VAT; and
3. Consumption type VAT (Bhattarai and Koirala, 2004:18.4).

Now, let us discuss each of them in brief.

2.1.3.1 GNP type VAT

When the firms are not permitted to deduct even the amount of depreciation on capital goods, the tax is imposed on GNP. The base of tax is total consumption goods plus all final product capital goods. The base of tax in GNP types = Gross investment + Consumption = GNP. Group domestic product type VAT neither excludes the purchase of Capital Goods nor the depreciation from the tax base. It means the tax is levied both on consumption and gross investment. Under this type, capital goods purchased by a firm from other firms are not deductible from the tax base in the year of purchase. It also does not allow the deduction of depreciation from the tax base in subsequent years. Tax is levied both on consumption and gross investment. The tax base on this type is gross domestic product.

GNP type VAT = Gross Receipt - Cost of Intermediate Goods

2.1.3.2 Income type VAT

In this case, it is not the output of the consumption goods only which is taxed but also capital goods from which depreciation is deductible. Thus, it becomes a tax on net national product and the tax base is the same as that of a personal income tax without exemptions. The base of the tax in income types = GNP – Depreciation i.e. Net investment + Consumption = NNI (Net National Income). Income type VAT includes all capital goods purchased from other firm in the year of purchase while depreciation is excluded from the tax case. The tax is levied on both consumption and net income. Income Type VAT= Gross Receipt- cost of intermediate Goods -Depreciation. The income type VAT does not exclude capital goods purchased from other firms from the tax base in the year of purchase. This type, however, excludes depreciation from the Tax base in subsequent years the tax falls both on consumption and net investment. The tax base of this type is the net national income.

2.1.3.3 Consumption type VAT

Under the consumption type of VAT, all capital goods purchased from other firms in the year of purchases are excluded from the tax base while depreciation is not deducted from the tax base in subsequent year. Since investment is not relieved from the taxation under this variant, the base of tax is consumption. The base of tax in consumption types = Gross National Product – Gross Investment = GNP - GI = Total consumption expenditure. Under consumption type VAT, all capital goods purchased from other firms, in the year of purchase, are excluded from the tax base while depreciation is not deducted from the tax base in subsequent years. The base of tax is consumption since investment is relieved from taxation under this type. In Consumption type VAT system, VAT is not imposed on the purchase of capital goods from other forms and depreciation is not deducted from the tax base in the subsequent years. Consumption type VAT is widely used. So by the term VAT we basically mean the consumption type VAT.

Consumption Type VAT = Gross Domestic Products - Cost of Intermediate

Goods - Cost of Capital Goods

Among three types of VAT, the consumption variant has been widely used in several countries in Europe and elsewhere in the recent years. Nepal has also adopted this type of VAT. The reason for the popularity of this type is that this variant does not affect decisions regarding investment and growth since it relieves investment techniques in favor of labor intensive production. On the other hand, since the growth national product variant creates "a substantial disincentive for saving investment and capital intensive production "it is not likely to be a member of tax family of any country. Furthermore, the consumption variant is more attractive then the income variant from the consideration of foreign trade, because the consumption variant in compatible with the destination principle of tax action which has been used by many countries. In the other hand, the income variant is consistent with the original principle of taxation. This is why many countries selected the consumption variant and why in this study also by VAT we basically mean the consumption variant.

2.1.4 Comparison of VAT with a Sales Tax

Value added tax (VAT) avoids the cascade effect of sales tax by taxing only the *value added* at each stage of production. For this reason, throughout the world, VAT has been gaining favor over traditional sales taxes. In principle, VAT applies to all provisions of goods and services. VAT is assessed and collected on the value of goods or services that have been provided every time there is a transaction (sale/purchase). The seller charges VAT to the buyer, and the seller pays this VAT to the government. If, however, the purchaser is not an end user, but the goods or services purchased are costs to its business, the tax it has paid for such purchases can be deducted from the tax it charges to its customers. The government only receives the difference; in other words, it is paid tax on the gross margin of each transaction, by each participant in the sales chain (www.answers.com/topic/value-added-tax).

Sales tax is normally charged on end users (consumers). The VAT mechanism means that the end-user tax is the same as it would be with a sales tax. The main difference is the extra accounting required by those in the middle of the supply chain; this disadvantage of VAT is balanced by application of the same tax to each member of the production chain regardless of its position in it and the position of its customers, reducing the effort required to check and certify their status. When the VAT system has few, if any, exemptions such as with GST in New Zealand, payment of VAT is even simpler.

A general economic idea is that if sales taxes exceed 10 %, people start engaging in widespread tax evading activity (like buying over the Internet, pretending to be a business, buying at wholesale, buying products through an employer etc.) On the other hand, total VAT rates can rise above 10% without widespread evasion because of the novel collection mechanism. However, because of its particular mechanism of collection, VAT becomes quite easily the target of specific frauds like carousel fraud, which can be very expensive in terms of loss of tax incomes for states (www.answers.com/topic/value-added-tax).

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In many developing countries such as India, sales tax \ VAT are key revenue sources as high unemployment and low per capital income render other income sources inadequate. However, there is strong opposition to this by many sub-national governments as it leads to an overall reduction in the revenue they collect as well as a loss of some autonomy.

Sales tax is normally charged on end users (consumer). The VAT mechanism means that the end-user tax is the same as it would be with a sales tax. The main difference is the extra accounting required by those in the middle of the supply in this disadvantage of VAT is balanced by application of the same tax to each member of the production chain regardless of its position in it and the position of its customers, reducing the effort required to check and certify their status. When the VAT system has few if any, exemptions such as with GST in New Zealand, payment of VAT is even simpler.

A general economic idea is that if sales taxes exceeded 10%, starts engaging in widespread tax evading activity (like buying over the internet, pretending to be a business, buying at wholesale, buying products through an employer etc.) On the other hand, total VAT rates can raise above 10% without widespread evasion because of the novel collection mechanism. Citation needed however, because of its particular mechanism of collection, VAT because quite easily the target of specific frauds lied carousel fraud, which can be very expensive in terms of loss of tax incomes for states.

2.1.5 Introduction of VAT

Value added tax is newly developed modern and scientific tax system, which is recently innovated in the field of taxation. It is hybrid taxation from the retail level of sales tax. So VAT is an advance form of sales tax. It has spread all over the world which in a short span of time. It has gained huge popularity in short period of time in a history of taxation.

In the field of taxation, VAT has been considered as an attractive alternative to indirect tax system. It has been emerging as a main element of the worldwide tax reforms although it is the youngest form of taxation innovated in the second half of the twentieth century. Value added tax is a tax imposed on "value added" by a business firm a goods and services are the successive stage of production and distribution. Value added on a commodity or services is simply the excess of sales value over purchase by business entity. The VAT is collected from seller in the basis of their value added each stage of business process, thus the same value in never taxed twice and never produces cumulative effect.

VAT for a firm is nothing but its gross receipts from sales minus all expenditure on goods and services purchased from other firms. In the production and distribution process, a firm buys materials from other firms. This material may include principle

raw materials, auxiliary raw materials, chemical, electricity, and goods such as machinery equipment, building, furniture & vehicles. The firm adds value to these purchased materials by processing of handing them with the help of its own factor of production such as labor, land, capital etc. This increase in the value of output over inputs is the value added by a firm is equivalent to its payment of wages, salaries, rent and interest plus its profit and this value added is the base of VAT.

VAT is new concept of collection revenue. Each step of goods and services are levied to tax on its added value. It covers the value added to each commodity by a firm during all stages of production and distribution and the VAT is shifted forward completely to the ultimate users.

We can able to get a clear concept of VAT through an example. Consider the case of sugar production. A farmer sugarcane and sells it to the miller. Miller adds value in the process of changing sugarcane in to sugar. Value added of miller constitutes all expenditure including profit and miller with an increased value. Ultimately sugar is sold to the consumers with some additional value. Thus, at each stage of production and distribution, value is added as sum total of all such added value exactly equals to the finals sates value of the sugar. The following table shows the simple process of calculating VAT. In Nepal valued added tax (VAT) was introduced on 16 Nov 1997. This tax was levied in place of the sales tax, hotel tax, contract tax and entertainment tax.

Table 2.1

Simple Process of Calculating VAT

Stages Cost	Price	Value	Added	Selling price	Before VAT	VAT @
Producer	-	-	500	65	565	65
Stockiest	500	100	600	78	678	13
Wholesaler	600	100	700	91	791	13
Retailer	700	100	800	104	904	13
Total						104

Source: Arbitrarily Estimated Figure

From the above table, by using a VAT rate @ 13% the producer pays of Rs.65 as a VAT to the government. The stockiest collects VAT of Rs.78 in his sales but has an input tax credit of Rs.65 and thus remits Rs.13 to the government. Likewise, the wholesaler collects VAT of Rs.91 but deducts his input tax Rs. 78, and remits the balance of 13 to the government account. On the same way, retailer collects Rs.104 as VAT and remits Rs. 13 to the government after deduct his input tax of Rs 91. At last; the consumer will pay 104 as VAT. Finally, the government gets total revenue of 104 (i.e. 65+13+13+13) from all stages.

2.1.5.1 Exemption

Exemption simply means the goods and services free from a tax justification. Under this Approach foods or services is subject to exemption and input tax incurred there is not refundable. One of the other words, where a supply of a commodity or services is exempt from VAT means the condition where the traders do not pay VAT. "The exemption, at one of the stages, may be granted only to small firm in that stages as a means of reducing administrative costs relative to revenue. Exemption of the final product may be intended not as completed exemption but only as an exemption of value added to that particular product at the final stages. The tax credit can be restricted accordingly. Such a product may be termed quasi exempt" (Shoup, 1969).

"Exemption means an exclusion of certain kinds of business transaction of a person (who engaged in supplying goods and services) from the tax net. An exempted person does not have to fulfill the formalities e.g. Registration, keeping account, issuing invoices and filling of return which are required by VAT. In other words, an exempted person does not have to deal with the VAT administration and pay tax similarly VAT administration has nothing to do with the exempted person" (Khadka, 1997).

The purchaser will not pay VAT on tax exempt goods and services and supplier is not allowed input tax credits on purchases related to the following goods and services.

1. Goods and services of basic needs which include rice, pulses, flour, fresh fish, meat eggs, fruits, flowers, edible oil, piped water, wood fuel etc.
2. Basics agricultural products are also tax-exempt for example paddy, wheat, maize, millet, cereals and vegetables.

3. The expenses of buying goods and services required to grow basic agricultural products are tax-exempt. This includes live animals, agricultural, inputs including machinery, manure, fertilizer and pesticides.
4. Social welfare services including medicine, medical services, vegetarian services and Educational services.
5. Goods made for the use of disabled persons.
6. Educational and cultural goods and services such as books and other printed materials, Radio and television transmissions. Artistic goods, cultural programmes, non-professional Sporting events and admissions to educational and cultural facilities.
7. Air transport.
8. Personal services are also tax-exempt. These are services provided, for example, by actors and other entertainers, sportsmen, writers, translators and manpower supplier's agents.
9. Financial and insurance services.
10. Postage and revenue stamps, bank notes, cheque books.

2.1.5.2 Zero - Rating

Zero rating means taxing goods or services with zero rates. If zero rating is granted for a Particular goods, the goods is technically taxable and the tax payer (supplies of goods) is Required to fulfilled all the formalities like that of a regular tax payers with of difference that the supplier of zero rated goods is not required to pay tax and he is allowed to claim back the tax, if any one purchases. For example if experts are zero rates, the expert is able to get the refund of the tax on his purchase, which he has used for producing the export items (Shoup Carls S.,1988).

acting is an actual rate of VAT against which credit for VAT paid and inputs can be claimed and thereby a full rebate obtained. So zero-rating a VAT rate has a rate of zero percent, which is imposed on selected goods and services. It is nothing, except a tax-free provision of VAT especially for the selected goods and services.

In most of countries exports are zero rated so that the exporter is able to get the refund of the tax on his purchased, which he has used, for producing the exportable items. As zero rated items of transaction are within the tax net, although effectively they don't

attract any VAT, a purchaser will obtain a repayment of input tax borne in his purchase of goods and services, meaning that zero rated items or transaction if the objective to full exempting. Zero rating is also desirable tax to the poor either not at all or relatively less than well to do. If the zero rates are applied only at the first stages, the tax credit methods work satisfactorily, there is no over taxation (Shop, 1969). A zero rates goods do not bear any tax at all while and exempted goods may bear a tax element in its price. Further, differentiation between these two aspects is based on the administrative work. Business enterprises concerned with the Zero-rated goods and services are the formal member like all other VAT registered members and hence they have to fulfill the entire formalities associate with the VAT operation. But business enterprises having the transaction of only exempted goods and services have no concern with VAT administration.

2.1.5.3 Threshold

Threshold is a point at which an indexation provision becomes operative. Thus, threshold is a VAT of an upper limit beyond which VAT system is in operation. The traders which have low level of transaction will have a lower revenue yield relative to the compliance cost and either they are capable to fulfill all the formalities of VAT. Further, it will create administrative complexity if all the small vendors are registered in VAT. In such a situation, threshold is also an important provision of VAT, which keeps the small vendors beyond the tax net. Thus, threshold is a kind if exemption, which is based in the amount of the transaction but not on the kinds of goods and services. So threshold must be said on the basis of the production and the distribution system in a country concerned and the extent of education and record keeping at various levels of volume among business firms.

2.1.5.4 Tax rate

Rate means positive rate excluding zero rate. Design of tax rate structure is an important aspect of the VAT. The design of rate structure is chiefly influenced by revenue requirement, administrative simplicity efficiency, type of products, tax burden etc. However, the entire requirement cannot be achieved simultaneously as one may be contrasting to another. On the basis of the statistical picture given by those countries adopting: - "VAT as a fiscal instrument with the differential VAT rate

in the world". Theoretically and practically, the rate of VAT may be diversified in to two rates. They are:

Single VAT rate

In simple, single VAT rates means a VAT of which tax rate is fixed only at one number. In other words, if tax rate in VAT is fixed at less than two tax rates for all level including the wholesaler, the producer and retailer. It is said to be single tax rate. For example, suppose if tax rate is 15% it fixed for all level of VAT purposes. The fixed VAT rate is then, known as only single VAT rate. In practice, almost countries of the world favored single VAT rate rather than multiple VAT rates, because it has many merits. Firstly, its singularity brings simplicity, VAT administration side. Secondly, its simplicity reduced the cost of VAT administrative operation. Thirdly, it is easily understandable to the customer, the trader and others. Fourthly, for transparency, it makes easy for record keeping and account will be minimum due to the effectiveness of VAT administration which is stimulated by single VAT rate.

Multiple VAT rate

Differential VAT rate makes tax burden to higher incomes class more than to lower income class so that the vertical progressive may be stored in thee society. The gap between the higher income class and the lower income class may distort the economy. Therefore, it should be multiple for the sound economy.

1. Differential VAT rate discourages luxurious life and unproductive expenditure, and Encourages social welfare for the lower income class by imposing two different VAT rates.

2. Since multiple VAT rates enlarge its tax coverage by including all kinds of goods and Services, the estimated revenue level may be collected. The higher ratio of revenue Collection supports the additional development activates.

3. To implement the policy of production especially for domestic products for Industrialization, differential VAT rate is suitable instrument that is applied for "discourage imported goods and encourages domestic goods." so differential VAT rate is protective umbrella for domestic goods.

2.1.5.5 Imported Goods Taxed

The VAT act schedule I lists imports which are tax-exempt. Some of these include prescription drugs, basic needs, groceries, medical devices and agricultural products. Most imports however are fully taxable at customs point. There after these are treated on the same basis as domestically produced goods. The VAT in imported goods is collected by custom. It is calculated on the dutiable value of the goods, in other words on the value of the goods including transportation, insurance, freight and commissions plus any duty or other taxes payable on the goods. The value for the duty of the goods is determined in accordance with the valuation provisions contained in the Customs Act. Registrants may claim input tax credit for the VAT paid on imported goods used in their commercial activities.

2.1.5.6 Exports Goods Taxed

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

2.1.5.7 Obligations of VAT Registrants

VAT registrants are required to:

-) Submit VAT return and pay tax within the 25th day of the following month
-) Provide their customers with a tax invoice.
-) Maintain purchase book, sales book, VAT account.
-) Keep the VAT records for a period of 6 years.
-) Inform the IRO of changes to the business including new address, telephone number or are organization of a partnership within 15 days.
-) Put their certificate of registration in the premises where customers may easily see and read it.
-) Allow tax officers to enter the business to examine the business records and the stock on hand.

2.1.5.8 Books of Account

Every VAT registrant requires keeping records of all the invoices either received or issued, including the serial number and date of issue. In general, VAT liability is determined on the basis of the accounts kept by the taxpayers himself. The record should be kept in such a way that VAT authorities are able to check the accuracy of the VAT returns. Such records are kept fairly for long time generally 4 to 6 years. In general account must be maintained on the accrual basis. VAT liability should be calculated accordingly. This is because if it is levied only on the cash basis, taxpayers might delay payments. VAT registrants are required maintain purchase and sales books and its list of all the sales and purchase in the corresponding book. They are also required to prepare for a VAT account.

a. Purchase Book

VAT registrants are required to maintain an account of their business purchase for VAT purpose purchase book refers to the account of the VAT registrant, which includes all the transactions for business purchase. The record must be kept on the basis of invoice. At the end of each accounting period, the VAT registrant must total the amount of taxable purchases/imports; tax exempt purchase, imports and tax paid on purchase/imports.

b. Sales Book

Similarly, VAT registrants are also required to maintain an account of their sales for VAT purpose. Sales book is also an invoice-based account. At the end of each accounting period VAT registrants needs to total the taxable account (standard and zero rated) and tax-exempt sales, they have made in that period and tax collected on sales. If they make both taxable and tax exempt purchase and sales, they are required to calculate the proportion of input tax they are entitled to the tax period.

2.1.5.9 VAT Account

VAT registrants are also required to maintain the VAT account. It is monthly summary of Taxable purchases and sales and VAT paid on purchases and charged on sales.

Tax Credit and Tax Refund

Taxpayers (vendors) allowed deducting their input tax from output tax. This is known as tax credit or tax invoice method of tax computation.

The refund is the difference of gap between output tax and input tax, when the amount of input tax is higher than the amount of output tax. Such a situation generally arises in the case of exports because exports are zero-rated and in order to relieve them from the burden of the VAT tax refund takes place. Here output tax means tax amount which is collected on sales and input tax means paid amount on purchases. The taxpayer may apply to the Inland Revenue office for a refund only if the taxpayer is a regular exporter with more than 50% of his sales exported or has more input tax than output tax for a continuous period of at least 6 months.

Auditing

Auditing is the universal method for the control of VAT and prevention of tax evasion. The purpose of the VAT audit is found out according to the law and regulation, the actual VAT liability of the taxpayers.

2.1.5.10 Administration

Here, administration leads VAT administration. Administration means the Management of affairs. Its organization should be strong and reached to the Grass root level so that policies and programmes of government can be functioned to the people. VAT administration is responsible for setting Operational guidelines, programme development and evaluation, design of Forms and instructions, statistical analysis, budget development and resource Allocation.

2.2 Reviews of Related Studies

2.2.1 Review at National Context

Dahal, (1996), In his article "*a few words about VAT*" has written "VAT is a most scientific, innovative and powerful tax with built-in quality of universal application for both developed and developing economies. The biggest virtue of VAT is that it is revenue buoyant and highly instrumental for resource mobilization especially in an economy with an acute shortage of resources." he further added, Nepal has entered into a major global tax system with the introduction of VAT. VAT is an account-based tax that leads to transparency and accountability both as the part of taxpayers and collectors. Open border, non-magnetized economy, non-issuance of invoice etc. Are major problems that would marginalize the prospects for resource mobilization in Nepal. This calls for introducing stringent regulations to deal with the delinquency of tax, maintaining records properly and improving efficiency of VAT administration. The success of VAT will have significant bearing on the economy of Nepal."

Gyawali, (february 20, 2000) in his article "*VAT and its implementation*" pointed out major issues. The major findings of his article are pointed as:

-) The businessperson of VAT exempted goods and having transactions below threshold need not register in VAT.
-) Business firms having transactions below threshold with the business of taxable goods are volunteer to register in VAT.
-) The businessmen and industrialists transfer the collected amount of VAT to government, so they are the mediator.
-) The level of awareness of general customer needs to be increased they must know about VAT whether it rises prices of commodity or not, whether they are paying VAT to exempted goods or to non-registered businessmen.
-) If consumer pay VAT to non-registered businessmen it is worthless since non-registered businessmen cannot collect VAT. If they collect VAT there is a provision to pay double amount of collection as punishment.

Khadka (2000) entitled "*The Nepalese Tax System*" examined and evaluated the value added tax in Nepal from its introduction to its impact on the economy. He covered the reasons for adopting VAT, basic features, operation of VAT, VAT implementation,

revenue performance, existing problems of VAT, future strategy, including various data and illustrations.

The book points out following reason for the introduction of VAT in Nepal:

-) The first and important reason was to develop a stable source of revenue by broadening the tax base.
-) Nepalese tax system is massively dominated by custom duties but the contribution of custom duties has been decreasing due to reduction in import tariff in line with the liberal economic policies adopted since 1992/93 and in line with the custom duties reform taking place around the world since the early 1990s.
-) It was necessary to introduce VAT in Nepal to generate revenue required for improving its deteriorating macro-economic performance.
-) The adoption of VAT was also essential to establish an account -based modern transparent tax system.

Nepalese VAT possesses some basic features as mentioned in this book, they are pointed as:

1. Nepal has adopted a consumption type of VAT.
2. VAT is based on the destination principle.
3. VAT is a broad-base tax.
4. VAT is levied with a single positive rate of 10%.
5. Exports of goods and services are zero-rated.
6. Some goods and services are exempted from VAT.

The level of registration threshold is fixed at Rs. 2 million.

Regarding the revenue performance, Khadka was optimistic in affirming that VAT would generate more and more revenue in the days to come when it was fully operational.

Pointing out the existing problems of VAT in Nepal, the author stated "It is not easy to Implement a broad-based VAT in the present Nepalese context where smuggling and under valuation are common and the amount of unauthorized trade is considered

to be very significant. This type of trade does not come in the tax net. Since VAT tries to dismantle this type of trade, it is not easily acceptable by those traders who are involved particularly in unauthorized cross - border trade. It has also been common to grant many exemptions and incentives under various taxes, including the sales tax system. VAT intended to abolish them, which was necessary to broaden the tax base and rationalize the tax system."

Silwal (2002) in his book "*Value Added Tax: A Nepalese Experience*" had covered all aspect of VAT. In writer's word "VAT is an all stages non-cascading tax system. It extends to all levels of production and distribution. Similarly, it covers all stages and services. Any discrimination in taxing goods or services or exempting any of them renders VAT ineffective." The book gives main focus on Nepalese tax system. The book clearly analyze why the government of Nepal introduced VAT. HMG announced retail level sales tax at the rate of 10% covering a whole range of goods and services. There was no procedural law to administer it. When RST introduced in Nepal, literacy level was just meager and billing and record keeping was fanciful. In this situation, required revenue could not take place, which in turn into the development expenditures. So that a modern, efficient and neutral tax like VAT was therefore preferred to free from past difficulties.

The writer expressed a version by borrowing HMG declaration that - "Major changes must be made in order to make tax administration fair, efficient and effective. The hostility, harassment and corruption that currently exist between the tax office and the business community must end if Nepal is to have a modern tax system. The business wants the system c hanged and willing to pay a reasonable tax but they want the system transparent and fair."

Silwal suggested that a poorly designed VAT accompanied by weak administration would just drain the treasury. So utmost care is necessary while designing a VAT. According to him the following fact were considered while designing a VAT in Nepal.

-) Tax base issues
-) Rate structure issues

) Exemption issues and

) Threshold issues

Finally the author reached in a conclusion that the introduction of VAT provides an opportunity to sweep away the cobwebs and revamp a substantial part of the tax administration. In every country, where it has been implemented properly, the VAT has proved itself as revenue productive tax. However, the benefit form VAT depends upon its coverage.

Jyoti (June 15, 2003) in an article "*Problems in VAT Implementation*" published in Deshantar magazine, tried to describe the problems of VAT and they are pointed as:

) Weak in billing system.

) More and unnecessary goods and services are in the area of exemption.

) Potential taxpayers are ignoring registration.

) Unsatisfactory tax-return.

) Delay in tax-return processing.

) Increase in unpaid tax amount.

) Discussion about the threshold.

Finally, Dr. Jyoti concluded that all these problems of VAT are avoidable. Strong and smooth administration could avoid these problems and VAT should be effective to generate more and more revenue.

Bista (1999) in his M.A. dissertation on "*Value Added Tax: It's Issues and Effects*" the objective of the study is to examine the importance of VAT with respect to resource mobilization and to identify the problem of VAT and its prospects in developing countries like Nepal. The study basically stands on secondary data. Data analyzing tools are simple statistical tools e.g. percentage, ratio etc. In his study, he found the following facts with respect to his objective.

VAT can mobilize the rest of revenue resources by broadening tax base and tackling all illegal business activities. Tax officers are not specialized or the professionalism is not developed on tax officers. Public awareness is low to make people aware. Paper

media commitment towards VAT is weak, open boarder is the main cause of unauthorized trade and unofficial trade. He recommended the following things most necessarily to make the VAT effective. Political parties as well as leaders should show their commitment towards VAT implementation. Government should manage the necessary physical environment so that the VAT administrations can function properly and effectively. There should be good co-operation between government and business community. Talking with India should solve problem arisen by open boarder. VAT officials should be trained. These are the main recommendation made by him.

Nepal Chamber of Commerce (1997) to analyses the possible effects of VAT on Nepalese economy makes some observation. They includes adverse effects on price level, increase in the price of imported in the prices of imported goods would hit the import business and re-export of imported goods leading to a decline in the revenue from import tax, the account keeping requirement of the VAT would increase the tax compliance cost and cost of doing business, it would adversely affect the small traders.

The study concludes that a VAT in Nepal should not be implemented on experimental basic to know its pros and cons and after that a full VAT may be considered.

Upadhaya (2002);in his dissertation "*Value Add Tax*" has outlined that, although some achievements have been realized in the field of registration and refund and in reducing the number of non fiber, the result is still far from satisfaction. He finds that the implementation of value added tax is not working property. He has found the following problems in the VAT implementation.

-) Proper invoicing system hasn't been established.
-) Under valuation of imported goods in customs point.
-) There is no proper co-ordination between tax collection departments.
-) The fixation of threshold has been a debatable issue between tax payer and administration.
-) The entire consumers are not aware of VAT.

Devkota(2000), in his M.A. dissertation on "A Study on Value Added Tax Imposition in Nepal" Basic objectives of the study were to see the effectiveness of present

information and communication networking in imposition of VAT. He has collected primary data to gather opinions and views relevant to study objectives. Statistical tools he used are simple as ratio, percentage, average etc.

According to him, main problems in implementation of VAT are lack of VAT education to taxpayers and low public awareness level towards VAT. Value Added Tax system has not created positive thinking to taxpayers. The customers do not have habit to collect invoices while purchasing goods and services, which is the most important part of success and failure of the VAT implementation. He also found the communication gap between government and private sector towards VAT. It seems lack of enough preparation for implementation of VAT in Nepal.

Ghimire (1998); in his M.A. dissertation entitled “Value Added Tax Key Issues in Nepal” tries to examine the various issues pertinent to VAT in Nepal. His study is based on primary data by administering question to VAT in Nepal. Data analysis tools used in his dissertation are simple statistical tools such as average percentage, ratio etc. He has followed analytical as well as descriptive research design.

He has made confusion that the existence of small traders in large proportion raised a problem due to their low operation skill, lack of accounting record illiteracy and high compliance cost. Existence of open boarder and large amount of unauthorized trade from India to Nepal passes a great threat to the success of VAT in Nepal. Illegal imports would help to form a channel resulting in a large scale of tax evasion.

He has made some recommendations for the successful implementation of VAT in Nepal. They are strong administration education program to relevant persons, registration extensive training program to VAT personal, technical data base system, combination of various revenue teams, co-ordination of VAT department with other departments, close co-operation between government and private sector etc.

Khanal (2000); made a dissertation entitled on “Value Added Tax Issues and Options in Nepal”, examined and opined that VAT would be an improvement over the sales tax system. Adoption of VAT in the place of sales tax would insure certain, gain though the gain may be of least amount. That is why; a move towards VAT would be ‘better’ but not an ‘ideal’ step.

He found that the major hurdles for the applicability of VAT in Nepal are the existence of larger proportion of small traders in trading activities, unfavorable business structure and impracticable administration, existence of open border and large amount of unauthorized trade from India, under valuation of imports and lack of consciousness of Tax Law of Nepal.

Gautam (2006); talked about the contribution of VAT in government revenue and problem faced by it. He has used different type of questionnaire to various ranks of employees. The researcher used both primary and secondary data and has reached to the following conclusion:

-) VAT is a kind of indirect tax which is found to be superior to any other tax system for collecting the internal revenue, contribution of VAT in total indirect tax is more and higher.
-) The import VAT revenue is higher than internal VAT revenue.
-) Poor management is also cause of ineffective resource mobilization.
-) The growth rate of registrants is increasing. It shows the implementation status is satisfactory but due to the lack of transparency in business activities, weak cross checking mechanism, transition manipulation practices conclude that may potential tax payer are out of VAT.
-) The price change on goods and services may create double problem for tax.

Thapa (1994), in his article Value-added tax in Nepalese context applies the theoretical analysis and deals with theoretical issues. He conclude considering the present condition of Nepal facing high government expenditure, low revenue effort, high dependency foreign lone needs to more growth of the economy and because of low revenue potentiality from direct taxes. There is a prompt need to improve the sales tax of Nepal. In this context there is no other alternate except introducing VAT in Nepal.

Nepal (2011), states on “The Role of Value Added Tax in Total Revenue Collection from Large Taxpayers through Large Taxpayer’s Office”. The main objectives in the research are to analyze the contribution of Value Added Tax in government revenue,

to find out the total revenue collection by Large Tax Payer's Office along with Value Added Tax, to find out the relationship between Value Added Tax Collection and Large Tax Payers Office establishment, to assess issues and strategies of Value Added Tax.

The major findings of Nepal research includes :- there may be lack of publicity and effective monitoring, lack of awareness in implementation of Value Added Tax, the fragile political situation and the economic slowdown cause the inefficiency in Value Added Tax, Lack of Proper bookkeeping. To overcome these problems some recover majors found by Nepal's research are :- an implementation plan should be made to conduct the office effectively and efficiently, a clear line of communication and coordination should be developed with IROs in the frontline and Inland Revenue department, a collection strategy needs to be developed and implemented effectively in order to collect the increasing amounts of arrear, to improve billing condition in the market needs regular supervision, audits and investigation, consumer education is required to promote the use of invoice, the value added tax should be increased instead of increasing the rate of VAT in order to increase the revenue under VAT, most of the businessmen are not registered for VAT, the accounting should be transparent and VAT officers should be control auditing as far as possible , Income tax, Custom tax and other laws are interrelated to VAT. Thus these existing laws should be close co-operation between private sectors and government sectors for the successful implementation of VAT, both sectors should always be taken confidence by each other.

2.2.2 Review at International Level

Shoup (1969), in his famous book "Public Finance" considered value added tax as the latest and probably the final stage in historical development of general sales tax, imposed on the value added by the business firms. He explained VAT, as the difference between sales proceeds and the cost of materials etc. Purchased from other firms, which is the tax base of a VAT. He further added, a firm adds value added by processing or handling these purchased items with its labor force and its own machinery, building or other capital goods.

Musgrave and Musgrave(1976), in their book "Public finance and Theory and Practices" taking about the types of VAT and its practicability i.e. GNP, income and

consumption. They had preferred the latest type of VAT as more applicable and reliable one for both efficiency and quality, which was similar to the retail sales tax and seemed to be more practical for poor countries. Likewise the invoice method for calculation was more preferable and did have the advantage of the value added approach.

Regarding the problem of VAT, Musgrave and Musgrave remarked, "A sales tax may be imposed on either single or multiple forms. If the later one is implemented in the value added (rather than turnover) sense, it turns to be equivalent to a corresponding single tax. At each and every stage the value of product is increased and this price rises accordingly, which is the "value added - the tax base."

Hsiung (1991) explain VAT taking as example of Taiwan, which was in effect since 1986. \according to her, VAT in Taiwan was implemented in order to increase the competitiveness of exports and improve the efficiency of business tax structure. VAT had replaced business receipt tax, stamp tax and commodity tax which constituted 28 percent of total tax revenue. The impact of VAT showed that the business tax revenue increased considerably although the reform was aimed to be revenue- neutral.

Zarbede(2009);Value added Tax is the indirect tax on the consumption of the goods, paid by its original Producer upon the change in goods or upon the transfer of goods to its ultimate consumers . It is based on value of the goods, added by the transferor.It is the tax in relation to the difference of the value added by the transferor and not it is a profit. After adopting VAT every seller of goods and services provider has to pay the tax after availing the input tax credit. So, it is the form of collecting sales tax under which tax is collected in each stage on the value added goods.

EU(2009); has defined VAT as a general tax on the consumption of goods and service, applied at each stage of production, whose legal evidence is on final consumers.

Goode (1986) in "Public Finance in Developing Countries" describes VAT as the most important innovation in public finance. VAT applies to the tax imposed on the value added at successive stage of production and distribution. VAT, a sales tax on consumption is fairer than an income tax because the later results double taxation of saving is unconvincing but the former lacks the progressiveness, which serves by later.

Goode has pointed following advantages of VAT:

-) . It is broad based and relatively neutral.
-) It avoids both simple cascading and cumulative taxation of goods of producers that are not physically incorporated in products.
-) . Spreading the tax over the several stages of production and distribution is often considered as an administrative advantage compared with collecting it all at one stage because an enterprise has less incentive to evade tax.
-) It generates the possibility of issuing information as a cross checks on compliance with other taxes particularly income taxes.

Besides these suitability of Value Added Tax is questionable for countries where small enterprises are important accounting is unreliable and administrative is weak.

Richard (1986),In the book "government finance in developing countries", described VAT as the most important tax innovation of the second half of the 20th century and it was classified as a form at sales tax as consumption. The tax applied purchase of material input and certain services.

Due and Meyer (1988) examined the VAT in Dominican Republic. Ignoring the hostile reactions of business sector, labour union and even political parties.VAT was introduced in 1983 in Dominican Republic. The increased record-keeping requirement became the main issue in the medium and small sizes business dominated economy of Dominican, also the belief that VAT was responsible for the inflation become another obstacle, but the inflation was due to other reasons. There was general agreement that the enforcement of the tax hadn't been adequate mainly because of lack of personnel. Evasion was wide spread, many firms failed to register. The overall evolution of the tax in the country therefore remained rather negative. While the tax has brought additional revenue, the inadequate enforcement and failure to extend it to the commercial sector as planned, and the use to making shift, distorting system in the latter have resulted in serious failure to attain the advantage of complete value added tax. The experience of the country with the tax provides a warning to other developing countries not to attempt to use a value added tax expending beyond to import and manufacturing sectors without careful consideration of the ability of the

wholesale and retail sector to operate the tax, and general attitude of these sectors towards the tax.

Choir Kwang (1977), in the paper entitled "value added tax in the republic of Korea" judged the impact of VAT in Korea. The government of republic of Korea introduced general type of VAT of European model in 1977 with the objective of simplification of tax restructure and administration, the promotion of exports, capital formation and maintenance of neutrality in indirect tax system. The government spent a good number of years for preparation and became success to convey the message that the adoption of VAT benefited the business community in Korea. It showed a good impact on the investment. In its overall evaluation, the VAT has broadened tax base, reduced evasions, increased revenue and solved major problems associated with the previous tax system.

Besides the positive impact stated above, the republic of Korea experience with VAT had made it clear that it was not so simple in practice. It created more or less arbitrary Distortions in trade and consumptions and inequalities in the distribution of tax burden.

Singh (1996), in his book "Public Finance in Theory and Practice". Stated that administration of VAT does not require firms to calculate Value Added Tax. VAT is administrated by invoice method. He found the merits of VAT as neutral and efficient resource allocation, neutral between different goods and services, neutral between business, neutral between types of production and distribution. Since neutrality is important in produced in goods is possible in VAT system because it does not distort any one of the above.

Tait(1991),In a seminar "value added tax on Asia" Presented a paper entitled "VAT policy issues: structure, regressively, inflation and exports" in Jakarta (Indonesia) and later arranged on the occasional paper (88) IMF Washington D.C. edited by the same author in 1991, mainly concerned on the policy issue of VAT by illustrating some theoretical as well as empirical proofs:

-) VAT provides new buoyant revenue based and improves tax system in terms of neutrality and efficiency.

-) Experience broadly shows that VAT contributes from 12 percent to 30 percent of revenue in most countries representing above 5 to 10 percent of gross national product.
-) VAT is alternative of retailer sales tax. However both do not fully tax the unofficial Business but the under reporting of sales value will show up under the VAT.
-) It is preferable that VAT has the capacity of covering all the stage of production to the Retail level and the services.
-) VAT simply changes relative prices but not the overall price increase. Tax increase should be deflationary.

Lastly, at least if VAT cannot promote exports world, it makes the system easier. A VAT Administration is affected by the decisions regarding: whether all retail sales are included, should services be taxed, choice of proper rates and the treatment of capital goods, financial services, food, small traders.

CHAPTER - III

RESEARCH METHODOLOGY

3.1 Concept of Research Methodology

Research is a system and method of finding right solution for the problem where as research methodology refers to the various steps undertaken by researcher to find so far will be collected .Examined and evaluated them to make conclusion.

Research methodology is a process arriving to the solution a problem through planned and systematic dealing with the collection. Analysis and interpretation of the fact and figures, research methodology refers to the variance sequential steps to adopt by a researcher in studying a problem with certain objective in view. This chapter is devoted to the research methodology applied in the study for, the achievement for desired objective both primary as well as secondary source conduct this study. Opinion survey technique was adopted while collecting primary data to find out the views of respondents representing different groups related to value added tax .This opinion survey was adopted to find out the practical aspect of VAT .while conducting the opinion survey questionnaires were distributed to the Tax expert .VAT officers, businessmen and consumers in the sizeable manner. It known as a path from which we can systematically solve the research problems. For this purpose following research method will be used.

3.2 Research Design

Value added tax is very new concept of tax in present scenario of Nepalese economic system. Though it has accomplished about eighteenth years of implementation. Sufficient data are not available for an intensive study.

Basically, this study is based on problems in the process of revenue collection from VAT in Nepal. The study has tried to find out the result of objective by its own procedure. It is divided in to five chapter introduction, review of literature, research methodology, presentation and analysis of and conclusion and recommendation of the study. Hence, the research methodology followed in the study can be term a survey, analytical and descriptive research design.

3.3 Population and Sample

In order to benefit this research work, Non- Random Sampling method is used to achieve quick decision and better result from the small sample size. So this research is taken purposive or judgment sampling, in which most important units includes under investigation. For this 40 sample sizes is selected out of total population from Kathmandu city. The respondents have been divided into four groups.

-) Tax experts
-) Tax officers
-) Businessmen/traders
-) consumers

3.4 Nature and Sources of Data

Primary as well as secondary data have been collected in order to achieve the real and fact result. All the possible and useful data and views as far available have been collected. The major sources of data are as follows;

3.4.1 Primary Data

The major tool used for the collection of primary data is distribution of a questionnaire to a response of persons. A set of questionnaire was developed and information. The questionnaire was distributed to four tax groups; tax experts and tax officers are selected from tax department various sectors of tax officers in Kathmandu taxpayers i.e. businessmen and consumers are selected from different manufacturing company, trading company, department stores, shopping centre, financial company etc.

3.4.2 Secondary Data

The secondary sources of data have been collected in order to achieve the real and fact result from this research. All the useful and possible data as per availability have been collected .The secondary source of data and information are derived from published books newspapers, journals, reports and dissertations etc. The major sources of secondary data are;

-) Publication of Inland revenue Department (IRD) (various Annual Reports , VAT Acts and Rules ,Brochures on various publication of IRD and VAT projects)
-) Budget speeches of Years (2002-2013)
-) Economic survey (2002-2013)

-) Ministry of finance (MOF)
-) Publication of VAT department
-) Published document of national planning commission
-) Book related to VAT
-) Previous research work
-) National newspaper, journals, magazines.
-) Internet (<http://www.ird.gov.np>)

3.5 Data Collection Technique / Method

Different types of the data from several sources are necessary for this study. In process of collecting primary data, the methods like telephone inquiry formal & informal interview and questionnaire, analysis have been adopted wherever necessary. Likewise, secondary data have been collect using the methods like frequent visit of various libraries. Related tax institution and websites, similarly various books, journals, articles etc. published by concerned office will studied. As per the need of research everything will be done for data collection.

3.6 Data Collection and Procedure

Total sets or questionnaire where distribute to the selected respondents in order to get actual and accurate and information. Distribution work has been done personally rather than sending by any to get accurate and actual information in time.

3.7 Methods of Data Analysis and Interpretation

Data collected from various resources are arranged, managed, edited, tabulated, analyzed and presented in proper forms. Such processed data and information are interpreted and explanted as necessary. The analysis of data is done by using various statistical tools to achieve the desired objectives.

3.8 Tools Used

All the collected data and information are tabulated into separate format and analyzed. For analyzing the data, simple statistical tools have been used which are simple percentage method, measure of central tendency measure of dispersion, correlation, time series analysis, graphs, chart, diagrams etc.

CHAPTER - IV

PRESENTATION AND ANALYSIS OF DATA

4.1 Revenue Structure of Nepal

Even after the introduction of planned development, Nepal has been facing growing resource gap rapidly. This need has specially pronounced the urgency in domestic resource mobilization. But in developing nation like Nepal, portions of foreign grants and loans are increasing and have produced bitter experiences. The repayment of principal and interest has produced burden and has decreased resource for the social welfare activities and no doubt that the existence of government proofs by the activities of government which enhance the economic and social status of the people. In order to perform such social or intended programs, government needs huge amount of resources. Such type of economic revenues is collected from internal and external sources. Total revenue is comprised up of total tax revenue and total non-tax revenue. Tax revenue consists of customs, taxes imposed upon consumption and production of goods and Services, taxes as property and income etc. And non-tax revenue is composite of fees, fines, penalties, dividend, interest, sales of goods and services and other miscellaneous receipts.

In developed economy economic like USA, UK etc. Direct tax pays a leading role for the internal resource mobilization where as in developing countries like Nepal, indirect tax pays pioneering role by dominating direct tax. In general, how much direct tax can mobilize the internal resource shows the magnitude of economic development. But in the context of Nepal, indirect taxation is the principle source to general revenue. So, to divert the economy in the channel of development, it is necessary to increase the share of direct tax, ultimately decreasing the share of indirect tax. Therefore, the attention should be focused on the sufficient resource mobilization through direct taxation.

Direct tax is actually paid by the person on whom it is imposed legally ³². By definition, direct tax is a charged imposed by governmental authority up to property, individual or transaction to rouse money for public purpose ³³. Direct tax is a levy by the government on the income and wealth received by households and business enterprise in order to raise revenue and as an instrument of fiscal policy. Direct tax is

so called because it is normally assumed that the real burden of payment falls directly on the person or the business enterprises immediately responsible for paying them and can be passed on to anybody else. Direct tax is progressive so far as the amount paid varies significantly according to the income and wealth of the taxpayer.

With very limited tax base and narrow coverage, direct tax in Nepal seems too less effective to mobilize the domestic resources. Although it is and inevitable instrument of fiscal policy and hence, it must be designed and practiced properly. In general, revenue productivity of the direct tax goes on increasing as the economy of the countries grows over time. If the economy growth increases, per capita income per annum of the country will automatically raise. In depth it means that he possesses the ability to pay direct tax. Thus, the magnitude of direct tax goes up and substitutes in the place of indirect taxes magnitude. So higher magnitude of the direct tax indicates to the less developed or developing country and hence country need to accelerate the growth path to substitute the share of direct tax is less than other developing economies like Pakistan, Bangladesh, etc. Thus, it lies as a minor source of tax revenue source of Nepal. Direct tax in Nepalese economy is compassed of different taxes namely income tax, land tax, property tax, wealth tax, interest tax, and tax on registration.

In the current situation, income tax is one of the major sources of direct tax. Nepal is levying four different types of income tax. Its categories are individual income tax, corporate income, tax, house rent tax and interest tax. On the other side, property tax in another major direct tax. It includes land revenue, Bhumikar, house and land registration and house and land tax. The average largest share in the direct tax is occupied by income tax.

The major component, of indirect tax in Nepalese tax structure constitutes custom duty, excise duty, sales duty, sales tax/ VAT and context tax. Custom duties are composed of mainly import duties. Other component of indirect tax like entertainment tax, hotel tax and other tax contribute every nominal share because they are included in VAT.

Like tax revenue, non-tax revenue is another source of the government revenue in the structure. It is not imposed compulsory by public authority to the tax payers. Fees, fines, penalties, dividend interest, sales of goods and service etc ate the bases of non

tax revenue. The composition of non tax revenue in Nepalese tax system is of the following factors such as charges, fees, fines, forfeitures, receipts from sales of commodities and services, dividends, royalty, sales of fixed assets, principle and interest payment etc. "While there is some scope of generating more revenue through the operational performances, these sources cannot be used effectively as a revenue raised since most of these sources are levied not for revenue purposed."

4.1.1 Composition of Tax Revenue

The following table shows the composition of tax revenue and the share of direct and indirect tax in total tax revenue:

Table 4.1
Composition of Tax Revenue

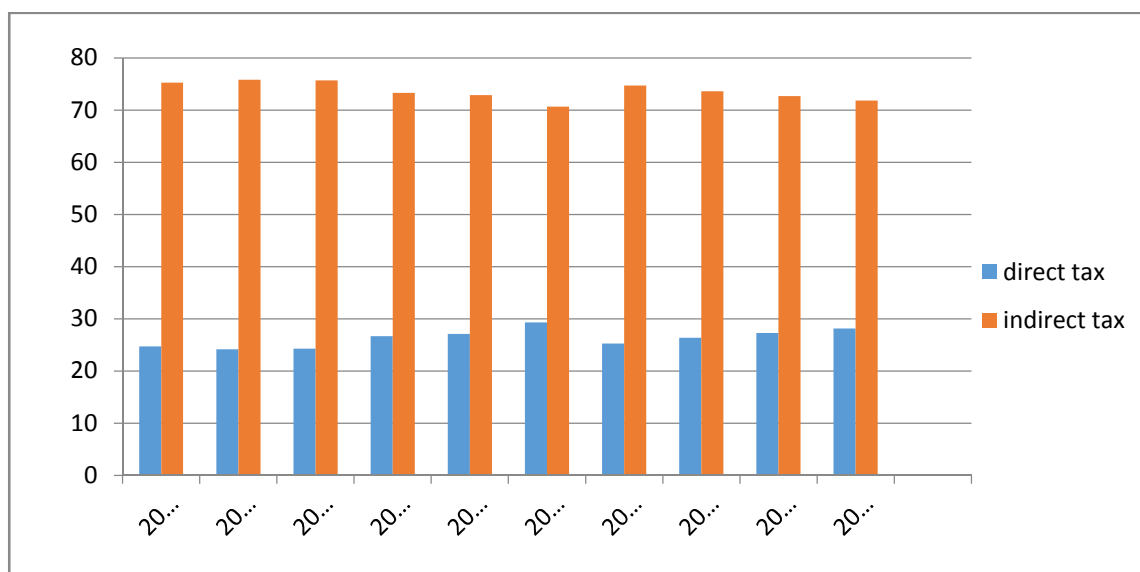
fiscal year	direct tax		indirect tax		total tax revenue	
	Amount	%	amount	%	amount	%
2003/04	11912.60	24.73	36260.40	75.27	48173	100
2004/05	13071.80	24.16	41032.90	75.84	54104.7	100
2005/06	13968.10	24.29	43532.30	75.71	57500.4	100
2006/07	18980.30	26.29	52146.40	73.31	71126.7	100
2007/08	23087.7	27.11	62067.82	72.89	85155.58	100
2008/09	34320.7	29.32	82727	70.68	117047.7	100
2009/10	40396	25.28	119389.3	74.72	159785.3	100
2010/11	46720.3	26.36	130506.9	73.64	177227.2	100
2011/2012	57770.2	27.29	15395.1	72.71	211721.8	100
2012/2013	73012.7	28.17	186202.3	71.83	259215	100

Source: Economic Survey 2012/13

From the above data we can conclude that in developing countries like Nepal indirect tax plays a vital role in revenue generation. Direct tax has been drawn least in the FY 2004/05 (24.16) and the greatest value reached in the FY 2008/09 (29.32 %). Similarly, indirect tax has the lowest indication in the FY 2008/09 (70.68 %), and the highest value reached in the FY 2004/05 (75.84%) can present the above data in the following bar diagram:

Diagram 4.1

Composition of Tax Revenue



The diagram shows the ratio of direct and indirect tax on the total tax revenue. In an economy of Nepal there is few possibility to generate the revenue from the direct tax. So, indirect tax is the most important sources of the revenue collection. The above maps speak clearly about this matter. But increasing trend of direct tax implies that country should give emphasis on mobilizing the resource through direct taxation rather than indirect taxation .However, the percentages share of indirect tax is more than the direct tax, it is because of the adoption of liberalization policy by the government.

4.1.2 Tax GDP Ratio in Nepal

The tax GDP ratio has been shown in table 4.2, the table shows increasing tax GDP ratio for the study period. In FY 2003/04 the ratio is 10.74 which has increased to 40.76 in FY 2012/13. In FY 2004/05 to 2005/06, there are small change in the percentages of GDP, through the total Tax revenue. But in the FY 2006/07 to 2012/13, the GDP growing continuously, because the increasing rate of tax revenue. It shows that the tax revenue plays or can play important role in economic growth or GDP.

Table 4.2

Tax GDP Ratio in Nepal

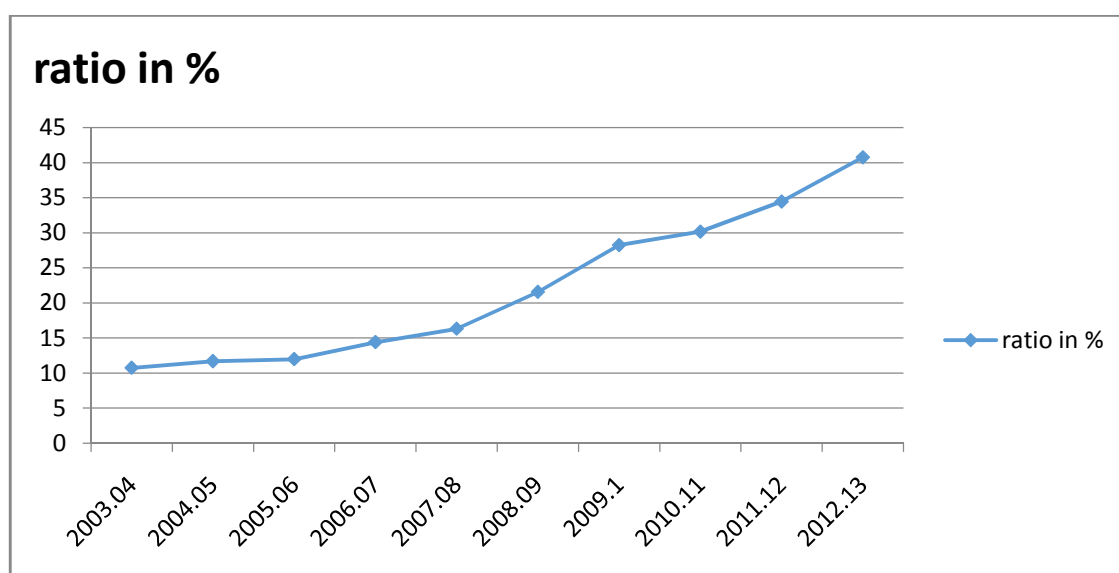
FY	GDP	total tax revenue	% of GDP
2003/04	448654	48173	10.74
2004/05	463165	54104.7	11.68
2005/06	48043.5	57500.4	11.97
2006/07	49365.1	71126.7	14.41
2007/08	52226	85155.58	16.31
2008/09	542652	117047.7	21.57
2009/10	565759	159785.3	28.24
2010/11	587534	177227.2	30.16
2011/12	61463.7	211721.8	34.45
2012/13	163591.7	259214.9	40.76

Source: Economic Survey, MOF 2012/13

The above table can amicably be presented in the following line diagram:

Diagram 4.2

Tax GDP Ratio in Nepal



The diagram shows the Tax GDP ratio in Nepal in FY 2003/04 to 2012/13. In the beginning of FY 2003/04 percentages of the Tax ratio in GDP on the line of 10%. It

has increased at the decreasing rate until the FY 2007/08. Then it has increased by rapidly and meet the line of 40%. From the above diagram we can conclude that tax has been most important source of government revenue. So, it has more contribute in the GDP.

4.1.3 Contribution of VAT in Total Revenue

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

Table 4.3

Contribution of VAT in Total Revenue

FY	TOTAL REVENUE	VAT REVENUE	% of VAT REVENUE
2003/04	62331	14478.9	23.21
2004/05	70122.7	18885.4	26.93
2005/06	72281.9	21610.7	29.89
2006/07	87712.1	26095.6	29.75
2007/08	107622.5	29815.7	27.70
2008/09	143474.5	39700.9	27.67
2009/10	177990.9	54920.9	30.86
2010/11	198375.9	61663.6	31.08
2011/12	244374.6	70930.4	29.03
2012/13	296021.1	83418.4	28.18

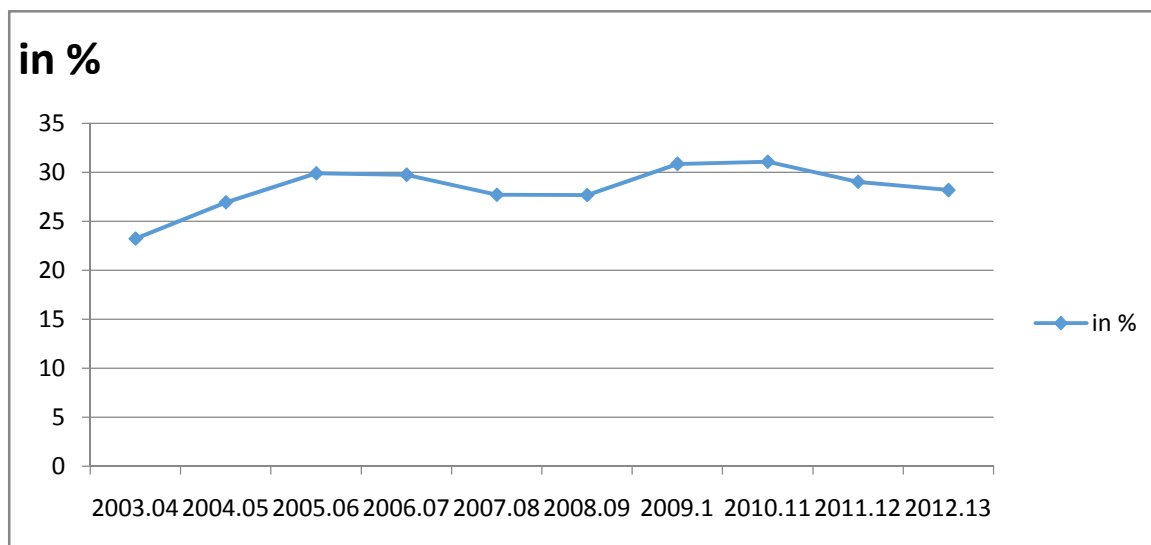
Source: MOF 2012/13

In the Table 4.3, takes the data in FY 2003/04 to 2012/13 (10 years) to show the contribution of Vat in the total revenue. In FY 2003/04 vat revenue contributes only 23.21% in total revenue. Then in FY 2004/05 it has 26.93%, that increasing trend of vat in total revenue reach 31.08% in FY 2010/11. It has the great contribute of vat in total revenue. Hence, we can say that vat is the most important sources of revenue generation. In the table lowest percent of VAT revenue is in FY 2003/04 (23.2); and the highest is in FY2010/11 (31.08 %). It shows the increasing trend of the VAT revenue on the total revenue.

We can present the above data in the following pie diagram also

Diagram 4.3

Contribution of VAT in Total Revenue



The diagram shows the contribution of vat in total revenue, which takes the data in the period of 2003-2013. In the beginning FY 2003/04, contribution of vat in the total revenue between the line of 20% to 25%. So on it takes the highest points above the line of 30% in FY 2010/11. So it is clear that contribution of vat in total revenue is above the line of 30%.

4.1.4 Contribution of VAT in Total Tax Revenue

The percentage contribution of VAT revenue in total tax revenue is presented in the table below:

Table 4.4

Contribution of VAT in Total Tax Revenue

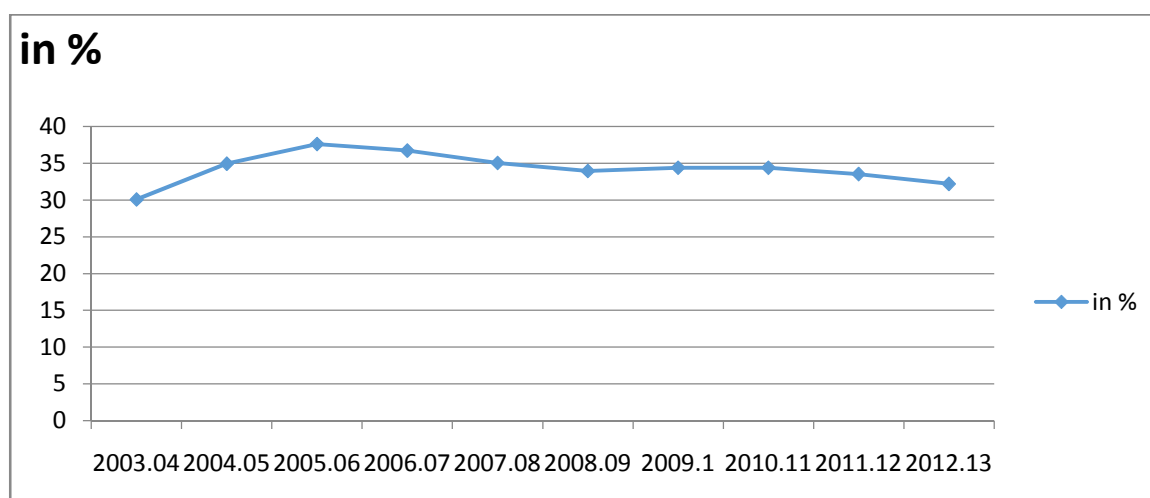
(Rs. in millions)

FY	TOTAL REVENUE	TAX	VATRs	Contribution of VAT in Total Tax Revenue
2003/04	48173		14478.9	30.06
2004/05	54104.7		18885.4	34.91
2005/06	57500.4		21610.7	37.58
2006/07	71126.7		26095.6	36.69
2007/08	85155.58		29815.7	35.01
2008/09	117047.7		39700.9	33.92
2009/10	159785.3		54920.9	34.37
2010/11	177227.8		61663.6	34.37
2011/12	211721.8		70930.4	33.51
2012/13	259214.9		83418.4	32.18

Source: MOF2012/13

Diagram 4.4

Contribution of VAT in Total Tax Revenue



As indicated above table and diagram the lowest contribution of VAT in total tax revenue is of the FY 2003/04 (30.06%); and the highest is of 2005/06 (37.58 %). Hence the contribution of VAT in total tax revenue is more and attracting further; it is in increasing style.

4.1.5 Share of VAT in Total Indirect Tax

The following table shows the share of VAT in total indirect tax.

Table 4.5

Share of VAT in Total Indirect Tax

(Rs. in millions)

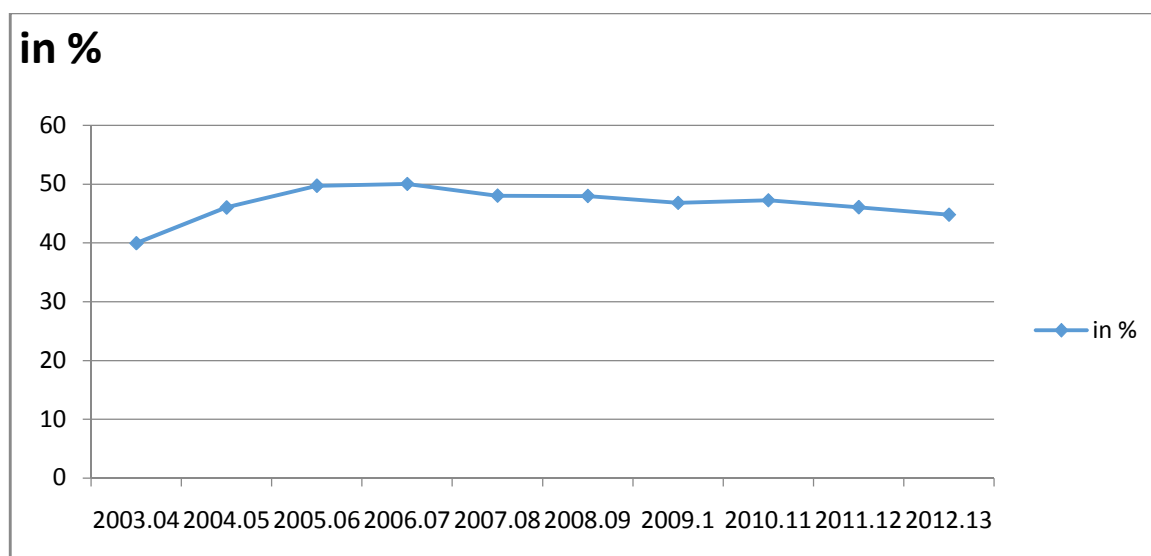
FY	TOTAL INDIRECT TAX	VAT Revenue	% of VAT Revenue
2003/04	36260.4	14478.9	39.93
2004/05	41032.9	18885.4	46.03
2005/06	43462.3	21610.7	49.72
2006/07	52146.3	29815.7	50.04
2007/08	66067.7	39700.9	48.04
2008/09	82727	54700.9	47.99
2009/10	119389.3	54920.9	46.8
2010/11	130509.9	61663.6	47.25
2011/12	153951.6	70930.4	46.07
2012/13	18202.3	88418.4	44.79

Source: MOF, 2012/13

The table shows that the contribution of VAT in total indirect tax revenue is more and attractive. According to the table 4.5, the lowest contribution of VAT is of the FY 2003/04(39.93); and the highest contribution is of 2006/07 (50.04).

Diagram 4.5

Share of VAT in Total Indirect Tax



The above diagram shows the share of vat in total indirect tax. The government generates the total tax revenue through the direct and indirect tax. Vat is one of the most important sources of indirect tax .So, to know the contribution of vat in total indirect tax the diagram can be used. In the diagram, the lowest share of vat in FY 2003/04, which has stay below the line of 40%. So on the highest share of vat in FY 2006/07, which has stay on above the line of 50%.

Table 4.6

Share of VAT in Total GDP

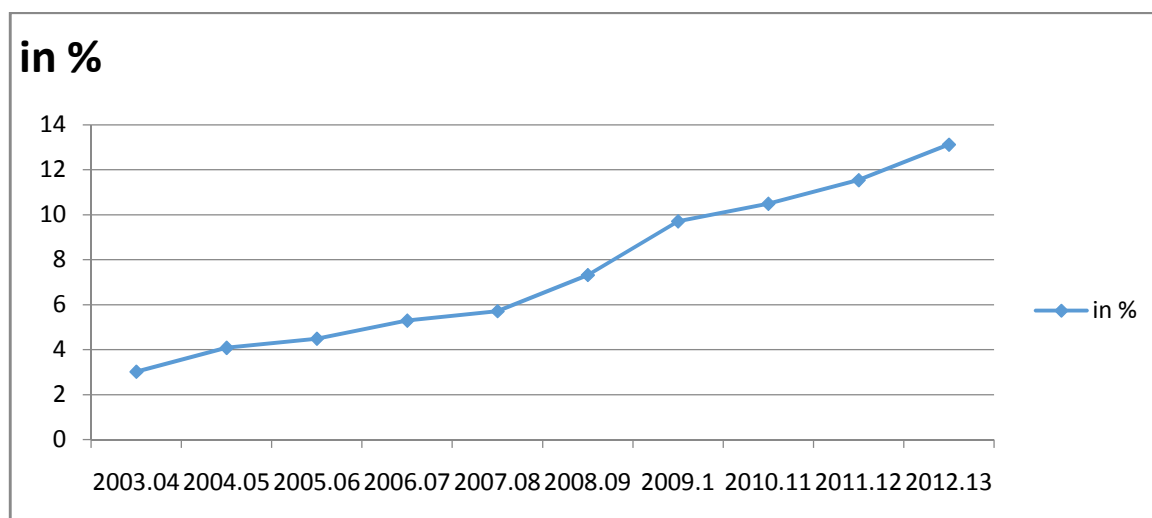
(Rs. in million)

FY	GDP	VAT Revenue	% of VAT Revenue
2003/04	448654	14478.9	3.02
2004/05	463165	18885.4	4.08
2005/06	480435	21610.7	4.49
2006/07	493651	26095.6	5.29
2007/08	322260	29815.7	5.71
2008/09	542652	39700.9	7.32
2009/10	565759	549209	9.71
2010/11	587534	61663.6	10.49
2011/12	614637	70930.4	11.54
2012/13	635917	88951.4	13.12

Source: Economic Survey,MOF;2012/13

The table can also be presented in the following line diagram:

Diagram 4.6
Share of VAT in Total GDP



As shown in the table and diagram 4.6, the share of VAT in GDP is 2.80 in FY 2001/02; it has increased to 4.21 in 2002/03 and slightly decreased till 2005/06. Then again, it has slightly increased till the FY 2008/09.

4.2 Analysis of Primary Data

Table 4.7

Knowledge about VAT

a) Sufficient Knowledge b) No knowledge c) Only listening d) Little

S.N.	Group of respondents	Sample size	A	B	C	D
1.	Tax experts	5	5	0	0	0
2.	Tax officers	5	5	0	0	0
3.	Businessmen	10	10	0	0	0
4.	Consumers	20	10	2	5	3
Total		40	30	2	5	3
Percentage		100%	75%	5%	12.5%	7.5%

Source: Field Survey, 2014

Table 4.7 shows that most of the respondents (75 %) have the knowledge about VAT. Yet, the government authorities are found weak as they could not launch public awareness programmes to the general public. Some general public (12.5 %) have only listening about VAT, without the thorough knowledge on its major substance and implication.

Table 4.9

VAT Paid to Whom?

a) Government b) Businessmen c) I do not know

S.N.	Group of respondents	Sample size	A	B	C
1.	Tax experts	5	5	0	0
2.	Tax officers	5	5	0	0
3.	Businessmen	10	10	0	0
4.	Consumers	20	11	7	2
Total		40	31	7	2
Percentage		100%	77.5%	17.5%	5%

Source: Field Survey, 2014

Major portion of the sampled respondent (77.5 %) are of the opinion that VAT will be paid to the government. Yet, another larger portion (17.5 %) is of the opinion that VAT will be paid to businessmen. This shows that 17.5 % don't exactly know the source and the end of VAT.

Table 4.10

Challenges Being Tackled in Implementation of VAT in Nepal

- a) lack of awareness rules and education b) Selfish motive of the private sector c) Self motive of the personal d) Loose mechanism of the government e) All of above

S.N.	Group of respondents	Sample size	A	B	C	D	E
1.	Tax experts	5	0	3	0	0	0
2.	Tax officers	5	0	3	0	0	0
3.	Businessmen	10	3	1	3	3	2
4.	Consumers	20	4	1	3	3	10
Total		40	7	8	6	6	12
Percentage		100%	17.5%	20%	17.5%	15%	30%

Most of the respondents think that all the four alternatives are required for proper implementation of VAT. Yet, 20 % of the respondents think that selfish motive of the private sector is the main challenge.

Table 4.11

View at Billing System

- a) Possible b) Impossible c) Most Implemented d) I don't know

S.N.	Group of respondents	Sample size	A	B	C	D
1.	Tax experts	5	2	0	3	0
2.	Tax officers	5	3	0	2	0
3.	Businessmen	10	3	2	4	1
4.	Consumers	20	6	3	6	5
Total		40	14	5	15	6
Percentage		100%	35%	12.5%	37.5%	15%

Source: Field Survey, 2014

Table 4.11 shows that 35 % of the total respondents are positive on the proper billing system. It also shows that 15 % don't know what the billing system is. Most of the experts (60 %) are of the opinion that billing system have mostly been implemented.

Table 4.12

Price Rise Due to VAT System

a) Yes b) No c) I don't know

S.N.	Group of respondents	Sample size	A	B	C
1.	Tax experts	5	0	5	0
2.	Tax officers	5	0	5	0
3.	Businessmen	10	8	0	2
4.	Consumers	20	8	5	7
Total		40	16	15	9
Percentage		100%	40%	37.5%	22.5%

Source : Field Survey, 2014

Table 4.12 displays that 40 % of the respondents are of the opinion that price will be raised due to VAT system. 37.5 % believe that price will not be raised due to VAT system. In fact, VAT will increase the price of the commodities because it is indirect tax and that tax will be collected by the customers and paid to the government by the business people.

Table 4.1

Tax Burden of VAT to the Tax Payer

a)Higher b) Lower c) Normal d) Zero e) I don't know

S.N.	Group of respondents	Sample size	A	B	C	D	E
1.	Tax experts	5	0	0	1	4	0
2.	Tax officers	5	0	0	3	2	0
3.	Businessmen	10	4	0	4	2	0
4.	Consumers	20	1	1	6	7	5
Total		40	5	1	14	15	5
Percentage		100%	12.5%	2.5%	35%	37.5%	12.5%

Source: Field Survey, 2014

Table 4.13 displays that 37.5 % respondents are of the opinion that there will be nil burden to the tax payers due to VAT system. 25 % experts are of the opinion that burden will be normal to the tax payer. 2.5 % respondents think that burden will be lower to the tax payers. 40 % of the businessmen think that burden will be high. It shows that the people who are indulged in illegal business, they feel burden of tax because they are afraid of showing all the transactions of the firm to the government and finally as if they have to pay more tax.

Table 4.14
Sufficiency of Current Legal Provisions and Rules of VAT in Nepal

a) Yes b) No c) Moderate d) I don't know

S.N.	Group of respondents	Sample size	A	B	C	D
1.	Tax experts	5	3	0	2	0
2.	Tax officers	5	2	0	3	0
3.	Businessmen	10	0	7	3	0
4.	Consumers	20	5	5	5	5
Total		40	10	12	13	5
Percentage		100%	25%	30%	32.5%	12.5%

Source: Field Survey, 2014

Table 4.14 displays that out of 30 % of total respondents, 70 % businessmen are strongly opposing the present legal provisions. It is a pathetic that out of 12.5 % of the respondents, 25 % consumers do not know at all about the legal provisions of tax. 30 % of the total respondent's are of the opinion that present VAT system is not sufficient and thus should better be improved.

Table 4.15

Suggestion offered for the better implementation of VAT in Nepal

S.N.	Group of respondents	Sample size	Government should follow hard and fast techniques, rules and mechanisms	Mass awareness should be exercised	Every citizen should think that it is their duty to involve in the state action	Transparency and governance should be followed
1.	Tax experts	5	19	20	21	20
2.	Tax officers	5	20	20	19	19
3.	Businessmen	10	20	15	12	15
4.	Consumers	20	36	16	18	30
Total		40	95	71	80	84
Percentage		100%	29%	21.5%	24.24%	25.45%

Source: Field Survey, 2014

Table 4.15 displays that highest portion of the respondents (29 %) are of the opinion that government should follow hard and fast techniques, rules and mechanisms. Mass awareness has received least priority (21.5 %) among the four alternatives. Tax experts and officers have not so much discriminated among the four alternatives.

Table 4.16

Main Problems of Present VAT System in Business Sector

a)Registration b) Account Keeping c) Billing System d) I don't know

S.N.	Group of respondents	Sample size	A	B	C	D
1.	Tax experts	5	0	0	5	0
2.	Tax officers	5	0	0	5	0
3.	Businessmen	10	3	1	5	1
4.	Consumers	20	0	0	12	3
Total		40	3	1	27	4
Percentage		100%	7.5%	2.5%	67.5%	10%

Source : Field Survey, 2014

Table 4.16 shows that 67.5 % respondents think that billing system is the main problem of VAT system in business sector. Out of 67.5 % of the respondents, 100 % experts and tax officers focused on billing system. Yet, 10 % respondents have nil knowledge about the problems of VAT system.

Billing is the main problem of present VAT system because the seller has various products including VAT and non-VAT. Customers also don't know the items which is VAT-able and which is not. Customers will buy all the items, so in this case billing will be the problem. Again, for the seller they have to keep all the gray market products and real market products where grey market products will not make any impact on VAT and real market goods will impact on VAT and stock. So in this case, billing is the problem and main problem is grey market.

Table 4.17

Major Weaknesses of VAT Administration

- a) Lack of expert b) Lack of trained man power c) Lack of physical structure
 d) Weak economy e) I don't know

S.N.	Group of respondents	Sample size	A	B	C	D	E
1.	Tax experts	5	0	4	0	1	0
2.	Tax officers	5	2	3	0	0	0
3.	Businessmen	10	5	5	0	0	0
4.	Consumers	20	3	13	2	1	1
Total		40	10	25	2	2	1
Percentage		100%	25%	62.5%	5%	5%	2.5%

Source: Field Survey, 2014

Table 4.17 concludes that lack of trained man power is the main weakness of VAT Administration. Out of 62.5 % of the respondents, 80 % of the experts focused on lack of trained man power. 25 % of the respondents are of the opinion that lack of expert is also another major weakness of VAT administration.

Table 4.18

Efforts Needed to Make VAT Effectively Successful awareness programs

S.N.	Group of respondents	Sample size	Strengthen and improve VAT administration	Train and educate the citizen about the value of tax paying	Improve VAT law and regulations	Launch public awareness programs
1.	Tax experts	5	21	21	19	21
2.	Tax officers	5	17	21	21	21
3.	Businessmen	10	20	15	12	15
4.	Consumers	20	32	22	14	27
Total		40	90	79	76	84
Percentage		100%	27.35%	24%	23.10%	25.53%

Table 4.18 shows that all the four alternatives are of almost equal value to make VAT effectively successful. Yet, strengthening and improvement of VAT administration has deserved highest priority (27.35 %) to make VAT effectively successful. Second priority goes on to launching public awareness programmers (25.53).

Table 4.19

Major Challenging Problems of VAT System

S. N.	Group of respondents	Sample size	Smuggling and Undervaluation	Lack of proper billing	Legal provisions	Mass Awareness
1.	Tax experts	5	22	21	13	18
2.	Tax officers	5	17	21	21	21
3.	Businessmen	10	28	32	27	30
4.	Consumers	20	29	20	27	25
Total		40	96	94	88	94
Percentage		100%	25.80%	25.26%	23.65%	25.26%

Table 4.19 shows that major challenging problems of vat system, which are smuggling and undervaluation, mass awareness, lack of proper billing, legal provisions. All the four alternatives deserve almost equal and importance. Yet, lack of mass awareness and lack of proper billing have deserved higher priorities both (25.26 %).

CHAPTER - V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Value added tax is a tax imposed on "Value added" by business firms on goods and services at the successive stages of production and distribution "value added" on a commodity or services is simply the excess of sales value over purchases by a business entity. VAT is multiple stage commodities and service based one of the best form of sales tax.

The VAT has been considered as an attractive alternative to existing indirect system, spreading around the world at a speed which is unmatched by any other tax in the recent time. It is the youngest form of taxation innovated in the second half of the twentieth century; it has been emerging as a main element of the world wide tax reforms. Since Nepal is severely defeated by the problems of fiscal deficits, resource gap and foreign debt servicing, VAT was conceived as an effective neutral and more productive tool for mobilizing domestic resources.

The VAT is collected from sellers on the basis of their "value added" at each of the stages of business process, thus the same value is never taxed twice and never produces cumulative either. Burden of the VAT is presumably shifted forward to the consumer. The optimum base of VAT is gross national product. The VAT firstly launched in France in 1954 however it was introduced by German industrialist Carl F. Van Siemen.

In the Nepalese context, VAT was implemented in 16 Nov. 1997 when the tax system review task force headed by Prof. M.K. Dahal proposed and recommended to implement VAT. The structure of Nepalese VAT is designed in VAT act 2052. Its coverage is defined with reference to both taxable transactions and taxable persons. The base of VAT is the value added by each firm through its production and distribution activities. According to VAT act 2052 the tax rate is 10% (now changed to 13%) and experts are subject to rate of zero %. There are certain cases such as exemptions and zero ratings under which commodities are tax free. A taxpayer is allowed to deduct the tax paid on purchase for his business from the collected on

sales. This deduction is known as an input tax credit. Under the Nepalese VAT system, there is a provision for the refund of VAT. Such a situation arises in the case of zero rated supplies such as export. Small vendors having an annual turnover of certain amount (Rs. 2 million) are not required to register under the VAT system.

Among the various type of VAT, gross national product type, income type and consumption type, the later one excludes capital goods from its base, thus do not penalize investment and growth. It is considered to be neutral regarding the methods of production and administratively feasible. Three principal methods, ensuring the VAT base are additions subtraction method and invoice or tax credit method. The invoice method is more popular in the world. VAT paid on total purchases minus VAT paid on total sales by a firm is the net VAT liability under this method. While addition method adds factor products and sales value minus purchases under the subtraction method. The tax credit method is considered as a tool for cross-checking measures under the VAT system. In this sense, VAT is said to be self-policing in nature to adjust international trade VAT uses one of the two principles i.e., origin or destination principle. In Nepal, consumption type, tax credit method VAT based on the destination principle with single positive rate of 13% is in practice.

Nepal introduced VAT system for several reasons. It was necessary to introduce such a tax to develop a stable source of revenue, to broaden the tax base, to promote economic growth to generate revenue required for improving its deteriorating macro economic performance, to establish an account based modern transparent tax system, to make the tax system more scientific to gain the confidence of donors, and to make the Nepalese tax system effective. In the empirical study, the analysis has been done about VAT on the basis of information collected form experts, tax officers, businessmen, and consumers. The tool basically used is questionnaire. The questions were asked to 40 different individual related to this field. Empirical as well as theoretical analysis shows that VAT is superior to other types of sales tax. Not only that, most of respondents have also viewed in VAT as best instrument for resource mobilization, bright future and discouraging illegal business. Similarly, most of the respondents (especially

Tax experts, VAT officers), argued that billing problem, open boarder, administrative

Incapability as haunting problem. They also discussed about legal provisions, choice between single or multi-rated VAT, behavior of tax personnel, rate of VAT, need of public awareness programmed etc.

Nepal introduced VAT system because of several reasons. It was necessary to introduce such a tax system to develop a stable source of revenue to broaden the tax base to promote economic growth, to generate revenue required for improving its deteriorating macro economic performance, to establish an account based modern transparent tax system, to make the tax system more scientific, to gain the confidence of donors and to make the Nepalese tax system effective.

In the previous days of VAT implementation it had to face so many protests. It had become very difficult to convince people and business vendors about the effectiveness of VAT. The IRD conducted many programmed to aware people about its applicability and proved that VAT is not extra burden to people but is the modified form of sales tax which reduces the tax burden by removing cascading effects of sales tax. It has been about 13 years of VAT implementation and now people are now aware of VAT. However, it has not reached that position where it would have been. Number of VAT registrants is increasing per year. But there is still a need of effective programmed to bring the large number of potential business vendors under the VAT registration.

The contribution to government revenue is significant. Since, VAT is a broad based tax system; it is obvious that it should contribute significantly to the revenue. The contribution to revenue has the increasing trend. However, the share of VAT in GDP is very low. The most of the share of VAT is contributed from import. Nowadays, VAT from domestic products is in increasing trend.

VAT has now reached the adult form but there are so many challenges that are need to be solved to make the system more effective. The lack of proper billing system, smuggling and undervaluation, weak performance of tax administration, low level of public consciousness, rampant corruption, political instability, geographical barriers, open boarder and unauthorized trade, narrow tax base, lack of coordination between custom office and VAT related offices etc are the major challenges of VAT implementation. Improvement is necessary in such area.

5.2 Conclusion

Value Added Tax puts greater significances in revenue mobilization in Nepal. The Reason behind this is that VAT system is transparent with broad tax base and discouraging tax evasion. So, it is necessary to say that VAT is the most important source if the government revenue. VAT is a most scientific, innovation and powerful tax system with built in quality of universal application for both developed and developing economies. VAT system makes it possible to broaden the tax base, eliminate the tax evasion and cascading, create an investment friendly environment and finally to increase to government revenue. This is a matter of great pride that Nepal has entered in to a major global tax system with the introduction of VAT. However there are several issues in VAT system in Nepal, which can be explain below;

-) VAT as a major instrument and important policy tools have an important role towards increasing the rate of capital formulation and also achieving a high rate of economic growth.
-) VAT is expected to occupy an importance part of Nepal's revenue in a country with a narrow basis for revenue to assume this tax which is based on consumption and imposed at all stages of production and distribution due to catch-up self policing feature the VAT system is more effective.
-) In Now days developing as well as developed countries in the world have increasingly focused their attention towards reforming the tax system by standardizing and improving the poorly designed Tax structure in order to mobilize high volume of resources for the development purposes and make the economy healthy and efficient in this sense the successful implementation and effective structure of VAT system to contribute the government revenue of Nepal.
-) Adoption of VAT system for Nepal is both compulsion and necessary .The globalization and recent trend of trade and tax system has affected the Nepalese economy .As Nepal is one of the member of WTO, it is necessary to decrease the custom duty and excise duty. Consumption based tax is only an alternative to more revenue which directly helps to increase domestic resources for development works.

- J The structure and the trend of Nepalese VAT system improving and increasing continuously. It shows that there is better improvement and making effective policy or administration part .But it is not sufficient to reach the economic goal of the nation.
- J In spite of VAT is a major instrument to achieve the high rate of economic growth, there are many challenges and problems on the successively implementation on VAT system in Nepal. The main problems and challenges are; lack of suitable policy of government, ineffective billing system , existence of open boarder large amount of unauthorized trade, lack of coordination of VAT department and traders, lack of public awareness etc.
- J To make effective and efficient implementation of VAT there may be improve some problems in VAT system such as, effective policy of government ,increasing awareness of the consumer improving billing system, review the policy of threshold, exemption ,to overviews on smuggling and undervaluation etc.
- J Lastly, this research try to shows that the structure and challenges of VAT system in Nepal and also find out that the broad base and uniform basis VAT is a better instrument for managing the economy, promote the exports and improving the balance of payments.

5.3 Recommendations

There are some vital problems in implementation of VAT system as mentioned in previous chapter. These problems are quite challenging to the concerned authorities from the point of view of their financial performance. Thus, it is very, very important that we find some effective troubleshooting of the above problems and execute them with full force. Now, Question may arise as to what might be the solution of the above problems.

Some Useful Recommendations on Administrative and Legal Reform for Better Implementation of VAT in Nepal

- J Unproductive, corrupted, inefficient staff lacking practical and specialized training is a serious problem. So, providing training to such staff is highly essential.

-) Taxpayers, customers are ignorant about VAT system. They have lack of proper
-) Knowledge about computation of tax liability, taking invoice of their purchases. So, Emphasis should be given to taxpayer education. The issuance of proper bill for every taxable sells must be made mandatory.
-) Providing various facilities to VAT registrants can increase VAT compliance. The tax administration can select genuine businessmen and reward them.
-) There should be close cooperation between the private sector and government sector for the successful implementation of VAT system.
-) VAT collection on import is remarkably higher than domestic production, such high dependency on import is not good signal for the government therefore authority should take an effective step to encourage domestic production.
-) Special incentives should be provided to small business person to increase registration trend.
-) The existing exemption and zero rating list is rather long. Exemptions and zero rating have on impact not only on revenue collection but also on economic efficiency and administration. Thus, the existing labyrinth of exemptions and zero rating in VAT must be avoided from tax act.
-) A reasonable threshold (down from the current Rs. 2 million), wide range of supplies under the tax net would be an appropriate strategy for immediate future.
-) Government has been providing tax refund facility to business organization and foreign diplomacy and foreign aided project. Tax refund is one of the sources of tax Leakage. Therefore, tax authority should manage tax refund facility properly.

As per the equity principle of taxation, the government may apply different rates of VAT to luxury good and essential goods. There is injustice in levying more tax on Conspicuous consumption..VAT laws should be effectively implemented.

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APPENDIX-I

Questionnaire

Dear Sir/Madam,

Kindly allow me to introduce myself as a student engaged in a research work on "VAT in

Nepal: Challenges in Its structure" for the fulfillment of my dissertation for the Master's Degree in Tribhuvan University, Kathmandu.

I humbly request for yours valuable comments, views, suggestions and information on this issue which would prove very useful for my study. That's why I request you to fulfill the following questionnaire.

I hope for your kind cooperation and assure you that whatever information you provide me will solely be utilized in research work.

A study on Value Added Tax in Nepal and Challenges in Its Implementation

Questionnaire:

Name of respondents:

Office/organization:

Business.....

Consumer.....

1) Do you know about VAT?

a) Yes b) No c) Only listening d) little

2) To whom VAT will be paid?

a) Government b) Businessmen c) I don't know

3) What challenges do you face in implementation of VAT in Nepal?

a) Lack of awareness rules and education b) Selfish motive of the private sector c)

Selfish motive of the personnel d) Loose mechanism of the government

4) What is your view about billing system?

a) Possible b) Impossible c) Most implemented d) I do n't know

5) Will price rise due to VAT system?

a) Yes b) No c) I don't know

6) What do you think about the tax burden of VAT to the taxpayer?

a) Higher b) lower c) Normal d) Zero e) I don't know

7) Do you think that current legal provisions and rules of VAT is sufficient in Nepal?

a) Yes b) No c) Moderate d) I don't know

8) What suggestion will you offer for the better implementation of VAT in Nepal?

	Efforts Needed to Make Better Implementation of VAT	Likert-Type Scale				
		1/20 %	2/40 %	3/60%	4/80 %	5/100%
	Government should follow hard and fast techniques, rules and mechanisms					
	Mass awareness should be exercised					
	Every citizen should think that it is their duty to involve in the state action					
	Transparency and e-governance should be followed					

If any, please specify.....

[Note that 1 represent lowest value and 5 represents highest value]

9) What are the main problems of present VAT system in business sector

a) Registration b) Account keeping c) Billing system d) I don't know

10) What are the major weaknesses of VAT administration?

a) Lack of expert b) Lack of trained manpower c) Lack of physical structure

d) Weak economy e) I don't know

11) What kinds of effort are needed to make VAT effectively successful?

Please give your perception about VAT on the following sub-categories:]

S.N.	Efforts needed to make VAT successful	Likert-type scale				
		1/20%	2/40%	3/60%	4/80%	5/100%
1	Strength and improve VAT administration					
2	Trained and educated Effort					
3	Improve VAT laws and regulation					
4	Public awareness Programmes					

If any, please specify.....

12) What are the major challenging problems of VAT system?

Please give your perception about VAT on the following sub-categories:

S.N.

Major Challenging Problems of VAT

S.N.	Major Challenging Problems of VAT	Likert-type scale				
		1/20%	2/40%	3/60%	4/80%	5/100%
1	Smuggling and under valuation					
2	Lack of proper billing					
3	Legal provisions					
4	Mass awareness					

If any, please specify.....