

CHAPTER -1

INTRODUCTION

1.1. Background of the Study

Tax is compulsory burden to the people who have taxable income. It is major sources of government revenue. In other words tax is any compulsory levy from individual, householders and firm to central or local government. The person or entity that has taxable income is liable to pay tax without expecting any direct benefit from the government. Tax is computed and paid as per prescribed in the law. In the modern world, taxation has been takes as the most effective tools for rising national revenue. The government by mobilizing adequate resources through taxation night invest them in various development programmers. In this way, in the underdeveloped countries the government might play an important role in promoting capital formation breaking the various circles of poverty and by mobilizing adequate through taxation. In order to improve the quality of people's lives, Nepal has given number one priority to development through planned effort. Nepal has pursuing planned development for nearly five decades, but the country's poverty ratio still remains one of the highest in the world. Poverty reduction is identified as major objective and need for mobilization of additional resources has been growing. In the context of liberal policy adopted by the nation, the formulation of a policy of financial resources mobilization has become necessary. However, the government of Nepal (GON) has stressed on resource mobilization, it failed to achieve the targeted progress. Nepal joined the rank of those countries which mobilize low total revenue in the share of the Gross Domestic Product (GDP). So, this situation evidently indicates the need for increasing the quality of mobilization of the revenue.

In the Nepalese context, saving is low because of the low economic growth and vice-versa. Relation between (GDS) to (GDP) is low. Because the level of income is low, level of consumption of essential is also low. Consumption increase in the level of income induces further consumption. Narrowing the gap between saving and investment remains another matter of concern. GDS need to be sustained at higher level and directed to investment to attain sustainable and higher economic growth.

The tax reform exercise has been the most important and technically the most existing component of reform program in the economic sector. In the present

context of raising needs of development expenditure and deficiency of government revenue there is need of entire reforms. The government of the country requires sufficient revenue to carryout development plans to handle day-to-day administration, to maintain peace and security, to maintain law and order and other public welfare activities. The government collects revenue from various sources such as tax, revenue from public enterprises, special assessment, fee, fines, grants and assessment etc. Among them tax is main source of government revenue. While considering the ratio of tax revenue to national production, that tax collection has been significant in comparison with tax potential. While little attention is being paid to revenue collection, equal weakness in tax related law, rules, procedures and administration have caused huge leakages in revenue. Tax payers have not been able to pay taxes due to legal and procedural difficulties. Such problems are made prevent particularly in the area of direct taxation. Due to this, our dependency on indirect tax has been very high and its import on low income group is very high. Government of Nepal (GON) is committed to mobilize revenue in accordance with taxpaying capacity of the people by changing revenue structure and administration procedure. For this, the government review laws, rules and administrative procedures related to tax. The use of taxes is safer for financing public revenue in developing countries. Deficit financing brings dangerous situation of inflation and external debt are not always reliable. Taxation, in the modern tax has been taken as the best effective tools for raising the ratio of saving to national income. Taxation as most viable method of resource mobilization may exists of imposition of new taxes, increase in rate of existing taxes. Widening the taxes coverage and improving the administrative effectiveness etc. In normal circumstances, taxation seems to be the most effective and perhaps the least harmful ways of mobilizing internal resource.

Tax are emphasized in all countries developed as well as developing because they have the potentiality for increasing the yield of tax system and achieving a system of taxation that satisfies the demand for equity and social justice (singh,1991;127)

A tax is compulsory contribution imposed by a public authority, irrespective of exact amount of services rendered to the tax payer in return and legal offense. According to Seligman, tax is a compulsory contribution from a person to the government to defray expenses incurred in the common interest of all without reference to special benefit conferred.

Tax is computed and paid as per prescribed in the law in the modern world. Taxation has been taken as the most effective tool for rising national revenue. The government by mobilizing adequate resources through taxation might invest them in various development programmes. In this way, in the underdeveloped countries the government might play an important role in promoting capital formation, breaking the various circles of poverty and by mobilizing adequate through taxation. The tax can be classified into two parts

-) Direct Tax
-) Indirect Tax

Direct tax is a tax paid by a person on whom it is legally imposed. In direct tax, the person paying and bearing tax is the same. This tax is directly imposed on those who have taxable income and the tax is paid by the tax payer directly. The direct tax is Income Tax, Property Tax, Interest Tax, Contract Tax, Vehicle Tax, Gift Tax and Expenditure Tax.

An indirect tax is a tax imposed on one person but partly or wholly paid by another. In indirect tax the person paying and bearing the tax is different. It is the tax on consumption expenditure. The following are the indirect tax Value Added Tax, Hotel Tax, Entertainment Tax, Excise Duty, Import and Export Duty.

Among the indirect tax value added tax is the most recently introduced in the field of taxation. Value added tax, popularly known as "VAT" in the short form is conceived by Dr. Wilhelm von Siemens of Germany for the first time in 1919AD. He advised the then German authorities to implement the system in order to solve the problem of short government revenue they were facing in those days. In fact, the system is conceptualized with two objectives. First objective is to streamline a tax system which ensures perennial and dependable source of more and more funds to the government. Second objective is to adopt a system under which business community be taxed on actual turnover of their economic activities. Though the system is conceptualized with such noble objectives, it remained virtually far from being implemented for decades. In 1949AD its extensive or detailed form is envisaged in order to introduce reform in tax system of Japan. 1950s is the decade when the most developed and prosperous nations of the world were badly suffering from aftermath of the deep great economic slump of 1930s, and the ravaging the II great world war. In those days government of the countries, so suffered, were totally disquiet to find away to

heal the unfathomable economic catastrophe of the 1930s “Great depression and the Great War”

For the first time in the world France introduced VAT system in 1954AD, limiting in to transactions of whole sale stage only in industrial sector. Later the country extended the system in 1968AD. Ivory Coast and Senegal of continent of Africa are second and third countries who introduced the system in 1960 and 1961AD respectively.

In SAARC region, Pakistan was the first adaptor of VAT. It is implemented VAT in 1990. Introduce first as Modified Value Added Tax (MOD VAT) IN 1996. But actually in India VAT replaced sales tax on 4 January, 2005. In Nepal Value Added Tax act was enacted by 1995 and started to implement only on 16 November, 1997. This tax was levied in place of the manufacturing level sales tax, hotel tax, contract tax, and entertainment tax. Value Added in each economic activity from production to consumption. It means VAT is charged to value addition done to prepare the final product. Generally the tax base (value added) can be directly ascertained from the following equation.

Value Added (Tax Base) = Conversion cost + Profit

Where,

Conversion cost = Wages + Interest + Rents + Depreciation

Finally the value added may not be calculated directly but the exact result is obtained by levying tax on the total sales and deducting the tax on purchase from the tax on sales.

1.2. Statement of Problems

Now a day, every sector of the Nepalese now in facing various problems such as high inflation, low economic growth, declining productivity, increasing unemployment, uneasy investment climate, unequal development, climate change, high and low rainfalls. Today investors are suspicious about the security of their investment in futures, business is suffering from strangle market and ever diminishing demands. Moreover, individual professional are also having their mind and time distracted by this situation of the country are in a drastic decline. The economy is in the state of recession. Per capita income of Nepalese people is only 320dollar according to World Bank.

After the restoration of democratic government in 1991, the poverty alleviation was accorded high priority and incorporated in its tenth plan as principle objectives to mitigate poverty. Despite more than four decades of planned development, the Nepalese economy is persistently suffering from general poverty and stagnation. It has led to several economic and social disturbances in the country. Therefore, widespread poverty and illiteracy is the main cause of the effective implementation of VAT in Nepal. "VAT regime is extremely challenging in a burgeoning economy like Nepal where with long open border, a large segment of the economy is yet to be monetized.

In the decade of 1950s, the amount received from land tax, forests and contract were the main income source of the government and thereafter, gradually, custom duties became the government's primary source of income. The regular expenses of government are increasing each year. So, government required more revenue for its development work internal source of revenue is inadequate and depended on external sources, "when mobilizing resources from external sources, the compulsory to agree to the various terms and conditions laid by the donor countries or organization prevail. But, in addition, it also breeds many anomalies. The increasing dependence on external resource is not a positive for economic progress"

Nepal still remains as one of the members of ten poorest countries in the world. Despite more than four decades of planned development, the Nepalese economy is persistently suffering from general poverty stagnation. The low income people of Nepal suffered from economic humiliation ever before than they are suffering today and this has led to several economic and political disturbances in the country. Tax reform and adaptation of VAT is important fiscal phenomenon. The adoption of VAT as a substitute of existing sales taxes is expected to improve Nepal's tax system in various ways. VAT is a broad based tax, it is based on self-assessment system and provides the facility of tax credit as well as tax refund, increase the revenue elasticity and it avoids cascading effect existed in sales tax and contains catch-up effect (perhaps it is the most charming feature of VAT). Similarly, it has also some merits. Such as, less chance of tax evasion, simple to administer, transparent and minimum burden to consumers, mass participation of tax payer and it is based on VAT not on total price. So, price does not increase as a result of VAT. It is expected that the VAT would contribute more than 40% of countries total revenue. It is the reality shown in developed countries.

VAT is a new experiment in Nepalese tax system. So, many problems and difficulties had to be faced in primary phase of implementation. There is no conducive environment for executing the concept of VAT. The tendency of unnecessarily troubling taxpayers must be stopped to ensure a friendly atmosphere at various tax collecting offices. The major problem associated with VAT is lack of knowledge. In Nepal most of the taxpayers are unknown about the VAT. The billing system is also confusing for the taxpayer. The billing system is lacking. Most of the businessmen does not issue VAT bill to their customers. The general concept is that, VAT increases the prices of commodities and services.

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 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 challenges to Nepal's tax system was felt necessary (T1651)

To avoid the deficit budget, effective implementation of VAT would be an important tool. In Nepalese tax structure, sales tax is suffered from very low tax base, cascading effect and distortion effect. But, VAT is considered as the best form of sales tax having many merits like as; self policing catching up effect, broad base, mass participation, and transparent amount based neutral etc. Least developed countries are facing numerous problems in the process of economic development. Nepal is an example to this condition. More than one third of total population is below the poverty line. The majorities of people have out of reach to get basic needs. Government needs huge amount of capital to meet growing public expenditure. The government expenditure rate is exceeding over the growth rate of revenue almost every year from the beginning of the planned development in Nepal

Thus, the study focuses on how to overcome resource gap problem and effective implementation of VAT in order to increase in its contribution to the national revenue. Even the Nepal government, Nepal has implemented VAT from the 16 November 1997 various objections have risen through private sector. Nepal chamber of commerce and industry has stated the existing facility in the sales tax, should be given VAT also. Various problems have indicated through

private sector. I.e. VAT should levy of the product basis. It should be levied party on the product, threshold should not be limited.

1.3. Objective of the study:

This tax system running on its 12th years and not new in the Nepalese context, so this study tries to identify the current issue on VAT and government efforts to make VAT effective and the major objective of the study in to analyses the contribution of VAT in government revenue and its implementation in the context of Nepal the specific objectives of this study are as follows:

-) To study and examine the historical background of VAT
-) To study and analyse the present provision and status of VAT system in Nepal.
-) To compare VAT with other major sources of revenue.
-) To find out the problems of effectiveness of VAT implementation and its possible correction measures.

1.4. Significance of the study

This study explains the producers of tax refund and judicial trend in tax refund which makes people easy to know how VAT paid can be refunded with existing laws. This study makes other researcher easy to conduct further research on VAT implementation in Nepal. It may be helpful for the businessmen and the consumers as well who are still last amid the confusion about the proper implementation of VAT. This study is not only for study and to full fill the knowledge gap but as examine the burning problem of Nepalese economy with relating VAT. VAT is implementation on various sectors such as production, manufacturing, export, import etc. In this context examination of sectors wise contribution of VAT helps policy makers to make program and policies.

So, the research is significant in the sense that it's through study may facilitate the government making policy and solving the implementation problems and VAT relate issues.

Despite more than 13years of VAT implementation, many Nepalese are unknown about various aspects of it. This study basically concentrates on administrative structure of VAT, the importance of VAT to improve internal resource mobilization, existing issues of VAT in Nepal and provided effective suggestion to making VAT effectiveness. In this regard, this study carries a

great significance to mobilize additional resources through improved and successful implementation of VAT and hence make the country self dependent to some extent instead of the rapidly persisting resource gap.

1.5. Limitation of the study

The study has very limited area of investigation. It is only a part and partial analysis of the corpus of tax system. The comprehensive study of the tax system is not possible in this research work due to its certain deadline for completion. The history of VAT is not so long in Nepal. When talking about VAT, it implicitly concerns the corpus of the taxation like income tax and others, but this study would not go that far. The information and data were collected from the IRD office, MOF and other concerned offices. Due to time and resource limitation mainly secondary data were used in this study. So, it is largely dependent on the reliability of secondary data. These all constraints have limited the boundary of the study. Despite such limitations, the attempt has been made to make it profitable. This study has been concentrated about the study of value added tax in Nepal. It is not complete study of the whole tax system in Nepal. Mainly secondary data has been used. The views of respondents are collected only in the Kathmandu valley. Due to time and resource constraints, this study extends up to the period of 2009/2010 only. This research has been conducted to fulfil the requirements of MBS course within prescribed time. Some limitations that occurred in the study are as below:

-) This study covers the period from FY1999/2000 to 2009/2010.
-) The study is based on analytical and descriptive types of research.
-) Due to the small size, it may not fully represent Nepal as whole. Survey will be conducted with in Kathmandu valley only.

1.6. Organization of the study

This study is divided into following five chapters:

Chapter -1. The first chapter describes the theoretical knowledge of VAT and VAT in Nepal with statement of problem together with the objective of the study. It will also describe the suitable methodology, limitation importance of the study etc.

Chapter -2. The second chapter includes literature review, which will help to become clear about what other scholars have already done and what remains to be done in this subject. This chapter covers concept of VAT, provision of VAT and calculating of VAT etc.

Chapter -3. In the third chapter deals of research design, sources of data, data collection techniques and analysis of data.

Chapter -4. In the fourth chapter deals with the presentation and analyses of data presentation either in tabulation and graphic of both, analysing in accordance with suitable tools.

Chapter -5. In the fifth chapter covers summary of this study, conclusion of research finding and recommendation for effective implementation of VAT.

CHAPTER –II

REVIEW OF LITERATURE

This chapter deals with the review of relating to the topic of the study in more details and descriptive manner. For this purpose various book, journal and past thesis are reviewed. This study reviewed the available international literature as well as national literatures. To review study, different books, reports, journals and research studies published by various institution unpublished dissertations submitted by master level student have been received. This chapter deals with the conceptual framework, which conclude concepts of VAT briefly present the provision of VAT, provides an overview of VAT system in Nepal, describes the methods of calculating VAT, and reviews earlier studies. In addition, it also helps to justify the research gap.

2.1. Conceptual Review

2.1.1 Historical Background of VAT.

Value Added Tax popularly known as “ VAT” in short forms is conceived by Belheim Fon Simens of town any for the first time in 1919AD(pandit:2056) advised the German authorities to implement the system in order to solve the problem of short government revenue they are facing in those days. In fact, the system is conceptualized with two objectives. First objective is to streamline a tax system, which ensures perennial and dependable source of more and more fund, to government. Second objectives of their economic activities though the system is conceptualized with such noble objectives, it remained virtually far from being implemented for decades in 1949AD. It’s extensive or detours form is envisaged in order to introduce reform in tax system of Japan. 1950s is the decade when the past developed and prosperous nations of the worlds were badly suffering from after month of the great sum of 1930s and ravaging the Second World War. In those days, government of the counties, so suffered, were totally disquieted do find a way to heal the unfathomable economic catastrophe of the 1930s great depression and Great War.

In fact, a scientific and a feasible tax system is a must to any government of any country at anytime in order to establish good governance and lead a nation to prosperity, progressive and sustainable tax system in a country. Ideal tax system

is a pre-requisite for goods governance is a state since prehistoric period. Below is cited an important incident of Mahabharata period, “After pandavs transformed Khandarprastra into indraprastha, the prosperous state, they invited their predecessors from Hastinapur on a certain Yudhishthir, the eldest of the Pandavs requested their uncle Vidur, the prime minister of Hastinapur to tell them secrets of good governance on. This Vidur said, “Your majesty a kind has to look always into how his people are taxed. If state taxes her people beyond them can pay, they will be compelled to convert themselves into sophism and this will need a nation to retrogression” (Shrestha 2062). For the first time in the world France introduced VAT system in 1954AD. Limiting it to transaction of wholesale stage only in industrial sector. Later the country extended the system in 1968 AD. Ivory Coast and Senegal of continent of Africa is second and third countries who introduced the system in 1960 and 1961AD respectively. Establishment of European Economic Community i.e. European Union required all its members’ countries to adopt the system. Therefore the system spread their comparatively very quickly. Among the member’s countries of OECD, all countries except USA have adopted the system. All major SAARC and ASEAN countries of continent of Asia are found cool towards introduction of the system. Meanwhile the system spread gradually in South American countries as well Brazil is first South American countries, who introduced the system and by 1998AD country of the continent in total have implemented the system.

By eighties’ decade all major European countries both EC and Non EC have adopted VAT system. Nineties’ decade is the period when the largest number of countries introduced the system. During this decade Russia and other federal state of USSR such as Estonia, Ukraine, Tajikistan, Georgia, Lithuania, Latvia etc to who belong to European region have introduced the system. By the end of 2000AD 47 EC have implemented the system. Europe is the continent where the target number of countries has excited the system. Costa Rica and Nicaragua are two North American countries who introduced VAT system in 1975 AD by 2000 AD. Almost all major countries of continent have adopted the system except U.S.A. In U.S.A. too, lot of preparation have been made to introduce two systems. In Asia, Vietnam is the first country who introduced the VAT system on July 1973. The country withdraws the system soon and again implemented the system on January 1, 1999. The third largest countries of the world in area and the first largest country of the world in population china and one of the smallest countries of world, Singapore have introduced VAT on October 1, 1984 and

April 1994 respectively. Among one of most densely populated countries. The biggest democracy of the world, India introduced VAT on April 2005, Japan on April 1, 1989. Altogether 17 countries of Asia have implemented the system by 2000A.D. countries of oceanic too have implemented VAT in their region. New Zealand, Papua New Guinea Australia is major countries of oceanic who have implemented VAT system by 2000AD.

As VAT is less harsh and more revenue-productive, it has been spreading all over the world. This tax has been adopted by eight countries by the end of the 1960s. Since then the tax has been introduced by at least one country each year except 1974, 1978 and 1979, Now more than 130 countries have adopted VAT and in fact, VAT has become a popular topic for tax reform in recent years.

2.1.2 Introduction of Value Added Tax

VAT applies to supplies of goods and services for consideration other than exempt goods by taxable person. VAT shall be charge on any supply of goods or services. VAT is a tax on trading transaction. The real VAT payer is the consumer not the producer.

The VAT is broad based tax as it covers the value added to each commodity by a form during all stage of production and distribution. It is a modern tax system to improve the collection to taxes, to increase efficiency and to reduce tax evasion. It is also regarded as the backbone of income tax system. VAT is levied on value added at each stage of production and distribution activities. The stage may be import, export, manufacturing, wholesaling, and retailing.

2.1.3 Meaning of VAT

Different experts and institutions have attempted to give the meaning of VAT according to their own interpretations. Here some of their definitions may be studied.

VAT is a general consumption tax assessed on the value added to goods and services. It is a general tax that applies, in principle to all commercial activities involving the production and distribution of goods and the provision of services. It is a consumption tax because it is borne ultimately by the final consumer. It is not a charge on companies. It is charged as a percentage of prices. This means that the actual tax burden is visible at each stage in the production and distribution chain. It 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 seller rather

than the consumer). As VAT is intended as a tax on consumption, exports (Which are by definition, consumed abroad) are usually not subject to VAT or VAT is refunded.(Bhattarai & Koirala 2007;321)

Value Added Tax, popularly known as ‘VAT’ is a special types of indirect tax in which a sum of money is levied at a particular stage in the sale of a product or service.

Source: (www.economywattch.com/business-and-economy/vat.html)

Value Added Tax (VAT), or goods and services tax (GST), is tax on 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 who does into bear the entire cost of the tax. To avoid double taxation on final consumption, exports (which by definition are consumed abroad) are usually not subject to VAT and VAT charged under such circumstances is usually refundable.

(Source:en.wikipedia.org/wiki/value_added_tax)

Value Added Tax is not an additional tax, but has replaced taxes such as sales tax, hotel tax, contract tax and entertainment tax that used to be levied on the sale of goods and services. (Source Khadka.1997:11)

From the above definition, it is obvious that VAT is an indirect tax which is the newest and significant experiment done on the modern tax system. Like its predecessor, i.e. the sales tax. VAT is also levied on the sale of goods and services (GST). VAT is a broad-based tax as it also covers the value added to each commodity by a firm during all stages of production and distribution. It is a modern tax system to improve the collection of taxes, to increases efficiency and to lessen tax evasion.

VAT is modern and scientific tax system. It is not similar to custom, excise duty or sales taxes that have borne the traditions or historical heritage. It is not a tax that has been improved and amended and accordingly inserted and deleted. It is a tax of the 21st century since it is highly developed and refined. It is a tax that suits the present speed of knowledge, development and skill. Moreover, it confirms with the present context of liberalization, privatization, and globalization. It is easily adaptable with the open economy system and matches with the private sector and the market economy of the present day. It is a tax

that is transparent and has an in-built system of self-control. There can be no difference of opinion on the above facts.

In summary, the value added tax system is designed to address various problems associated with the conventional sales tax system. It is a tax that has developed as an alternative for the traditional sales tax. That is why it is also called improvised version of sales tax (IRD& VAT project 2001:95) as clarified by Chandra Mani Adhikari. It is also an improved and reformed sales tax (Adhikari, 20036). In sales tax, there is no provision for input tax credit, which means that the end consumer may pay tax on an input that has already been taxed previously. This is known as cascading and leads to increases consumer tax and price levels, which increases the rate of evasion and can be detrimental to economic growth. In contrast, the VAT that has been levied in the previous level can deducted while paying taxes on the later levels. It has a special system where a person trying to deceive tax will be caught on either one of the subsequent levels. Therefore, the trend of tax evasion is highly discouraged.

2.1.4 Adoption of VAT in Nepal

The implementation of VAT system in Nepal is being quite late then other countries of the world because VAT was the new concept. In the field of taxation. After the transition of democracy in 1990, the government lunched a reform program to promote modern market oriented economy, evil maintaining sound macroeconomic policies. A major structural reform initiated then was to introduce.VAT system in the country. The government adopted a policy of adopting VAT in eight year plan (1992-1997). Similarly, the 1993/1994 budget stated that VAT would be introduced within a year two.

VAT steering committee and VAT tax force were formed in 1993. As a part of its liberal economic policy, UN accepted forms to study VAT system. The technical assistance of HIID under the USAID financial assistance took up the study. This assistance was suspended in 1995,, resumed in 1996 and continued till 1997, GN started exploring donors for the continuation as VAT program. The DANIDA accepted the government required the pledge to support VAT project. The DANIDA had been extending technique assistance since1997. VAT act was passed in 1995 by the parliament meanwhile the department of VAT in 1996. It had the full responsibility to administer VAT system, VAT interacts and training programmes were organized by the representative of

FNCCI, NCC journalist, chartered accounts association businessmen and several other professional groups.

As VAT law was designed to handle a single standard rate, the multiple rates of sales tax were unified in ingrate is percent from the rate of 10 to 20 percent. Again, some more training instructions programs in form companies, meetings etc. We have to convince people about the introduction of VAT system. VAT task force was set up with members from VAT administration, FNCCI, NCC and consumer forum. The cabinet improved VAT regulation in 1997. The national VAT steering committee consisting of representation from GN, FNCCI, NCC and donors was formed. Another AVAT task force was formed with member from GN,, industry and commerce sector. Besides VAT act and regulation, the ministry of finance approved nine volume of manual in 1997. In a run up the budget for the fiscal year 1997/1998, the government decided to convert hotel tax into the sales tax and the rate of tax was also reduced to 10% from is 20%.Despite opposition from the international monitory fund of such rate reductions. There was significant revenue risk associated with the rate reduction, GN went ahead with, it agenda. The HIID had made a study meanwhile about appropriate rate of VAT. The study recommended is percent as a revenue neutral rate. At the time of announcing its budget of the fiscal year 1997/1998, the government did not need the recommendation. Similarly, exemptions of the sell tax were not brought in line with what was listed in Act, 1995.

The final date of the introduction of VAT was set for November 16, 1997 and game into practice. The existing sales tax act, 2023, hotel tax act, 2018, contract tax act 2023 and Entertainment tax act 2017 were repealed along with the implementation of VAT later Nepal government has increased rate of VAT to 13% with affect from Magh1, 2061. In the introduction phase, it faced many problems. There was protest against it through business community. Several rounds Negotiations were held to reach in an amicable settlement.

In fact, the implementation of VAT was not easy in the beginning years. It was a matter of great debate. A large number of trader's were against VAT. Now, the situation has charged. Despite some short comings, the overall functioning of VAT, so far is satisfactory.

2.1.5 Types of VAT

In partial sense, there are three types of VAT basis difference between all three types' lies in how capital equipment which a producer buys for use in the business is treated in computation of VAT.

) Consumption type

The consumption types of VAT, which is not imposed on the purchase of capital goods during the period of purchasing year. Under this variant, the producers are free from the liability of paying tax due to the consumptions based tax. The government provision on depreciation will be taxed in succeeding year. All capital goods are purchased from other firms in the year of purchase is excluded from the tax base while depreciation is not deducted from the tax base in subsequent year. The consumption type of value added tax will help the trade in investment of capital goods for production. They are not liable to pay tax instantly in consumption type. So, consumption of $VAT = GDP - \text{cost of intermediate goods} - \text{cost of capital goods}$.

) Income type

Tax payers are not free from tax base in the purchasing of capital goods from other firm but the trade can exclude depreciation from tax in the subsequent year. The income type of VAT does not exclude capital goods purchased from other firms from the tax based in the year of purchase. This variant however, does exclude depreciation from the tax base in the subsequent year. Moreover, under this system and excess of year- end inventory is excluded; tax is liable in both consumption and net investment. The tax revenue under this type is regarded as national income, so the name of this type is also said as income type. Furthermore, the VAT can be assessed in all business. Since, it does not need discriminate incorporated business. If tax paid on durable capital goods is not deductible at the time of purchase of the equipment, but on depreciation basis over the life of equipment. The total base of tax is the same as that of a personal income tax of equipment. it is same as that of a personal income tax without exemption that is total consumption plus real investment during the period.

J The gross national product type

In both consumption type and income type, a taxpayer is liable to pay either in subsequent year or in running year in single way. In this way these two types of value added tax could be said as single effect of value added tax. But the concept of Gross national product type is deviated from these two types. The gross national product type of value added tax is not single effect tax system. In this type the taxpayer will be liable to pay tax on purchase of capital goods in the purchasing time. Similarly the taxpayers will not get provision of deduction of depreciation from tax base in succeeding year. The gross national product type of value added tax can be taken as double (malty) effect tax and paid both in running year and subsequent year this type of value added tax including consumption plus Gross investment “by the name of firms are not permitted to deduct or refund tax on durable capital goods, which means whatever goods and services are produced or imported are fully liable to pay tax.” Under this variant capital goods purchased by a firm from other firms are not allowed to deduct of depreciation from the tax base on the subsequent year tax. The double or multiple effect type of vat can be taken as best one from the point of view of government, but from the point of view of taxpayer, it will make double effect to taxpayers hence it is not so goods in comparison to income type and consumption type of vat. So, GDP type of VAT= Gross receipt- cost of intermediate goods.

2.1.6 Methods of computing VAT

VAT can be collected by using the different methods of computation however, the choice of appropriate methods depends on the type of VAT employed and the principle under which VAT is adopted. The VAT can be computed by employing any of three methods;

- 1 Additional method,
- 2 Subtraction method, and
- 3 Tax- credit method;

Among above “the last method has never been utilized” (Due, 1976:71)

1. Additional method:

Under this method Value Added is the total sum of factor payments made by the business firms, which is equivalent to the gross income received by the factors of production. The tax base is computed by adding the payments made by the firm to factors of productions employed in turning out the product, such as wages, interest, rent, royalties and profits (Sullivan, 1965; 7). Thus, VAT under addition method is the function of the total factor payment as given by;

$$\text{VAT} = f(W + R + I + P);$$

Where,

W=Wages, R=Rent, I=Interest, P=Profit

If the firm construct its own capital goods rather than purchasing it, this addition method captures the value added by the firm. The capital method is readily applicable to the income type but clumsy for the consumption type of VAT (Musgrave and Musgrave, 1976; 401). Virtually, no country uses the addition method, although Argentina and Israel have applied it to selected economic activities, such as banking and finance, where value of inputs and outputs is difficult to measure. From the practical point of views, this method is more complex to compute. It would be awkward to use the addition method to compute the vase of the consumption type of Value Added Tax, since to the net profit figure there would have to value added depreciation and excess of opening inventory over closing inventory (deducted, as a part of cost of goods sold, in computing net profits), with the subtraction of capital goods purchased or produced within the firm and subtraction of an excess of closing inventory over opening inventory (Shoup, 1969; 258).

2. Subtraction Method:

Under this method, value added is determined as net turnover,, which is obtained by subtracting the cost of materials from sales proceeds(khadka,1989;5), and the procedure was used the Michigan VAT (Due,1976;71). Value added is obtained by subtracting purchase of produced goods from the figure of sales during the period, as given in functional form by,

$$\text{VAT} = F (S_v - P_v)$$

Where, F= function, S_v = Sales value, P_v = Purchase value

This method of calculating VAT is suitable for the consumption variants' of VAT. This method is not well suited for discrimination among types of consumer goods but it need not only any adjustment to operate correctly for import under the origin principle. Same thing also happens to the addition method. However, under the discrimination principle, these both methods of direct calculation cannot supply the export rebate or the import compensating tax, when there is not uniform rate to all stage of value added of all goods and services.

3. Tax credit method

Tax credit method is also known as the invoice method and uses as indirect subscription technique to compute the tax liability. Value added, as such is never calculated at all, in this method, but the effect is the same as it the figure was calculated and the tax rate applied. Since, the firm deducts the amount of the tax paid on its purchases during the period from the figure calculated by applying the tax rate to its figure of taxable sales for the period. Under this method, taxpayers are allowed to subtract the taxes already paid by their suppliers and passed on to them from the gross tax liability, which is levied on the total value of their sales. Thus, in contrast to the subtraction method, which deducts purchases from sales and levies taxes on the differences, tax on purchases is subtracted from the tax on sales under the tax credit method (Khadka, 1989). Hence, net tax liability is given by the following equation

$$\text{VAT} = f(\text{outputs} - \text{inputs}) = (\text{Tax paid on sales} - \text{tax paid on purchases})$$

Among the three methods of computing VAT the tax credit method is widely favoured in the country of the European Economic Community and elsewhere. The invoice method is use generally in European country and constitutes an advantage of the value added approach, especially in countries where, tax compliance is otherwise poor (Musgrave and Musgrave; 1976:402). The tax credit method is so superior to the other method in terms of the application and enforcement as well as adoptability to various rate modifications, which is now universally employed. The tax credit method can be especially useful it is desire to reduce the rate of the value added tax at same stage in the production and distribution process, say the raw material or firm products stage, for administration reason, without reducing the total tax paid on total value added(shoup,1969:259). However, this tax credit method fails to give credit for tax prior to the exempt that is given to either the pre import domestic stages except the first stage because the tax credit chain is broken. The tax credit method encounters still move difficulties under an origin principle value added tax that imposes different stage simply for administrative reasons. Beyond this positive and negative aspect of tax credit method, it has a power to make the overall rate depends

on the imposed at the stage of production or distribution. Whatever may be the rate at various earlier stage, the process of calculation VAT liability under different method are shown in the table below.

Calculation of VAT revenue (T) in different methods may be expressed as follows:

-) Addition method; $T=t(\text{wages}+\text{rent}+\text{interest}+\text{profit})$
-) Subtraction method $T=t(\text{sales value}-\text{purchase value})$
-) Tax credit method $T=t\{t(\text{tax on sale})-t(\text{tax on purchase})\}$

Where, t= percentage rate.

Above expression will be clear from the following illustration.

Table No. -1

Computation of VAT in different method:

S.N.	Description	Importer	Manufac turer	whole saler	Retailer	Total
1.	Purchase value(exclusive tax)	0	200	500	700	1400
2.	10% tax on purchase	0	20	50	70	140
3.	Wages	80	120	80	40	120
4.	Rent	60	80	60	30	230
5.	Interest	30	60	30	20	140
6.	Profit	30	40	30	10	110
7.	Value added 3+4+5+6	200	300	200	100	800
8.	Sales value (excluding tax 1+7)	200	500	700	800	2200
9.	10% tax sale	20	50	70	80	220
10.	VAT liabilities in:					
10a.	Addition method 10% of (3+4+5+6)	20	30	20	10	80
10b.	Subtraction method 10% of(8-1)	20	30	20	10	8
10c.	Tax credit method(9-2)	20	30	20	10	80
11.	Actual sales price (sales value +VAT)	220	530	720	810	2280

Source: arbitrarily estimated figure.

For the purpose of calculation of VAT, the purchase value at the point of import is shown zero. From the above illustration it is clear that, if the tax rate is same throughout the production and distribution method, the VAT amount to

be paid is same in all the methods. Only calculation procedures are different. Finally, all the burden of tax falls on consumer. In this example, the consumer has paid Rs.80 against VAT. The government collects the same amount not only one stage rather than different amount from different stages of production and distribution i.e., Rs.20 at the custom point in advance from the importer, RS.30 from the manufacturer Rs.20 from wholesaler and Rs.10 from retailer.

2.1.7 Principles of VAT

VAT can be implemented under either the origin or the destination principle.

A. Origin principle

Under this method, the tax base is obtained by adding the incomes produced by the firm. This implies that all exports are taxable and all imports are non-taxable. Where there is a border and cross-county trade. This principle gets important to imported goods or services over domestic production. Countries with international boundaries do not prefer to have this principle. But in European community (EC) where there is a common border this principle of taxation is essential. The main reason blind not following this principle is of revenue loss. It also discourages the export either directly or indirectly.

B. Destination Principle

The most popular form of principle adopted by a large number of countries is destination principle. Under this principle, goods or services are taxed on at the place where they are produced but the place where they are consumed. This means all imports are taxed while all kinds of goods and services are free to taxation. The main advantage of this principle is non-discrimination between import and internal production. This principle is favourable for promoting export. Many countries follow this principle because they are eager to boost export. Nepal's VAT system is also characterized by the Destination principle.

2.1.8 History and Development of VAT

Tax is collected by government to meet the need of budget. Among the various types of tax, the sales tax is one of the major sources. VAT is the most scientific system of sales tax. In the early days, the tax from the consumption and production is collected as sales tax. But now, it is almost completely replaced y the VAT. THE CONCEPT OF vat was introduced in1919by Dr. Wilhem Von Sieman in Germany. This concept was brought to replace the

“Usnatzsterller” (multi stage sales tax) due to its undesirable effects, particularly cascading and vertical integration of the latter tax (MST) for the first time. The Germany knew the administrative complication of the VAT system. So, it has the fear to implement. Therefore, the rate of unsatzstener is reducing instead of the implementation of VAT. In 1921, the America was implementing the corporate income tax. Prof. Thomas S Adams suggested the tax for the united state of America to replace the existing tax system. Until early 50s the development of VAT remained limited only in the theory.

France was the first implementer of VAT in 1954 covering only in the industrial sector the VAT was limited to only up to whole level. But these countries limited the VAT only on import and manufacturing stage.

In late 60s, VAT started to become popular. Countries like Denmark and Brazil adopted this system of tax in 1967. France, the first implementer of VAT, extended it to the retail level for the first time. And Germany also adopted VAT in the same year. In 1969, the countries like Netherlands and Sweden also adopted VAT in their countries. In 1970, 1971 and 1973, Luxembourg, Belgium and Ireland introduced the vat respectively.

In Asia, Vietnam was the first country to introduce this most scientific tax system. The country adopted VAT in 1973. The trend being VAT popular was increasing all over the world. In 1977, 1984, 1985, and 1986 South Korea, China, Indonesia and Taiwan introduced VAT respectively. Similarly, VAT was introduced by Philippine in 1988, Japan in 1989, Thailand in 1992 and Singapore in 1994.

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

2.2 Value Added Tax Law in Nepal

2.2.1 History and Development of VAT in Nepal

Nepalese ancient tax system was based on Vedas, Smritis and Purans. Directives propounded by Yagyabalka, Chanakya were main source of taxation system. In the eighties, various countries, to maintain a sound macroeconomic policy, adopted various takes of reform programs. This program was in swing in 1990's. As the adoption of reform program was at the heart of worldwide policies. Nepal was no exception. The Nepalese government revealed its intention for the adoption of various reform programs to promote market oriented economy in the Eighth plan (1990-1995) document. In a process to reform task policy, it has mentioned that some time in the mid-plan period a VAT will be introduced in the country. Before that VAT was completely unknown word to the general people of Nepal. After a restoration of democracy in 1992/93, a two-tier sales tax system was in function at that period.

Under this system dealers and distribution of nine-selected items were required to register for sales purpose and collect tax on their sales. It was extended further to five more items in 1993/94. Only the amount of tax paid to manufactures was allowed to credit. Further, sole distribution or agents of the foreign firm or companies and their wholesalers were also required to register for the purpose of collection of sales tax.

As a parts of its liberal economic policy, the government of Nepal asked donors to study the VAT system. Finally a VAT task force was created in the sales tax and Excise Department in 1993. United state agency for international development (USAID) and Consultancy Assistance for Economic Reform for international development (HIID) started the study in order to makes the necessary preparation for the introduction of VAT. The task force was fully devoted to accomplishing preparatory work. It prepared the draft for VAT legislation, organization, staffing and exemptions. Due to political instability frequent changes in the priority for the implementation of VAT. The task force could not continue its job. At the time of creation of task forces, the Nepali congress was in absolute majority in the parliament.

A midterm poll changed the political scenario. The United Marxist-Leninist (UML) party created a minority government where as the Nepali congress became the opposition party. The government led by UML could not reveal its positive attitude towards the implementation of VAT. In the contrary the two-

tier sales tax was declared to be removed in its 1994/95 budget. This negative step hurt the donor agencies and consequently the USAID suspended its support and Harvard institute for international developments experts returned. The VAT task force was dismantled, soon after the verdict of the Supreme Court to re-install the dissolved parliament. A coalition government led by Nepali congress, formed and it showed as earlier, a firm commitment to introduce VAT in its F/Y 1996/97 budget. The USAID resumed its support but is allocated for the study of VAT had already been transferred to other projects. Again, scarcity of fund is realized by the government and search of the donor who can provide the necessary fund and technical assistance for the implementation of VAT after all the DANIDA supported the VAT project, it is continuously supporting till now.

As a part of preparatory work, the VAT Act was passed in 1996 by the parliament. The government in 1997 approved VAT regulation. In the same year, the department of sales government Tax and Excise were renamed as the department of value added tax. After a year, the ministry of finance approved nine volumes of manuals. Furthermore, VAT taskforce organized a various discussion and interaction program related to VAT in different parts of the country. Various introductory brochures were published and distributed to the potential taxpayers, businessmen and the administrative staffs. The vat was initially scheduled to be effective from July 1997. The government was planned to register the potential taxpayer in VAT from this period. In support of VAT, the government decided to rationalize the tax structure by educating the rate of income tax, Sales tax and custom duties in advance. The VAT was to replace the Hotel tax, the entertainment tax and the contract tax. For this purpose the VAT task force was preparing its work in accordance with the schedule. Meanwhile the private sector of business field opposed the government policy on adoption of VAT. Nepal chamber of commerce held a nationwide discussion program among traders, industrialists and their representative association in March 1997 to collect the attitude towards the introduction of VAT which was scheduled to be operated from two month later.

Business person protested the decision of the adopting of VAT with the slogan “NO VAT” issue of VAT resulting in a conflict between the government and the private of business sector. Finally the government decided to postpone the date of application for four months. The government also announced the date for the VAT to be effective from November 16, 1997. With a view to facilitating the functioning of VAT the government made an arrangement in the

budget for F/Y 1997/98 to convert the Hotel tax into the sales tax. The rate of the sales tax reduced from 15% to 10%. Further the rate and the slab of income tax and customs duty were also lowered. The government took a heavy revenue risk by curtailing the rate and structures of various taxes without prior demand of the taxpayers.

In the mean time the business group was also divided into two groups. Industrialist was in favour of VAT whereas the trading group was against it. Despite heavy protest by the trading group, the government implemented the VAT from the scheduled date of November 16, 1997.

Even after adoption of VAT the days were not as easy as expected. Trading, businessmen were completely against the VAT whereas industrialists were in favour of it with heavy concession on various taxes. The government announced all the concessions without prior plan in budget speech four month before the date of VAT implementation, which could not motivate the businessmen. On the one hand the businessmen enjoyed the privilege provided by the government for the successful enforcement of VAT. On the other they continued to protest against VAT.

Political situation was also volatile. The government was in a pressure to quit. As usual, the businessmen were against VAT. Industrialists were in favour of further concession in tax regime that was against the principle of VAT. VAT administrators were not fully aware of its system. Due to various reasons VAT could not function as expected. The business community demanded the continuation of all exemptions and incentives granted under the sales tax system. Businessmen were also very angry at the function of octroi, a local tax FNCCI, a apex body of private sector, decided on February 4 1998 that they would not sit for negotiations with the government regarding the implementation of VAT unless the government scrapped out octroi.

On March 1998, the government and the private sector reached agreement regarding the modalities of the implementation of VAT. Exemption of industrial machinery and tractors soft behave towards the retailer, acceptance of the bill value in import point set up a committee in order to reviews the VAT law and establishment of permanent revenue board where the main agreement. Since most of the agreed points were not activated the businessmen again began to oppose VAT. A series of discussion took place before the presentation for the F/Y 1998/99 budget. The demands of businessmen were increasing

considering the volatile situation of the political party. The government requested for the agreement but the businessmen rejected the proposal and did not sign in agreement. Even, though the government addressed few issues that were asked by the businessmen. Finance bill 1998 incorporated following changes.

-) The threshold was increased from Rs.1 million to Rs.2million.
-) Cottage industry got relief from the registration in VAT.
-) A special arrangement to be provided to settle the old stock of businessmen.
-) The rate of interest was reduced to 15% from 18%.
-) The rate of penalty of the late filing of return fixed at 0.15% per day instead of 100%.
-) Tax offices were empowered to issue a tax assessment if tax payer cannot justify the reason for under invoicing
-) Firms, companies and industries are required to issue serially numbered invoice with their names and addresses. The VAT administration may inspect, with prior approval of the DG of the VAT department. The books of accounts of unregistered vendors in connection with VAT, and may penalize if the books of accounts are not maintained properly.
-) A list of exempted items increased.

Despite above mentioned provision. The government also announced the several measures in the field of income tax, customs duty and revenue investigation with a view to rationalize the tax in accordance with VAT principle. Provision of some corrective measures provided for the simplification of tax collection irritated businessmen more than were attracted towards it. They continue to oppose the VAT system vigorously.

Finally both parties agreed not to implement the provisions provided by the finance Act until they reached an agreement. Ultimately, both parties agreed on 39 points on September, 1998. Most of the agreement was in connection with the further exemptions and concessions in various fields. VAT as well as to the taxes. Few of them were in adverse direction of VAT principle.

VAT administrations had allocated a TPIN (taxpayer identification number) consisting of nine digits to registered taxpayer with a view to process data in computer. It was developed as per international standard. Last ninth digit was for checking the accuracy of the number. Which is called check number; all the records of taxpayer are stored in the computer in data base format. As the computer processed all the data of taxpayer, it has become an integral part of VAT administration. Before that all the records were kept manually.

In accordance with the purpose of integrating VAT and tax department into one department from coming year a provision was made in finance act.1999 that “A PAN (permanent account number) was allocated to the registrant of income tax from the next fiscal year”. For this purpose the taxpayer service centre established under the department of tax. PAN was also similar to TPIN those tax payers who have already received the TPIN were converted to PAN with same number. The service of this centre was only confined to nine offices of Kathmandu valley.

Issuance of PAN was accessed to all tax payers of the country from December16, 1999 after the establishment of Inland Revenue Department (IRD). For the simplification of management of date a database computer system has been developed since the inception of VAT in Nepal.

With a view to provide all the services from the e same window and to make effective mobilization of internal resource, the government decided to integrate the Department of VAT and department of tax. The department of VAT merged into department of tax on april.2000. Through the budget speech for F/Y 2001/02, the government announced to establish “Inland Revenue Department” from july2000.

Before the merger, there were 17 offices under the VAT department and 41 offices under the tax department. To over the whole kingdom of Nepal, all those offices merged together and established 21offices on the basis of including geographical region, number of taxpayer, taxpayer services and potentially of tax collection. Out of them four offices were classified into “A” class, two into “B” class, three into “C” class, four into “D” class, and five into “E” classes. Officials and staffs were recognized according to its work load. The newly established department will administer the following taxes from the same window.

1. Income tax (individual and corporate income tax. Remuneration income tax, interest tax, house rent tax.)
2. Value added tax
3. Non-tax (dividend, principal and interest payment, royalty, charges and fees)
4. Other related charges and fees related to excisable goods.

VAT has been justified in the light of government fiscal imbalances and need for extra revenue mobilization through an efficient tax system. The government of Nepal has increased VAT to 13% effective from Magh 1 2061

In Nepal Value Added Tax act was enacted by 1995 and started to implement only at 16 Nov, 1997. Value Added Tax Act divided four different Tax Act, such as Sales tax Act, Hotel Tax Act, Contract Tax Act and Entertainment Tax Act.

VAT replaces the old sales Tax, Contract Tax, Hotel Tax and Entertainment Tax. It is believe that successful implementation of VAT will helps to generate customs duties and income tax also and it is expected to enhance the revenue collection and it is closely associated with the GDP. This Act classifies good and services under three category they are VAT able goods and services, exempted goods and services and zero rated goods and services. It is applied at a single rate (presently 13%, initially 10%) based on addition of value of the goods and services at each stage in the process of supply and delivery of goods and services.

Since then second and various amendments have already been made by different finance Acts on Value Added Tax Act, 1995 and 8th amendment have been made in the value added tax rules.1997. Various directives have been issued by the concerned authority to implement the VAT in Nepal.

2.2.2. Basic features of Nepalese VAT system

The type of VAT adopted by Nepal in conventional similar to that implemented over 130 countries around the world, it has injected some special features into vat system to make it uniquely Nepalese. The following are the main features of the Nepalese vat system:

The adoption of consumption type of VAT because VAT is finally borne by the consumer

-) The consumption of VAT through tax credit method.
-) The principle of destination
-) The level of threshold in Rs.2 million.
-) The facility of tax refund
-) The application of VAT to all business turns over through the retail stages.
-) The rate of VAT is single and positive @13%
-) The provision of exemption and zero rate for the goods and services.
-) The allowance of tax credit for taxable supplies including the zero rate supply
-) Small entrepreneurs are exempted to register in VAT office.
-) Self assessment system.

2.2.3 Coverage of VAT in Nepal

Vat is a tax on goods and services consumed in Nepal. The tax is based on the principle that each producer or distributor adds value. In some way, to the materials they have purchased and it is this added value that is taxed at each stage of the production and distribution. The coverage of VAT in Nepal is based on transfer, sales, supply, import and export of goods and services except some special provisions. It is levied on the value added at each stage of the production or distribution. Every persons or firms or companies who are involved in such transaction liable to paid and collect tax. The actual coverage is structured by the standard and zero rates as well as tax exempted provisions. In other words, tax coverage is guided by tax invoice system VAT is administered by invoice method.

2.2.3.1 Standard rated area

Nepal has adopted “Inclusive Basket System” which means board-based tax coverage under this system all transaction regarding transfer. Sales, supply, import and export of goods and services, where value added exists are taxable, except some special provisions. The value added tax act 1995 has made provision for exempted goods and services under special Laws. Unless this provision, all the value added economic transaction are taxable and tax is collected @ of 13%. This is called standard rated area.

2.2.3.2 Zero Rated Areas

Under the VAT system some goods and services are, or may be, taxed at zero – rate. The objective of this zero rate is to relieve some goods and services from taxation working under regular VAT system and net for the purpose of promoting and encouraging export and maintaining diplomatic behaviours. Under this purchaser is allowed to credit the tax paid off on inputs or purchase in concern. However, one has to maintain all records regarding VAT. The VAT is meant to apply only to the consumption of goods and services in Nepal. Suppliers made in Nepal that are exported are taxable at zero –rate. Exporters are allowed to claims inputs tax credits for VAT paid or payable on purchase of goods and service relating to their commercial activities. Export taxed at zero percent (0%) includes exports of both goods and services.

2.2.3.3 Exempted Goods and Services:

Under VAT system all goods and services are divided in to two basic categories; taxable and tax-exempt. Goods and service are either taxed at the standard rate of 13% or they are taxed at zero percent. Those taxed at the standard tax include all goods and services except those that are specified as taxed at zero percent of tax-exempted. According to VAT Act 1996, the purchase will not pay VAT on tax exempt goods and services and the supplier is not allowed input tax credit on purchase related to the following goods and services.

2.2.3.4 Structure of Nepalese Tax System:

Not only to collect the large amount of tax but also to maintain the economic stability and social justice through improvement the distribution of wealth area the primary objective s of taxation. In this tax structure stands as a mirror of the fiscal policy instruments. The taxable capacity of government as well as ability of people to pay tax is the major factor of designing the tax structure. For the underdeveloped countries like Nepal the role of taxation in the process of economic development is considerably significant. In this respect, the tax structure has vital role in development

Tax system was informal during early shah period; it was bounded by traditional land tax and other fines etc. In Rena Period, taxes where levied on agriculture income from forest and mines, business etc. However, the specify tax system and trend of revenue collection was commenced with the budget

speech of 1951. But which are limited to traditional sectors. Income tax was introduced from fiscal year 1959/60 and sales tax. Contract tax, house and rent tax in 1965 /66. Tax reform programs and implementation of new tax system where continuous in Nepalese tax structure. In this way the government introduce VAT from 1997.

2.2.3.5 Need for Reforms on Present Tax System in Nepal

The tax reform exercise has been the most important and technically the most exciting component of the reform programme in the fiscal sector.

Arguments put forward in favour of reforms in Nepalese tax system are:

-) To enhance more revenue needs.
-) To enable tax administration.
-) To fulfil the increasing resource gap.
-) To face the problem of continuing and raising difficulties
-) Tax reform in viable for liberal in competitive economy
-) To increase productivity efficiency.

There is a global trend of tax reforms. In this way there were as many as twenty-five-tax reform programmers between 1984-1990 in major Asian developing countries also trend continued in Latin American, Europe and Asia from 1990-1995 (Fiscal issue number 4 IRET Washington DC 1984, page 173).

2.2.3.6 VAT as a Tax Reformer in Nepal:

A study on it is theoretical importance Nepal is small country with different society, different people and different religions and different geographical construction. About 40% of the people are literate. Value added tax is a kind of reformed and modified tax system. Which has been held in the country few years ago for supplement of the tax, hotel tax, entertainment tax etc? From the past experience, it provides the government of Nepal has been able to collect more tax than with the previous system (i.e. sales tax, hotel tax, and entertainment tax). Lack of highly qualified and educated people, government of Nepal has able to implement effectively this new tax system. The following arguments reveal VATs timely importance in Nepal.

2.2.3.7 Control of the Corruption

First of all is necessary to control the corruption from the country by implementing the customer awareness policy to collect the more revenue (tax) of the government. Lack of the education and effective management control system, the government of Nepal has not been able to collect more tax. For example, a businessman records his business transactions in the two different books of the account. i. e the original and the duplicate one meant to be shown to the tax department. Due to this corruption the appropriate (net) amount of the tax could never be collected. Hopefully this new system minimizes these kinds of fraudulent transactions.

2.2.3.8 Lack of Education:

Nepal is not only the poor country but it is also lagging behind in education. Only 40% of people are literate. Business person are³ not only the people to blame but general customer also does not bother to ask for the bill. This is because of the lack of education. Consumers do not understand the importance of the bill and do not ask for it. So, to collect the tax and control the funds people must be literate and give importance to billing system and the tax system as a whole.

2.2.3.9 Lack of Customer's Awareness

As describe above the people of Nepal are illiterate and do not know about the tax or the VAT system in particular. So, it is necessary to raise their awareness about the billing system. Encouraging them to receive the bills after the product is purchased. By this funds would be collected, facilitating the development of the nation in the long run.

2.2.3.10 Collection of More Government Revenue

This new policy of tax system has changed each and every stage³ of business transaction (supplier, producer, distributor, wholesaler and retailer). This new flexible policy of the transaction will definitely help the government to collect more revenue in fair and clean manner, eventually contributing to the development of the nation. This will ensure the increase of per capital income of the Nepalese people.

2.2.3.11 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 administered in different and more developed form. The prices to be charged under VAT and sales tax do not differ. Under the VAT system, consumer known 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 than sales tax. VAT is levied at each stage from production to sales but sales tax is levied on only certain level of sales. Following example will clarify that VAT does not increase the prices of goods on services.

Example:

An importer imported a certain article for Rs. 1000. Then it was passed on to wholesaler and retailer before reaching to the final consumer. Importer, wholesaler and retailer charged 10% profit/ mark up on their costs each. Not following tables are used to find out the cost price to consumer in both tax systems.

Table No-2

Computation of sales tax and the cost price to consumer

Channel	Cost price	Value added	Selling price	Sales tax@13%	Selling price inclusive sales tax
Importer to	1000	100	1100	143	1243
Wholesaler to retailer	1243	124.3	1367.3	177.75	1545.05
Retailer to consumer	1545.05	154.50	1699.55	220.94	1920.5
Sales tax collected=Rs.541.69			Cost price to consumer=Rs.1920.50		

Table No-3

Computation of sales tax and the cost price to consumer

Channel	Cost price	Value added	Selling price before VAT	VAT@13%	Selling price include	VAT payable
Imported Goods	1000	-	-	130	-	130
Importer to wholesaler	1000	100	1100	143	1243	13
Wholesaler to retailer	1100	110		157	1367.3	14.30
Retailer to consumer	1210	121		173	1504.03	15.73
Cost price to consumer=1504.03			VAT=130+13+14.3+15.73=173.03			

From all above it is known that

-) VAT is scientific, modern, progressive as compared to sales tax
-) Sales tax is levied on total amount of cost of sales and tax amount of earlier stages is included in cost of sales. On the other hand, VAT is levied not on the total cost of sales but on the amount of value added in each stage.
-) Unlike in sales tax, under the VAT system the consumers know the amount of tax contributed by them.

These are the general facts demonstrating the VAT is superior to sales tax. But this section uses various statistical tools like correlation analysis, time series analysis and others to prove the superiority of VAT over the sales tax.

2.2.3.12. Superiority of VAT to Sales Tax in its Various Forms

Before the introduction of VAT, Sales Tax was on vogue in Nepal. There were different types of sales taxes which are named after the channel using them. The mostly common sales taxes were manufacturing level sales tax (hereafter.MST), Wholesale level sales tax (WST) and retail level sales tax (RST).

2.2.3.13 Superiority of VAT in Manufacturing Level Sales Tax (MST& Wholesale Level Tax (WST)

MST is imposed on manufacturer or producer. MST and excise appear to be identical since they both are imposed on manufacturer. However, excises are levied on production not on sales while MST is imposed on the sale made by producers or manufacturers. The main intention of a MST is to make the charge at that point by reference to the “factory door” price.(Khadka,1985:30).

Wholesale tax (WST) is imposed on the last wholesale transaction. In other words, it applies to the sales by the wholesaler to the retailer.

VAT has a broader base than MST and WST because VAT. As already known from its definition, is a broad based tax system while the scope of MST and WST is rather limited and narrow. Moreover, VAT brings more goods and services under its tax net than the MST and WST. In other words, VAT earns more revenue than the MST and WST. So, a lower rate can be applied to obtain the same revenue.

VAT is more neutral than the MST and WST. There is a possibility for a cascading effect in that they are likely to impose tax upon the tax. The result of cascading is that rise in price caused by the tax tends to become higher than the amount of tax. Apart from it, taxes levied on inputs stimulate the producers to economize their inputs, resulting in a less efficient choice of inputs. This in turn leads to inefficiency in production. MST encourages producers to deliberately shift some of their function to their dealers, thereby causing cutting out of the jobs or operations of the firms. This lowers the tax base, resulting in the lower tax revenue. As for WST, in developing countries much wholesaling is conducted on a small scale basis where wholesalers do not keep adequate records. So, it is difficult to control and administer this tax. Nepal had a bitter experience with this form of sales tax. Furthermore, the tax base of wholesale tax is also narrower than the VAT. Similarly, since WST is not neutral, business persons could easily avoid tax liability through re organization of their business. In order to avoid tax, manufacturers directly sell to retailers keeping the wholesale stage out of existence.(Khadka.1985;33)

As VAT is imposed only on the value added input is exempt from taxation. Furthermore, the investment is also tax- exempt: it is neutral regarding the investment decision.

The MST discriminates between the domestic products and imports because the profit margins of the manufacturers are included under the base of this tax but not the profit margin of the importers. In other words, the effective rate of MST becomes higher on domestic products than on import. But VAT, unlike MST, puts an equal burden on both imports and domestic products since the burden of this tax depends on the final price. It improves the efficiency and competitiveness of domestic products in the international market by freeing exports from tax burden.

VAT is administratively more binding than the MST and WST because VAT brings a larger number of vendors, including retailers within the tax net. It can also be said that VAT simplifies tax administration in some ways.

Another shortcoming of MST is that it is very difficult to impose tax on services because services are directly rendered to the consumers.

In the similar fashion, the tax payers are very fearful in that the VAT is levied right through the retail stage. They are caught at a later stage though they somehow had an opportunity to evade tax at an earlier stage. Thus, they instinctively feel prone to pay tax at the earlier stages. This leads to more revenue collection. Since there is a high likelihood to evade tax under MST and WST, the revenue can hardly be generated as expected. Moreover VAT is clearly shown on invoices. This certainly facilitates the cross-checking as well. So conclusively it can be said that VAT supersedes both MST and WST in all the aspects described above.

2.2.3.14 Superiority of VAT to Retail Sales Tax (RST)

Retail sales tax is imposed on the final sale to the consumer. By contrast, retail sales tax is considered to be better than the MST and WST on many grounds. So, this tax is also identical to VAT in the sense that the base of both taxes is consumption. Since the base of these taxes is the same, a given tax rate should generate the same amount of revenue under the either system. However retail sales tax is also not free from limitations.

Another similarity is that both VAT and RST are neutral to production and distribution. As VAT is levied only on the value added at each stage, tax liability remains the same irrespective of the system of production and distribution. Total tax paid on a commodity or service depends rather on the rate of tax and on the total value added of that commodity or service, but not on the

number of stages through which it passes. Similarly the RST is also levied on the actual selling price to the customer. The total amount of tax depends on the rate of tax and final price of a given commodity. It has nothing to do with the stages. In this way both VAT and RST are considered vertically neutral. Both VAT and RST appear to be foreign trade friendly, because there is a possibility to refund the exact amount of tax levied earlier on export under VAT. Under the RST, most of the exports take place before the tax is levied. Exports by retailers are exempted from tax. So, no necessity to refund tax on exports under the RST

Even if there are many similarities between VAT and RST, still RST is also not free from limitations. The first limitation is the large number of small retailers brought under the tax net. Developing countries generally lack an adequate and efficient system of tax administration which could administer effectively such number of retailers. Whereas VAT has wide coverage, the direct impact of the tax is spread out over a much wider range of taxpayers than is the case with any of the above sales taxes and much of the tax is collected from large firms at stages prior to retailing. (Due, 1968; 552)

Another limitation of RST is that tax evasion is more likely under this tax system because if a retailer does not file his return, then there is no question to raise tax from him or her. But under the VAT, tax evasion is more difficult and minimum. Since the tax is levied at different stages, it spread out over a large number of tax payers. Hence, each tax payer also to pay relatively a small fraction of the tax so, there will be less incentive for tax evasion in comparison with the RST. Moreover tax evasion is quite difficult at pre- retail stage because of the cross- checking method. Also it is in the interest of a taxable person to insist on his suppliers collecting the tax and furnishing an invoice, as otherwise he would not be able to claim tax credit.(Khadka.1985;41). If the retailers do evade, there will be not much loss in revenue because a large part of the tax has been already collected prior to the retail level.

2.2.4 Tax Administration

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

In the Nepalese periphery, Ministry of Finance is the main responsible body for collecting financial resources and managing the public expenditure. Department of Customs Revenue Administration training centre, Department of Revenue Investigation and Inland Revenue Department are the wings of Ministry of Finance. Previously the VAT was administered by department of Value Added Tax. By 2001-2002, the government merged the Department of Taxation and the Department of Value Added Tax and named it "Inland Revenue Department" (IRD). IRD is currently responsible for the administration of the taxes like income taxes, corporate tax, Value Added Tax. Excises and certain fees and duties like Entertainment fee, Film development fee, tourism development fee and liquor control duty, smoking liquor duty, special fee, etc. Likewise the department is also responsible for monitoring the non-tax revenue of the government. This department is located in the Kathmandu valley. Under IRD there are 21 Inland Revenue Offices through the country. These offices and department jointly administer the VAT as well as income taxes. The government of Nepal has the authority to appoint Tax officers in required numbers. Similarly, the jurisdiction of a tax officer should also be prescribed by the government.

All tax officials are the civil servants under the revenue service. Thus, IRD is the authority to mobilize inland revenues including VAT.

The IRD has functional organizational structure. From operational point of view it has been divided into two wings. One is policy related and other is operational wings. The operational wings contain six functional works and these are taxpayer service, tax audit, investigation, collection, tax refund and others. Similarly policy related wing contains the sections related to personnel administration. The government of Nepal may delegate tax administration related authority to other government officer. Similarly the VAT Act has provided the authority to the government to define the jurisdiction of tax officers. Thus the department carries out the functions such as tax administration, making tax policy, tax treaty and international taxation, review and appeal related tax matters, advance ruling, tax enforcement and investigation, tax audit, tax refund, excise and liquor administration, tax payer services. (Adhikari, 2003:30-31)

2.2.4.1 Registration (VAT Act 2052: sec10)

For the implementation of VAT it is essential that producers and suppliers liable to taxation register themselves in time. According to VAT Act and VAT related other laws of Nepal. The persons (the suppliers on distributors or producers dealing with taxable goods and services) are required to register in the concerned Inland Revenue Office and obtain the TPIN. In other words, the person who gets involved in commercial activities having the turnover that exceeds the given threshold it required to register for the VAT purpose.

A person means an individual, firm company, association, cooperative, institution, joint business partnership, trust, and government body or religious organization. Similarly those persons who fall below the defined threshold no not necessarily have to register. But if they want, they can register and take TPIN refers to the taxpayer identification number that is to be allocated to each registrant during the registration process. For the registration, first of all the taxpayer should get the prescribed form (in Nepali).from any Inland Revenue Office. The TPIN or PAN is very important regarding the Inland Revenue administration. The taxpayer should include his TPIN in the documents related to VAT office, income tax, customs, imports and exports, and banks. Registration is required for any business with annual taxable sale of more than Rs.2 million. Regarding the calculation of turnover zero-rated sales if firm it is impossible to identify the purchase, sales, stock, the tax officer may treat all these transact6tions as turnover and may assess the tax. This mean if the zero rated sales exceed the threshold, taxpayer is liable to register. VAT registrants are required to pay VAT on or before the 25th day following the end of each month. Every taxpayer that is involved in taxable sales exceeding the prescribed threshold is liable to register for VAT before starting their business of 30 days after starting their business. They must provide their customers with a tax invoice and should maintain records and keep then VAT records for a period of 6 years. It is required to give notice and advice to the concerned Inland Revenue office if any changes to the business such as new address, telephone number or a reorganization of the partnership. They post their certificate of registration at their principal place and copies of it at all branches where the customers may easily notice and observe it. They should allow tax officers to enter the business to examine the business records and the stock at hand (Adhikari.2003:31-32).

2.2.4.2 Deregistration (VAT Act 2052:sec10-2)

A VAT registration may be cancelled by anyone whose total taxable sales for consecutive calendar quarters is not more than Rs.1000000 and who has been registered for a full fiscal year or by persons who no longer have commercial activities. Regarding the cancellation of registration the VAT Act has mentioned the following conditions:

-) If the organization is closed or transferred or collapses in case of corporate body.
-) If the business is running under proprietorship with the owner dead
-) If the partnership is dissolved
-) If the distributor or producers stops selling or producing taxable goods and services.
-) If the business was registered by mistake.

Regarding the cancellation, the tax officer collects the tax on the capital and other goods that the tax credit facility has been taken by taxpayer previously. The categories falling under this ground neither are required to collect VAT nor allowed claiming a refund of VAT that they have in producing their goods and services for sale. (Adhikari, 2003:34).

2.2.4.3 Accounting (VAT regulation Act 1996:Annex8-9)

The effectiveness of VAT depends on the VAT accounting system. It should neither contain unnecessary details nor is inadequate so that it cannot provide appropriate and useful information. The VAT accounting should be information-based as well as less costly. The accounting in VAT consists in the process of maintaining purchase, sales book, VAT account and stock. Thus purchase and sales books are the main part of VAT accounting. The purchase book contains such information as TPIN. The suppliers name with TPIN. The customers named with TPIN. Similarly in the sales book date, invoice number, name and number of the supplier, purchase price and taxable price of the import, taxable value and the amounts of VAT should be recorded. The purchase book is a certified register. The registrants should maintain or record all the purchases during the period, all the goods and services either taxable or non-taxable appearing in separate columns. Likewise, the sales book is another main part of VAT accounting it should be posted on the basis of sales invoice

chronologically showing the amount of standard and zero-rated sales amount and the tax amount. At the end of tax period it should be totalled while mentioning the amounts in the VAT account. The VAT account is monthly summary showing the sources of the figure used in the VAT return. In order to complete the VAT return, a taxpayer should need to ensure that the amount of VAT paid on purchase, the amount of VAT collected on sales, a method of distinguishing between taxable and exempt sales, the time of goods and services supplied and proof that goods were exported (Adhikari,2003:35).

2.2.4.4 VAT Invoice (VAT Regulation Act 1996: Annex 8-9)

Every registrant is required to issue a tax invoice to the recipient in supplying any goods and services. The specimen of an invoice has been prescribed in schedule five and six of VAT regulation 1997. It is necessary to maintain sellers Pan, Buyers PAN whether it is registered in VAT or not, average of sellers and buyers , date of transaction , date of invoice issue , description and price of goods and VAT amount on the tax invoice issue description and price of goods and VAT amount on the tax amount. The invoice must be issued in sequential order for the starting of every fiscal year, a minimum of three copies of each invoice raise. First copy must be provided to purchase maintaining tax invoice.

Only retailers are facilitating to issue abbreviated invoice with prior approval of tax officer it is not necessary to maintain details in abbreviated invoice as shown in tax invoice. it can't be issue for transaction exceeding Rs.5000 including VAT. It also must be issued sequential order. It shall be the duty of a registered person to provide a tax invoice who ask for. A recipient who receives and abbreviated tax invoice shall not be allowed to edit the input tax. It and abbreviated tax invoice, tax is calculated by multiplying the sales value by rate of tax divide by adding 100 to rate of tax.

2.2.4.5 Return Filing (sec-18)

VAT is based on self assessment system. taxpayer calculation all taxes every registers tax payer required submitting the return to a tax officer within 25 days after the close of tax period such return all have to be submitted whether or not or taxable transaction was carried out in that tax period. Folioed to submit the return in specified time is penalized: Nil return or credit returned Rs.1000 flatly. Debit return 0.05% per day of due amount or Rs.1000 whichever is higher.

2.2.4.6 VAT Collection

The producers and suppliers are the agents for tax collection on behalf of the department or VAT administration. Usually they collect VAT on sales on deposit on collected amount after crediting the tax (if any amount remains) in prescribed public treasury account. Tax should be collected in selling price that comprises the costs related to transportation and distribution expenses as well as profit. Excise duty, custom and other tax except income taxes are also included under the selling price. But the trade discount and trade commission are not included. A person who is not registrant is not entitled to collect tax. The collection of VAT is not the responsibility only of the business community but also of the Revenue Offices. In Nepalese context, if the tax payers fail both deposits collected tax by regular system, the tax officer may implement various method and measures to collect the tax areas. These methods they may employ are as follows:

-) Deducting the tax from the refundable tax amount
-) Processing the tax payers fixed and current account
-) Auctioning the property owned by the taxpayer
-) Deducting from the bank account
-) Deducting from the amount payable to taxpayers by Government Offices or Government owned enterprises
-) Deducting from the amount payable by the third person with the prior approval of the taxpayers
-) Blocking the tax payers export import business (Adhikari,2003:40-41)

2.2.4.7 Tax Credit

VAT is grounded on tax credit method. All the tax paid on purchase of goods and services including assets, stationery and other expenses, related to business are allowed to credit full amount from the output tax collected on sales. There are some good, which is very difficult to ascertain whether stated in rule 41(1), tax may not be deducted in respect to the following goods and services.

-) Beverage
-) Alcohol or alcohol mixed beverages such as liquors and beers.
-) Petrol
-) Entertainment expenses.

Some goods are used for the both purposes of the business and personal use. Tax paid to the following goods may be deducted on the following proportions.

-) On automobiles (any motor vehicle with three or more wheels used on a road for carriage of passenger. 40 percent of purchase value):

2.2.4.8 Assessment

VAT is self assessed tax. Taxpayer assesses their liability themselves. They are self- allowed to get credit tax paid on purchase. Self-f assessment system is developed in the assumption does not satisfy. Taxpayer may assess wrongly on may fail to pay correct tax. To correct this situation there is a provision of management tax assessment, which is done by the tax officials. Following criteria has been fixed for management tax assessment.

- a) It tax is not field
- b) If tax return is filed lately
- c) If tax return contains incomplete information or
- d) If tax official has reason to believe the tax is not genie.

2.2.4.9 Refund

Excess of input tax over output tax in any tax period can be adjusted in the following tax period by carrying forward to next period or can claim for refund to the tax office. Two major criteria have been fixed in VAT law for the claim of refund by taxpayer. IT is allowed to claim either by regular export basis or by regular six months credit basis. Exporter having more than fifty percent export to total sales is treated as regular exporters.

There is also a separate provision of refund for the diplomat and foreign aided projects; they are allowed to claim refund immediately.

2.2.4.10 MIS (Management Information System)

The tax system should be backed by good and effective information technology which must be taxpayers friendly and conducive to the tax administration as well. Scientific information provides highly sophisticated and standardized services to the tax payers, providing them with needed and adequate information at the right time and also to the management and the decision makers. To meet this very purpose, a separate department called “information technology section (IT section), is separately installed. Management information system (MIS) does the following functions:

-) Processing of tax application form and related information.
-) Updating the taxpayer’s individual accounts.
-) Entering, processing and preservation of the central data.
-) Preparing of master record in database format regarding tax collection, refund, tax credit, registration, de-registration and the business closure.
-) Managing of integrated information between department and field offices.
-) Managing and preservation of data and information for a long period.

The IRD posts the data in taxpayers account and sends the result to the related Revenue offices. The information of taxpayer is kept confidential according to VAT Act. DANIDA VAT project has contributed a lot to systematization of the MIS in Nepal (Adhikari, 2003;54)

2.2.4.11 Appeal

A taxpayer may file an appeal to the Revenue Tribunal within 35 days against tax assessment of penalty charged by a tax officer of an order by the Director General relating to the suspension of this place of transaction and provision of appeal to director general relating to the suspension of this place of transaction. A provision of appeal to director general has also been included in first amendment in VAT act as a choice to taxpayer.

Before filling the appeal he taxpayer must deposit the disputed amount of the assessed tax due the rest of the amount of the tax due plus the whole amount of the fine shall have to be deposited or a bank guarantee of the same has to be provided.

2.2.4.12 Offences and Penalties

In the VAT Act, there is a special provision for the offences and penalties too. The registrant is liable to fine or penalties if the lies fail to use the registration number or do not clearly display his registration certificate. Fails to file a return, does not issue invoices, fails to keep an up-to-date account of transaction, obstruct the visit by tax officer, prepare false accounts and invoices or attempts to evade tax. According to VAT Act, action is taken in case of the following:

-) Non- registration (those falling under taxable criteria)
-) Non filers or stop filers
-) Who has tax due/arrears
-) Who has no VAT accounts and records as prescribed by the law?

2.2.4.13 Rewards

According to VAT Act, if a person provides information with solid evidence showing that a tax payer has evaded or attempted to evade all or some portions of tax, he will be rewarded with the amount equal to 20% of the amount of tax collected on that basis of such information. The DG himself is responsible for rewarding the informants.

2.3 Review of Related Studies

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

2.3.1 Review of Books

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

The book *nepalma mulya abhibridhi kar siddhanta ra byabahar* is collection of different articles published in various newspapers and written by Dr. Rup

Bahadur Khadka during 1994 to 1997. The main objective of this book is to bring public awareness regarding the implementation of VAT. It cites the examples of India, China and Bangladesh where VAT had been already introduced. It has made an attempt to justify the rationale for introducing VAT in Nepal. The legal, procedural and structural aspects of VAT are also covered in the book. The success story of Singapore and the failure of Ghana and its implication to Nepal are delineated in the study.

In the book *Kardatako Guide* by Shakti Prasad Pundit (1996). Mr. Pundit gives a glimpse of different forms of taxes and their provisions. He tries to make one aware about the general terminology of VAT and its application in Nepal. He clearly defines every term of VAT that is associated with the VAT system and the procedure that the business community has to follow if it falls under the threshold.

Another book entitled *Value Added Tax in Nepal: theory and Practice* (2003) is written by Chandra Mani Adhikari which comprises of three chapters. The first chapter deals with the theoretical concept of VAT which includes historical background, objectives, merits and demerits of VAT. The second chapter comprises the practice of Nepalese VAT which deals with the introduction of VAT in Nepal, different terminologies associated with VAT, the tax administration system and legal provisions made for the VAT implementation in Nepal. The third chapter consists of different model questions on VAT, specimens of VAT related forms and Accounts and Value Added Tax Rule 1997 and Value Added Tax Act 1996.

Puspa Ran Kandel published a textbook entitled *"Tax Laws & Tax Planning in Nepal"* in 2004. The book was designed to fulfil the needs of MBS and BBS levels under T.U. This book was very useful to the students and teachers to know the legal provisions of the Income Tax Act 2058. The book has attached an unofficial translation of the tax laws both Act and Rule – related to value added tax and income tax. This book was more informative rather than analytical.

In 2004, MR. Surendra Keshar AMATYA, Dr. Bihari Binod Pokhrel and Mr. Rewanta Kumar Dahal published a book entitled *"Taxation in Nepal (income tax, property tax & value added tax)"*. This book has exclusively been designed for the subject taxation in Nepal as per the syllabus prescribed by the faculty of Management, Tribhuvan University for 3rd year of Bachelor of Business Studies (BBS). Unlike other books available on this subject, this book makes an in-depth approach to the study of income tax, property tax and value added tax in

Nepal in order to meet the specific requirements of those students who are studying taxation as a concentration elective subject at BBS 3rd year. This book was very useful to know the legal provision of Income Tax Act 2058 and Value added tax ACT 2052. Theoretical aspects as well as numerical problems of income tax and value added tax are shrewdly presented in this book. However the book was failed to analyze legal provision with numerical examples on the topic of income taxation of insurance business.

The book named “Tax Laws and Tax are planning” written by Mr. Ishwor Bhattarai and Mr. Girija Prasad Koirala published in 2006 described the income tax system in depth. This book includes the separate chapter on value added tax. It describes s VAT practices in Nepal with several theoretical aspects and numerical examples. This book was specifically designed for the students of MBS 2nd years under Tribhuvan University. However, the book was failed to mention legal provisions with examples regarding taxation of income from insurance business in detail.

Narayan Prasad Silwal in his book *Value Added Tax; A Nepalese Experience (2008)*.discloses the empirical finding of VAT after its implication. He was actively associated in VAT administration from the very beginning. He regarded sales tax system as

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

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

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

He further added “taking into account all these factors, it was quite reasonable to postpone the scheduled date from April 16 to November 16, 1997 because the CAT being a modern a voluntary tax had to rely on the computerized

information system as well as the cooperation of the business community”. Tax base, rate structure exemption and the threshold issues were major factors affecting VAT design in Nepal. According to his study staff recruitment, issue of retention and issue of attitudes of staff are crucial problems in administration front.

2.3.2 Review of Journals and Articles

VAT: *Analysis and suggestion* (Dr. Roop Jyoti, New Business Age: 2002))- New Business Age. Feb2002 issue contains this article by famous industrialist and intellectual personality called Dr. Roop Jyoti. According to him VAT was introduced in Nepal in response to realization that a fundamental change was necessary in the country’s revenue policy. The business community was strongly against the VAT in the beginning but the gradually withdrew the opposition as they went on being clearer about positive aspects of the VAT and also its simplicity. Government went through many negotiations with business communities before implementing VAT in the Kingdom of Nepal. Taxpayers were opposed to VAT not because of any defect in VAT as a system. Rather they were afraid of frequent contacts with revenue officials who were historically notorious for a behaviour that exploited the taxpayers. The success of the VAT is dependent on some prerequisites, such as:

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

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

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

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

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

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

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

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

Tax system and its reform in Nepal (Dr. Gobinda Bd. Thapa, Business Age: 2003)-

An article entitled “tax system and its reforms in Nepal” written by Dr. Gobinda Gd. Thapa, was published in the business age in Dec2003 views that VAT as an important element of tax return program

Value added tax and its legal scrutiny (Mr. Yadav Prasad dhungana, Business age: 2003)- Mr. Yadav Prasad dhungana has scrutinized the legal aspects of VAT in value added tax and its legal scrutiny. He concludes that as other areas of economy that are heavily influenced by political instability, corruption, bad governance, frequent change in government and moist revolution VAT also witnesses weak implementation owing to these hurdles.

2.3.3 Review of Previous Researches and Dissertations

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

Nepal chamber of commerce also made a study to analyze the possible effects of VAT in Nepalese economy in 1997: Dr. Pushpa Raj Rajkarnikar headed the team. The main findings of the study according to report are as follows:

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

The report suggested for a partial VAT on some commodities. It was in favour of phase-wise implementation of VAT. The study analyses negative impact of VAT neglecting its positive impact.

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

VAT, to examine the structure of VAT in Nepal, to observe the contribution of VAT to resource mobilization and to analyze the existing problems of VAT in Nepal through the primary and secondary data and information, has concluded that the main problems for business houses are account keeping and billing and the weakness of VAT administration are lack of motivation and service minded attitude among tax officials lack of honesty in VAT officers.

Though from the theoretical point of view it is sure that VAT system is the best and advanced fiscal tool, its effect in the context of Nepal is not as expected because of the lack of strong and honest tax administer, lack of motivation and service minded attitude among the tax officials, lack of the cooperation of business community, lack of strong coordination between tax collectors and taxpayer lack of strong political commitment and weak public consciousness. He has further recommended some suggestion for better solution of these problems. Tax related information should be published regularly. Interview programs with professor, researcher, tax experts, and economists should be conducted and published through advertising media. Often escape away from actual custom duty, as under valuation of the goods has been a tradition. Thus to overcome these problems, the government either has to collect the custom duty of the actual price of the goods or it has to fix the actual price of the goods in the market. Enforcement should be effective through more audits. Investigation and collection visits and integrated approach to total tax system should be introduced for successful implementation of VAT. Hem Chandra Basnet (2002), in his dissertation. VAT present status and future prospects in Nepal. By using the analytical and explanatory research design and having the objective to assess the present status and future prospect of VAT and its effects on various aspects of economy has concluded that the implementation of VAT in Nepal would have very poor results than expected due to poor planning and poor implementation. But VAT implementation has been becoming more and more effective and VAT net has been spreading and revenue collection is not the constant raise establishing in firmly in Nepal. It is expected that positive impact can be seen in tax collection as code of conduct announced recently includes all the required ingredients, such as utilization of tax revenue, respecting the taxpayers, simplification in the service and improvement in the behaviour of the tax administrators. Moreover, he recommended that tax related newspapers, pamphlets, radio, television etc. Interview programs with professors, researchers, tax experts, and economists should be conducted and published through advertising media, similarly the students at school campus level

curriculum should include tax education and social obligation of paying tax. Border should be effectively controlled to prevent the illegal trade. There should be a broader tax adjustment checking and highway checking should be practical effectively to prevent any kind of illegal trade. The accounting should be transparent and VAT officer should control auditing as far as possible.

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

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

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

Deb Raj Dhakal submitted his MBS thesis on A study on Practices of Value Added Tax in Nepal in 2004. His thesis was guided by the primary objectives like reviewing Nepal's overall tax structure for the period 1990/1991 to 2001/2002 examining the theoretical background of VAT, analyzing the existing VAT system of Nepal with special emphasis on revenue mobilization and identifying the major problems of VAT in Nepal. His study ids also chiefly

based on the secondary sources and the research design descriptive in nature with the use of figure ratios, percentages, tables and graphs whenever and wherever necessary. He also concluded that the implementation of VAT system has a greater significance in Nepal. However he comments that the VAT system in Nepal from its inception has been facing innumerable problems. Which curtail its merits and effectiveness?

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

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

The unpublished dissertation entitled Resource Mobilization Through Value Added Tax in Nepal undertaken by Pawan Kumar Neupane in 2006 has the basic objective to examine historical background of value added tax and to analyze mobilization of revenue through VAT. Mr. Neupane also provided the bird eye view of the practicing scenario of VAT in the foreign countries. He conducted a research applying secondary data to analyze simple ration and also use of observation method. He concluded that VAT administration has to begin its program package very strictly and immediately to register the traders, who are supposed to get registered in the VAT in order to control the leakage of revenue and to control tax evasion so that the number of the taxpayers would increase and hence the revenue collection would also increase exponentially. He

complains that in Nepal, after the implementation of VAT, the government has hardly paid any attention to the consumers. He gave several reasons behind this. According to him, fatter the implementation of VAT attempt was made to inform the public about some no-VAT including commodities through the public means of communications like radio, television and newspapers, but it could not prove effective.

As a result the consumers are on the other hand, as he argues, the businessmen opposing the VAT had raised the prices of daily consumption goods like rice, vegetable etc , which had added future burden to the consumers. The government, he observed, could neither reduce the price not punish those businessmen against such act. Instead, the government compromised with that businessman. These are some of the grievances articulated by Neupane in the conclusion of the thesis, but he also gives some recommendations. His constructive recommendations were.

1. The boundary of Value added tax (VAT) should be increased instead of increasing the rate of VAT in order to increase the tax amount under VAT.
2. The concentration must e given to bring the use of billing in all trading concern.
3. The most important one, the consumer should be comprehensively educated about the nature and beneficial aspects of VAT.

CHAPTER-III

RESEARCH METHODOLOGY

Introduction

Research simply means to search again and again. It is a systematic activity to achieve truth of finding solution to a problem. It is a process of a systematic and in-depth study or research of any particular topic, subject or area of investigation backed by the collection, compilation, presentation and interpretation of relevant details or data. Methodology is the research method used to test the hypothesis. So, the research methodology refers to the overall research process, which a researcher conducts during his/her study. “The purpose of research is to discover answers to questions through the application of scientific procedures. The main aim of research is to find the truth which is hidden and which has not been discovered at yet” (Kothari, 1990:7)

3.1 Research Design

The research design is a plan, structure and strategy of investigation conceived so as to obtain answers to research questions and to control variance. The plan is the overall scheme or program of the research. It includes an outline of what the investigator will do from writing the hypothesis and their operational implications to the final analysis of the data. The purpose of the research design is to provide a maximum amount of information relevant to the problem under investigation at a minimum cost. This research study is concerned with past phenomena both descriptive and analytical.

3.2. Population and Sample:

The population for this study was comprised of the entire person belonging to or associated with Value Added Tax in Nepal. They were tax administrators, experts, business persons and customers. In order to fulfil the objectives of the study, 45 samples from the population in the Kathmandu valley were carefully selected by consultation with lecturers and best judgements of the researcher. The respondents could be divided into three groups. The following table shows the respondent and the size of samples.

Table No-4

Group of respondents and sample size:

S.N.	Group of respondents	Sample size	Percentage
1.	Tax administrator/expert	10	22
2.	Business persons	20	45
3.	Customers	15	33
Total		45	100

3.3. Nature and Source of Data:

Both primary as well as secondary data were collected in order to achieve the real and factual result out of this research. Since the nature of these primary and secondary data is different, collection procedure also tend to vary. A set of questionnaires was designed and distributed to type selected respondents well learned in and at least familiar to VAT and its implications. Information and data were also collected from respondents through fields visit by the researcher. The secondary data were collected through annual reports, different books and publications. The sources and data collection procedure is explained below.

A. Primary Sources:

The primary data were collected through following techniques:

- a. Interview
- b. Questionnaire
- c. Telephone queries.
- d. Discussion with Resource persons.

B. Secondary sources:

The secondary data of this research were collected from the following source:

- a. Published and unpublished report, articles and dissertation on the concerned subject.
- b. Publication and annual report of Inland Revenue Department (IRD)
- c. Different publication of central bureau of statistics.
- d. Various books written by tax officers and scholars

- e. Publications, budget speeches and economic survey of various fiscal year of Ministry of Finance, the government of Nepal
- f. Newspapers , such as Gorkhapatra, the rising Nepal, the kantipur daily, and so on
- g. Publications of various VAT department
- h. Websites.

The collected data through secondary sources have been tabulated in different ways according to the requirement of the study.

3.4. Techniques of presentation and Analysis of Data

In the process of presentation and analysis of the data, various statistical tools were used in order to get the meaningful result. Collected data from primary and secondary sources were first processed for tabulation and analysis. For the purpose of analysis, following simple statistical tools were used:

- a. simple average,
- b. simple percentage,
- c. graphs, charts and diagrams,
- d. trend analysis

CHAPTER - IV

PRESENTATION AND ANALYSIS OF DATA

4.1 Presentation of Analysis of Secondary Data

4.1.1 Revenue structure of Nepal

The total revenue of government of Nepal is collected from tax and non-tax sectors. The tax revenue, which is compulsory sacrifice of the peoples, can divide in to two components i.e. direct tax and indirect tax. Those revenues collected as income tax, land tax, property tax, etc are direct tax and those revenue collected as sales tax, value added tax (VAT), customs and contract tax et c are an indirect tax.

Another sides, the government has received other kinds of revenues, e.g. postal service charge, fees, fines and penalty etc are non- tax revenues. Non- tax revenue are not imposed specially views of revenue collection. The Nepalese economy amount of tax revenue is generally higher than that of non-tax revenue. In Nepal, the contribution of tax revenue used to be almost 80% and non tax revenue almost 20%. The structure can see in the Table no.5

Table No-5

Revenue Trend in Nepal

(Rs. In millions)

Fiscal year (FY)	Total revenue	Tax revenue	% of tax revenue	Non-tax revenue	% of non-tax revenue
1999/2000	42893.80	33152.10	77.29	9741.60	22.71
2000/2001	48893.60	38865.10	79.49	10028.8	20.51
2001/2002	50445.50	39330.60	77.97	11115.0	22.03
2002/2003	56229.80	42586.90	75.74	13642.7	24.26
2003/2004	62331.00	48173.00	77.29	14158.0	22.71
2004/2005	70122.70	54104.70	77.16	16018.0	22.84
2005/2006	72282.10	57430.40	79.45	14851.7	20.55
2006/2007	87712.08	71126.73	81.09	16585.35	18.91
2007/2008	107622.48	85155.46	79.12	22467.02	20.88
2008/2009	143474.49	117051.91	81.58	26422.58	18.42
2009/2010	179945.82	156294.92	87.00	23650.90	13.00

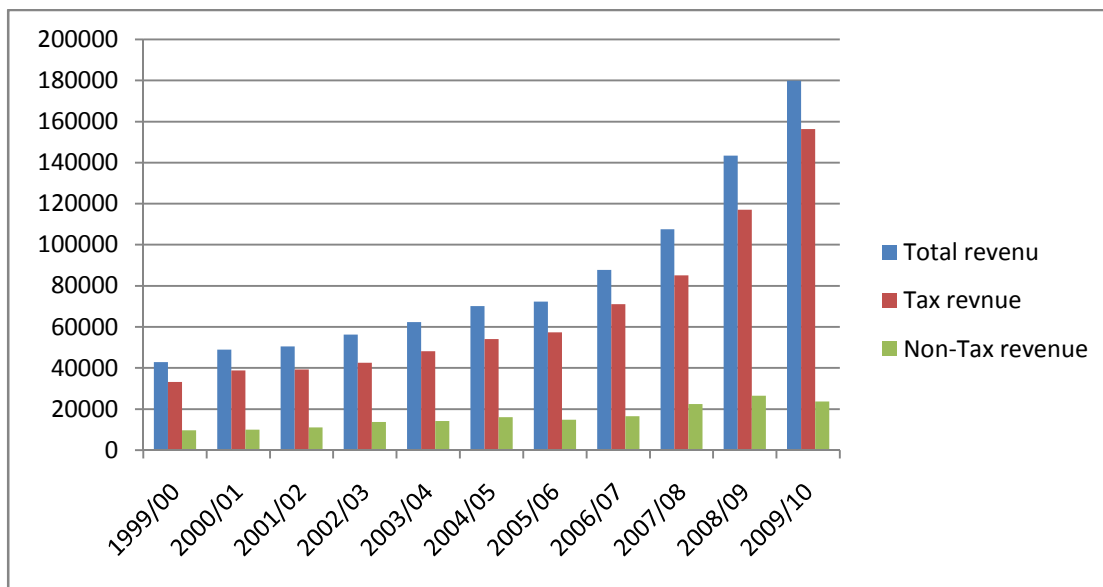
Source: annual report 2009/20101, Inland Revenue department

Economic survey 2009/2010, Ministry of finance

The above table demonstrates the structure of total revenue of the government and after implementation of VAT. The contribution of tax revenue on total revenue in the year 1999/2000 is 77.29% and the contribution of non-tax revenue on total revenue is 22.71% and gradually increasing and decreasing ratio up to 2009/2010. The contribution of tax revenue on total revenue in the year 2009/2010 is 87.00% and the contribution of non-tax revenue on total revenue is 13.00%. But overall all judging the figures presented in the table, no significant changes have occurred so far after the implementation of VAT. This only proves the lack of contribution of VAT to raise tax revenue of the government proportionately which can be presented in the following graph also.

Figure No. -1

Structure of Total Revenue, Tax Revenue and Non-Tax Revenue



*Source: Annual Report 2009/2010, Inland Revenue Department
Economic survey: 2009/2010 Ministry of Finance*

4.1.2 Structure of Tax Revenue

This is the compulsory levy made to government treasury by public. Tax is levied either directly on income or indirectly on consumption of goods and services. Indirect tax is collected mainly from customs and the consumption of goods and services. Supremacy of tax user of indirect tax is one of the important features of the developing economies. The propensity to consumption is higher in developing countries due to their marginal income the insignificant level of saving marginal results into the poor level of the collection of direct tax. The

heavy reliance of indirect taxation in Nepal is justified on the administrative ground. Nepal is not a condition to generate adequate revenue from direct taxation agriculture is the main occupation of the Nepalese people.

The industrial development is very primitive in Nepal. It contributes only about 10% in the GDP. The per capita income of Nepalese people is extremely low. In Nepalese economy the contribution of direct tax is very low, it is almost 20% of total tax and contribution of indirect tax is remarkably higher than direct tax it is almost 80% of total tax revenue. The table below shows the structure of total tax revenue.

Table No- 6

Structure of Total Tax Revenue

(Rs. in millions)

Fiscal year	Total tax revenue	Direct tax		Indirect tax	
		Amount	% of Total revenue	Amount	% of total revenue
1999/2000	33152.10	8951.50	27.00	14200.60	73
2000/2001	38865.10	10159.40	26.14	28705.70	73.86
2001/2002	39330.60	10597.50	26.94	28733.10	73.06
2002/2003	42586.90	10105.70	23.73	32481.20	76.27
2003/2004	48173.00	11912.6	24.73	36260.40	75.27
2004/2005	54104.70	13071.8	24.16	41032.9	75.84
2005/2006	57430.40	13968.1	24.32	43462.3	75.68
2006/2007	71126.73	18980.29	26.69	52146.44	73.31
2007/2008	85155.46	19077.81	22.40	66077.65	77.60

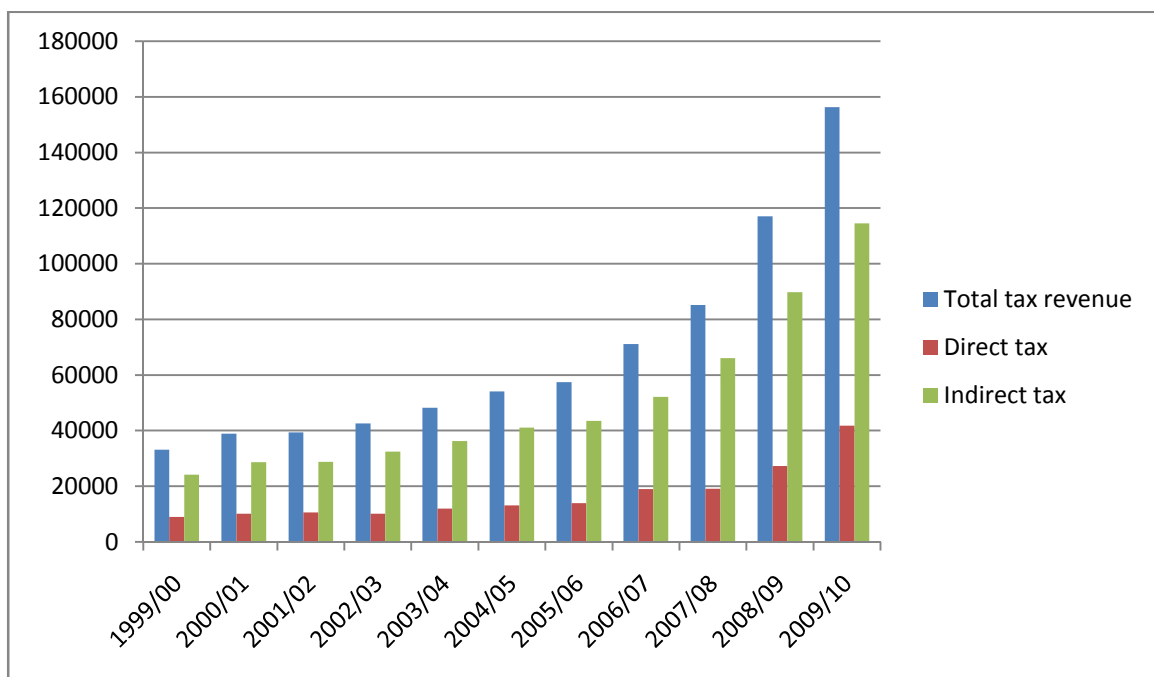
2008/2009	117051.91	27246.43	23.28	89805.48	76.72
2009/2010	156294.93	41750.18	27.00	114544.75	73.00

Source: annual report 2009/2010, Inland Revenue department

Economic survey: 2009/2010, MOF

Figure No.2

Structure of tax revenue



According to the above data, the contribution of the direct tax is very low. Contributions of direct tax revenue in the year 1999/2000 are 27% and there after gradually increase and decrease up to 2009/2010. On the other hand contribution of indirect tax revenue is also in same position of direct tax as increasing and decreasing up to 2009/2010. Although the value added tax belongs to the indirect tax category, introduction of this tax does not increase the share of indirect tax on total revenue. The tax experts always say that implementation of VAT helps to collect more revenue and also help to collect more income tax and other direct taxes due to its transparency characteristics.

Total tax revenue increase drastically after 2009/2010 which shows that the claim of tax experts has been come true in successful implementation of VAT.

4.1.3 Registration

Registration is a preliminary step in the whole process of VAT system and the threshold limit of VAT registration in Rs. 2million. All tax payers whose taxable transaction stands above Rs, 2millions are compulsorily required to register for VAT. But those firms whose turnover is apparently below the prescribed threshold limit also can go for registration if they so desire. The firms having more than RS.2 million who were not previously registered under sales tax required to register for VAT within 90 days from 16 November.1997and the date of issue of VAT Act. it was however not necessary to register if they only dealt with tax exempt goods and services. Similarly, the Nepalese VAT act does not allow branch or division registration system.

Table No-7

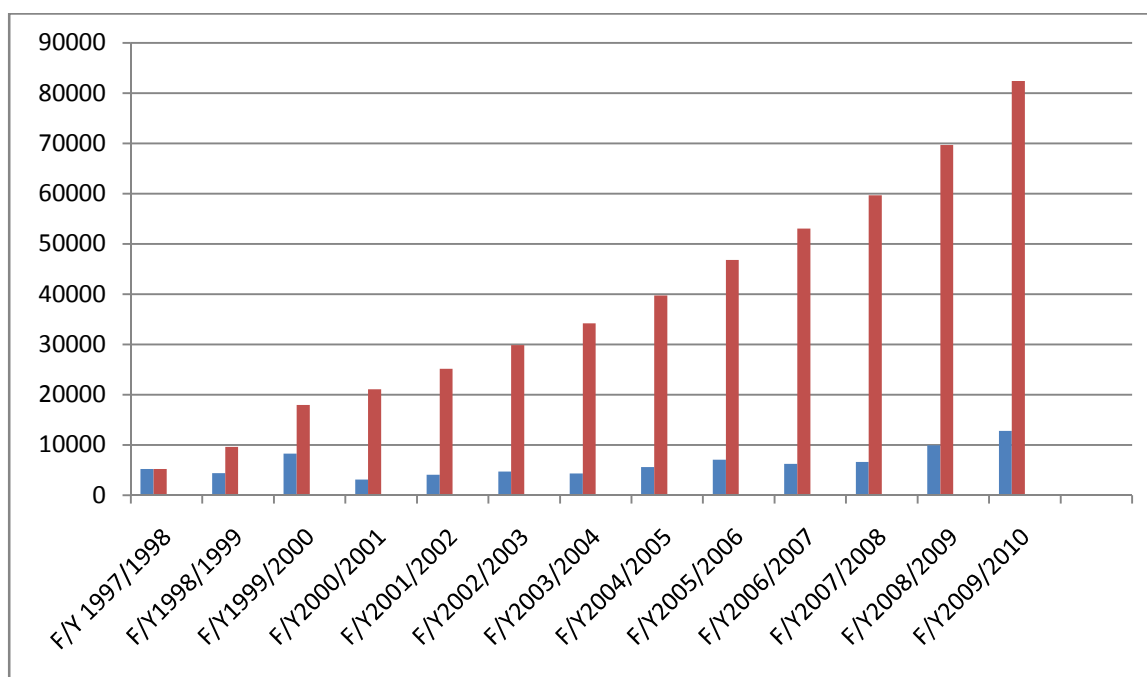
Year-wise number of VAT registrants

Fiscal year	No. of VAT registrant	Cumulative total	Rate of increase
1997/1998	5237	5237	-
1998/1999	4405	9642	84.11
1999/2000	8305	17947	86.13
2000/2001	3146	21093	17.53
2001/2002	4056	25149	19.23
2002/2003	4723	29872	18.78
2003/2004	4302	34174	14.40
2004/2005	5602	39776	16.39
2005/2006	7055	46831	17.74
2006/2007	6241	53072	13.33
2007/2008	6635	59707	12.50
2008/2009	9946	69653	16.66
2009/2010	12780	82433	18.33

Source: Annual report 2009/2010, Inland Revenue Department.

Figure No -3

Year-wise numbers of VAT Registrants.



Source: Annual Report of 2005/2006 to 2009/2010

The number of sales tax registrant was 2045 at the time of the introduction of VAT in 1997. Among them those with an annual transaction above the VAT registration threshold were converted into VAT registrants from 16 Nov. 1997. While between those having transaction below the threshold level some registered voluntarily and other remained under the VAT net. Other potential tax payers that were outside the sales tax net registered for VAT over the year. The member of VAT registrant increased gradually. In one side one tax payers registered under the revenue department and in the other side some registrant tax payers cancelled their registration under VAT department. This is proved by the above table and chart which shows in the year 1997/1998, 5237 tax payers registered for VAT.

In the year 1998/1999 new tax payers registered were 4405 and the total tax pays increased to 9642 by 84.11%. The growth rate of vat registration remained at a high level in the fiscal year 1999/2000 at about 86.13% both voluntarily and compulsorily, the business communities came under VAT flag because there is a legal provision in the VAT law that the government bodies are required to buy only from the VAT registrants in case of their purchases exceeding certain amount. This seems to have compelled them to register for VAT. However, the

figure above shows the trend is in the steady line with sporadic rise. But that is negligible. The percentage is on the decrease finally ending up at 18.33% in the fiscal year.2009/2010.

4.1.4 Non – Filers

There is a legal provision in the VAT law that all the registrants are required to submit their tax return after 25 days of completion of the tax period. It does not matter whether any transaction takes place within that period or not. It is necessary to submit the tax return within the specified time. Registrants who fail to submit their tax return is known as non filers. The table and chart below illustrate the no, of non-filers in each fiscal year from 200/2001 to 2009/2010.

Table No-8

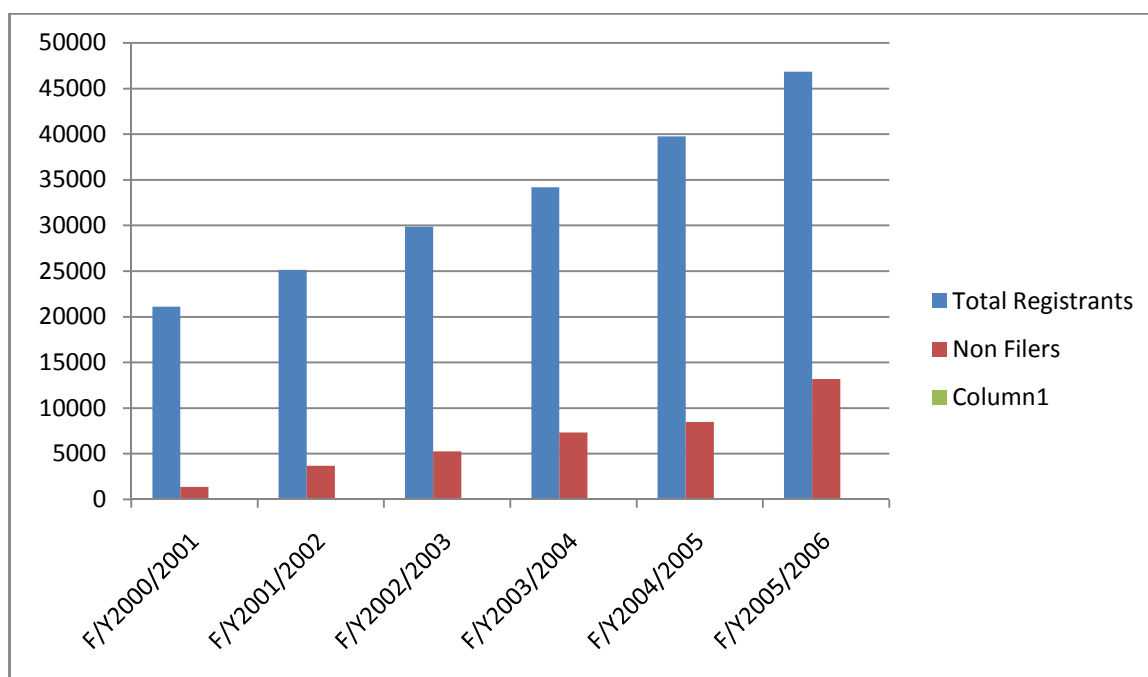
Year-wise number of VAT Return Non Filers (2001-2010)

Fiscal year	Total Registrants	Non-Filers	Percentage
2000/2001	21093	1383	6.72
2001/2002	25149	3676	15.18
2002/2003	29872	5255	17.59
2003/2004	34174	7322	21.43
2004/2005	39776	8492	22.96
2005/2006	46831	13198	21.63
2006/2007	53072	7098	14.58
2007/2008	59707	9050	15.16
2008/2009	69653	13040	18.72
2009/2010	82433	9878	11.98

Source: Annual Report 2005/2006 to 2009/2010, Inland Revenue Department.

Figure No-4

Status of VAT Return Non Filers



The Table No.17 and figure 4 above show that the status of Non –filers were in increasing trend from the fiscal years 2000/2001 to 2009/2010. In the fiscal year 2000/2001, only 4 percent failed to submit the tax return. But this trend was on the increase in each subsequent year until the fiscal year 2005/2006. But in 2006/2007, the trend once again declined showing a significant check on Taxpayers’ habit of not6 submitting the tax return then after it is increased to 18.72% in fiscal year 2008/2009. In 2009/2010 the taxpayer’s habit is change to submit the return in time so; it is decreased from 18.72 from 11.98% on the other hand it foretell s a good sign for the future trend as well because it is said that the morning shows the day.

4.1.5 Tax Returns

Tax returns means a return furnished by a Taxpayer in regard to the tax payable for transactions carried out during the tax period. A study on the status of tax return facilitates the forecasting of the amount of potential tax collection. In general, the tax return includes debit, credit and nil tax return. Debit return implies the return which the tax payer furnishes declaring to pay tax. Debit return in a favourable position shows the output tax exceeding input tax credit. Credit return is just opposite of debit return. If in-put tax is greater than output tax, the possibility of credit return is realized. As the credit return increases the

liability to refund also increase. So, debit return is favourable for the government. If there is no transaction during the particular tax period, then it is nil or zero return. The status of tax return is depicted in table and figure below.

Table No-9

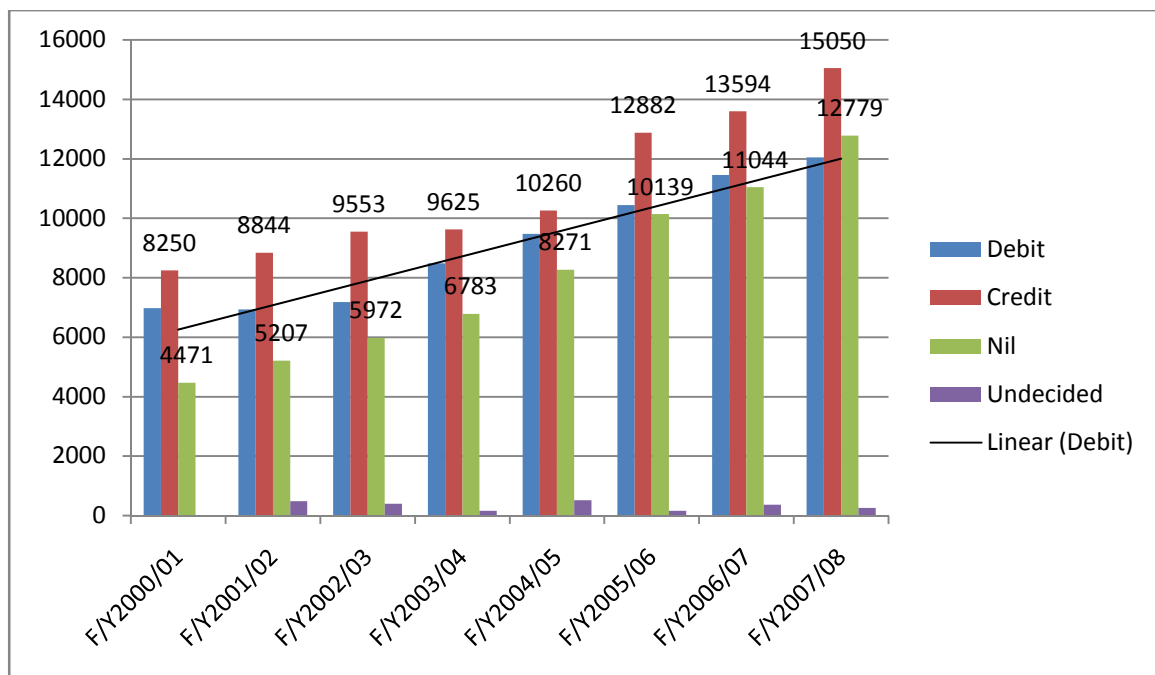
Status of tax returns:

Fiscal year	Debit		Credit		Nil		Undecided		Total
	No.	%	No.	%	No.	%	No.	%	
2000/01	6975	35.39	8250	41.86	4471	22.68	14	0.07	19710
2001/02	6936	32.30	8844	41.19	5207	24.25	486	2.26	21473
2002/03	7178	31.06	9553	41.36	5972	25.85	396	1.72	23099
2003/04	8483	33.87	9625	38.42	6783	27.08	158	0.63	25059
2004/05	9478	32.20	10260	36.00	8271	29.00	516	1.80	28525
2005/06	10449	31.06	12882	38.17	10139	30.14	163	0.40	33633
2006/07	11457	31.43	13594	37.29	11044	30.29	362	0.99	36457
2007/08	12052	30.02	15050	37.49	12779	31.83	258	0.64	40139

Source: Annual report of Inland Revenue Department

Figure No.5

Status of Tax Return



The Table No.18 and figure 5 reveal that the credit return is higher than the debit return. This is considered something not so good for the VAT system. In

the fiscal year 2000/2001, the ratio of debit return to the total return is 35.39% whereas the credit return stood at 41.86%. From then onwards, the figure just seemed to rise due to the provision to carry forward credit from the sales tax and the provision also of getting credit facility of old stock. But the continuous increase of the credit refund is definitely not a good sign for the government who needs to think about this in time.

It is a duty of Inland Revenue Department to seriously come up with measures to make sure this doesn't happen in future. Unless the governments proactive enough to figure out the actual cause behind the increasing trend of credit return, nil return and undecided return which in the above table is not high though, the government's intention to mobilize VAT as resource may be just a daydream. So, complete tax audit and investigation on these issues must be a top priority of the government.

4.1.6 Revenue Collection from VAT

VAT is considered as modern and scientific tax system in sales tax family. Nepal has adopted VAT since fiscal year 1997/98. Since then the actual collection of VAT from the fiscal year 2000/2001 to 2009/2010 has been shown below.

Table No-10

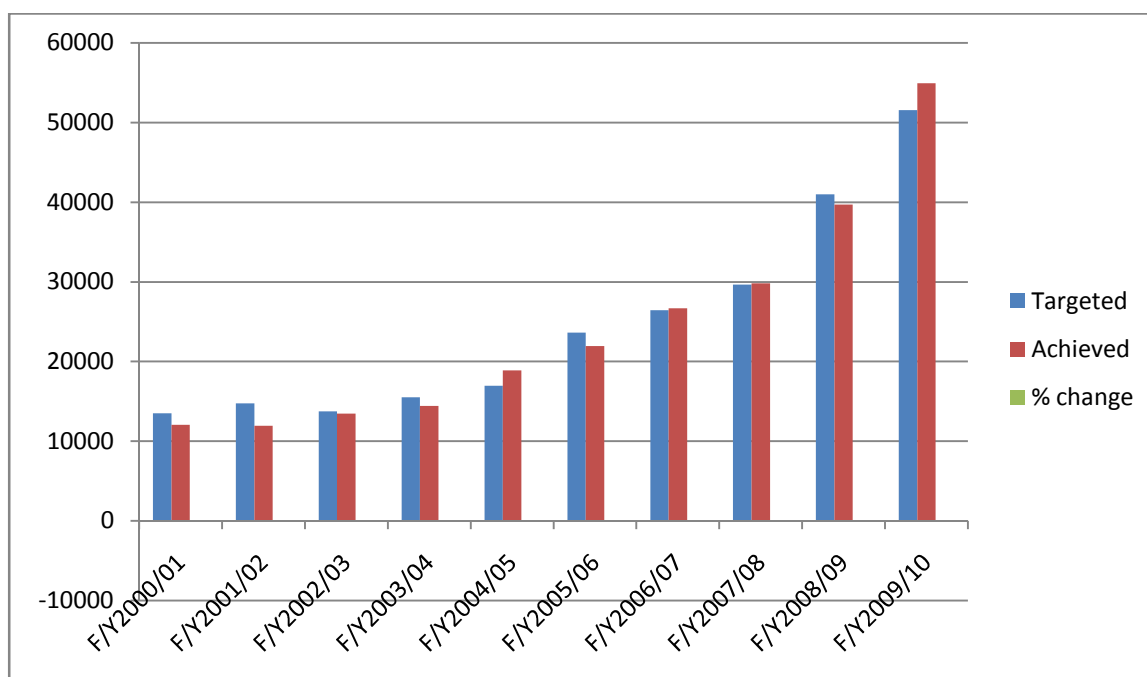
Revenue collection from VAT *(Rs. in millions)*

Fiscal Year	Targeted	Achieved	% change
2000/01	13500.00	12050.00	-11
2001/02	14750.00	11947.95	-19
2002/03	13730.05	13449.12	-2
2003/04	15503.50	14448.89	-7
2004/05	16950.00	18894.63	11
2005/06	23650.00	21946.01	-7
2006/07	26463.00	26704.18	1
2007/08	29651.90	29815.70	1
2008/09	41000	39700.00	-3
2009/10	51560.00	54920.86	6

Source: Annual Report 2009/2010, Inland Revenue Department

Figure -6

Status of target and achievement of VAT collection



Vat was introduced in order to meet the revenue gap that government had been facing for a long time. In the fiscal year 1999/00 total Rs.9860.00 million was collected where as expected or targeted was Rs.10460 million in the same year which is less by 6% than targeted. The figure is not shown in the table though because the data shown range from the fiscal year 2000/2001 to 2006/07 only. Similarly, in the fiscal year 2001/02 achieved VAT was Rs. 11947.95

Million whereas targeted was Rs.14750.00 million which is 38% less than targeted. However, by small margin of 2% only differ between targeted and achieved in the fiscal year 2002/03. In the fiscal year 2004/05, the revenue actually collected even exceeded the targeted one. In figure, the targeted revenue for that period was Rs.16950 million where as the collected revenue amounted to RS.18894.63i.e.11% more than the targeted one. But the boom period in revenue collection was to soon be followed by the depression when the 11% increase went far down to -7% in the fiscal year 2005/06 with the targeted revenue Rs.23650 million and the actual collection only amounting to Rs.21996 million. This trend seems to be improved again in the following fiscal year 2006/07 when the actual revenue marginally exceeded the targeted one by 1% in both of fiscal year 2006/07 and 2007/08 but in fiscal year 2008/09 there is decrease of revenue by 3% of the target. The change in the revenue collection

was triggered partially by the major change in the Nepalese political scenario that took place in the aftermath of the people's movement part 2 on April 2005. Now as can be seen in the figure above, after for the last few years, comparatively the trend of revenue collection is good one although it is still in a fluctuating nature.

4.1.7 Composition of VAT Revenue

VAT is levied on both domestically produced goods and services and imported goods and services. Nepalese economy is agricultural based. More than 60% people are farmer and the farming is unorganized. Agriculture production through unorganized sector is exempted from VAT. Most of the products and services are imported from neighbouring countries and third countries. Thus import generates more VAT revenue than domestically produced goods and services. The composition of VAT revenue collection from imports and exports are shown in a table in the next page.

Table No-11

Composition of VAT revenue

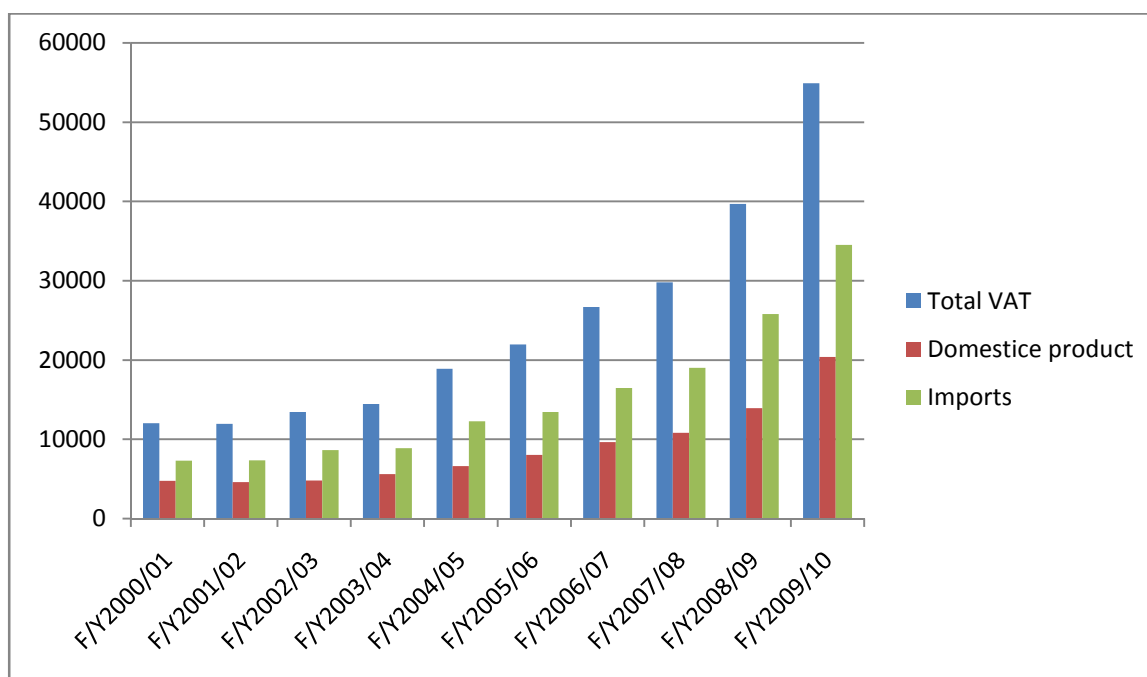
(Rs. in millions)

Fiscal year	Total revenue	VAT		Imports	
		Domestic products		Amount	%
		Amount	%	Amount	%
2000/2001	12050.00	4744.72	39.38	7303.04	60.61
2001/2002	11947.95	4608.37	38.57	1339.58	61.43
2002/2003	13449.12	4819.61	35.84	8629.51	64.16
2003/2004	14448.89	5604.12	38.79	8874.77	61.42
2004/2005	18894.63	6624.33	35.06	12270.29	64.94
2005/2006	21946.01	8150.50	37.14	13462.54	61.34
2006/2007	26704.18	9631.33	36.06	16464.27	61.65
2007/2008	29815.70	10808.24	36.25	19007.46	63.75
2008/2009	39700.00	13918.49	35.06	25782.42	64.94
2009/2010	54920.86	20379.83	37.11	34541.03	62.89

Sources: Annual report of 2009/2010, Inland Revenue Department

Figure No-7

Composition of VAT revenue



In fiscal year 2000/01, share of domestic and imported VAT revenue in total revenue was 39.38% and 60.61% respectively while in the fiscal year 2002/03 is 35.83% to 64.16%. In the fiscal year 2009/10 domestic products contributed 37.11% where as imported goods contributed 62.89% in the total VAT structure, collection from imports share about two- third and collection from domestic source occupies one-third only.

4.1.8 Share of VAT Revenue to Gross Domestic Product (GDP)

Gross domestic product is the total final output of goods and services produced by the countries territory by residents and non- residents, regardless of its collection between domestic and foreign claims. The VAT/ GDP ratio measures the consistency of the growth of VAT revenue with the corresponding growth in gross National Product. This is an indicator of the utilization of taxable capacity. Normally, the growth of VAT revenue mobilization in line with the growth in GDP is desirable for the rapid economic development of a country. The collection of VAT revenue is more reliable than the direct tax revenue non tax revenue which facilitates the process of economic planning and development in the country. VAT has been introducing in Nepal to increase the contribution towards revenue generation. The contribution of VAT revenue in GDP is shown below.

Table No-12

VAT Revenue as percentage of GDP

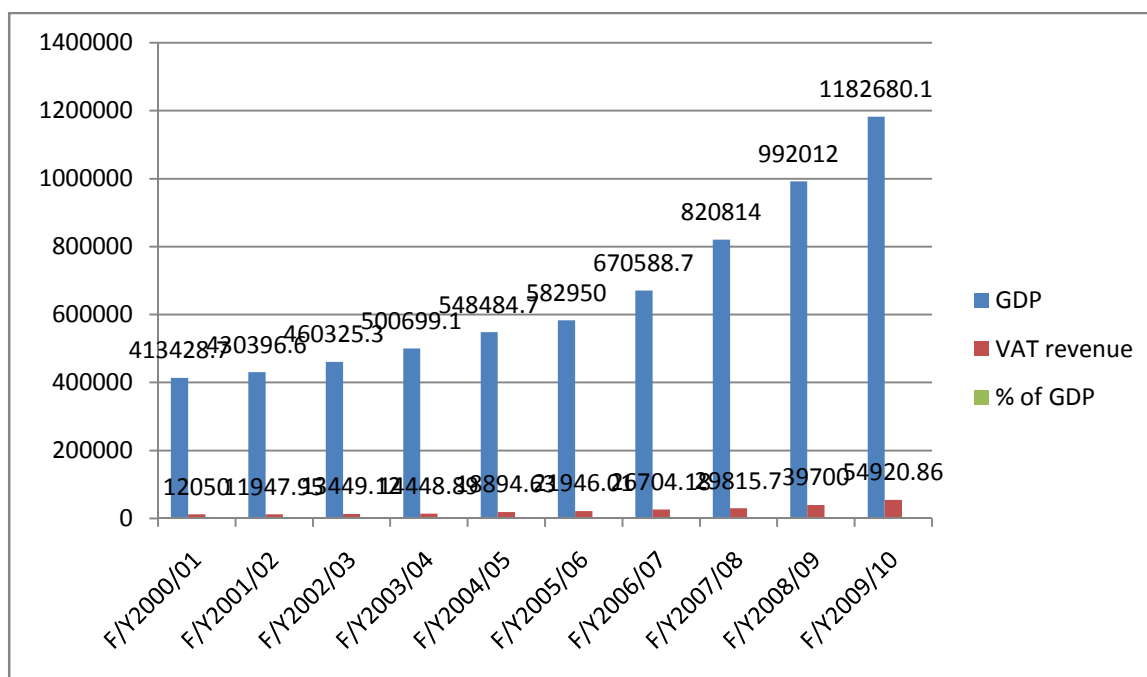
(Rs. in millions)

Fiscal year	GDP	VAT Revenue	% of GDP
2000/2001	413428.70	12050.00	2.9
2001/2002	430396.60	11947.95	2.78
2002/2003	460325.30	13449.12	2.92
2003/2004	500699.10	14448.89	2.89
2004/2005	548484.70	18894.63	3.44
2005/2006	582950.00	21946.01	3.76
2006/2007	670588.70	26704.18	3.98
2007/2008	820814.00	29815.70	3.63
2008/2009	992012.00	39700.00	4.00
2009/2010	1182680.10	54920.86	4.64

Source: Annual Report of 2009/2010. Inland Revenue Department

Figure No-8

Share of VAT revenue in GDP



Above table reveals that share of VAT revenue in GDP is 3.01% in an average through the analysis period. The contribution made through VAT in GDP is very low. In Fiscal year 2000/2001, total amount Rs.. 12050millions was

collected as VAT which was only 2.73% of GDP. However, though insignificantly, the percentage shows the increasing trend, but very low percentage off GDP throughout all the years of analysis. The highest percentage i.e.4.14% was recorded in the fiscal year 2009/2010 with VAT revenue amounting aRs.54920.86 millions. So, in conclusion, the contribution made through VAT in GDP is slightly low.

4.1.9 Share of VAT revenue in Total Revenue

Total revenue includes Tax Revenue and Non-Tax revenue. The contribution of VAT revenue to the total revenue has been shown in the Table.

Table No-13

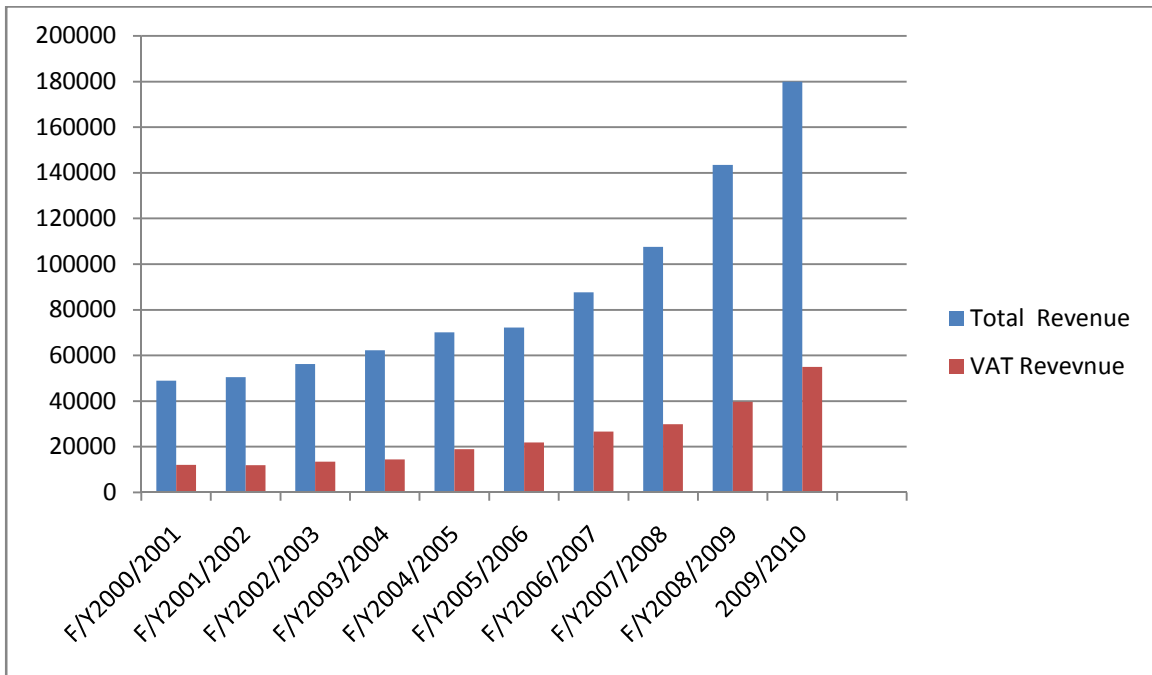
VAT Revenue as percentage of Total Revenue *(Rs. in millions)*

Fiscal Year	Total Revenue	VAT Revenue	% of Total Revenue
2000/2001	48893.60	12050.00	24.65
2001/2002	50445.50	11947.95	23.68
2002/2003	56229.80	13449.12	23.92
2003/2004	62331.00	14448.89	23.18
2004/2005	70122.70	18894.63	26.95
2005/2006	72282.10	21946.01	30.59
2006/2007	87712.08	26704.18	34.45
2007/2008	107622.48	29815.70	27.70
2008/2009	143474.49	39700.00	27.67
2009/2010	179945.82	54920.86	30.52

Source: Annual report of 2009/10, Inland Revenue Department, MOF, Economic survey

FigureNo.9

Share of VAT Revenue in Total Revenue



Above table reveals that and average contribution of VAT to the total revenue is 26.75. in the fiscal year2000/2001, its contibution was 24.65% . it kept increasing in the following years ending up with 31.00%.in highest one in the fiscal year2006/2007 and again decreases up to 2009/2010. The same figure can be better viewed in the chart.

4.1.10 Share of VAT Revenue in Total Tax Revenue

The contribution of VAT revenue to the total tax revenue has been shown in the following table.

Table No-14

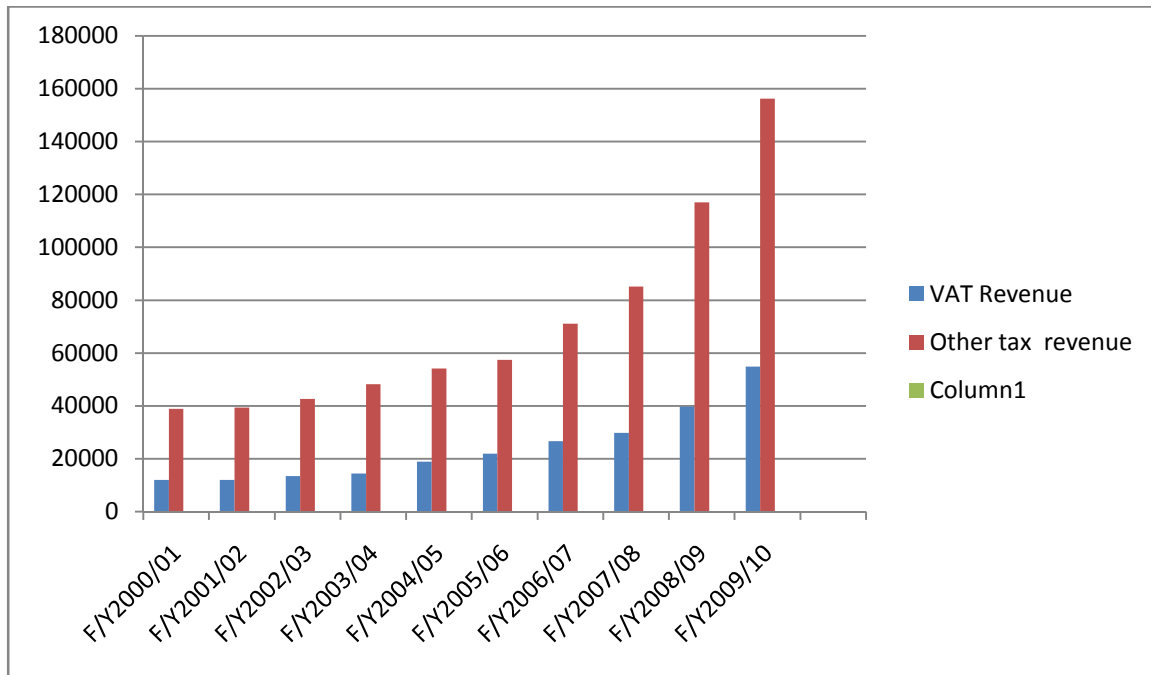
VAT Revenue As % of Total Tax Revenue

Fiscal year	Total Tax Revenue	VAT Revenue	% of Total Tax Revenue
2000/2001	38865.10	12050.00	31.00
2001/2002	39330.60	11947.95	30.38
2002/2003	42586.90	13449.12	31.58
2003/2004	48173.00	14448.89	29.99
2004/2005	54104.70	18894.63	34.92
2005/2006	57430.40	21946.01	38.21
2006/2007	71126.73	26704.18	37.54
2007/2008	85155.46	29815.70	35.01
2008/2009	117051.91	39700.00	33.92
2009/2010	156294.93	54920.86	35.13

Source: Annual Report 2009/2010, Inland Revenue Department

Figure No-10

VAT Revenue as percentage of total revenue



The above table shows that there is high share of VAT in total revenue in Nepal. In the fiscal year 2000/01, the percentage of VAT in total tax revenue is 31% similarly in the fiscal year 2009/10 it was increased to 35.13% which is increase than 1.21% of 2008/2009. The average contribution of VAT to the total revenue is 33.78% which is fraction above the half of the total tax revenue. This proves that Nepalese tax revenue without the inclusion of VAT is unthinkable.

4.2 Presentation and Analysis of Primary Data:

It refers to the sources from which first hand information can be collected, mostly, the sources will be people.

4.2.1 VAT Administration

Tax administration plays a critical role in the effective implementation of any tax system success and effectiveness of VAT in Nepal hinges on the administrative capability. In other words the tax system in developing countries like Nepal must be designed in such a way that it can be administered effectively with existing administered effectively with existing administrative capability. In this regard, shoup, suggests that in a developing country, still at an early stage of development where most business activity is fragmented among small firms a turnover may be preferred on administrative grounds. If only retail

trade is fragmented, the value added technique may be applied in a less than comprehensive manner to affect only imports, manufactures, extra active industries and perhaps wholesalers. (shoup, 1998:149). Poor administration can hinder the utility of VAT in Nepal. VAT is a modern and new tax system which cannot be implemented without efficient and modernized administrative setup Nepalese industrialist and businessmen did not have any faith and positive remarks on the VAT administration and its refund system ads past records of deficiency of tax administration. The past records may be a mirror which reflects the things that are going to happen in future. Even in the past, government came up with so many stereotyped promises to facilitate the business communities but all were eventually proved abortive. So this time, they hardly have any confidence on the government policy and commitments. If administrative capability is not so strong to administer taxes, the theoretical merits of the VAT only remain on paper. So it is most important to judge the capability of present VAT administration. To judge the capability of present VAT administration question was asked and the result so obtained has been presented in the table as follow:

Table No15

Efficiency of Nepalese VAT administration

Respondents	Tax officials		Business persons		Consumers		Total	
	No	%	No	%	No	%	No	%
Efficient	7	70	1	5		0	8	17.70
Inefficient	1	10	10	50	8	53.33	19	42.22
Needs improvement	2	20	9	45	7	46.67	18	40.00
Total	10	100	20	100	15	100	45	100

According to Table No-15,

42.22% of the total respondent views that present administration absolutely unable to handle VAT. However, 40% are optimistic. Their view is that if certain improvements can be made within the tax administration there will certainly be possibilities of positive result. According to them:

i. past records reveal that the revenue administration has mostly failed to fulfil the administrative requirement for various taxes while expected outcome has

become only theoretical. This indicates that the same will be the case in the future because past is the mirror on which the future is reflected.

ii. Many government policies in Nepal are implemented without proper consideration and preparation. Most deplorably, the government of Nepal is used to performing the task in hurry or none the spur of the moment without giving it a detailed thought. This has often resulted in the failure of the policies it has formulated. Regarding VAT, the case is more or less similar in that the government is still unable to shatter its status quo.

iii. The government should convince the business communities and make them a part of policy making. The involvement of the private sector in the formulation of rules and regulations and addressing and solving of the basic issues are often overlooked.

4.2.2 VAT as the best way to increase public revenue

Table No 16

Best way to increase public revenue through VAT

Respondents	Tax officials		Business persons		Consumers		Total	
	No.	%	No.	%	No.	%	No.	%
Increasing tax	1	10				0	1	2.22
Widening its coverage	7	70	15	75	9	60.00	30	66.77
Discouraging tax evasion	2	20	4	20	6	40	13	28.89
Others			1	5			1	2.22
Total	10	100	20	100	15	100	45	100

Above table shows that the best way to increase public revenue through VAT is to widen its, coverage because 66.77% of the total respondents are found to think along that time. About 28.89% went for the option of discouraging the tax evasion. The public awareness program also has a great bearing on the phenomenal increase of public revenue.

4.2.3 Habit of taking bills on purchases

The customers are found to have neglected taking or ever asking for the bills after they have purchased goods or services. Likewise, the salespersons also don't bother to provide them with any bills. VAT calls for the issuance of the bills. So, this habit can be taken as the critical problem for the smooth implementation of VAT system. Even if some give bills, it is not guaranteed that they are proper ones or are not fake ones. The respondents gave following variegated answer when asked about this.

Table No-17

Habit of taking bills on purchase

Respondents	Tax officials		Business persons		Consumers		Total	
	No.	%	No.	%	No.	%	No.	%
Yes on every purchase	5	50	5	25	1	6.67	11	24.44
Yes, on most of the purchase	5	50	13	65	2	13.33	20	44.44
Yes, but not regular			2	10	10	66.67	12	26.67
No I never get any bill					2	13.33	2	4.5
Total	10	100	20	100	15	100	45	100

The table shows that 50% of tax officials, 65% of business and 13.33% of consumers have the habit of taking bills on most of their purchases. In total 24.44% of people take bills on every of their purchases. About 26.67% of people have the habit of taking bills but are not so serious about it so they are not regular about picking up bills on their purchases. 4.45% of people complain that they are not given any bill when they buy goods or services. It is a liability to every salesman to produce the bills whereas demand for bills is the lawful right of every customer.

4.2.4 Percentage of Customers Demanding Bills

Because of many factors, like lack of awareness among customers and so on. The customers themselves feel cumbersome to ask for the bills from the salesman, thus provoking him to evade tax. When asked whether they demand bills or not on their purchases, the following numbers are found to be following the rule:

Table No -18

Percentage of Customers Demanding Bills

Respondents	Tax officials		Business persons		Consumers		Total	
	No.	%	No.	%	No.	%	No.	%
Less than 20	9	90	12	60	10	66.67	31	68.89
20-40	1	10	3	15	4	26.67	8	107.78
40-60			1	5	1	6.66	2	4.44
60-80			2	10			2	4.45
Above			2	10			2	4.44
Total	10	100	20	100	15	100	45	100

The above table shows that that tax officials have the opinion that less than 20% demands for bills. 66.67% of customers have the same opinion (3 out of 20) businessmen argue that 20 to 40% customers ask for bills. This statement is supported by 26.67% of the customers. 10% of the businessmen suggest that above 80% of customers demand for bills. To sum up, the total percent of customers demanding for bill is less than 20% was 68.89%. Habit of asking for bill by 40% to 60% adjusts 4.45% only.

4.2.5. VAT Education

VAT is newly introduced scientific tax system to everybody should be educated about it. About VAT education, few people are aware of this very term. Customers believe that VAT will increase the price of the goods and services so they don't want to be even educated about it. Businessmen are also against it as they also lack the proper knowledge about VAT so VAT should be the topic of discussion and matter of concern for the successful implementation. The following feedback has been collected from the survey:

Table No-19

Effective media for VAT Education

Respondents	Tax officials		Business persons		Consumers		Total	
	No.	%	No.	%	No.	%	No.	%
Alternative choice								
Radio and T.V.	2	20	12	60	5	33.33	19	42.22
Newspaper	5	50	3	15	7	46.67	15	33.33
Booklets/ pamphlets			2	10	1	6.66	3	6.67
Wall painting/banner	2	20	1	5	1	6.67	4	8.89
Seminars	1	10	2	10	1	6.67	4	8.89
Total	10	100	20	100	15	100	45	100

The above table shows that 42.22% suggest radio and TV as the effective media as VAT education. Newspaper might be another source of education is suggested by 50% of VAT officials. About 6.67% suggest that the booklets and pamphlets may be the best media for VAT education. This media proves to be ineffective, thereby must be replaced by other forms of media.

4.2.6 Weaknesses in VAT Administration

The following survey shows what the respondents feel about the administration of VAT and what lead to the weakness in the administration.

Table No-20***Weakness in VAT administration***

Respondents	Tax officials		Business persons		Consumers		Total	
	No.	%	No.	%	No.	%	No.	%
Alternative choices								
Lack of expertise	4	40	2	10	5	33.33	11	24.44
Lack of trained manpower	2	20	14	70	6	40	22	48.89
Corruption bribing			4	20	4	26.67	8	17.78
Lack of physical infrastructure	3	30					3	6.67
Lack of sufficient field offices	1	10					1	2.22
Total	10	100	20	100	15	100	45	100

Every study related to VAT suggests that administration is the main problem in Nepal. Unless and until administration is transparent, capable, trend and honest, the government's intention to collect revenue through VAT will be limited to nothing more than just a daydream. Table 11 shows that 40% of tax officials attribute the lack of expertise to the weakness in administration. In total, 24.44% of people suggest the lack of expertise in VAT administration. About 48.89% point to the lack of trained manpower while 17.78% boldly accused the officials of corruption and bribing while the tax officials remain silent about this. According to them, the corruption and bribery is deeply rooted in Nepalese administration.

4.2.7 Behaviour of VAT Administrator Towards Taxpayers

The following survey shows what the respondents which are only business persons feel about the administrator's behaviour towards them.

Table No-21

Behaviour of VAT administrator towards taxpayers

Respondents	Business persons	
	No.	%
Alternative choices		
Very helpful	12	60
Helpful	3	15
Very troublesome and show in their work	2	10
Disrespectful, treating badly	1	5
Total	20	100

The table No-21 shows that about 30% of businessmen have the view that the VAT administrators are helpful. About 70% view that tax official's work in study and troublesome manner, not finishing the work in time and causing unnecessary trouble to them. Some even believe that VAT administrators are incapable, disrespectful and dishonest, i.e. finishing work only after they are sufficiently bribed.

4.2.8 Problems in VAT collection

The reason behind the introduction of VAT is mainly to increase public revenue. VAT is collected from taxpayers. Modern and scientific as the VAT is, it is expected that VAT tax collection will pick up significantly through VAT, but the result has not been satisfactory yet. The crucial question is: what are the problems behind it? There may be various problems causing a setback to the collection of VAT. Four alternatives were given to the respondent so, that they can ranked them at will. Total marks given by tax officials, businessmen and consumers can be seen from table no.-22.

Table No-22

Problems in VAT collection

Respondents	Tax officials		Business persons		consumers		Total	
	No.	%	No.	%	No.	%	No.	%
Alternative choices								
Registration	2	20	6	30	4	26.67	12	26.67
Account keeping	3	30	6	30	5	33.33	14	31.11
Billing	4	40	3	15	5	33.33	12	26.67
Tax refunding	1	10	5	25	1	6.67	7	15.55
Total	10	100	20	100	15	100	45	100

As shown in above table, about 31.11% believe that account keeping is the biggest problem in VAT collection. Among them 30% of tax officials, 30% of businessmen and 33.33% of consumers supported this alternative. Second greatest problem on VAT collection is billing. About 26.67% believes that billing is one of the problems. Total percentage of 15.55 says that tax refunding is problem in the collection of VAT in Nepal.

4.2.9 Problems in Account Keeping

Account keeping is also one of the problems in the successful implementation of VAT. Most of the businessmen are still in the old mind-set and run their business is the traditional way in Nepal. Especially small traders apparently don't want to keep the transparent and clean record of their transactions. Why so? Respondents were asked that question; the following table shows what their answers are:

Table No-23***Problems in account keeping***

Respondents	Tax officials		Business persons		Consumers		Total	
	No.	%	No.	%	No.	%	No.	%
Alternative choices								
Illiteracy	2	20	2	10	3	20	7	15.56
Not used a/c keeping	3	30	14	70	4	26.67	21	46.67
Rules and regulation still confusing			2	10	2	13.33	4	8.89
Tax evasion in difficult under VAT	5	50	2	10	6	40	13	28.89
Total	10	100	20	100	15	100	45	100

From the above table, it can be concluded that about 46.67% are not used to account keeping. This is supported by the views of 70% of businessmen and 30% of tax officials. About 15.56% suggest that illiteracy is another problem

4.2.10 Problems in the Implementation of VAT

Respondents were asked what problem there might be in successful implementation of VAT. Their response is recorded in the following table.

Table No.-24***Problems in implementation of VAT***

Respondents	Tax officials		Business persons		Consumers		Total	
	No.	%	No.	%	No.	%	No.	%
Alternative choices								
Administrative Incapability	1	10	5	25	3	20	9	20
Under invoicing	2	20	1	5	4	26.67	7	15.56
Frequent	1	10	4	20	1	6.67	6	13.33

change in acts								
Lack of public awareness	2	20	3	15	4	26.67	9	20
Lack of long term policy and strategy	2	20	3	15	1	6.67	6	13.33
Taxpayers unknown to VAT	2	20	4	20	2	13.33	8	17.78
Total	10	100	20	100	15	100	45	100

Table No. 16 reveals, that about 20% point to the lack of public awareness for the problem in the effective VAT implementation. Due to the lack of public awareness, customers hardly demand any bills on their purchase. Total 20% consider administrative incapability as a hindrance to VAT implementation. Tax payers are oblivious to the term VAT itself.

4.3 Major findings of the study:

On the basis of preceding chapters and data presentation and analysis, some important findings of the research are presented in summary as follows:

1. The VAT system that has been implemented in Nepal has completed 14 years of its operation and enters into 15 year. B
2. ut the data presented in this research is only of the 13 years i.e. 1997-98 to 2009/10 due to several constraints. Due to various complexities and problems this tax system has not been able to achieve the expected level of success.
3. Theoretically VAT is superior to sales tax in many of its form. As it was abolished already, there is no possibility to compare it with VAT now. So, only theoretical superiority is established.
4. A large amount of government revenue comes from taxation. More than 75% of government revenue comes from taxation whereas the contribution of non- tax revenue is less than 25% in Nepalese tax structure. The contribution of tax revenue was expected to increase after the implementation of VAT. But implementation of VAT did not increase the contribution of tax revenue on total revenue significantly.

5. Though VAT has been implemented in Nepal in order to generate more revenue, but the efficiency of the Nepalese VAT administration is not satisfactory and not up to the expectation of the general people.
6. Only few members of consumers have habit of taking bills on their purchases. Customers have no habit to take bill on their purchase. This implies that there is very low public awareness and consciousness level towards VAT. On the other hand, businessmen do not want to issue bills. The businessmen have the intention of 'malpractice' on VAT. So, they don't provide bills to customers. This indicates the very need of supervision and rational auditing.

The percentage of customer demanding bills on their purchase is very low. This might be the cause of ignorance and no habit of taking bills. Taxpayers are not satisfied with the VAT administration. Only few administrators show helpful behaviour towards them. Most of the VAT administrators complete their works very slowly and in steady manner. This type of behaviour has created great tension and frustration among taxpayers. Professionalism has not been developed yet in VAT in Nepal. Lack of trained manpower's and expertise affects the fluency of VAT administration. Physical infrastructure is also lacking. Unless and until administration is made transparent capable and trained, the government's intention to collect comparatively more revenue through VAT is just a daydream. There is little knowledge about VAT to taxpayers and low public consciousness level in Nepal. To educate taxpayers and all the concerned bodies, educational program has to be launched in an effective way. But whatever programme has been underway is not sufficient to create its impact on people. Most of the respondents suggest that Radio/TV might be best media to educate taxpayers and consumers. Newspaper might be another good alternative.

The expected amount of VAT collection is not possible due to lack of maintenance of proper accounts which is very serious problems. Billing is also a very serious problem regarding VAT collection. Customers do not have the habit of keeping bills on their every purchase and business does not feel liable to provide bills on their every sale to customers. The only motive not to provide bills is for tax evasion. It had been noticed that traditional Nepalese businessmen do not have the habit of maintaining

their account. Tax evasion is very difficult if account is properly maintained. Some are illiterate and some desire to evade tax.

Administrative incapability, under invoicing/ UN billing and lack of public awareness towards VAT are main problem in the process of VAT implementation in Nepal.

7. Number of taxpayer registrants under VAT has been increasing year after year. The ratio of registrants just kept fluctuating, decreasing sharply in 2007/2008 as 12.50. But in 2008/2009 is good position as 16.66 and 2009/2010 as 18.33 respectively.
8. The status of non-files is not also satisfaction. In fiscal year 2004/2008, it had increased up to 22.96% although it had decreased to 18.72% in the fiscal year 2008/2009 but the trend seems to be fluctuating. There is never a constant proportionate increase.
9. Credit returns status in the increasing trend from every fiscal year. Nil tax return and undecided tax return are also increasing year. This is not good sign for Nepalese revenue. Unless the government is active to find out the increasing trend of credit return nil return and undecided return. VAT cannot be the effective tool for revenue generation.
10. Up to the fiscal year 2005/2006, the government failed to meet the target revenue. It was only in fiscal year 2009/2010 that it had just touched the target in the fairly low margin. Even after the implementation of 13 years ago, the government could never get rid of this dire situation.
11. In Nepal collection of VAT has been classified as imports and domestic sources, out of which collection from imports has significant share i.e. Rs. 34541.03 million in the fiscal year 2009/2010 as compared to domestic contribution amounting to just Rs. 20379.83 million or just 37.11% of the total VAT revenue in the same fiscal year. This surely indicates that there is heavy dependence as imports rather than domestic product.
12. The contribution of VAT to GDP is just 3.49% in an average of 10 years. The contribution of VAT to GDP reached 4.64% in the fiscal year 2009/2010. So the VAT/GDP ratio is very low.

13. The contribution of VAT in total revenue is to the satisfactory level either in an average, it could contribute 6% of the total revenue which is indicating the good position in the year 2009/2010.
14. Hopefully, an average share of VAT revenue in the total tax revenue is pretty good ie. Just about 35.13% which simply indicates that VAT through implementation wise faring very poorly, is still emerging as the important sources of revenue generation.
15. So, far as the price to the consumer is concerned, as with the sells tax, the consumer pays the same amount to the retailer. There is no difference in consumer price which paid for the product or services.

CHAPTER- V

SUMMARY CONCLUSION AND RECOMMENDATION

This chapter is the final chapter of the research which briefly deals with the summary of the study. It also tries to draw the final conclusion of the study while attempting to offer various recommendations to make the aspects of VAT better in future.

5.1 Summary

This research work is entitled “A Study On Issues And Practice Of Value Added Tax In Nepal”, has been carried out to ponder into the theoretical knowledge of VAT and top examine the administration system of VAT especially in the Kathmandu valley, to assess the post implementation period of VAT as compared to the period before the implementation in connection with generating revenue to examine whether VAT is superior to Sales Tax. To achieve those objectives empirical analysis have been done with the help of 10 years data (i.e. from physical year 2000/2001 To 2009/2010) and questionnaire developed by the researcher.

The study has been divided into five chapters. The contents of those chapters are as follows

Chapter I: Introduction

Chapter II: Review if Literature

Chapter III: Research Methodology

Chapter IV: Presentation and Analysis of Data

Chapter V: Summary, Conclusion and Recommendations

The first chapter begins with the brief background of the study i.e. the introduction to Taxation itself. It types and all relevant information about Taxation which is essential for having some understanding about VAT, the main topic. The chapter also goes on to discuss the main focus of the study, research questions, objective of the study, significance of the study, limitation of the study and organization of the study. Therefore this chapter presents the outline of the study highlighting its main aims and the reasons for carrying out the research.

In the second chapter, theoretical framework of VAT has been discussed. This chapter includes introduction to VAT, types of VAT, methods of computation of VAT, principles of VAT, historical development of VAT around the global and in Nepal, Coverage of VAT in Nepal and Tax administration also. Likewise in the resume of earlier studies, related materials like books, dissertations and journals have been reviewed.

The third chapter briefly explain the research design, nature and source of data.

The fourth chapter is the main body of the researcher work which has two main sections viz. presentation and analysis of data, and major findings of the study. This chapter begins with the need for reforms on the present tax system in Nepal, the reform in Tax begin the VAT. Its importance was also studied. It also tries to show the superiority of VAT to different forms of Sales Tax. The study then moves on to examine the trend preceding and following the implementation of VAT in Nepal. The sample survey of 45 concerned people consisting of tax officials, Businessmen and Consumers was conducted to throw light on the administration system of Nepal. About 9 questions were asked them about the various issues relating to administration of VAT in Nepal. The study also discussed the trend of registration, cancellation of registration. Non-filers, tax return, revenue collection from VAT, composition of VAT revenue, share of VAT revenue to GDP, to total revenue and to Total Tax Revenue. The chapter then studies the future trend of GDP, VAT ratio. This will set a benchmark for the future action plan to ensure the growth of the ratio. For studying these various issues, data from the 9 fiscal years, i.e. from 2000/2001 to 2009/2010 has been used. To analyze the relationship of VAT with GDP, Total Revenue, total Tax Revenue and Total Indirect Tax Revenue, After all these studies were made, the study came up with major findings which were also included in this chapter.

The fifth and final chapter contains the summary of the four earlier chapters. This chapter also has conclusion of the research and attempt to offer various suggestions and recommendations for the enhancement and betterment of VAT in Nepal.

5.2 Conclusion

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

Recently, developing as well as developed countries in the world have increasingly focus than attention towards reforming the tax system by standardizing and improving the poorly designed tax structure in order to mobilize high volume of resources for the development purposes and make the economy healthy, efficient and self sufficient to a large extend. In this regard, VAT has become a point of attraction for about more than 130 countries in the world including Nepal. Existed sales tax along with contract tax, entertainment tax and hotel tax were replaced by VAT since 1997 in Nepal. VAT was initially expected to have a high revenue yield due to its broader coverage and basis. Elimination economic distortions caused by tax system, elimination of cascading and pyramiding effects, creation of the competitive business environment, strengthen foreign trade etc. as it were, are other features of VAT theoretically, expected to be fulfilled in the real practice.

It was not easy for the Nepalese government to implement VAT easily as there were many objections and complaints from the business community. But after some dialogue and negotiations, the government was able to implement it to the satisfaction of all. However, there are several issues in the applicability of VAT in Nepal. One of the key issues is administrative capability and situation which definitely are of great importance for the effective implementation of VAT in Nepal. Actually VAT was introducing in Nepal in an ambitious hope to increase the revenue and particularly stop the leakage made through other forms of taxes. But history has shown that the government gas already tried many reforms in the field of taxation but no alternative have effectively materialized because it lacked proper planning and in other words leading to administrative failure. Indeed, this is true in the case of VAT also. Nepalese businessmen are generally found to avoid the frequent contact with the tax officials because they are widely known for unofficial benefits. Even in the administrative area, there is a widespread corruption. From the survey, it is clear that it is difficult for the customers to get the job done by officials without sufficiently bring them. There

are the serious concerns. In order to make VAT applicable, following things should be considered:

- i. Administrative power and credibility
- ii. Tax payers identification
- iii. Registration and educational program
- iv. Incentives for small traders
- v. Co-ordination with private sector
- vi. Feasibility of refund system
- vii. Electronic media

Currently DANIDA and GTA have jointly established a VAT project in order to assist the implementation of VAT in Nepal. While the numbers of registrants are increasing but the tax collection has not been satisfactory when compared to the number of registrants. Public awareness is very low. The salesmen are not used to issuing bills and the consumers to receiving them. Undervaluation and smuggling of goods are mostly found. The problem seems to be aggravated by the government's increasing the VAT rate to 13% which immensely discourages the customer in demanding bills on their purchases.

Truly, recent increment in VAT rate has a fairly negative influence on general people. Their viewpoint is to broaden the tax base instead of increasing the tax rate. Tax rate has been increased time and again for nothing, but this does not get reflected in real revenue mobilizations. Rates should be continued for a long time for transparency and must be incorporated in VAT Act itself. So, the government has to pay serious heed in increasing the tax base instead of increasing the tax rates. International experience tells us that the gradual lowering of duties or tax rate is an effective tool in achieving the desired goals rather than increasing it.

Periodical policy has also been obstacles for its speedy enforcement, and a major hurdle that has hurt revenue generation. Excise duty is an important source for VAT, but it has not been effectively administered. Customs officials are more worried on custom duty than VAT collection. Widespread leakages are normal practice due to lack of professionalism, integrity, technically competent, and international orientation. Tax auditors have been auditing without basic knowledge and academic background. As it's weakly enforced, many sectors are out of tax net. Tax payers complain that the procedures are complicated and time consuming during the decision making process from eighty percent of

taxpayers, who pay only twenty percent of revenue. The system is not new; many countries has already tried with the lottery system and failed gaining from it. It means, we had no valid mechanism to bring the potential payers into net, and no valid mechanism has been developed on bringing them into the tax net. The April 2005 movement (also known as the second janandolan) is a harbinger of new hope in Nepal. It was intended to over through the old feudal regime replacing it with the new sovereign and people ruled system. Nepalese people are beginning to dream of different New Nepal following the constituent assembly. Under such situation, the old status quo in the administrative field also must changes. Surely, this is a real challenge to the administrators and the policy makers of Nepal. In other words, this is not happening at the moment. If that status quo could not be broken, no matter whatever big changes take place, they could have no influence at all. This is a real paradox. However, if the nation is to March fast enough to keep pace with the momentum of development of political change, it must come out with a new inventory of concepts and strategies as opposed to the old stereotyped ones. It is a well known fact that the industrialization of Japan, Hong Kong and South Korea was possible because of their tax policies. So, under the changed system in the country, a tax system definitely could play a crucial role in course of nation-building. Sweeping and radical reforms on VAT system with a comprehensive incentive package based on VAT concept would help the economy boom.

A bold vision, evolutionary leadership, efficient bureaucrats, honest tax payers plus collectors and graft-free society are the invisible infrastructures required. So, all must think from a long-term perspective rather than weighing up immediate pros and cons. The Inland Revenue Department must come up with a forward-moving process, concrete action plan and policies to cope with the global challenge in order to accelerate the reform process.

5.3 Recommendations

On the basis of research, the following corrective measures are recommended for the better administration and implementation of VAT system in Nepal.

1. A proper co-ordination between IRD and MOF should be established. Unpractical Acts, Rules and Regulations should be amended. VAT laws needs to review on the basis of experience gained so far VAT laws are effective implemented.

2. Unproductive, corrupted, inefficient staff lacking practical and specialization training is a serious problem. So, providing training to such staff is highly essential.
3. The tax administration should be very watchful to prevent any kind of malpractice, fraud and tax evasion. Utmost care should be taken to prevent any kind of bribing and corruption. Tax officials should effectively be monitored.
4. Taxpayers, customers are clearly ignoring the VAT system and taking it for granted. They have lack of proper knowledge about computation of tax liability, taking invoice or bill on their purchases. So, emphasis should be given in educating the tax payers. The issuance of proper bill for every taxable sells must be made mandatory.
5. The success of VAT system is not only the success of the IRD, but also the success of nation as a whole. The role of general media, radio, TV, newspaper plays an important one. Emphasis should be given on mass media. Awareness towards VAT system should be created among general public, nongovernmental and government organization.
6. Computer system and networking program through online service must be developed and linked so as to make the work simple and easy. Computer links between tax officer and custom offices should be maintained.
7. Government has been providing tax refund 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.
8. Research and investigation should be conducted on various issues, such as the effect of VAT on price, economic growth, investment and measure for solving VAT problems should be recommended by the tax group. VAT law to be reviewed on the basis of experience gained so far.
9. The accounting system should be transparent. Taxpayers should be encouraged to register their business voluntarily. Instead of forcefully coercing tax payers, providing various facilities to them can increase VAT compliance. The tax administration can select genuine business persons and reward them.
10. Border should be effectively controlled to prevent the illegal trade. Warehouse and highways checking should be done effectively to prevent any kind of illegal trade.

11. VAT collection on import is remarkably higher than domestic production. Government should take effective steps to encourage domestic production.
12. Lots of efforts should be made to reestablish a functionally well organized organization where the tasks are carried out in a modern, effective, transparent and service minded manner.
13. Most of the national economic activities are dependent upon agriculture and large portion of GDP coming from agricultural sectors remains out of tax net. Thus VAT should also be levied on agriculture sector with sufficient exception for generating more tax revenue. This will increase VAT/GDP ratio.
14. Most of the taxpayers are not satisfied with VAT administrators. They always have complaints against the administrators who do their jobs rather slowly, harassing the customers unnecessarily. The work that is to be finished today is postponed for the next day. This is their habit. Therefore it is suggested that tax administrators should be consumer-focused and result oriented.
15. Lastly the periodic information about VAT is now available on the website as well. For the researcher this is a great privilege. But the website is not updated and doesn't have the older reports. So, the website must be updated from time to time and must be kept up-to-date. And all backup copies of the old (old fiscal years) annual reports and economic surveys must also be available on the website. This facilitates the researchers greatly and other concerned bodies, even the consumers, because for minor information, they would not have to frequent the Inland Revenue Department and Ministry of Finance.

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6. Whether VAT increases price of the goods or not was asked to the respondent ?
 i) Yes ii) No iii) Don't know
7. Whether you/they ask for VAT bill with the seller or not after purchasing goods from market ?
 i) Yes ii) No iii) No need to ask for iv) Occasionally
8. What kind of goods should come under VAT net ?
 i) All kind of goods and serves
 ii) Expect basic needs goods.
 iii) Imported goods only.
 iv) Other if any.
9. What is the basis of charging VAT ?
 i) On the amount of value addition
 ii) On the profit amount ?
 iii) On the amount of sales ?
 iv) Don't know
 v) Others
10. What should be the period for which VAT return it to be submitted to IRD ?
 i) 1 month ii) 2months
 ii) iii) 4 months iv) Depends on the nature of business.
11. What should be the period or deadline for payment of VAT ?
 i) By 7th of next month
 ii) By 15th month.
 iii) By 25th month.
 iv) By any time as per wish.
12. Who needs to keep tax plate as per Act ?
 i) VAT registered tax payers.
 ii) Person dealing in vatable goods & services.
 iii) Person dealing in non Vatable goods
 iv) All above.

13. What the accountant and business man actually want form revenue administration ?
- i) Effective laws and rule.
 - ii) Co-operation and help.
 - iii) Fast service.
 - iv) Easy tax payment system.
 - v) others if any.
14. Whether E-filling has become effective or not
- i) Yes ii) No iii) Don't know
15. As per VAT act, Accountant and tax payers are required to be maintained in prescribed for mates certain record and what may think about that record and its use ?
- i) Yes ii) No
16. Whether it is compulsory to take VAT invoice on purchase Rs. 10000/- or above ?
- i) It is ok.
 - ii) Amount should be increased.
 - iii) Amount should be decreased.
17. What should be yours opinion on new service sector to be included on VAT list, please tick
- i) Agricultural sector
 - ii) Private education sector
 - iii) Private health sector
 - iv) Private media sector
 - v) Private Airline sector
 - vi) Banking sector.
18. What is your opinion on revising registration criteria under VAT act ?
- i) Reducing threshold limit
 - ii) Increase the list of some special kind of business.
 - iii) Other if any
19. What should be your opinion regarding inclusion of real estate (land, building) sector on VAT net ?
- i) It is Ok.
 - ii) It doesn't make any effective
 - iii) Good and need to add some more area.

20. How the government can increase the revenue base of VAT.
- i) Reduce the threshold
 - ii) Include all service sector
 - iii) Incorporate agricultural sector.
 - iv) Reduce tax exempted goods.
 - v) Others if any.