CONTRIBUTION OF VALUE ADDED TAX TO GOVERNMENT REVENUE IN NEPAL

A Thesis

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CHAPTER I

INTRODUCTION

1.1 Background of the Study

Economic development has been one of the most popular slogans in almost all the developing countries all over the world. Similarly, achievement of high rate of economic growth rate, reduction of income disparities and poverty and improvement of living standard of people are some of the development strategies towards which most of the government's efforts have been directed in developing countries. It is known that government needs more revenue for overall economic development and state welfare. Besides this, for meeting day- to-day expenditure, government also requires some sources of income, these are the challenging tasks, which demand increasing necessity of regular expenditure in general and development expenditure particular. However, resource mobilization is very low, compelling the government to depend on foreign assistance heavily (Parajuli, 2009). Development expenditure has been dependent almost entirely on foreign aid. It is known that external assistance is uncertain, inconvenient and not good for healthy development. Foreign aids are not bad for economic development of the nation, but the experience of most of the developing countries shows that there are negative effects of increasing international grants and loans to finance and the public development activities. Thus, the government should depend on its own resources for generating revenue to spend these regular as well as development activities.

Government collects revenue from tax and non-tax sources. Tax is key source for revenue mobilization. Tax is a compulsory contribution, as prescribed by law, to the government for a common benefit upon the residents of the state. Taxes are major fiscal policy instrument and important government policy tools have an important role in increasing the rate of capital formation and thereby a high rate of economic growth can be achieved. Increase in taxes may be directed to increase in saving through the postponement of consumption. To increase in saving as available for making useful and productive investments. Taxation may also play a dual role. On the one hand, taxation may be used to make the maximum volume of resource available to the public sector. On the other hand, taxation may be used to promote useful investment

in the private sector and to prevent the resource from being dissipated over speculative and unproductive investment as well as over lavish and luxuries consumption. Thus, taxes in developing countries are the severe means of raising revenue (Uprety, 2004).

There are two ways to raise tax either by indirect tax or direct tax. Tax is a direct one when the incidence and impact are on the same person e.g. income tax. Indirect tax simply implies that a tax in which the burden or incidence of tax does not directly fall on the taxpayers but shifts towards other persons and the real income are affected indirectly e.g. Value Added Tax, custom duties etc.

In least developed countries like Nepal, role of indirect tax is seen to be more important and VAT is the most important innovation of the second half of the twentieth century, which is considered as an effective means to collect revenue as a reformed sales tax of indirect tax system. The Value Added Tax is recent origin in the field of taxation.

The concept of VAT was developed for the first time by Dr. Wilhelm V. Siemens in Germany in 1919. The concept of VAT was developed further in 1949 by a tax mission in Japan headed by Prof. Carls S. Shoup, the tax however remains as only a topic of academic interest until 1953. In 1954, France introduced VAT covering the industrial sector. The tax was however limited up to the wholesale level. By the end of 1960s only eight countries including France, Brazil, Germany, Netherlands, Sweden etc. had introduced VAT. Since then VAT has been introduced by at least one country each year.

The concept of VAT in Nepal was introduced in early 1990s. Government of Nepal indicated its intention to introduce VAT in the eighth plan, subsequently the finance minister declared to introduce a two- tier sales tax system to make the base of implementing VAT from the fiscal year 1992/93. A VAT task force was created in 1993 under the financial assistance of USAID in order to make necessary preparation for the introduction of VAT. The VAT task was force to prepare the draft of VAT legislation.

The parliament of Nepal Enacted "Value Added Tax Act – 1995 (2052)", Subsequently VAT regulation was made in 1996; the act was passed in 1995. Its implementation was delayed due to political instability and strong opposition from business community. VAT with single rate of 10 percent has been fully implemented with its effect from 16 November, 1997. It has replaced sales tax, hotel tax, contract tax and entertainment tax. VAT is a new tax system for Nepal, it has been justified in the light of government fiscal imbalance and need for extra revenue mobilization through an efficient tax system. The government of Nepal has been increased VAT 10 percent to 13 percent effecting from 15 February, 2004. Its name (Value Added Tax) implies, a tax in the value added to a commodity or service.

1.2 Statement of the Problem

Despite more than five decades of planned development efforts, Nepalese economy is victimized by poverty, income inequality and unemployment. Nepal is in 138th position among 169 countries. The low income leads Nepalese people under vicious circle of poverty. GNP per-capita income is just around 862 US$. The number of population living below, the poverty line is 25.4%, political scenario has changed, but economic system is traditional, needs and aspirations of people have been risen tremendously, but economic growth is poor (3.54%) and unable to support and fulfill the needs of people (Economic Survey, 2017).

The economic performance of the country in major areas is also disappointing. The economic growth rate is not going to support the increasing population. Basic macroeconomic indicator of Nepal shows that Nepal's economic performance is not satisfactory. The widening resource gaps- revenue expenditure gap, saving investment gap, import-export gap of the country has further affected the economic stability of the country. The ever increasing government expenditure and limited sources of revenue lead the country to several fiscal crises over many years. The share of foreign aids in development expenditure is more than 50 percent. The burden of foreign debt is increasing year by year (Kharel, 2011).

The persisting budgetary deficits and increasing dependency on foreign assistance for financing deficits present a dismal picture of country's prospects. The design of taxes in Nepal is so poor and defective; those revenue raising instruments have very

disappointing performance. The weak performance of taxes in raising revenue is the major factors in Nepal's low tax GDP ratio. Nepal's tax structure is less productive. The major defect of Nepalese tax system is very narrow base, mainly because the larger proportion of GDP originating from the agricultural sector remains out of tax net. Similarly, other problems are low contribution of direct taxes, low voluntary tax, compliance, very weak tax administration, wide spread tax evasion, burdensome legal and administrative procedures etc.

The scope of direct tax through income taxes and property taxes are rather limited because of the low administrative expertise and large scale of tax evasion. On the other hand, the rates of indirect tax like import tax and excise duties are also gradually being lowered because of trade liberalization policy. In this situation, only revenue raising device may be tax on internal transaction of goods and services.

In this situation, there is no alternative way of VAT in the place of existing sales tax system, which is less productive and narrow base. The problem is that most of the general public doesn't know the concept of VAT even that businessmen have not clearly understand it. In such situation, government should abolish that sort of problem and make VAT remarkable.

Hence, the statement of problems are listed below:

1.   What is the volume of indirect tax and direct tax in total tax revenue?
2.   What is the structure and trend of VAT in Nepal?
3.   What is the contribution of VAT in tax revenue in Nepal?

1.3. Objective of the Study

The main research objectives are as follows:

1.   To identify the volume of indirect tax and direct tax in total tax revenue.
2.   To analyze the structure and trend of the VAT in Nepal.
3.   To examine the contribution of VAT in the total tax revenue in Nepal.

1.4 Significance of the Study

VAT can play an important role in the process of development in developing countries like Nepal which needs higher revenue to fulfill various responsibilities. If it is properly implemented VAT provides various financial needs. For the successful implementation of VAT co-ordination between government and business community is needed.

VAT is the modern form of sales taxation. It has been implemented since 1997 in Nepal. There is need of deeper and wider study about VAT in Nepal. In this context, many empirical and theoretical studies have been conducted to examine the various problems and prospects of VAT in Nepal. The study will be directly beneficial to policy makers, private sector, researcher and general people. Policy makers will be able to identify the areas needed for improvement .It will help the re-searcher to carry out their research a step ahead about VAT.

1.5 Limitations of the Study

The study has been conducted with the following limitations:

1. Major data use in this study are based on secondary data. The reliability test has not been done.
2. The study concern only a period of 2006/07 to 2015/16 and conclusions has been drawn based on the data of stated period only.
3. Only those factors which are contributing the government revenue from taxes including VAT have been considered.

1.6 Organization of the Study

The study is organized into following five chapters:

Chapter I: Introduction deals with general background, statement of the problems, objectives of the study, scope of the study, need of the study, plan of the study and limitations of the study.

Chapter II: Review of Literature includes the review of literature based on previous studies.

Chapter III: Research methodology is related with the research methodology used in this study which includes research design, nature and source of data, population and sample, etc.

Chapter IV: Data presentation, analysis, and interpretation is related with presentation and analysis of data.

Chapter V: Summary, conclusion and recommendations.is concerned with the summary, conclusion and recommendations.

References are also included at the end of the study

CHAPTER II

LITERATURE REVIEW

A literature review is an evaluative report of information found the literature related to selected areas of study. The review should describe, evaluate and clarify this literature. Basically the literature review is found to be divided in two parts conceptual and empirical review. The conceptual review includes the major types of act and provision related income tax and empirical review includes review of previous studies.

2.1 Conceptual Review

2.1.1 Concept and types of VAT

Value Added Tax (VAT) is the most recent innovation in the field of taxation. It is considered as one of the most powerful tools of the fiscal policy. From the experience of VAT in several countries, many economist and policy makers have agreed on VAT is probably the best indirect tax as it gained a remarkable popularity in such a short span of time.

VAT replaces old sales tax, contract tax, hotel tax, and entertainment tax. It has been designed to collect the same revenue as the four taxes it replaced. Since the collection of both customs duties and income tax depends to a great extent upon the effectiveness of VAT. It is expected to help in revenue.

VAT is 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 increase efficiency and to lessen tax evasion. It is also regarded as the backbone of income tax system in Nepal. VAT is multiple sales, which has grown on a hybrid of turnover tax and retail level sales tax. It is similar to turnover tax in the sense that both these taxes are imposed at each stage in the production and distribution process. VAT is similar to the retails stage sales tax because the tax base of VAT (consumption type VAT) and of the retails level sales tax on consumer goods and services are identical. VAT, however differs from retails

level sales tax in the sense that the former is imposed at each stage of production and distribution while the latter is imposed only on one stage, which is the final stage. Theoretically, VAT is broad-based as it covers the value added to each commodity by firm during all stages of production and distribution. There is the presumption that VAT is shifted forward completely to the consumers.

Types of VAT

VAT has been classified on several bases and it can be basically classified into three categories namely consumption type of VAT, income type VAT and production type of VAT. The difference among such types of VAT depends upon the treatment of capital goods purchased from other firms and the treatment of depreciation for the purpose of tax base (value added). That is why, discussion is concentrated within the treatment of these two items for all types of VAT.

Consumption Type of VAT

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

Value-added = Wages+ Interest+ Rents+ Depreciation+ Profit- Capital goods purchased from outside (in the year of purchase)

The above equation clearly shows that the tax base is consumption because investments are free from taxation. Under this type of VAT, investments are encouraged because it excluded from tax base. Similarly, imports are taxed whereas exports are relieved from tax. Thus, tax base for the nation under this type is equal to the domestic consumption. Nepal has adopted it with tax credit method from very beginning.

Income Type of VAT

Under the income type VAT, capital goods purchased from outside suppliers are included in the tax base in the year of purchase but depreciation is excluded from the

tax base. The following equation is presented to make clear ideas about the tax base under it.

Value added=wages + interests + profits + capital goods purchased from outside (in the years purchase)

Or, Value added (tax base) = sales-purchase (excluding purchase of capital goods from outside in the year of purchase) - depreciation.

The above equation clearly shows that the value added is equal to the consumption plus net investment. It means the tax base for the nation is the net national income that comprises the consumption and then net investment of all firms with in the country.

Production Type of VAT

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

Value added=wages + interests +rent + depreciation + profits + capital goods purchased from outside (in the year of purchase).

Or, Value added (tax base) =sales − purchase (excluding purchase of capital goods from outside in the year of purchase).

The above mentioned equation obviously shows that the tax is imposed both on consumption and gross investment. This means that value added by all firms with in country constitute the gross national product (GNP). That is why; the tax base of this type of VAT is conceptually equal to the GNP. Thus, this type of VAT is also termed as gross nation product type VAT.

2.1.2   Methods of Computation of VAT

VAT can be computed by following three methods:

Addition Method

In this method, the tax base is calculated by adding the payments made by the firm to the factors of production employed in turning out the production such as wages, interest, rent, royalties and profits. This method is very close to income type of VAT that includes the reward to all the factor of production in its base because all payments made for the factors of production have to be added. It creates complexities in calculating them in practice. Virtually no country has based the additive method. However, Argentina and Israel have used it in selected economic activities, such as banking and finance, where value of inputs and outputs are difficult to measure (Due and Lander, 1977).

Subtraction Method

Under this method, cost of production is deducted from the base value. In other words, value added is determined as net turnover that is obtained by subtracting the cost of materials from sales proceed. It is much closed to consumption type VAT. Theoretically, it looks simple and easy but it is very difficult to compute especially where multiple rates of VAT exist. Problems like ascertaining tax value in an accounting period may also arise. Above two methods are called direct methods because value added is computed directly either by adding the payments made by the firms to the factors of production or by subtracting the cost of production from sales.

Tax Credit Method

Tax credit method is known as indirect subtraction method or invoice method. Under this method, input tax is credited from output tax and passed into next stage up to consumption level. Tax credit method is similar, to some extent subtraction method but the major difference among two are:

a.   In the earlier method, the tax base levied in the different amount of tax on sales and tax on purchase, where as in the latter method; the tax is levied on the different amount of sales value and purchase value.

b.   Earlier method requires invoices, while latter does not require.

2.1.3 Characteristics of VAT

The main characteristics of VAT can be stated as follows:

- a. It is form of indirect taxation
- b. It is broad based tax as it covers the value adds to each commodity by a firm during all stages of production and distribution.
- c. It is substitute for sales tax, hotel tax, contract tax and entertainment tax.
- d. It avoids cascading effect existed in sales tax and contains catch-up effect.
- e. It is based on self-assessment system and provides the facility of tax credit and tax refund.

2.2 Review of Previous Studies

2.2.1 International Context

Thripathy (1992) stated that VAT has distinct advantage as an instrument of resource mobilization. The tax on value represents a new technique for collecting taxes on output of economic enterprises.

If a tax on value added is imposed on sales minus the purchase of materials and also of capital expenditure items of an enterprise. According to him, in the developing countries the consumption type of Value Added Tax should be improved in every stage of manufacturing and distribution exempting. Beside its structure should be designed in such a manner that to impose a low rate of tax on food articles. The consumption type of Value Added Tax should be imposed in complete substitute of the tax on undistributed profit of companies because a large scale of evasion of tax revenue takes place in these countries with regard to sales taxation, whereas the taxation of corporate profit is administratively much more convenient.

As a complete substitute for sales tax, a Value Added Tax has important advantage. This may be summed up under the following broad categories:

a) Administrative advantage b) Promotion of economic growth c) Instrument of planning d) Promotion of economic efficiency and e) Healthy effect on exports

The most important point about the Value Added Tax for developing countries is that it will constitute a dynamic part of their tax system. Besides the Value Added Tax is the most obvious of tax which vary in response to short run economic fluctuation. It can be raised or lowered as the situation demands more quickly and easily than many other taxes. Thus, the Value Added Tax can constitute an important instrument of development the finance and economic stabilization in developing countries.

Masayuki (1994) stated that value added tax is often described as a regressive tax because it taxes consumption, and the propensity to consume tends to decrease as income rises. These measures include (i) exempting food and social necessities and (ii) taxing luxuries at high rates and necessities at low rates. The author referred that VAT of the subtraction type has two main variants, namely the tax credit method and the subtraction method. These two types of VAT have theoretically the same effects on a firm's liability for VAT and a firm's decision on price in cases where there is only one rate and there are no exemptions

Olu (1999) analyzed the impact of value added tax on key sectoral and macroeconomic aggregates, for Nigeria. A survey of VAT able Nigerian manufacturers, distributors, importers and suppliers of goods and services, organizations was conducted to gain insights into the way VAT is treated by these organizations. The survey shows that a majority of the VAT able organizations treat VAT in a price cascading manner by regarding it as cost contrary to expectations. Evidence from the way VAT revenue is being shared among the three levels of government in Nigeria suggests that this revenue is being re-injected into the economy.

Richard and Gendron (2006) discussed some recent critical literature on VAT in developing countries relating to its revenue productivity, its equity, and its impact on the development of the formal economy. The authors concluded based on two recent country studies that while there is merit in many of the criticisms that have been made, on the whole if a country needs a general consumption tax, as most developing countries do, then VAT is the one to have in almost all cases – although this conclusion certainly does not imply that the VAT already in force in most such countries is necessarily the 'best' VAT for their circumstances.

Keen (2007) reported that VAT actually does too good a job of raising tax revenue in United States. Further that the VAT does a bad job of taxing the informal sector-and that tariffs might be a better revenue-raising instrument for many developing countries.

Rita de la Feria (2008) reported that in most countries applying a VAT system, the activities and transactions undertaken by public sector bodies are not subject to full taxation. The rationale usually invoked to justify lack of full taxation is of a mixed conceptual and political kind. On one hand, there is a view that the activities of those bodies are hard to tax and that, in practice, it is almost impossible to establish a single VAT treatment applicable to all of them. One the other hand, and more importantly, there is a perception that exclusion of the products supplied by public sector bodies from full taxation, achieves social and distributional aims. The author considered thecurrent legislative framework, with special consideration being given to recent developments in this area, at both legislative and jurisprudential.

Keen and Lockwood (2010) explored the causes and consequences of the remarkable rise of the value added tax (VAT). It is observed that the introduction of a VAT, reduces the marginal cost of public funds and it leads an optimizing government to increase the tax ratio. This leads to the estimation, on a panel of 143 countries for 25 years, of a system describing both the probability of VAT adoption and the revenue impact of the VAT. The results point to a rich set of determinants of VAT adoption, and to a significant but complex impact on the revenue ratio. The estimates suggest, very tentatively, that most countries which have adopted a VAT have thereby gained a more effective tax instrument, though this is less apparent in sub-Saharan Africa.

Giesecke and Tran (2010) examined the multiple VAT rates, exemptions, registration rates, refund limitations, informal activity, taxation of domestic non-residents, and undeclared imports. The author made a comprehensive VAT compliance measure for Vietnam, a country with a complex VAT system. Their estimate of Vietnam's VAT compliance rate is about eleven percentage points higher than that calculated by the most popular measure of compliance, collection efficiency.

Eimear, Sean and Toll (2010) examined the distributional effects of Value Added Tax (VAT) in Ireland. Using the 2004/2005 Household Budget Survey, the authors

assessed the amount of VAT that households pay as a proportion of weekly disposable income. The authors measured VAT payments by equivalised income decile, households of different composition and different household sizes. The current system is highly regressive. With the use of a micro-simulation model the authors estimated the impact of changing the VAT rate on certain groups of items and the associated change in revenue. The authors considered how the imposition of a flat rate across all goods and services would affect households in different categories.

Jalata (2014) examined the role of the VAT on economic growth of Ethiopia from 2003to 2012 based on theoretical and empirical evidence. Under review both descriptive and inferential in nature was performed that uses data on five economic variables: the gross domestic product (GDP), VAT, total tax revenue (TTR), nontax revenue (NTR), foreign revenue (FR).The finding of the study reveals that VAT comparing with sales tax, boots the general economic growth of the Ethiopia but the issue of regressively resembling to sales tax still continues similarly. VAT, TTR and NTR except FR were significant but all of them positively contributed for economic growth during the periods under review. However, to be effective, it requires strong administration and cooperation of tax payer with taxing authority and government in general.

2.2.2 National Context

Bista (1999) examined the importance of VAT with respect to resource mobilization and to identify the problem of VAT and its prospect in developing countries like Nepal. The study basically stands on secondary data. Data analyzing tools are simple statistical tools e.g. percentage, ratio etc. In his study, he found the following facts with respect to his objective.

VAT can mobilize the rest of revenue resources by broadening tax base and tackling all illegal business activities. Tax officers are not specialized or the professionalism is not developed on tax officers. Public awareness is low to make people aware. Paper media commitment towards VAT is weak, open boarder is the main cause of unauthorized trade and unofficial trade. He recommended the following things most necessarily to make the VAT effective. Political parties as well as leaders should show their commitment towards VAT implementation. Government should manage

the necessary physical environment so that the VAT administrations can function properly and effectively. There should be good co-operation between government and business community. Talking with India should solve problem arisen by open boarder. VAT officials should be trained. These are the main recommendation made by him.

Devkota (2000) examined the effectiveness of present information and communication networking in imposition of VAT. He has collected primary data to gather opinions and views relevant to study objectives. Statistical tools he used are simple as ratio, percentage, average etc.

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

Koirala (2000) assessed the performance of VAT and to identify the problems of VAT with its prospects. It comprises both primary and secondary data. Problems regarding aggressive tax avoidance and evasion, weak enforcement of the law, fraudulent taxpayers etc. are addressed. Accordingly, he found the facts with respect to the objectives. Some policy changes look urgently desired at the moment. Exemption list must be trimmed down to reduce distortion in system and keep minimal tax rate. Emphasis should be put on the need to maintain good qualities of VAT (uniformity, a broad base, no cascading, buoyant revenue). A policy of increasing threshold and introducing annual turnover tax as well as to address no-billing and under-billing malpractices of the vendor's head-on.

Khanal (2000) examined that VAT would be an improvement over the sales tax system. Adoption of VAT in the place of sales tax would insure certain, gain though the gain may be of least amount. That is why, a move towards VAT would be 'better' but not an 'ideal' step. He found that the major hurdles for the applicability of VAT in Nepal are the existence of larger proportion of small traders in trading activities,

unfavorable business structure and impracticable administration, existence of open border and large amount of unauthorized trade from India, under valuation of imports and lack of consciousness of Tax Law of Nepal.

Gautam (2006) analyzed the contribution of VAT in government revenue and problem faced by it. He has used different type of questionnaire to various ranks of employees. The researcher used both primary and secondary data. The study found that VAT is a kind of indirect tax which is found to be superior to any other tax system for collecting the internal revenue, contribution of VAT in total indirect tax is more and higher. The import VAT revenue is higher than internal VAT revenue. The study also found that poor management is also cause of ineffective resource mobilization. The growth rate of registrants is increasing. It shows the implementation status is satisfactory but due to the lack of transparency in business activities, weak cross checking mechanism, transition manipulation practices conclude that may potential tax payer are out of VAT.

Dhakwa (2015), analyzed contribution of income tax to government revenue of Nepal. The study was done with basic objectives of analyzing the income tax structure of Nepal, identifying and predicting the share and trend of corporate income tax on government revenue of Nepal. In this study, researcher found that the contribution of tax revenue to total revenue was 77.29 percent in 2007/08. However the contribution of tax revenue was in decreasing trend. He also found that there was dominant role of indirect tax revenue in Nepalese tax revenue.

Lamsal (2016) presented contribution of income tax on government revenue. The study mainly focused on the removing and controlling income tax evasion for better resource mobilization. The main objective was to analysis the impact of income tax evasion on government revenue of Nepal. The study set further objectives which were to identify the way and cause of income tax evasion to estimate the volume and tendency of income tax evasion in small trade sector and to examine the role of income tax initializing the resources in Nepal. The study conducted the research following analytical as well as descriptive research design. Most of the data were from primary sources, which were collected through opinion survey field visit and interviews. Simple statistical analysis such as average and percentage were used as for

data analyzing tools, graphs, charts and table were used interpret visually the finding of the research.

The study concluded that there was widespread evasion of income tax in Nepal and income tax was suitable means for raising domestic resources. The study recommended for controlling tax evasion by controlling illegal business activities, increasing penalties and fines to tax evaders, compulsory maintenance of accounts etc.

Shrestha (2016) described revenue collection from income tax in Nepal. In this study, researcher described the conceptual framework, legal provision administrative aspect and structure of income tax in Nepal. Researcher conducted an opinion survey for problem and prospects of income tax in Nepal. Researcher found the problems of Nepalese income tax system were as mass poverty, narrow tax coverage, lack of consciousness of tax payer, predominance of agriculture, widespread evasion and avoidance of income tax, unscientific tax assessment procedures, inefficient tax administration, complicated tax laws and procedures instability in government policy. Researcher found various weak points in Nepal's tax administration. The major weak points are: failure to maintain proper account and second's defective selection of personally lack of trained and competent tax personnel, undue delay in making assessment, lack of motivating in tax personal, existence of corruption. Researcher suggested that income tax system would succeed if the tax system were widening of tax coverage, tax consciousness to people, minimize the evasion, avoidance problem, and enhance the self assessment system reform.

Kafle (2017) studied on income tax contribution from Nepalese public enterprises with reference to Nepal Electricity Authority. Researcher found that income tax is a suitable source for mobilizing domestic resources. It may enhance the government revenue, promote socio-economic justice and encourage private sector investment. The study found that lack of clear, transparent and progressive economic policy are the main reasons for unsatisfactory income tax system of Nepal. Existing corporate tax rate has been found unsuitable and single rate for all types of corporation is preferred. Increment of managerial efficiency of PEs, clear income tax policy, rules and regulation, effective tax administration system and the contribution of income tax from PEs were major recommendations by researcher.

Pant (2017) analyzed income tax management in Nepal. The study tried to show the income tax system and its role in national economy. The study concluded that there was problem of lack of effective personnel management, reward and punishment system, lack of managerial efficiency, poor income tax assessment procedure, poor tax information system, and lack of tax payer's education, very narrow coverage of income tax.

Aryal (2017) evaluated measuring responsiveness and productivity of Tax yields in Nepal's Tax Structure for the period between 1994/95 and 2013/14. The major findings of this study are the trend of different source of taxation showed that the contribution of total tax revenue from direct taxes has continuously declined and indirect taxes has continuously raised. The trend shows that magnitude as well as percentage contribution of traditional direct taxes i.e. lands tax decline continuously, oppositely income tax and registration duty are growing. High tax revenue contributor sector i.e. customs duties also was the first position. However, the revenue from import duties had set second position. It had substituted by sales tax. Excise duty was also in increasing trend. Therefore, Nepalese tax revenue was heavily reliant on indirect taxes.

According to his study, elasticity and buoyancy coefficients of overall taxes were less than unity. It meant that it was inelastic in nature. The export duty had negative elasticity. In fact, the inelastic nature of tax system in developing countries was an inheritance characteristic resulting from heavy reliance on indirect taxes. The share of indirect taxes around 70.5 percent and non-tax revenue were 6.9 percent on total revenue.

Poudel (2018) described income tax in Nepal and its structure and productivity. The study concluded that the reform of tax administration, successful implementation of VAT and establishment of standardized accounting system were necessary. Total revenue was dominated by tax revenue which is 78.2% and non tax revenue was only 21.9%. Tax revenue is increasing in recent days and non tax revenue is decreasing trend.

Luitel (2018) presented contribution of income tax to the government revenue of Nepal. The study concluded that the contribution of income tax to GDP was very low

in comparison with other developing countries. There were weak policy and commitments to collect revenue through income tax. Definition of Income was ambiguous and it should be modernized and simplified.

Bhandari (2018) recently studied tax avoidance and anti avoidance rules in Nepalese Perspective. The study concluded that there were narrow tax base, lack of clarification on the assessment procedure, highly corruption in tax administration wide spread of illegal business activities, poor development of intermediaries, unnecessary interference by influential persons and harassment to the tax payers.

2.3 Research Gap

VAT is a modern and transparent tax system. It is less distorted and more revenue productive. That is why; this tax has become a popular topic for tax reform and has been spreading all over the world since late 1960s. In the process of economic liberalization and globalization, VAT makes the tax system flexible. Majority of the statements utter that VAT is the latest innovation in the field of tax system. Though there has been more than one decade of VAT implementation in Nepal but the VAT system is not going on effective manner as it was intended to be. However, it is said that with the time period, the awareness of VAT is being increased every year which is proven from the information provided by the concerned government authorities but the studies have shown that unawareness of the public has been the main constraint to the effective VAT system in the context of Nepal. There have been fewer studies in this field and the studies which are carried out also are not in public domain and are far behind from the practical aspects. They are not able to reveal the exact position of the VAT system, its impact over the economy, familiarity among the concerned parties and attitude of the public at large towards it. So, it was felt of an emergence study about the VAT which can detect these constraints of VAT system; as the result this study has been conducted. Thus, this study will be valuable to fill the gap of former studies and intended to be useful to those who are interested about VAT in Nepal along with the students, scholars, stake holders, civil society, teachers, businessmen and government for academic as well as policy perspectives.

CHAPTER III
METHODOLOGY

Research methodology describes the methods and process applied in the entire study. In other words, research methodology is a systematic process to approach any research problem to and explore it objectively.

3.1 Research Design

The basic objective of this study is to examine the contribution of Value Added Tax to Government Revenue in Nepal. For the purpose descriptive research design has been followed. This study describes situation and events occurring at present by accumulating the past information and facts. So, this study is descriptive types of research. The study attempts to show the present situation of government revenue with direct and indirect taxes including VAT in Nepal by the analysis of past information and records..

3.2 Population and Sample

Since the availability of the data before 1997 were difficult, this study therefore, collects the data after the mentioned year. The study by its nature requires time series collection of quantitative data for the periods which is not randomly selected. The sample period for secondary data covers only from 2006/07 to 2015/16.

3.3 Nature and Sources of Data

In this study the secondary data is used. The secondary sources of data are the information desired from books, journals, newspapers, reports and dissertations etc. The major sources of secondary data are: budget speeches and economic survey, Ministry of Finance, publication of Center for Economic Development and Administration (CEDA), Tribhuvan University, records of Inland Revenue Department, dissertations related to VAT available at Central Library of Tribhuvan University. Publication of VAT projects, economic review and indicators from Nepal Rastra Bank etc. and other relevant data related to this study.

3.4 Variables Used in the Analysis Process

This study uses five economic variables:

GDP: Gross Domestic Product is the total final output of goods and services produced in the country's territory by residents and non-residents, regardless

VAT: Value Added Tax is broad based tax as it also covers the value added to each commodity by a firm during all stages of production and distribution.

TTR: Total tax revenue which is the summations of both direct and indirect tax excluding VAT.

NTR: Non tax revenue which is the summations of charges and fees, sale of goods and services, government investment income, miscellaneous revenue, pension contribution, extraordinary revenue, privatization proceeds and capital revenue.

However, the data of total government revenue (TGR) for the period was taken to describe the ratio of VAT to the respective TGR, TTR, and GDP. The researcher identified VAT, TTR and NTR as an independent variable and GDP as dependent variable to study

3.5 Data Processing Procedure

To address the objectives of the research and to analyze the data, both descriptive statistical methods was employed. The researcher uses simple statistical tools like ratio and percentage methods to analyze the independent variables of VAT, TTR, NTR, direct and indirect tax towards the GDP as dependent variable of economic growth indicator. The time series information (annual data) was used for statistical computations of the contribution. These statistical computations can be employed to explore the inherent relationships among the variables. Descriptive analysis techniques such as percentages and ratios have also been used.

3.6 Tools of Analysis of Data

The collected data and information from secondary sources were processed for tabulation and analysis. According to the subject matter and requirements, data have been tabulated into separate tables and format. Then the simple statistical analysis such as average, percentage etc have been used and calculated where necessary. They are presented and analyzed in the descriptive way. Graphs and diagrams have been presented to depict the findings of the research. Collected data have been categorized on the basis of nature and its different simple and complex tables. Most of the data have been presented in tables. Ms -Excel has been used for the analysis purpose.

CHAPTER IV

RESULTS

This chapter includes the analysis and presentation of secondary data. Data obtained from various sources have been tabulated and presented in tables and charts. This chapter has been divided into two main sub-headings. They are: 'contribution of VAT in government revenue' and 'the awareness level of tax payers regarding VAT in Nepal'. The data analysis and presentation are mentioned as follows.

4.1 Contribution of VAT to Government Revenue

The contribution of VAT in government revenue is presented and analyzed under the following sub-topics.

4.1.1 Revenue Structure of Nepal

The total revenue consists of tax revenue and non-tax revenue. The tax revenue can also be divided into two types as direct tax and indirect tax. First of all the revenue structure of Nepal on the basis of taken sample years is presented below with the help of Table 4.1 and Figures 4.1 and 4.2 respectively.

Table 4.1

Revenue Structure of Nepal by Year (Rs. in millions)

| Fiscal Year	Total Revenue	Tax Revenue		Non-Tax Revenue	
		Rs.	Percentage	Rs.	Percentage
2006/07	87711.9	71134.1	81.09	16585.3	18.91
2007/08	107546.1	85024.9	79.06	22521.2	20.94
2008/09	143474.5	117051.9	81.58	26422.6	18.42
2009/10	179946.0	154667.7	85.90	24278.3	14.10
2010/11	199818.8	171822.5	86.0	27995.9	14.00
2011/12	244372.9	211721.8	86.64	32651.1	13.36
2012/13	296021.1	259214.9	87.57	36806.2	12.43
2013/14	356620.8	312441.3	87.61	44179.5	12.39
2014/15	405866.4	355955.7	87.70	49910.7	12.30
2015/16	475012.1	427011.0	89.89	48001.1	10.11
Average	**249639.06**	**216604.58**	**85.30**	**32935.19**	**14.70**

Source: Economic Survey, 2016/17, MOF

Table 4.1 and Figures 4.1 depict that in every year the tax revenue has covered almost 79 percent of total revenue. The total revenue of the government in the 2008/09, the shares of tax revenue and non-tax revenue on total revenue are Rs. 117051.9 million and 26422.6 million respectively. Similarly, the contribution of tax revenue and non-tax revenue for the 2011/12 are Rs. 211721.8   million and Rs. 32651.1 million respectively. In percentage term, the contribution of tax revenue and non-tax revenue on total revenue for the 2011/12 are 86.64 percent and 13.36 percent respectively.

Figure 4.1

Contribution of Tax and Non-Tax Revenue as Percentage of Total Revenue
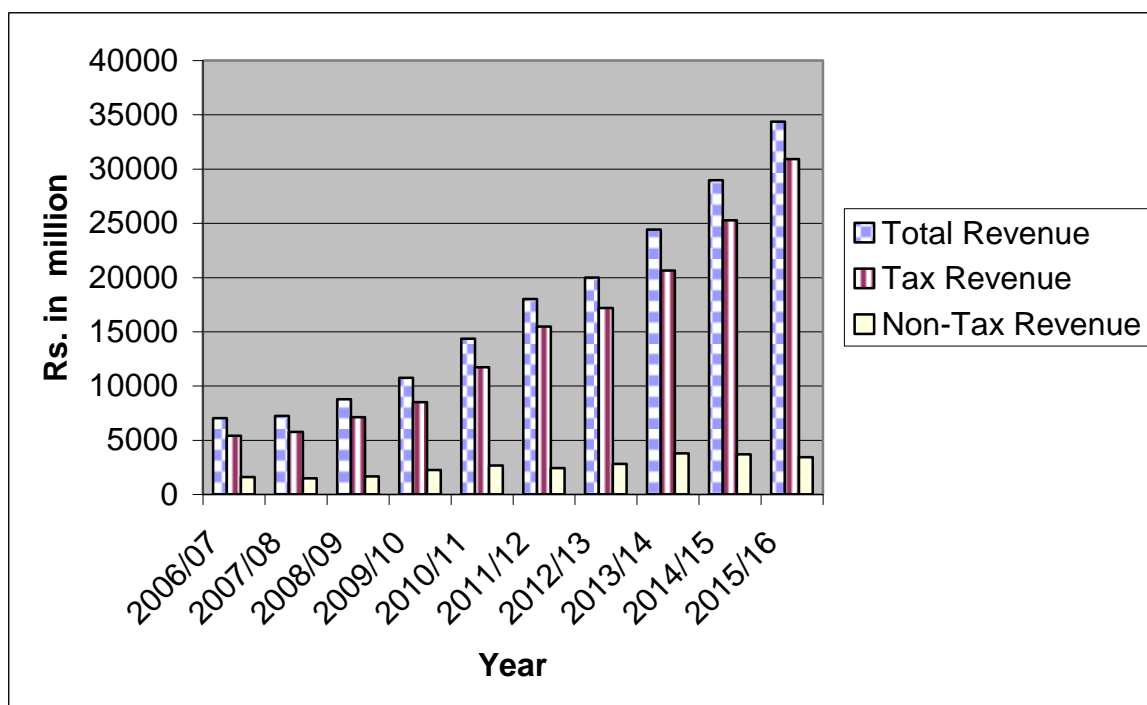
Source: Based on the Table 4.1

Table 4.1 and Figure 4.1 show that the contribution tax and non-tax revenue had increased to 81.58 percent and 18.42 percent respectively in the 2008/09. For 2013/14, their contributions were 87.61 percent and 12.39 percent respectively. The dominant role of tax revenue is thus, quite satisfactory as its amount had increased more significantly than the non-tax revenue over the period 2004/05 to 2013/14. The total revenue of 2015/16 was Rs. 475012.1 million, tax revenue is Rs. 427011.0 and non-tax revenue was Rs. 48001.1 million respectively. The mean value of total revenue, tax revenue and non-tax revenue were 119677.7 million, 101740 million and 18174.6 million respectively.

From the above analysis and the presentation of the data, it is clear that the revenue collection through both tax and non-tax sources are in the increasing trend. It is also clear that tax revenue has played major role for revenue collection in the context of Nepal. Within the reviewed fiscal years the portion of tax revenue is 85.30 percent in average and in the same way, portion for the non-tax revenue is 14.70 percent.

4.1.2 Tax Revenue Structure in Nepal

As it is the fact that the tax revenue is the major source of revenue collection of the government.The composition and the trend of tax revenue for the fiscal years 2006/07 to 2015/16 are presented in the Table 4.2 and figures 4.2 respectively.

Table 4.2

Tax Revenue Structure of Nepal by Year (Rs. in millions)

| Fiscal Year	Total Tax Revenue	Direct Tax		Indirect Tax	
		Rs.	Percentage	Rs.	Percentage
2006/07	71134.1	18987.7	26.69	52146.4	73.31
2007/08	85024.9	22957.2	27.00	62067.7	73.0
2008/09	117051.9	34320.7	29.32	82731.2	70.68
2009/10	154667.7	40122.8	25.94	114544.9	74.06
2010/11	171822.5	47699.9	27.76	124122.6	72.24
2011/12	211721.8	56446.4	26.66	155275.4	73.34
2012/13	259214.9	71407.5	27.55	187807.4	72.45
2013/14	312441.3	84734.6	27.12	227706.7	72.88
2014/15	355955.7	98490.8	27.67	257464.9	72.33
2015/16	427011.0	121118.7	28.36	305892.3	71.64
Average	**216604.58**	**59628.63**	**27.41**	**156975.95**	**72.59**

Source: Economic Survey, 2016/17, MOF

Table 4.2 and Figure 4.2 depict that the percentage of indirect tax is greater than direct tax. In a good tax system both types of taxes must be complementary and not competitive. Direct tax is considered as superior from welfare aspect and however it is considered as a crucial instrument to remove inequalities of income and wealth. Though direct tax is more reliable, indirect taxes also enable every body to contribute to the public revenue. It needs proper balance between two in order to reduce disparity of income and wealth and for proper distribution of tax burden.

Figure 4.2

Contribution of Direct and Indirect Tax Revenue as Percentage of Total Tax Revenue
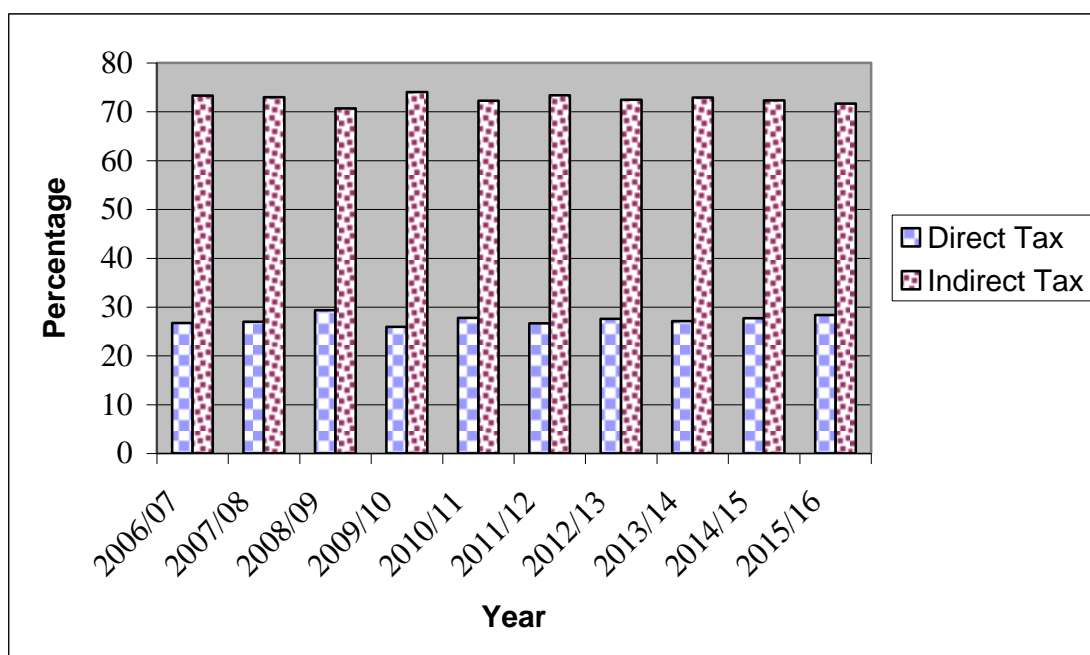
Source: Based on the Table 4.2

These amounts increased to Rs. 117051.9 million, Rs. 34320.7 million and Rs. 82731.2 million respectively in the 2008/09. In 2014/15, these amounts were Rs. 355955.7 million, Rs. 98490.8 million and Rs. 257464.9 million respectively. In 2015/16 the total tax revenue was Rs. 427011.0 million, in which direct tax revenue was 28.36 percent of total tax revenue and indirect tax revenue increased to 71.64 percent of total tax revenue.

In the Nepalese perspective, while the direct tax seems to be justified, the indirect tax is unavoidable. The direct tax is justified because it helps to mobilize revenue for the national exchequer and also assists to narrow the gap in the distribution of income and wealth between the richer and the poorer sections of the society, which is essential for development. However, under the existing circumstances, the direct tax cannot generate sufficient revenue to the national exchequer. It is only through the indirect tax that adequate revenue can be mobilized and the consumption of harmful commodities or the investment in the unproductive sectors of the economy can effectively be discouraged. Thus, though there is the need for Nepal government to

rely upon the direct tax, which would have a more dominating role in the Nepalese economy, at least for mobilizing adequate resources for development.

Thus, as we got the fact that total revenue collection is mainly contributed by the tax revenue in the comparison of non-tax revenue and, the same manner and situation has been occurred in case of tax revenue structure in Nepal on the behalf of the contribution of indirect tax to direct tax. Now, the further operations have been operated as below.

4.1.3 Trend of VAT Registration

The concept of VAT in Nepal started with the change in the then system of tax on sales known as sales tax. At the of time implementation of VAT for the first time, the registration started with those who fall under the threshold to be registered under the VAT Act. However, any business firm if wanted to be registered themselves under the VAT they can do it voluntarily on their wish.

Table 4.3

Trend of VAT Registration by Year

Fiscal Year	Number of New VAT Registrant	Total Number of VAT Registrant	Growth Rate in Percentage
2006/07	4723	29872	18.0
2007/08	4302	37174	14.0
2008/09	5602	39776	16.0
2009/10	7055	46831	18.
2010/11	6134	52965	13.0
2011/12	5635	58600	13.0
2012/13	4850	63450	8.3
2013/14	2840	66290	4.5

2014/15	3660	69950	5.5
2015/16	2810	72760	4.0
Average	**4761.10**	**53766.80**	**11.43**

Source: Economic Survey, 2016/17, MOF

Implementation of VAT in 1997/98 did not go as expected, especially when there was strong opposition from the business community. However, during the 21 years of VAT implementation, a number of tax payers awareness program has been successfully conducted. Massive advertisement campaigns have been conducted through printing and audio-visual aids to provide information about VAT to tax payers. Because of these efforts, VAT registration trend is increasing every year. VAT registration trend is depicted in the Table 4.3 and Charts 4.3 respectively.

Figure 4.3

**Trend of VAT Registration by Year**
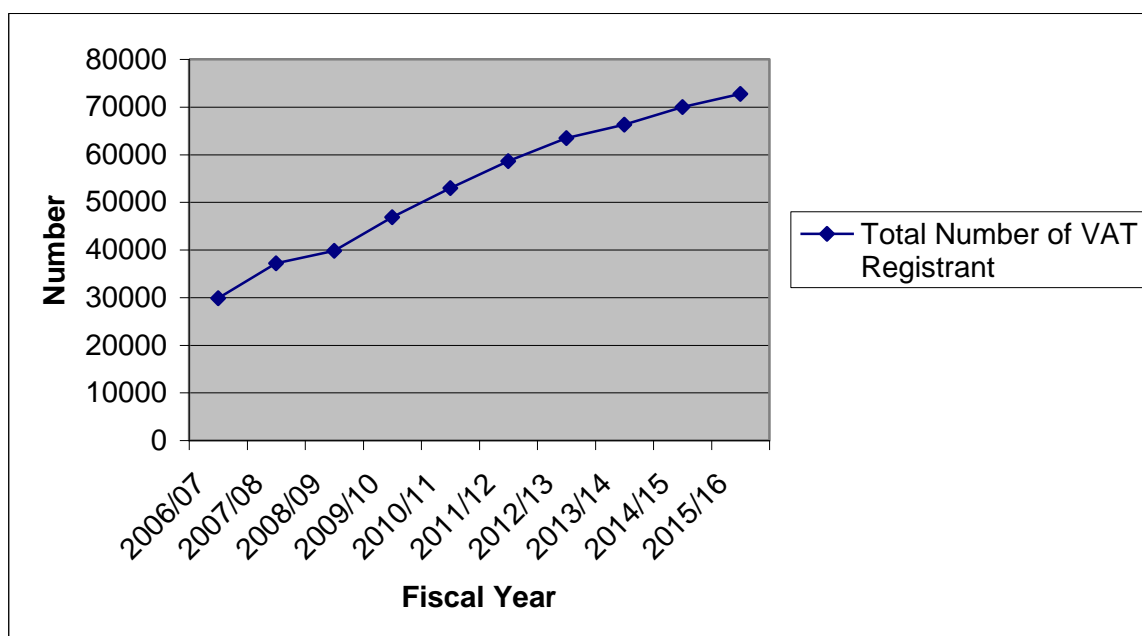
Source: Table 4.3

Table 4.3 and figure 4.3 portray that the total number of VAT registrants in 2006/07 was 4723 and it reached at 5635 in the fiscal year 2011/12. During the mentioned period, the number of VAT registrants increased from 29872 in the fiscal year

2006/07 to 58600 in the fiscal year 2011/12 by more than 2 folds and 72760 in fiscal year 2015/16. This shows that the trend of VAT registration is satisfactory though the average growth rate is only 29.80 percent. Similarly, figure 4.3 has shown the percentage growth rate of VAT registrants in Nepal which was 18 percent in FY 2006/07 and 4 percent in FY 2015/16.

Since, it was the beginning of VAT implementation when the growth rate of VAT registrants increased in rapid manner. After that, however the VAT registrants are in increasing trend but not by at large as it was in the beginning due to which the growth percentage shown in the 4.3 is boosted in the beginning years and is in slow increasing manner in the later years.

Figure 4.4

Trend of Percentage Growth Rate of VAT Registrants in Nepal by Year
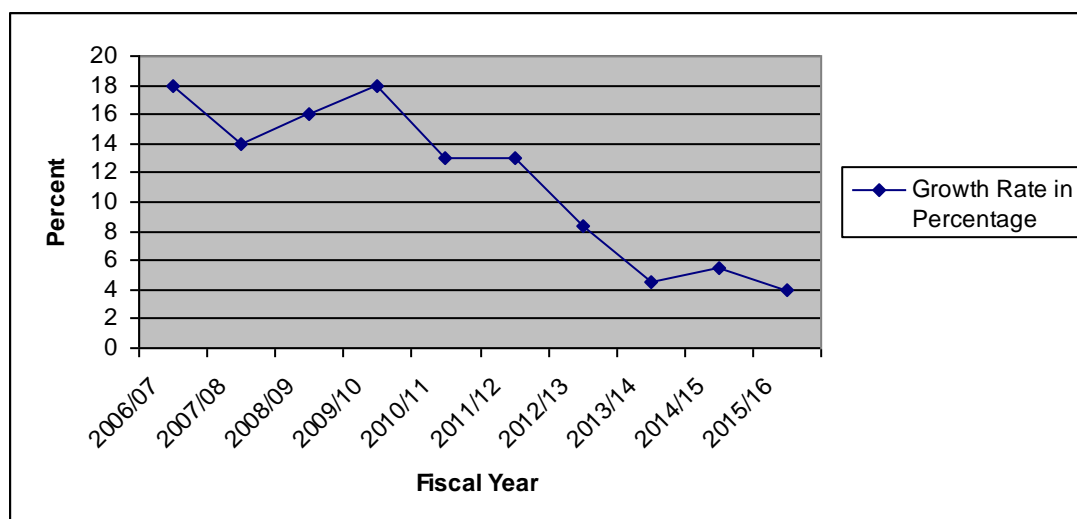
Source: Table 4.3

4.1.4 Trend of Revenue Collection through VAT

VAT is an essential tool for revenue collection in Nepalese economy. It is the best form of sales tax which will generate more revenue with less distortion in the economy because of its broad coverage, neutrality, transparency and fairness. The trend of revenue collection through VAT in different FYs is presented below.

Table 4.4

Revenue Collection through VAT and Its Percentage by Year (Rs. in millions)

Fiscal Year	Revenue Collection Through VAT	Percentage Change
2006/07	26095.6	-
2007/08	29815.7	14.26
2008/09	39700.9	33.15
2009/10	54920.9	38.34
2010/11	61663.6	12.28
2011/12	70930.40	15.03
2012/13	83418.40	17.61
2013/14	101104.6	21.20
2014/15	112521.8	11.29
2015/16	140891.7	25.21

Source: Economic Survey, 2016/17, MOF

Table 4.4 and figure 4.4 as depicted above show that the amount of VAT collection in the FY 2006/07 was Rs. 26095.6 millions. It increased by 15.03 percent and reached at Rs. 70930.40 millions in the FY 2011/12 and increased by 25.21 percent reached to 140891.7 million in FY 2015/16. Trend of revenue collection through VAT is seemed to be in increasing order.

Figure 4.5

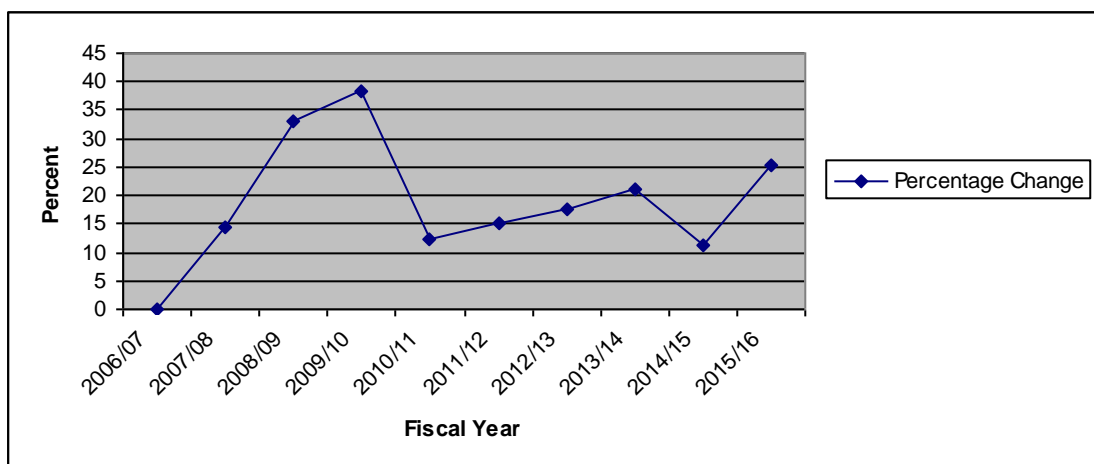**Revenue Collection through VAT by Year**
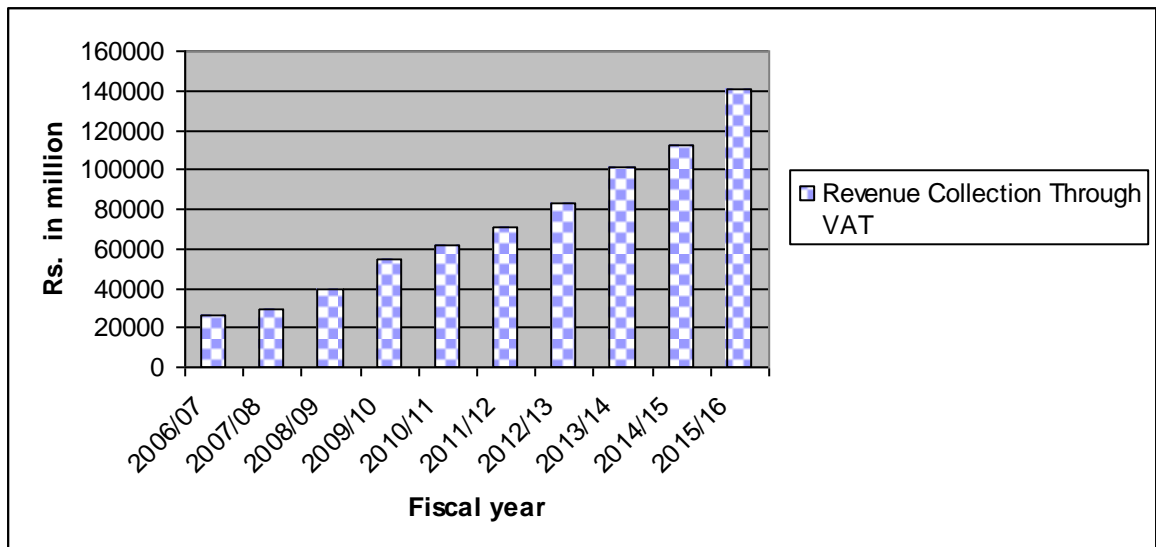
Source: Table 4.4

The percentage change i. e. increase in VAT revenue varies from 11.29 percent to 38.54 percent during the FYs i.e. 2006/07 to 2015/16 as it was 14.26 percent in the fiscal year 2006/07, Though in each FY the revenue collection through VAT is in positive side but the growth rate of the VAT revenue has not caught the constant increasing trend which has been fluctuated.

Figure 4.6

Revenue Collection through VAT (% Change) by Year

Source: Table 4.4

Despite of various difficulties in the implementation of VAT, the trend of revenue collection through VAT is not bad as thought. Since, VAT is mass based tax, it will prove to be stable base of revenue to government. However, it can be expected that more and more revenue can be generated in coming days, if implemented effectively and efficiently. For this, the major focus should be directed towards taxpayers' awareness program.

4.1.5 Contribution of VAT on Total Revenue

Since this research work seeks to assess the contribution of VAT to revenue collection. The portion of the VAT revenue to total revenue is estimated and shown in Table 4.5 and figure 4.7 and 4.8 as given below

Table 4.5

**Contribution of VAT Revenue to Total Revenue by Year (Rs. in millions)**

Fiscal Year	Total Revenue	VAT Revenue	% of VAT on Total Revenue
2006/07	87711.9	26095.6	29.75
2007/08	107546.1	29815.7	27.72
2008/09	143474.5	39700.9	27.67
2009/10	179946.0	54920.9	30.52
2010/11	199818.8	61663.6	30.86
2011/12	244372.9	70930.40	29.03
2012/13	296021.1	83418.40	28.18
2013/14	356620.8	101104.6	28.35
2014/15	405866.4	112521.8	27.72
2015/16	475012.1	140891.7	29.66

Source: Economic Survey,2016/17, MOF

The percentage portion of VAT revenue in the total revenue shown in the Table 4.5 has been ranged between 27.67 to 30.52 percent. It is clear that nearly one third of the revenue is the contribution of the VAT revenue to the total revenue. In FY 2006/07 the VAT revenue was Rs. 26095.6 million which increased up to Rs. 140891.7 million in the FY 2015/16.

Figure 4.7

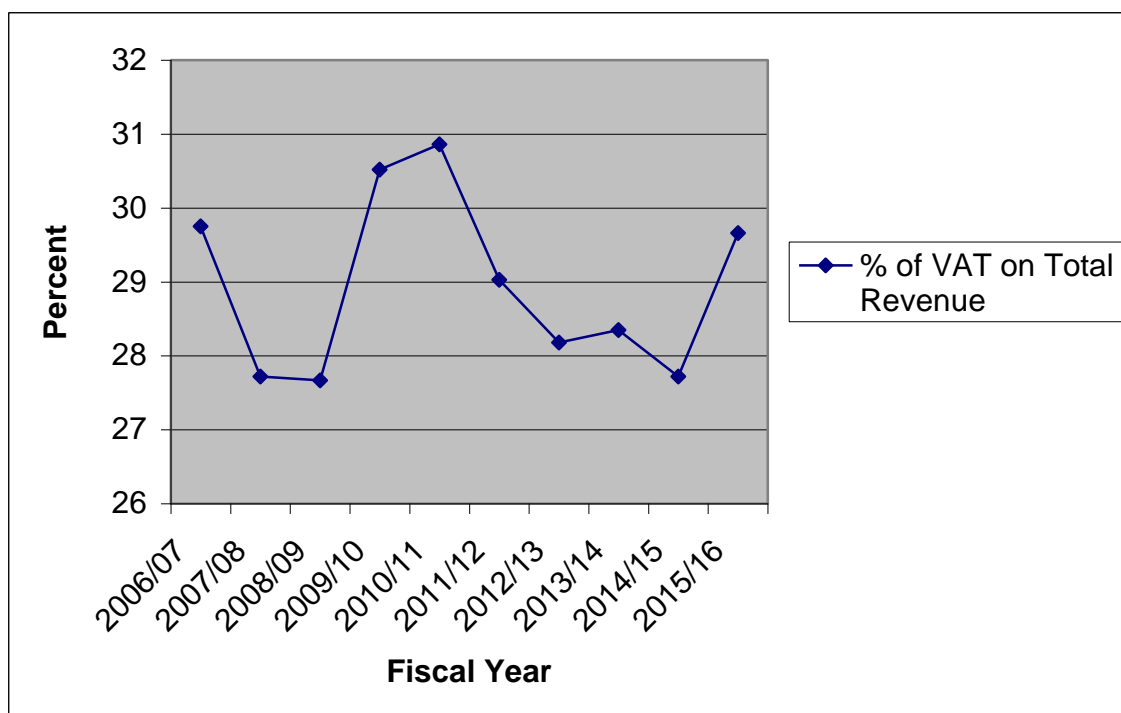**Share of VAT Revenue on Total Revenue by Year**
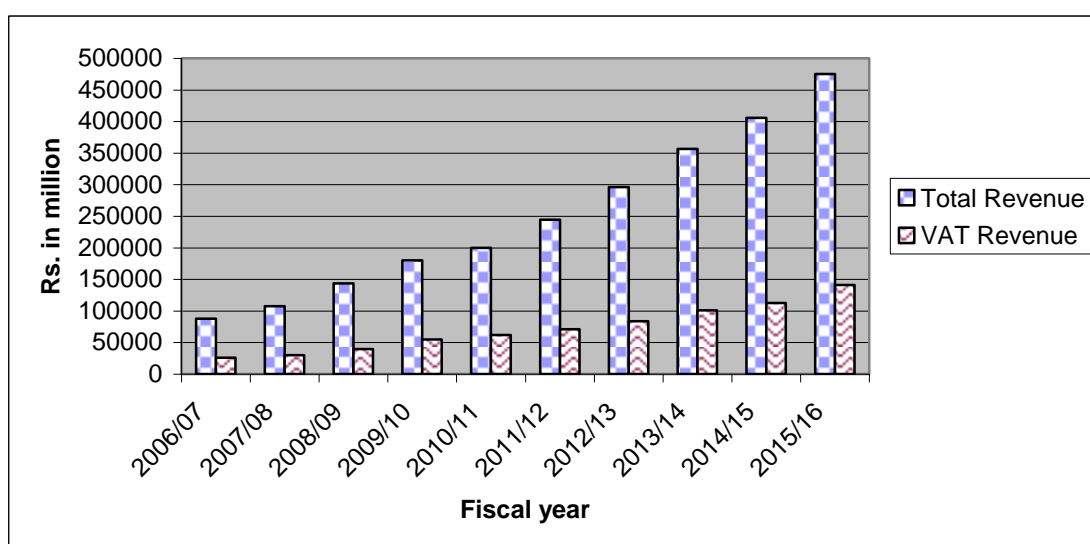
Source: Table 4.5

Thus, the amount collected from VAT revenue is in increasing trend along with the total revenue collected through the tax and the non-tax sources.

Figure 4.8

Percentage of VAT on Total Revenue

Source: Table 4.5

4.1.6 Share of VAT Revenue on Total Tax Revenue

Share has just got the portion of the VAT revenue on the total revenue in the earlier operation. Now, let's check out the share of VAT revenue on total tax revenue which is depicted in the following Table 4.6, Figures 4.9 and 4.10 respectively.

Table 4.6

Share of VAT Revenue on Total Tax Revenue by Year

Fiscal Year	Total Tax Revenue	VAT Revenue	Percentage of VAT on Total Tax Revenue
2006/07	71134.1	26095.6	36.69
2007/08	85024.9	29815.7	35.07
2008/09	117051.9	39700.9	33.92
2009/10	154667.7	54920.9	35.51

2010/11	171822.5	61663.6	35.89
2011/12	211721.8	70930.40	33.50
2012/13	259214.9	83418.40	32.18
2013/14	312441.3	101104.6	32.36
2014/15	355955.7	112521.8	31.61
2015/16	427011.0	140891.7	32.99

Source: Economic Survey, 2016/17, MOF

Table 4.6 reveals that the percentage portion of VAT revenue to the total tax revenue has ranged between the 31.61 to 36.69 percent during the review period.

Figure 4.9

Share of VAT Revenue on Total Tax Revenue by Year
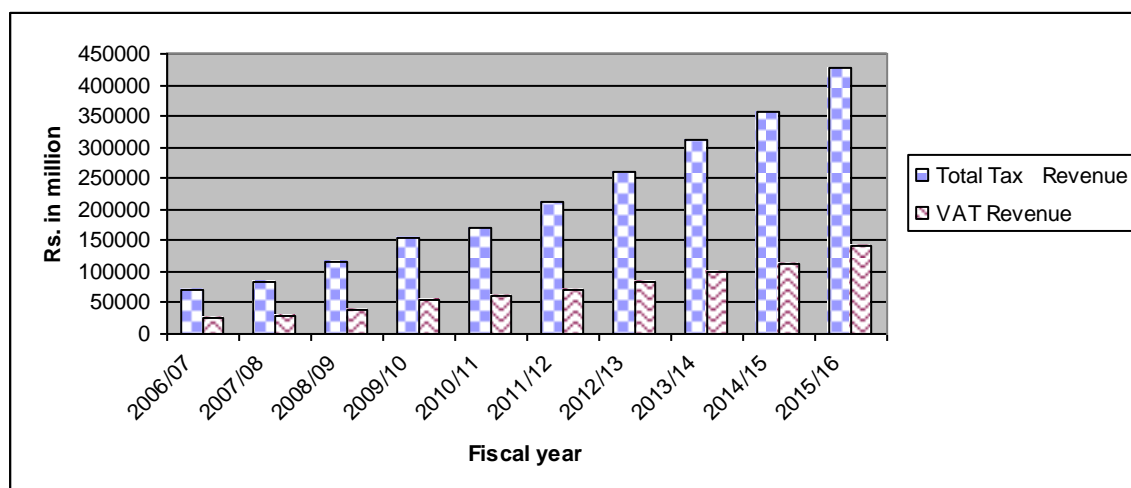
Source: Table 4.6

As it is also clear from the table and the diagrams that revenue collected through the VAT and total tax from FY 2006/07 to 2015/16 is in increasing trend and order in the every year. Their respective shares were Rs. 26095.6 millions and Rs. 71134.1 millions in FY 2006/07 and Rs. 140891.7 millions and Rs. 427011.0 millions in FY 2015/16.

Figure 4.10

Trend on Percentage of VAT on Total Tax Revenue
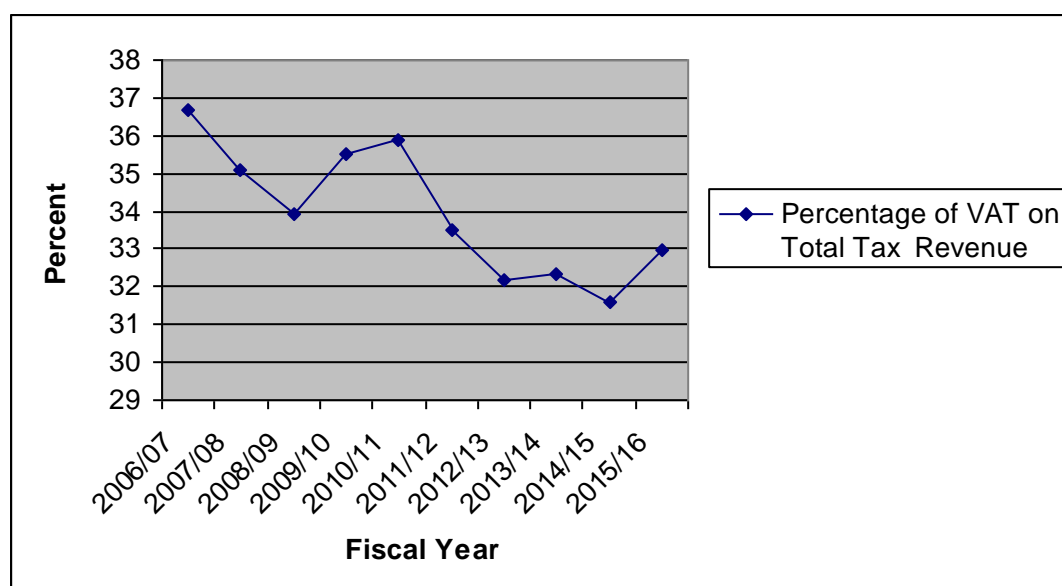
Source: Table 4.6

Thus, it is clearly come to know about the fact that almost about 1/3 of the total tax revenue is the portion of the VAT revenue. So, it can be said that VAT revenue has well contributed to the total tax revenue, since it consists of various tax items such as customs, tax on income, property, profit, land and registration along with other taxes on consumption and production of the goods and services.

4.1.7 Share of VAT Revenue on Total Indirect Tax Revenue

Tax revenue consists of direct tax revenue and indirect tax revenue. And the VAT falls under the indirect tax family. To know about the share of the VAT revenue on total indirect tax revenue, following estimation and presentation have been carried out.

Table 4.7

Share of VAT Revenue on Total Indirect Tax Revenue by Year (Rs. in millions)

Fiscal Year	Total Indirect Tax	VAT Revenue	Percentage
2006/07	52146.4	26095.6	50.04
2007/08	62067.7	29815.7	48.04
2008/09	82731.2	39700.9	47.99
2009/10	114544.9	54920.9	47.95
2010/11	124122.6	61663.6	49.68
2011/12	155275.4	70930.40	45.68
2012/13	187807.4	83418.40	44.42
2013/14	227706.7	101104.6	44.40
2014/15	257464.9	112521.8	43.70
2015/16	305892.3	140891.7	46.06

Source: Economic Survey, 2016/17, MOF

Table 4.7 and figures 4.12 depict that VAT revenue has increased with the increment of total indirect tax revenue. For example: in the FY 2006/07 the amount of total indirect tax was Rs. 52146.4 millions and the portion of the VAT revenue on it was Rs. 26095.6 million during the same FY which is 50.04 percent of total indirect tax revenue.

Figure 4.11

**Share of VAT Revenue on Total Indirect Tax Revenue by Year**
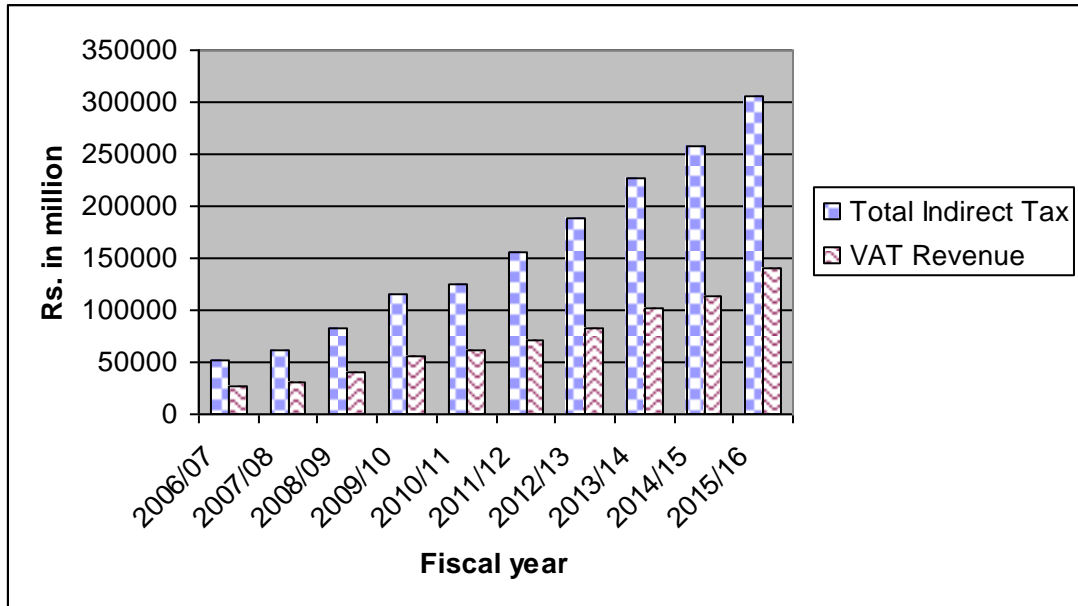
Source: Table 4.7

Similarly, in the FY 2008/09 the amount of the total indirect tax reached up to Rs. 305892.3 millions which consists of Rs. 140891.7 millions of VAT revenue on it and the amount occupies 46.06 percent of total indirect tax revenue.

Figure 4.12

Percentage Share of VAT Revenue on Total Indirect Tax Revenue by Year
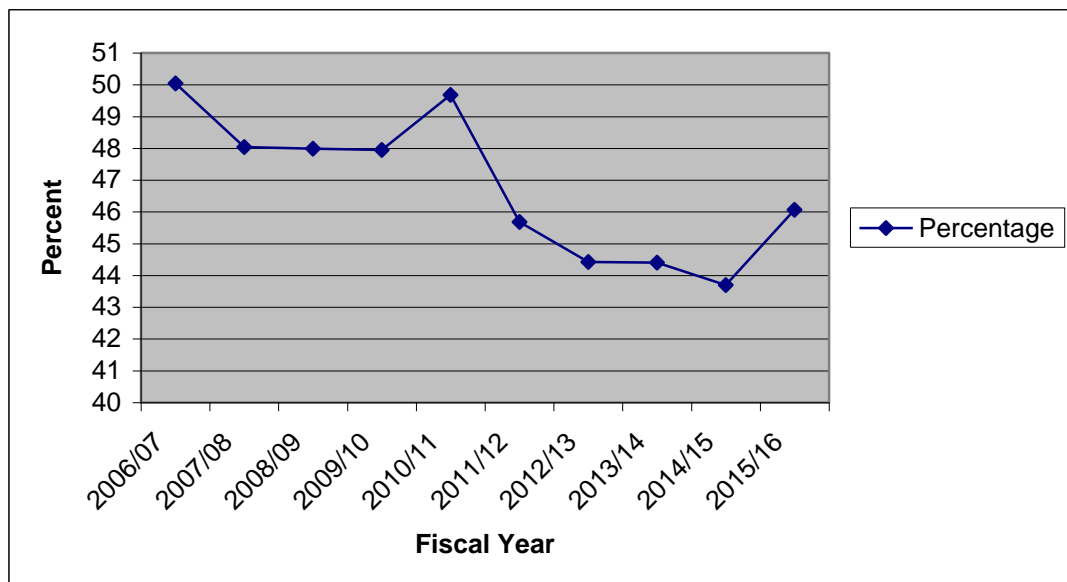
Source: Table 4.7

From the above pictorial presentations it can be noticed that the indirect tax and the portion of VAT revenue on it is in increasing form in each reviewed FY. Table 4.7 also has revealed the fact that the percentage of the VAT revenue on the total indirect tax revenue is ranged between the 40 to 50 percent during the studied FY.

Thus, the VAT revenue covers approximately 50% of total indirect tax revenue. Thus, it can be concluded that it is the most important source of revenue collection under the indirect tax revenue.

4.1.8 Contribution of VAT on GDP

From the earlier presentation it is cleared that the VAT revenue has played important role for increasing indirect tax revenue, tax revenue and total revenue for the country. Similarly, the VAT revenue has contributed to the government revenue as percent of GDP. The contribution of the VAT revenue on government revenue (GDP) is presented below.

Table 4.8

**Contribution of VAT to GDP by Year (Rs. in millions)**

Fiscal Year	GDP	VAT Revenue	% of VAT on GDP
2006/07	675859	26095.6	3.86
2007/08	755257	29815.7	3.95
2008/09	909528	39700.9	4.37
2009/10	1083420	54920.9	5.07
2010/11	1248480	61663.6	4.94
2011/12	1387480	70930.40	5.11
2012/13	1525220	83418.40	5.47
2013/14	1758740	101104.6	5.75
2014/15	1889410	112521.8	5.96
2015/16	2007280	140891.7	7.02

Source: Economic Survey, 2016/17, MOF

Figure 4.14 depicts that in the FY 2006/07 the GDP of Nepal was Rs. 675859 millions and the share of VAT revenue on it was Rs. 26095.6 which occupies 3.86 percent of GDP. In the same way, in the FY 2015/016 the GDP reached at Rs. 2007280 millions where the share of the VAT revenue is Rs. 140891.7 millions and the VAT revenue amount percentage is exactly 7.02 percent on the GDP.

Figure 4.13

**Portion of VAT Revenue on GDP by Year**
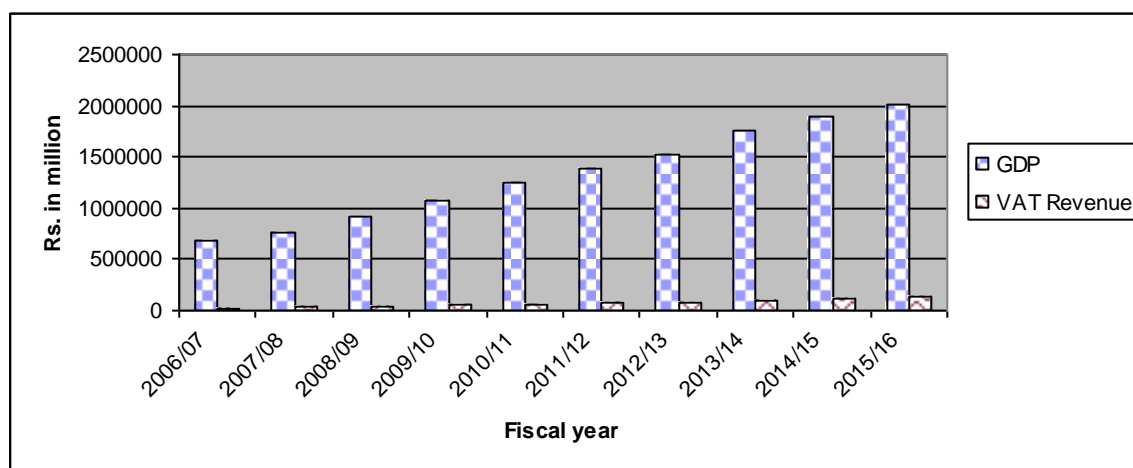
Source: Table 4.8

Both the GDP and VAT revenue along with percentage of VAT on GDP are in the increasing trend. When we observe the percentage contribution of VAT revenue on GDP, it has caught the increasing trend as the rate is 3.86, 3.95, 4.37, 5.07, 4.94, 5.11, 5.47, 5.75, 5.96 and 7.02 percent during the reviewed FYs.

Figure 4.14

Trend on Share of VAT Revenue to GDP by Year
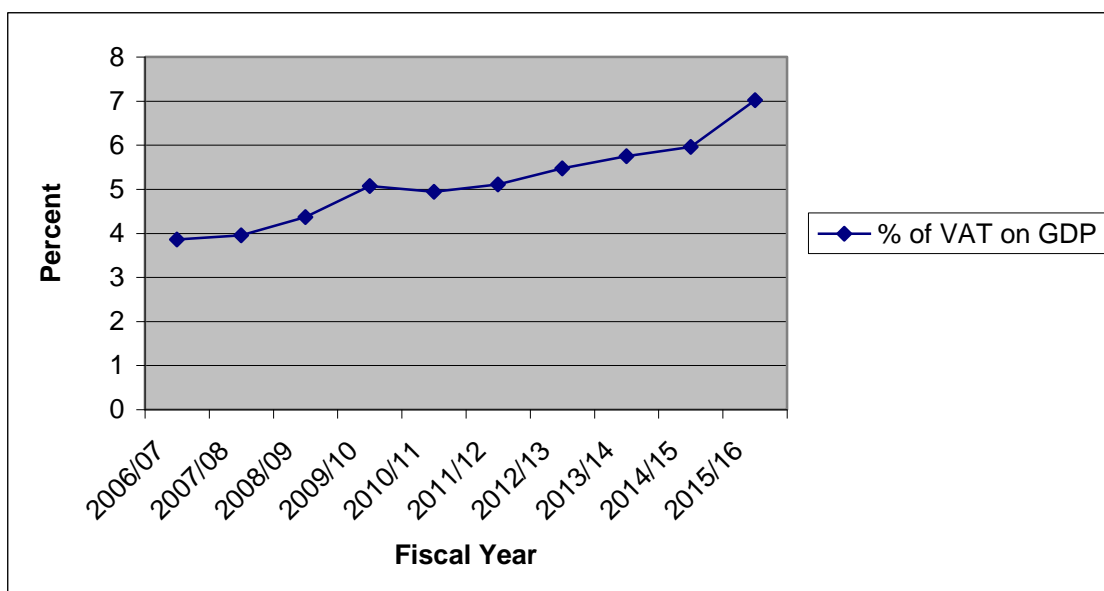
Source: Table 4.8

Thus, the VAT revenue alone has contributed to the GDP up to the 7.02 percent as it has shown an increasing feature; it is likely to increase in coming years.

4.2 Major Findings of the Study

The major findings of the study are as follows:

1. The contribution tax and non-tax revenue had increased to 81.58 percent and 18.42 percent respectively in the 2008/09. For 2013/14, their contributions were 87.61 percent and 12.39 percent respectively. The dominant role of tax revenue is thus, quite satisfactory as its amount had increased more significantly than the non-tax revenue over the period 2004/05 to 2013/14. The total revenue of 2015/16 was Rs. 475012.1 million, tax revenue is Rs. 427011.0 and non-tax revenue was Rs. 48001.1 million respectively. The mean value of total revenue, tax revenue and non-tax revenue were 119677.7 million, 101740 million and 18174.6 million respectively.

2. Direct tax is considered as superior from welfare aspect and however it is considered as a crucial instrument to remove inequalities of income and wealth. Though direct tax is more reliable, indirect taxes also enable every body to contribute to the public revenue. It needs proper balance between two

in order to reduce disparity of income and wealth and for proper distribution of tax burden.

3. The study found that the total number of VAT registrants in 2006/07 was 4723 and it reached at 5635 in the fiscal year 2011/12. During the mentioned period, the number of VAT registrants increased from 29872 in the fiscal year 2006/07 to 58600 in the fiscal year 2011/12 by more than 2 folds and 72760 in fiscal year 2015/16. This shows that the trend of VAT registration is satisfactory though the average growth rate is only 29.80 percent. Similarly, the study has shown the percentage growth rate of VAT registrants in Nepal which was 18 percent in FY 2006/07 and 4 percent in FY 2015/16.

4. Trend of revenue collection through VAT is seemed to be in increasing order. The percentage change i. e. increase in VAT revenue varies from 11.29 percent to 38.54 percent during the FYs i.e. 2006/07 to 2015/16 as it was 14.26 percent in the fiscal year 2006/07, Though in each FY the revenue collection through VAT is in positive side but the growth rate of the VAT revenue has not caught the constant increasing trend which has been fluctuated.

5. Despite of various difficulties in the implementation of VAT, the trend of revenue collection through VAT is not bad as thought. Since, VAT is mass based tax, it will prove to be stable base of revenue to government. However, it can be expected that more and more revenue can be generated in coming days, if implemented effectively and efficiently. For this, the major focus should be directed towards taxpayers' awareness program.

6. The percentage portion of VAT revenue in the total revenue has been ranged between 27.67 to 30.52 percent. It is clear that nearly one third of the revenue is the contribution of the VAT revenue to the total revenue.

7. In FY 2006/07 the VAT revenue was Rs. 26095.6 million which increased up to Rs. 140891.7 million in the FY 2015/16. Thus, the amount collected from VAT revenue is in increasing trend along with the total revenue collected through the tax and the non-tax sources.

8. It is found that the percentage portion of VAT revenue to the total tax revenue has ranged between the 31.61 to 36.69 percent during the review period. As it is also clear from the table and the diagrams that revenue collected through the VAT and total tax from FY 2006/07 to 2015/16 is in increasing trend and

order in the every year. Their respective shares were Rs. 26095.6 millions and Rs. 71134.1 millions in FY 2006/07 and Rs. 140891.7 millions and Rs. 427011.0 millions in FY 2015/16.

9. The study found that VAT revenue has increased with the increment of total indirect tax revenue. For example: in the FY 2006/07 the amount of total indirect tax was Rs. 52146.4 millions and the portion of the VAT revenue on it was Rs. 26095.6 million during the same FY which is 50.04 percent of total indirect tax revenue.

10. Similarly, in the FY 2008/09 the amount of the total indirect tax reached up to Rs. 305892.3 millions which consists of Rs. 140891.7 millions of VAT revenue on it and the amount occupies 46.06 percent of total indirect tax revenue. It can be noticed that the indirect tax and the portion of VAT revenue on it is in increasing form in each reviewed FY. The study also has revealed the fact that the percentage of the VAT revenue on the total indirect tax revenue is ranged between the 40 to 50 percent during the studied FY.

11. The study found that in the FY 2006/07 the GDP of Nepal was Rs. 675859 millions and the share of VAT revenue on it was Rs. 26095.6 which occupies 3.86 percent of GDP. In the same way, in the FY 2015/016 the GDP reached at Rs. 2007280 millions where the share of the VAT revenue is Rs. 140891.7 millions and the VAT revenue amount percentage is exactly 7.02 percent on the GDP.

12. Both the GDP and VAT revenue along with percentage of VAT on GDP are in the increasing trend. When we observe the percentage contribution of VAT revenue on GDP, it has caught the increasing trend as the rate is 3.86, 3.95, 4.37, 5.07, 4.94, 5.11, 5.47, 5.75, 5.96 and 7.02 percent during the reviewed FYs. Thus, the VAT revenue alone has contributed to the GDP up to the 7.02 percent as it has shown an increasing feature; it is likely to increase in coming years.

CHAPTER V

CONCLUSIONS

5.1 Summary

Taxation and economic development are two closely interrelated concepts. Taxation has an important role in country's economic development. In recent decades, many developing countries around the world have begun to focus their poorly designed tax structures as an integral part of their development efforts. Such reform has established some new trends. One of such trends is the increasing acceptance of VAT as an important part of their tax reform program.

Nepal has been undergoing through several fiscal crises due to limited sources of revenue and increasing government expenditure. The trend of gap between revenue expenditure shows that, it is even conducive to increase in future leading the country to a debt trap situation. In the wake of such a crisis Nepal has adopted a VAT.

For the effective and efficient VAT system, the awareness among the public regarding with VAT is very much important and said to be prerequisite for successful VAT system. Many studies found to be made for various aspects of VAT but awareness issue was not adjusted among those studies. To fulfill this gap, present study has tried to assess the awareness level of people regarding with VAT system in the context of Nepal. On the basis of review of related studies, analysis and interpretation of primary and secondary data, this study has made following objective wise summary, conclusions and recommendations. To achieve the objectives of this study, secondary data were used. For secondary data purpose various published and unpublished sources were used.

Tax revenue is the major contributor to the government revenue. It does not mean that government revenue is not contributed by the non tax revenue. But it is true that the portion of tax revenue is higher than the portion of non-tax revenue in the government revenue. The tax revenue has been a reliable and effective source for government revenue for every nation and economy. Taxes are levied primarily to raise government revenue for maintaining public expenditure. On the basis of its nature, tax

can be classified broadly in to the direct tax and indirect tax. And the VAT also is main contributor to the amount of indirect tax.

VAT can be regarded as an important innovation in the field of taxation of twentieth century. It is broad based modern tax system and is a type of indirect tax. VAT is intended to improve government revenue, to increase efficiency in administration and lessen the tax evasion. The VAT is totally a new form of taxation and an improved version of sales tax, since it is levied on value-added of goods and services in every stage of production and distribution of goods and services which has replaced many other taxes i.e. sales tax, hotel tax, contract tax and entertainment tax.

VAT was practiced by France at first in 1954 and which was followed by Ivory Coast in 1960 and by Brazil and Denmark in 1961. After this trend VAT earned its popularity and most of the nations started to adopt it, as the result more 130 nations have already adjusted VAT in their tax system. However, general awareness about VAT in Nepal was created before five years plan but it faced many pitfalls and facets. The eighth plan announced to apply VAT in Nepal at the end of the plan. The budget speech of FY 1993/94 extended its compliments towards VAT saying that 'To make sales tax as a principal source of revenue mobilization, government attempts will be directed to change sales into VAT gradually'. Ultimately, Nepal introduced VAT in Mangsir 01, 2054.

Nepal introduced VAT for several reasons; such as, to broaden the tax base, to establish a reliable and continuous source of public revenue, to generate revenue required for improving its poor and deteriorating macro economic performance, to establish an account based modern and transparent tax system, to tax system more scientific and specific, to gain the confidence of donors, to make Nepalese tax system more and more effective and efficient along with many other opportunities. Nepal has introduced the consumption type of VAT along with tax credit method based on destination principle with single rate of 10 percent at first which has been increased at 13 percent now. To keep small and petty business and vendors in order to promote entrepreneurship by providing them a cushion of not being registered into the VAT system, a minimum threshold has been specified for being registered vendors under VAT system. The wholesalers, retailers, dealers or services below the threshold level do not have to be registered under VAT and neither needs them to collect VAT on

their sales. The current threshold for VAT registration in Nepal is Rs. 2 millions. The other facts which were found during the study are as follows:

i) The contribution tax and non-tax revenue had increased to 81.58 percent and 18.42 percent respectively in the 2008/09. For 2013/14, their contributions were 87.61 percent and 12.39 percent respectively. The dominant role of tax revenue is thus, quite satisfactory as its amount had increased more significantly than the non-tax revenue over the period 2006/07 to 2015/16. The total revenue of 2015/16 was Rs. 475012.1 million, tax revenue is Rs. 427011.0 and non-tax revenue was Rs. 48001.1 million respectively. The mean value of total revenue, tax revenue and non-tax revenue were 119677.7 million, 101740 million and 18174.6 million respectively.

ii) Direct tax is considered as superior from welfare aspect and however it is considered as a crucial instrument to remove inequalities of income and wealth. Though direct tax is more reliable, indirect taxes also enable every body to contribute to the public revenue. It needs proper balance between two in order to reduce disparity of income and wealth and for proper distribution of tax burden.

iii) The study found that the total number of VAT registrants in 2006/07 was 4723 and it reached at 5635 in the fiscal year 2011/12. During the mentioned period, the number of VAT registrants increased from 29872 in the fiscal year 2006/07 to 58600 in the fiscal year 2011/12 by more than 2 folds and 72760 in fiscal year 2015/16. This shows that the trend of VAT registration is satisfactory though the average growth rate is only 29.80 percent. Similarly, the study has shown the percentage growth rate of VAT registrants in Nepal which was 18 percent in FY 2006/07 and 4 percent in FY 2015/16.

iv) Trend of revenue collection through VAT is seemed to be in increasing order. The percentage change i. e. increase in VAT revenue varies from 11.29 percent to 38.54 percent during the FYs i.e. 2006/07 to 2015/16 as it was 14.26 percent in the fiscal year 2006/07, Though in each FY the revenue collection through VAT is in positive side but the growth rate of the VAT revenue has not caught the constant increasing trend which has been fluctuated. Despite of various difficulties in the implementation of VAT, the trend of revenue collection through VAT is not bad as thought. Since, VAT is

mass based tax, it will prove to be stable base of revenue to government. However, it can be expected that more and more revenue can be generated in coming days, if implemented effectively and efficiently. For this, the major focus should be directed towards taxpayers' awareness program.

v) The percentage portion of VAT revenue in the total revenue has been ranged between 27.67 to 30.52 percent. It is clear that nearly one third of the revenue is the contribution of the VAT revenue to the total revenue. In FY 2006/07 the VAT revenue was Rs. 26095.6 million which increased up to Rs. 140891.7 million in the FY 2015/16. Thus, the amount collected from VAT revenue is in increasing trend along with the total revenue collected through the tax and the non-tax sources.

vi) It is found that the percentage portion of VAT revenue to the total tax revenue has ranged between the 31.61 to 36.69 percent during the review period. As it is also clear from the table and the diagrams that revenue collected through the VAT and total tax from FY 2006/07 to 2015/16 is in increasing trend and order in the every year. Their respective shares were Rs. 26095.6 millions and Rs. 71134.1 millions in FY 2006/07 and Rs. 140891.7 millions and Rs. 427011.0 millions in FY 2015/16.

vii) The study found that VAT revenue has increased with the increment of total indirect tax revenue. For example: in the FY 2006/07 the amount of total indirect tax was Rs. 52146.4 millions and the portion of the VAT revenue on it was Rs. 26095.6 million during the same FY which is 50.04 percent of total indirect tax revenue. Similarly, in the FY 2008/09 the amount of the total indirect tax reached up to Rs. 305892.3 millions which consists of Rs. 140891.7 millions of VAT revenue on it and the amount occupies 46.06 percent of total indirect tax revenue. From the study it is found that the indirect tax and the portion of VAT revenue on it is in increasing form in each reviewed FY. The study has revealed the fact that the percentage of the VAT revenue on the total indirect tax revenue is ranged between the 40 to 50 percent during the studied FY.

viii) The study found that in the FY 2006/07 the GDP of Nepal was Rs. 675859 millions and the share of VAT revenue on it was Rs. 26095.6 which occupies 3.86 percent of GDP. In the same way, in the FY 2015/016 the GDP reached at Rs. 2007280 millions where the share of the VAT revenue is Rs. 140891.7

millions and the VAT revenue amount percentage is exactly 7.02 percent on the GDP. Both the GDP and VAT revenue along with percentage of VAT on GDP are in the increasing trend. When we observe the percentage contribution of VAT revenue on GDP, it has caught the increasing trend as the rate is 3.86, 3.95, 4.37, 5.07, 4.94, 5.11, 5.47, 5.75, 5.96 and 7.02 percent during the reviewed FYs. Thus, the VAT revenue alone has contributed to the GDP up to the 7.02 percent as it has shown an increasing feature; it is likely to increase in coming years.

5.2 Conclusions

Nepal is facing many problems regarding VAT. Being least developed countries, Nepal is facing many problems and difficulties regarding with sustainable economic development. Being a poor nation it has common characteristics of least developed and developing countries; such as, dominance of massive poverty, hungriness, diseases, unemployment, heavy dependence on agriculture weak and poor infrastructure development, low level of income, lack of adequate entrepreneurship and readiness, high population growth rate, political instability, non-planned urbanization and habitation, dependency upon foreign aids and loans, low level of life expectancy and underdeveloped natural resources etc. In this sense, Nepal is far behind from modern development and economic growth as the developed countries have achieved. In this situation VAT may be an important tools and way for earning enough revenue for the GON.

VAT is the most prominent innovation of twentieth century in the field of taxation. Most of the developing countries along with developed countries have adopted this innovation and are fond of this system with its benefits. France was the country which adopted VAT system at first, afterward its popularity increased by day and night in the pace manner. It was the great step as Nepal introduced VAT system in Mangshir 01, 2054 (November 16, 1997) with ample possibilities and potentials. It was necessary to introduce VAT for GON to broaden its tax base, eliminate tax cascading, create an investment friendly tax system, have a simple and modern tax system that exempts export and basic goods from taxation and finally increase the overall revenue of government. This is the matter of pride that Nepal has entered into the global tax system with the introduction of VAT.

The VAT has been implemented as the major part of the tax reform program in Nepal. In this course, many reforms oriented activities have taken place; however, the implementation of VAT system went through various hitches and is facing innumerable problems which curtail its merits and effectiveness. Initially, its process slowed down due to administrative problems. Despite preliminary resistance and number of barriers it had faced, VAT has been largely accepted by the tax payers as well as business communities and relied upon by the government as an important tool for mobilizing the revenue needed to finance public expenditure.

The contribution of tax revenue to the total public revenue is higher than the contribution of non-tax revenue. The public revenue can broadly be divided into two types. They are tax revenue and non-tax revenue. In case of Nepalese revenue collection the contribution of tax revenue is more than 75 percent and the remaining portion i.e. 25 percent is the contribution of non-tax revenue. Among the items of tax revenue too, almost 1/3 of the revenue is collected through the VAT revenue. Thus, VAT revenue has played important role for increasing public revenue.

VAT in Nepal containsmany problems. They are, lack of public awareness, open boarder with India, problems on billing system, weak economic policy of government, lack of proper co-ordination between tax payers and tax administration, problems of tax refund and difficult accounting procedures. The effectiveness and efficiency of the VAT system depends upon the tax payers' awareness or education in the great extent. It is to be noted that there is positive relation between tax payers' education or tax payers' awareness and revenue collection through VAT for the country. It means the increasing number of aware or literate tax payers would contribute for increasing revenue potential of the nation. So, creation of public awareness about VAT is prerequisite for effective, efficient and fruitful VAT system. This also puts forward the need of encouraging tax payers for voluntary compliance and many reforms of tax administration should be aimed on motivating the tax payers which creates a positive attitude towards it. The government needs to take necessary steps to sort out emerging problems in success of VAT implementation which can be done through taxpayers' awareness program and education.

VAT must be effective and successful which largely depends upon the public awareness, honesty, faith and morality of tax officials and business community. There

is a need for positive willpower and appropriate provision of actions and procedures for the effective and efficient implementation of VAT. Further it should be supported by smooth and economy friendly environment where economic activities can be taken through without any hindrance. The government needs full co-operation from the tax administration, the tax payers and businessmen as well as consumers in its effort to generate more revenue. Apart from this government is required to learn from what it had not learned earlier from the past mistakes and demerits of the system and need to streamline the working procedures of the system. It is equally important that the government should justify the rationality of its policy and make consumers more assured about the policy that it has introduced is for the benefit of the people at large who further needs to be proved with effective implementation and action of government.

5.3 Implication

On the basis of major findings i.e. summary and conclusions presented in 5.1 and 5.2, the recommendations have been made as follows.

i)   During the study period i.e. FY 2006/07 to 2015/16, as it is found that the contribution of VAT revenue to the total revenue, to the total tax revenue, to the total indirect tax seems to be satisfactory. Besides this, there is ample potentiality of increasing this contribution at large as it is now for which government should proceed ahead with effective actions. For which the government should conduct the programs for motivating the people into the VAT registration. They should be made aware as the tax paid by them is for their betterment and convenience.There must be proper arrangement of reward provision for honest and moral tax payers. In the same way, strong penal provision should be made possible for offences caused by tax payers.

ii)   The contribution of VAT revenue to the government revenue (GDP) seems to be less. However, the trend on contribution of VAT revenue to the government revenue (GDP) is in increasing order, the GON needs to increase this trend in rapid manner as for as possible. In this regard, the VAT acts, rules and regulations should be clear, transparent and favorable for the good governance of the VAT system. They should not be remained only on theoretical aspects but also needed to be practiced in real behavior.

iii)   As many businessmen and traders who are out of tax net that are liable to be involved into the VAT registration, they should be identified and enforced to be registered into the VAT system. In the same way, the voluntary registration should be encouraged and made attractive by making provision for scientific tax refund and various reward system etc.

iv)   As the invoicing system is the heart of VAT system, the effectiveness of VAT system greatly depends upon the invoicing system. So, compulsory invoicing system during the purchase and sale of goods and services should be made possible. For which regular cross check, investigation and supervision should be made by concerned authorities and GON.

v)   Over the study period, we got that large number of businessmen/traders and consumers are still ignorant and unaware about the VAT, its composition, system and procedure. So, there is need of making arrangement for training, seminars, information campaigns, publication of journals for making them literate and aware regarding the VAT matters and system to make VAT system effective and efficient.

vi)   A regular information program should be launched to explain and narrate the tax laws, tax programs, tax benefit, tax rules and regulations with the view of stimulation, enthusiastic participation of the public to pay taxes through media such as, radio, television and newspaper etc.

vii)   Tax payers should be made aware as the tax paid by them is for their betterment and convenience. All the registrants should be required to display their registration certificates properly which is in increasing trend at present but needs to be monitored on regular basis by the tax officials and tax administration.

viii)   In case of Nepal, the VAT administration, monitoring and evaluation system is not effective which has encouraged tax evasion practices. So, effective and efficient auditing, investigation, monitoring and evaluation system is needed according to which corrupted and fraud officials and tax payers respectively must be strictly penalized and to those who are obedient and faithful to the VAT acts, rules and regulation should be rewarded and encouraged with different monetary and non-monetary incentives.

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