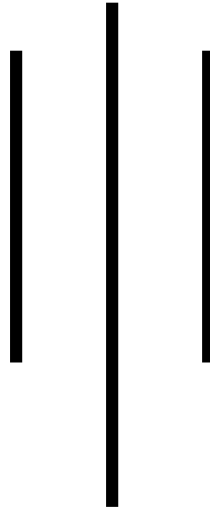


A THESIS WRITING
On
**IMPLEMENTATION OF VAT & ITS
CONTRIBUTION TO GOVERNMENT REVENUE**



Prepared by:

Sujita Shakya
M.B.S
Patan Multiple College
Roll No. 80/061/062

Submitted to :

Patan Multiple College
Faculty of Management
Tribhuvan University

In partial fulfillment of the requirement of the degree of Master of Business Studies
(M.B.S.)

16th April 2009



Ref. No.....

TRIBHUVAN UNIVERSITY
FACULTY OF MANAGEMENT
PATAN MULTIPLE CAMPUS

Phone: -5529911

Office of the Management
Patan Dhoka, Lalitpur, Nepal
Date:

Recommendation

This is to certify that the thesis submitted by

Ms. Sujita Shakya

Entitled “ VAT Implementation & Its Contribution to Government Revenue”
Has been approved by this department in the prescribed format of the faculty of
management. This thesis is forwarded for examination.

Dinesh Man Malego
Thesis supervisor

Krishna Badan Nakarmi
Campus Chief

Shiva Prasad Pokharel
Coordinator,,MBS Programme

Viva-Voce Sheet

We have conducted the viva-voce examination of the thesis presented
By Sujita Shakya

Entitled:

“Implementation of VAT & Its Contribution to Government Revenue”

And found the thesis to be the original work of the student and written according
to the prescribed format. We recommend the thesis to be accepted as partial
fulfillment of requirement for
Master’s degree in Business Studies (M.B.S.)

Viva – Voce Committee

Chairperson, Research Committee:

Member (Thesis Supervisor) :

(External expert) :

Declaration

I hereby declare that the work reported in this thesis entitled” Implementation of VAT & Its Contribution to Government Revenue” submitted to Patan Multiple Campus, Faculty of management, Tribhuvan University, is my original work one in the form of partial fulfillment of requirement of Masters degree in Business Studies (MBS) under the supervision of Mr. Dinesh Man Malego

Sujita Shakya

Roll No. 80

M.B.S

Date:

ACKNOWLEDGEMENT

It is said that learning by doing is most of the easiest and best way of studying. Anyone can learn easily by practicing it. By keeping consider on it, Tribhuvan University made a rule that Master Degree student must do research and prepare the thesis by performing the job practically on regarding subject.

This thesis is prepared on the topic of “Implementation of VAT & its Contribution to government revenue” for the subject of Tax. This research work could never have been completed without the invaluable cooperation and assistance of many individuals and organization.

First of all, I would like to express my sincere and gratitude to my tax Lecturer Mr. Dinesh Malego, Account & Finance Lecturer Mr. Yuga Raj Bhattarai of Patan Multiple College for his guidance and suggestion throughout this study. His guidance provided me the support to complete the research.

I am grateful to Mr. Nararaj Shrestha and Prakash Shrestha, the tax officer of VAT department for their valuable support in providing information and data.

At last but not the least I would like to thank to all the respondents whose suggestion helps me to analyze this thesis.

Sujita Shakya

M.B.S.

Roll No. 80/060

Patan Multiple College

Patan Dhoka, Lalitpur

List of tables

Table. 1 Calculation of VAT in Each Level	10
Table 2 Calculation of VAT Liabilities Under Additional Method	13
Table 3 Calculation of VAT Liabilities Under Subtraction Method	13
Table 4 Calculation of VAT Liabilities Under Tax Credit Method	14
Table 5 Calculation of Tax Under Tax Credit & Subtraction Method	15
Table 6 Panel A Calculation of Tax Liabilities under Sales Tax.	17
Table 6 Panel B Calculation of Tax Liabilities Under VAT	17
Table 7 Trend of VAT Registration	33
Table 8 Trend of VAT Deregistration	34
Table 9 Trend of VAT Return Filing	36
Table 10 Progressive Report of Upahar Program	54
Table 11 Sample Size	63
Table 12 Trend of Revenue Collection from VAT	64
Table 13 Contribution of VAT to Total Revenue	66
Table 14 Composition of VAT Revenue	67
Table 15 Percentage of VAT Revenue Collection on Total Tax	69
Table 16 Percentage of VAT Revenue Collection on Indirect Tax	70
Table 17 Composition of Indirect Tax	72
Table 18 Trend of VAT Collection	73
Table 19 Percentage of VAT Revenue to GDP	76
Table 20 Sample Size of Field Survey	77
Table 21 Respondents Views on VAT	78
Table 22 Respondents Views on VAT about Suitability of VAT in Nepal	78
Table 23 Respondents Views on Threshold Limit	79
Table 24 Respondents Views on Billing System	80
Table 25 Respondents Views on Price Rise due to VAT	81
Table 26 Respondents Views on Upahar Program	82
Table 27 Respondents Views on VAT Collection	82

Table 28 Respondents Views on Major Problems of VAT in Nepal	83
Table 29 Respondents Views on Role Play for Success of VAT	84
Table 30 Respondents Views on Launching Program to Encourage Public	85
Table 31 Respondents Views on Reason for Smuggling Business	86
Table 32 Respondents Views on Return Process	87

List of Diagrams

Diagram 1 Trend of Revenue Collection from VAT	65
Diagram 2 Percentage of VAT Contribution to Total Revenue	66
Diagram 3 Composition of VAT Revenue	68
Diagram 4 Percentage of VAT Revenue on Total Tax	69
Diagram 5 Percentage of VAT Revenue on Indirect Tax	71
Diagram 6 Composition of Indirect Tax	72
Diagram 7 Trend of VAT Collection	74
Diagram 8 Percentage of VAT Revenue to GDP	76

TABLE OF CONTENTS

Contents	Page No.
Approval Sheet	
Recommendation Letter	
Viva voice Letter	
Declaration Letter	
Acknowledgement	
List of Tables	
List of Diagrams	
Acronyms	
CHAPTER I : Introduction	
1.1 Background of the study	1-2
1.2 Statement of Problem	2-3
1.3 Objective of the Study	4
1.4 Limitation of the Study	4
1.5 Structure of the Study	4
CHAPTER II: Review of Literature	
2.1 CONCEPTURAL FRAMEWORK OF VAT	5-56
2.1.1 Introduction	5-6
2.1.2 Evolution and Development of VAT	7-9
2.1.3 How is VAT Collected	9-10
2.1.4 Types of VAT	10-12
2.1.5 Methods of Computing VAT	12-15
2.1.6 VAT as Substitutes of Sales Tax	15-17
2.1.7 Adoption of VAT in Nepal	18
2.1.8 Needs to Introduce VAT	18-20
2.1.9 Preparation for VAT Implementation in Nepal	20-24
2.1.9.1 VAT Law and VAT System	20-21
2.1.9.2 VAT Registration	22
2.1.9.3 VAT Education Program to Tax Payers	22-23
2.1.9.4 Administration and Training	23
2.1.9.5 Computerization	23-24
2.1.10 Basic Features of Nepalese VAT system	25-28
2.1.10.1 VAT Rate	25
2.1.10.2 Exemption	25-26
2.1.10.3 Zero Rating	26
2.1.10.4 Threshold	26
2.1.10.5 Taxable Value	27
2.1.10.6 Places of Supply	27
2.1.10.7 Time of Supply	27-28
2.1.11 Function of Value Added Tax	28-48
2.1.11.1 VAT Invoice	28

2.1.11.1.1 Tax Invoice	28-29
2.1.11.1.2 Brief Tax Invoice	29
2.1.11.1.3 Debit/Credit Note	29
2.1.11.2 Accounts	29-31
2.1.11.3 Records	31
2.1.11.4 VAT Registration	31-34
2.1.11.5 Tax Plate	34-35
2.1.11.6 Return	35-36
2.1.11.7 Non Flier	36-38
2.1.11.8 Tax Assessment	38-39
2.1.11.9 Collection of VAT	40
2.1.11.10 Tax Credit	40-41
2.1.11.11 Tax Audit	41
2.1.11.12 Tax Investigation	42
2.1.11.13 Tax Refund	42-45
2.1.11.14 Provision of Penalty	45
2.1.11.15 Provision of Reward	46
2.1.11.16 Appeals	46
2.1.11.17 VAT Administration	46-48
2.1.12 Problems of VAT on Effectively Implementation of VAT	49-52
2.1.12.1 Small Traders	49
2.1.12.2 Tax Evasion	49-50
2.1.12.3 Consciousness of People	51
2.1.12.4 Open Boarder and Batter System	51-52
2.1.13 Government Effort on VAT Implementation	52-56
2.1.13.1 Consumer Consciousness Upahar Program	52-55
2.1.13.2 Information & Technology	55-56
2.2 Review of Related Studies	57-60
2.3 Concluding Remarks	61
CHAPTER III : Research Methodology	
3.1 Research Design	62-63
3.2 Population & Sample	63
3.3 Data Collection Procedure	63
3.4 Data Analysis Procedure	63
CHAPTER IV : Data Presentation and Analysis	
4.1 Revenue Collection from VAT	64-65
4.2 Contribution of VAT to Total Revenue	65-67
4.3 Composition of VAT Revenue	67-68
4.4 Share of VAT Revenue to Total Tax	68-70
4.5 Share of VAT Revenue to Indirect Tax	70-71
4.6 Composition of Indirect Tax	71-72
4.7 Trend of VAT collection	73-75
4.8 % of Contribution of VAT to GDP	75-77
4.9 Results of Primary Data Analysis	77-88

4.10	Major Findings	88-89
------	----------------	-------

CHAPTER V : Summary, Conclusion and Recommendation

5.1	Summary	90-92
5.2	Conclusion	93-95
5.3	Recommendation	95-96

BIBLIOGRAPGY

Acronyms

ADB	=	Asian Development Bank
CBS	=	Central Bureau of Statistic
CEDA	=	Central for Economic Development
DANIDA	=	Danish International Development Agency
EEC	=	European Economic Community
ESAF	=	Enhance Structural Adjustment Framework
EU	=	European Union
FNCCI	=	Federation of Nepalese Chamber of Commerce
FY	=	Fiscal Year
GATT	=	General Agreement of Tariff and Trade
GDP	=	Government Domestic Product
HDR	=	Human Development Report
HIID	=	Howard Institute for International Development
IMF	=	International Monetary Fund
IRD	=	Inland Revenue Department
LDC	=	Least Developed Country
MOD-VAT	=	Modified Value Added Tax
MOF	=	Ministry of Finance
NPC	=	National Planning Commission
NRB	=	Nepal Rastra Bank
OECD	=	Organization for Economic Cooperation and Development
RLST	=	Retail Level Sales Tax
SAARC	=	South Asian Association for Regional Cooperation
TPIN	=	Tax Payer Identification Number
UK	=	United Kingdom
USA	=	United State of America
USAID	=	United States Agency for Intentional Development
VAT	=	Value Added Tax

CHAPTER I

Introduction

1.1 Background of the study

Economic Development of the country is, no doubt, the most important concern & the target of the government policy in undeveloped countries. To maximize the welfare of the people, efficient allocation of resources, reduction of income disparities & poverty, improvement of the living standard of people are some of the economic development strategies towards which most of the government efforts have been directed in developed countries. For the implementation of these strategies & to achieve the goals of economic development, Nepal needs large volume of resources/ revenues. Government collects revenues from various sources such as tax revenues from public enterprises special assessment, fees, grants, gifts, business income, fine & penalties etc,. Among of them, tax is the main source of government revenue. Since it is the permanent instrument of collecting revenues, it occupies the most important place in government treasury.

Tax can be generated by two ways: direct tax & indirect tax. Income tax, property tax, vehicle tax are the eg. of direct tax where as VAT, excise duty, import & export duty etc are comes under indirect tax. But tax payers have not been able to pay taxes due to legal & procedural difficulties. Such problems are made prevalent particularly in the area of direct taxation. Due to this our dependency on indirect tax has been very high.

Due to limitation of direct tax & its low performance in revenue collection indirect tax has been given preference by Nepal Government so to enhance for revenue mobilization VAT was introduced in Nepal. It has very prominent role in a country's revenue collection. The value added tax is indirect tax that is levied on the purchase value of goods or services at the time of sale. This tax is collected when a person purchases certain goods or services. The overall burden of this tax

goes to ultimate consumer. As the name implies, this is levied on the portion of the value added on goods / services by a seller. VAT considered as an improved, scientific, fair & proper method of indirect tax on consumption. It is an improved & modified form of sales tax.

In conclusion, VAT has been the most essential ingredient of tax reform of developing countries because it is the most improved form of sales tax which leads to revenue enhancement & economic efficiency. VAT have the advantages of raising revenue “invisibly”, that is, without appearing as taxes on the bill paid by the consumer. It is an important instrument for the internal resource mobilization. It can be the major elements of tax revenue to achieve the goal of rapid economic development for any under developing countries.

1.2 Statement of the problems

Heavy burden of regular expenses in comparison to the revenue is the main reason that government is fail to achieve its target result for the economic development. So government required more revenue for its development work. While internal source of revenue is inadequate & depended on external sources (foreign grants & loans). Too much dependency on the foreign grants can never be fruitful & effective way to collect the capital as required by the nation's development program.

To reduce the economic dependency on foreign assistance for development expenditure, the government needs to continue its efforts to mobilize domestic resources. So in this context it is essential to introduce a reliable tax system that would enable a natural growth of economic activities along with increasing the income of Nepal Government. And VAT is only the solution in this aspect. Effective implementation of VAT can be the major way in front of the government to meet the growing development expenditure. But the government has not been able to collect the expected revenue from Vat. And its main cause is widespread poverty, illiteracy, lack of information, creation of confusion & ignorance. Due to

the absence of clarity regarding VAT, it was opposed by businessman, professional & other sectors. VAT Act 2052 & VAT Regulation 053 have not been able to bring more business organization into the tax net. The evasion of VAT has been in the increasing rate since the beginning of its implementation. Nepal Government is hurry to introduce VAT without adequate preparation & consulting the business community. Administration is inefficient. Many business man & tax collectors are ignorant about this. They are confused which shop or what goods VAT is levied. Consumer is in still dilemma that which shop issue VAT bill & which not & those who demand invoice has to pay 13% more price. Businessman doesn't think that they are just agreeing to collect VAT in respect of government rather the businessman thinks that VAT is unnecessary botheration. The consumer accused business men of evading tax, the administrators are mute spectators and the businessmen for pretty selfishness say that it is difficult to achieve fair competition due to non implementation of VAT completely. The business man doesn't stop complaining that if VAT is added then the price of goods will increasing and the business will become dull & the consumers do not take invoices.

Nepal Government first applied VAT without any formal public agreement hoping the positive result but various problem have been appeared on the process of implementation of VAT as a result the outcome of implementation & experimentation of VAT is not as prosperous as it was expected. Moreover several tax payers have been maintaining two sets of account, issuing two types of invoices, collecting VAT form the buyers but not depositing them to the treasury & collecting. VAT without being registered seen as major problem in current scenario. Similarly, open boarder with neighbor county is major problem in VAT, due to which goods are coming through illegal means & government lose the revenue. The study is directed to resolve the following issues:

1. What is existing situation of the implementation of VAT to meet the growing development expenditure of government?
2. At what extent VAT can contribute to government revenue?

3. How far government is exerting effort for better implementation of VAT in practice?

1.3 Objective of the study

VAT has been implemented in Nepal with a view to increase government revenue through indirect tax reform program. It is now in ninth year of its implementation and this study tries to evaluate its implementation aspect over the ninth year. The specific objectives of the study are as follows:

1. To examine the implementation of VAT in Nepal
2. To evaluate the contribution of VAT in government revenue generation.
3. To observe the government efforts on better implementation of VAT.

1.4 Limitation of the study

VAT covers wide area. We can research VAT from different aspect in different topics like its implementation sector, its revenue contribution aspect, government effort to make VAT more effective, consumer interest in VAT, possibility of VAT evasion. VAT in the context of Nepal etc. But this study includes only the certain area. It is done within the valley and data are attached of six years only. The limitations of this study are pointed out below.

-) This study covers only the implementation of VAT, its contribution to government revenue & steps taken by government to make VAT more effective.
-) This study covers the period of only from 2000/2001-2005/2006
-) This study concentrates within the valley.

1.5. Structure of the study

This study is structured into five chapters. The first chapter focuses the whole study, which includes the background of the study, statement of the problem, objectives & limitation of the study. The second chapter includes the review of literature, conceptual aspect to Value Added Tax & review of related studies. The third chapter focuses on research methodology. The fourth chapter deals with the

presentation & analysis of data. The fifth or last chapter provides the summary, conclusion & recommendation.

CHAPTER II

Review of Literature

2.1 Conceptual Framework of VAT

VAT is an improved form of sales tax. It is a substitute for sales tax, hotel tax, contract tax & entertainment tax. It is more transparent than sales tax. Although it is eventually borne by the final consumer, VAT is collected at each stage of production & distribution chain.

Most of the developing countries have made tax reform program as a integral part of their development efforts for last 3 decades. Many more studies & research have been conducted in the world about its prospectus, issues, problems, option & its practices.

From the economist point of view, Musgrave & Musgrave, "A properly implemented value added tax is equivalent to corresponding single stage tax, unlike the expenditure tax, the value added tax is not a genuinely new form of taxation but merely a sales tax administered in a different form."

As per The Indian Taxation Enquiry Committee, "VAT in its comprehensive form is a tax on all goods & services (except export & government services), its special characteristics is being that it falls on the value added of each stage from the stage of production to retail stage."

2.1.1 Introduction

A Value Added Tax (VAT) is a fee that is assessed against business by a government at various points in the production of goods or services-usually any time a product resold or value is added to it. For tax purposes, value is added whenever the value of a product increases as a result of the application of a company's factor's of production, such as labor & equipment. VAT must be paid

by every company that handles a product during its transition from raw materials to finished goods. For eg tax is charged when a manufacturer sells to a wholesaler and again when a wholesaler sells to a retailer. With VAT, the taxable amount is based on the value added at each stage of the process of producing goods & bringing them to market. As an eg say that a company that makes cloths buys cotton yarn for Rs. 1,000 adds Rs. 500 to its value in terms of labor, depreciation of knitting machines & profits, then sells the cloths for Rs. 1500. VAT would be calculated as a percentage of Rs. 500 value added by turning cotton yarn into cloths. Of course, the company would also get credit for the amount of VAT it paid on purchase of inputs, like cotton yarn.

In general , the total VAT accrued during the production of goods is reflected in the price of items sold to final consumers, because each reseller along the way usually passes along its VAT costs. In this way, VAT is some what similar to a national sales tax, & the two forms of taxation are often compared by governments. Experts claim that VAT entails higher administrative cost but is easier to enforce than a national sales tax.

Business is in the VAT net

VAT is intended to be neutral in relation to trade, industry & consumers. For that reason imports are liable to VAT & exports are exempted for VAT.

In a VAT system all supplies of goods & services are in principle liable to VAT. But all countries that have introduced VAT have introduced certain exemptions. These are generally exemption based on social, educational & other considerations. Small vendors, who have previously been non taxable, shall apply for registration within 30 days of the date on which their annual turnover reaches the threshold at 2million rupees. A business who imports into Nepal goods valued at one hundred thousand rupees or more per annum for commercial purpose are also come into the VAT net.

2.1.2 Evolution & Development of VAT

Welhelm Von Siemens of Germany, in 1919 A.D., introduced VAT to replace multistage sales tax in order to avoid the undesirable effects, particularly cascading & pyramiding. The VAT proposal was seriously considered by the German government to mobilize the much needed resources. As the tax was new & thought to be complicated, it decided to reduce the rate of turnover tax instead of introducing the Fwca-Khanchi-Zei (VAT). The concept of VAT was developed further in 1949 by Tax Mission to Japan headed by Prof. Carl S. Shoup. However, the credit of using VAT at first goes to France. This country introduced VAT in 1954, limiting the tax up to the wholesale level. Before this VAT was only a topic of academic discussion. After three & half decades of evolution of VAT concept, France took courage to put VAT into practice.

By the end of 1960s, only eight countries including France, Brazil, Germany, the Netherlands, Sweden etc had introduced VAT. Since then, VAT has been introduced by at least one country each year & by now it has been adopted by more than 135 countries.

Pakistan is the 1st country introducing VAT in the SAARC country. India had introduced modified VAT (MOD-VAT) in 1986 for manufacturing products. The MOD-VAT is limited in scope. It covers only a half of the revenue collected. It is designed to collect excise duty & to avoid the disadvantage of input taxable such as cascading. Full VAT has been implemented there with effect from 1st April 2003. The concept of VAT was first adopted by France in 1954. By 2000, it was used by Canada & 40 other industrialized countries.

The year of the use of VAT in other countries of the world can be shown as follows :

Countries implementing VAT in different year.

Year	Name of the Country
1954	France ¹
1960	Ivory Coast
1961	Sinegal
1967	Brazil, Denmark
1968	Jermany, Urugway
1969	Netherland, Swiden
1970	Iqador, Luxjemberg, Norvey
1971	Belzium
1972	Ireland
1973	Austria, Bolivia, Itali, USA, Viatanam ²
1975	Aurjentina, Chilli, Colambia, Kostarika, Nikaraguwa
1976	Honduras, Israel, Peru
1977	Koria, Panama
1980	Mexico
1982	Highty
1983	Dominical Republic, Gwatemala
1984	China ³
1985	Indonesia, Turkey
1986	Moracco, newziland, Nyzar, Portugal, Spain, Tywan
1987	Granida, Greece
1988	Hungery, Philipins, Tunisiya
1989	Japan, Malabi
1990	Iceland, Kenya, Pakistan, Trinidad, Tobago
1991	Bangladesh, Benin, Canada, Jamaika, Mali, South Africa, Egypt,
1992	Algeriya, Armeniya, Ajerbaijan, Belarus, Cyprus, Alsalvador, Istoniya, Fiji, Kajakistan, kirgij Republic, Rusia, Tazikistan, Thiland, Turkmenistan, Ucrain, Uzbekistan, Moldova
1993	Burkina faso, Check Republic, Mangoliya, Paragway, Poland, Rumaniya, Jarjiya, Slovakiya, Venejuyela
1994	Bulgeriya, Finland, Lithauniya, Singapur, Western Samoa, Myadagaskar, Nizeriya
1995	Gyawon, Ghana ⁴ , Switzerland, Zambiya, Malta ⁵ , Mauritaniya, Togo, Latviya
1996	Albaniya, Gayena, Uganda
1997	Warwedos, Kongo Republic, Nepal
1998	Krosia, Mangoliya, Srilanka, Tanzaniya, Vanuatu
1999	Combodiya, Camrun, Mojambik, Netherlands Antils, Papua, Newjeniya, Slovaniya
2000	Austreliya, Chad, Myasidoniya, Nambiya, Sudan
2001	Ruwanda
2002	Lebnan
2003	Ithopiya, Lesotho, Sarbiya, Montenegro

¹France launched VAT in 1954 and levied only on import and manufacturing stage and in 1967 VAT extended to the retail level for the first time. ²Vietnam starts VAT In 1973 but it immediately displaced and again it has been placed in 1999. ³China imposed VAT in 1984 for the certain commodity and has been fully implemented from 1994. ⁴Ghana imposed VAT in 1995 and removed after three months and again it implemented in 1998. ⁵Malta imposed VAT in 1995 and due to the political change VAT removed in 1997 and in 1999 it has been re implemented.

In recent years, VAT has been proposed for use in the United States as a way to simplify business & personal income tax laws. Proponents claim that VAT would replace other forms of taxation & reduce the costs of tax compliance. In fact some people say that adopting VAT would eliminate tax returns for individuals & make the internal Revenue Service obsolete. On the other hand, opponents argue that VAT would be more complicated to implement than other tax reform options, such as a national sales tax. In France it becomes most important sources of State Finance, Accounting for approximately 45% of state revenues. Personal end-consumers of products, consumer & services cannot recover VAT on purchases, but businesses are able to recover VAT on the materials & services.

VAT was invented because very high sales taxes & tariffs encourage cheating & smuggling. It has been criticized on the grounds that it is a regressive tax.

2.1.3 How is VAT collected

VAT is collected from each and every distribution stage from production to final sales to consumers. Each distribution stage collects VAT from the value added at its own stage. It obtained by levying tax on total sales and deducts tax on purchases from tax on sales. eg. A manufacturer has imported raw materials to manufacture/producer some electric goods at Rs. 20,000 & after producing finished goods he sold it to wholesaler adding 10% profit on cost. Then the retailer

sold it to customer at 20% profit on cost price. On the basis of this figure VAT at the rate of 13% will be levied in the following manner:

Table 1
Calculation of VAT in each level

Channel	cost price exclusive VAT	Value Added	Selling price excluding VAT	VAT (13%)	Selling price including VAT	VAT payable to government
Importer	20,000	-	-	2,600	22,600	2,600
Manufacturer	20,000	2,000	22,000	2,860	24,860	260
Wholesaler	22,000	4,400	26,400	3,432	29,832	572
Retailer	26,400	5,280	31,680	4,118.4	35,798.4	986.4
Total						4,418.4

Table 1 shows that the importer collects Rs. 2,600 as a VAT on cost price & pays it to government. The manufacturer collects Rs. 2,860 & deducts input tax credit of Rs. 2,600 & paid 260 to the government. The wholesaler collects a VAT of Rs. 3,432 on sales but deducts his input tax of Rs. 2,860 & remit the balance of Rs. 572 to the government. Similarly retailer collects VAT of Rs. 4,418.40 which is eventually borne by consumer. Under the VAT system the consumers know the amount of tax contributed by them.

2.1.4 Types of VAT

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

- a) Consumption type VAT
- b) Income type VAT
- c) The Gross National Product Type VAT.

a) Consumption type VAT:

Under this type of VAT all capital goods purchased from other firms, in the year of purchase, are excluded from the tax base while depreciation is not deducted from tax base in the subsequent years. Since, investment is relieved from taxation under this variant, the base of this tax is consumption that is why this variant of VAT is known as consumption type VAT. As exports are relieved from tax, while imports are taxed, the base of this tax becomes identical to the base of retail sales tax on consumer goods & services. In equation form,

$$\begin{aligned} C &= \text{Gross National Product} - \text{Gross Investment} \\ &= \text{Total consumption expenditure} \end{aligned}$$

This type of VAT is attractive from administrative point of view, under this variant no need to classify capital as well as intermediate goods. Thus consumption type of variant, doesn't encourage to justify capital goods into intermediate goods.

Capital outlays are treated equally with current purchases. They are deducted fully at the time of purchase. Thus this type of VAT introduced neutrality in indirect taxation. It does not affect production process of firms either capital intensive or labor intensive firm because all invest are free from tax base.

b) Income type VAT

The income type VAT doesn't exclude capital goods purchased from other firms from the tax base in the year of purchase. This type however, excludes depreciation from the tax base in subsequent years. The tax falls both on consumption & net invest. The tax base of this type is the net national income.

$$\begin{aligned} \text{Income type} &= \text{Gross National Product} - \text{Depreciation} \\ &= \text{Net invest} + \text{consumption} \\ &= \text{Net national income} \end{aligned}$$

This type of VAT stimulates to distinguish capital good & intermediate goods. So it is further complicated since it requires the preparation of a depreciation table for tax purpose. This type variant is consistent with the original principal of taxation

where the goods are taxed in the country of production mean exports are taxed while imports are relieved from tax base. Because of the nature of the income type variant it is very difficult to make exports tax free completely.

c) The Gross National Product Type

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

$$\begin{aligned}\text{Base of VAT} &= \text{GDP} \\ &= \text{Consumption} + \text{GI}\end{aligned}$$

It fully discourage for capital intensive firms thus it is useful for only labor intensive firm. This type of VAT stimulates to distinguish capital good & intermediate goods.

Above three type of variant of VAT, we can conclude that consumption type of VAT has several advantage than income type of VAT & GNP variant. Thus many countries are using consumption type of VAT. VAT means generally consumption type of VAT.

2.1.5 Method of computing VAT

There are three methods of computing VAT:

1. Additional method
2. Subtraction method
3. Tax credit method

1. Addition Method

Addition Method is that where tax liability is calculated by adding the incomes produced by the firm. These incomes may include interest, profit, rent, wages etc. This method is appropriate for the income type of VAT.

VAT = t (wages + rent + interest + profit)

It can be shown in the following table.

Table 2
Calculation of VAT liabilities under additional method

(in Rs.)						
Stages	wages	Rent	Interest	Profit	Value Added	VAT (13%)
Manufacturer	50	200	100	150	500	65
Wholesaler	100	200	50	150	500	65
Retailer	150	200	100	250	700	91

Table 2 denotes how VAT liabilities are calculated. At first value added is find out by adding wages, rent, interest, profit i.e what ever cost incurred are added first then levied VAT in each stage on this added value .

2. Subtraction Method

Under this method VAT calculates by subtracting the cost of materials from sale proceeds. Thus VAT is levied on the amount, which is derived by subtracting purchase from sales. This method is suitable for consumption type VAT

Value Added= Sales – Purchases

VAT calculation under this method can be understood from the following table.

Table 3
Calculation of VAT liabilities under subtraction method

(in Rs.)				
Stages	Net purchases	Sales	Value Added	VAT (13%)
Manufacturer	5,000	5,500	500	65
Wholesaler	5,500	6,000	500	65
Retailer	6,000	6,700	700	91
Total	16,500	18,200	1,700	221

Table 3 shows value added is calculated by subtracting purchased value from sales value & 13% amount VAT is charged over the difference. In above table amount of net purchases for manufacturer is Rs. 5000. Manufacturer sales it in Rs. 5500. The difference will be 500 & 13% VAT is charged on this difference of Rs. 500. This calculation is repeated same in another stage.

3. Tax Credit Method

This method is known as invoice method. Tax is imposed on total value of sales and taxpayers are allowed to deduct from their gross tax liability, the taxes already paid by their suppliers and passed, on to them. As compared to subtraction method, which deducts purchases from sales & levies tax on difference, tax on purchase is deducted from the tax on sales.

Table 4
Calculation of VAT liabilities under tax credit method
(in Rs.)

Stages	Purchases	Sales	VAT 13% on purchase	VAT 13% on Sales	VAT payable to Government
Manufacturer	5,000	5,500	650	715	65
Wholesaler	5,500	6,000	715	780	65
Retailer	6,000	6,700	780	871	91
Total					221

Above table shows the purchase cost in manufacturer level is Rs. 5000. Manufacturer sales the product in Rs. 5500. Then Rs. 650 comes while 13% VAT calculated on purchase. After that VAT is calculated on sales & the amount is Rs. 715. The actual tax payable to government is the difference between Rs. 715 & Rs. 650 i.e. Rs. 65. In other stages VAT is calculated in similar way.

In above two methods, the result in subtraction & tax credit method is same, if tax is same rate through production to final distribution process. But if different tax rate is applied more than one rate then tax liability in these two methods may differ.

Table 5
Calculation of VAT liabilities under tax credit & Subtraction method
If VAT rate is 15% at the wholesaler stage & 13% at all

Stages	Purchases	Sales	Subtraction Method		Tax Credit Method		VAT payable to Government
			Value Added	VAT	VAT on purchase	VAT on sales	
Manufacturer	5,000	5,500	500	65	650	825	175
Wholesaler	5,500	6,000	500	75	825	780	(45)
Retailer	6,000	6,700	700	91	780	871	91
Total				231			221

Above tables show that VAT liability calculated by using any of three methods is same of Rs. 221 by applying 13% VAT rate but if VAT rate is change in any one stage then VAT liabilities is different in subtraction method where as in tax credit method changing rate doesn't affect. That's why it gets popularity in the world.

Tax credit method is widely popular in the world. This method is useful for exported goods. Tax is separately distinguished on invoice. Vendors have to show their purchase invoice for adjustment tax. Thus crosschecking possible through invoice facility & easy to refund tax for exporter where export is zero rating.

2.1.6 VAT as a substitutes of sales tax

A tax based on the sale of goods and services imposed for generating revenue is sales tax. There are three types of sales tax, namely, multiple stage sales tax; single stage sales tax & VAT. The tax imposed on each stage of sales is multistage sales tax, whereas the tax imposed on only one stage is single stage sales tax. In other words, if tax is imposed on manufacturer wholesaler & retailer, it is multistage sales tax. In contrast, where the tax is imposed either on manufacturer, wholesaler or retailer, it is single stage sales tax.

The nature of sales tax is that the tax in case of sales tax is levied on the total amount of cost of sales & the tax amount of earlier stage becomes the cost of the goods or services for next stage. VAT, in opposite, is levied on every business as a

fraction of the price of each taxable sales they make, but they are in turn reimbursed VAT on their purchases, so the VAT is applied to the value added to the goods at each stage of production.

Sales taxes are normally only charged on final sales to consumers, because of reimbursement, VAT has the same overall economic effect on final prices. The main difference is the extra accounting required by those in the middle of the supply chain; this disadvantage of VAT is balanced by application of the same tax to each member of the production chain regardless of its position in it & the position of its customers, reducing the effort required to check and clarify their status.

Sales tax in the world of taxation was introduced during 1st world war due to severe need of revenue. Upto 2nd world war this tax has been indispensable part of most of the tax system in the world. However, after 1955 sales tax was gradually replaced by the VAT. In Nepal sales tax was introduced in 2022B.S. At first in Nepal it was levied on retail stage. Nevertheless, in 2025 B.S., Wholesaler were the point of taxation. In 2031B.S. the system was again changed & the sales tax was imposed on manufacturer stage. Since Mangsir 1, 2054B.S. Sales tax was replaced by VAT in Nepal.

The standard way to implement of VAT is to say a business owes some percentage on the price of the good minus all taxes previously paid on the good. If VAT rates were 13%, retailer would pay 13% on value added Rs. 200 (Rs.26) minus taxes previously paid by the wholesaler on value added by importer Rs. 100 (Rs.13). In this eg. the wholesaler would have a Rs. 13 tax liability. Each business has a strong incentive for its suppliers to pay their taxes, allowing VAT rates to be higher with less tax evasion than a retail sales tax.

Table 6
Panel - A
Calculation of Tax Liabilities Under Sales Tax

Channel	Cost Price	Profit under Sales Tax	Selling Price	Sales Tax @13%	Selling Price including Sales tax
Importer to Whole Seller	5000	500	5500	715	6215
Whole Seller to Retailer	6215	621.5	6836.5	-	6836.5
Retailer to Consumer	6836.5	683.65	7520.15	-	7520.15

Table 3, Panel – A shows the calculation of tax amount under the sales tax. Under the sales tax, tax is calculated on first channel i.e. importer to wholesaler and levied on total cost after adding the value added or profit.

Panel - B
Calculation of Tax Liabilities Under VAT

Channel	Cost Price	Value Added	Selling price excluding VAT	VAT @ 13	Selling price including VAT	VAT payable to government
Imported goods	5000	-	-	650	-	650
Importer to Whole seller	5000	500	5500	715	6215	65
Whole seller to Retailer	5000	550	6050	786.5	6336.5	71.5
Retailer to Consumer	6050	605	6655	865.15	7520.15	78.65

From above table, it is clarified that tax can be collected more from Value Added Tax than sales tax, however, consumer paid same cost price in both types of tax. The reason is, in sales tax tax is only levied on a single where as Value Added Tax levied on each stages from production to sale. Sales tax is imposed on total amount of cost of sales & tax amount of earlier stages is included in cost of sales. On the other hand, Value Added Tax is levied not on the total cost of sales but on the amount of value added in each stage & consumer know the amount of tax contribution made by them.

2.1.7 Adoption of VAT in Nepal

However the concept of this tax in Nepal was introduced in early 1990s. Nepal government included the concept of introducing VAT in its eighth plan. Subsequently, the Prime Minister declared to introduce a two tier sale tax system to make the base of implementing VAT from the fiscal year 1992/93. A VAT tax 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 force prepares the draft of VAT legislation.

The parliament of Nepal enacted VAT Act 1995 in 1995. Subsequently VAT Regulation was made in 1996. Although the Act was passed in 1995, its implementation was delayed due to political instability & strong opposition from the business community. VAT with single rate of 10 % has been fully implemented with effect from 16th November 1997 (1st Mangsir 054). It has replaced sales tax, hotel tax, contract tax & entertainment tax. VAT has been justified in the light of government fiscal imbalance and need for extra revenue mobilization through an efficient tax system. Nepal Government has increased VAT to 13% with effect from Magh 1, 061.

It is a modern type of consumption tax. It intends to collect taxes on the consumption by private consumers. But also exempted business & government pays the tax on their purchases. VAT is an indirect tax, on which tax is collected from someone other than the person who actually bears the cost of the tax (namely the seller rather than the consumer).

2.1.8 Needs to introduce VAT

VAT is considered as the most important tax reform in the 20th century. VAT was introduced in Nepal for several reasons. Firstly, it was necessary to introduce VAT in order to avoid cascading effects. Under VAT tax was levied only on value added on each stage where as in sales tax was levied on total sales by which

consumer has to bear a big burden of tax amount & discourage them to pay tax. So to encourage consumer VAT is introduced.

VAT broadens the tax base as it could levy up to the retail point. To a certain extent, VAT is a self policing system because any understatement would disadvantage the buyer since the credit for input tax would be affected, while any over statement would result in higher tax liability for the seller. VAT was also expected to make exports tax free through zero rating and the refund mechanism for excess credit. Furthermore, the import or manufacturer level sales tax as unequal in the sense that it put proportionately higher burden on items that didn't have a high value added in the distribution process as compared to items that had a high value added. This meant that the tax burdened domestic products more than the imported luxury items. It was further discriminatory since it had more control on domestic products than imports, as manufacturers were required to be registered, maintain records of sales, obtain approval for their selling prices & submit monthly and annual returns where as importers did not have to fulfill of any of these formalities. This kind of system encourages import & discourages to use domestic products. So VAT need to be introduced to avoids such kind of difficulties.

In addition to the above, Nepal had to introduce VAT as its tax revenue, which was largely from customs duties, was shrinking due to the reduction in import tariffs. The import tariffs were being reduced as part of an overall tax reform and furthermore, a drastic reduction in customs tariffs by India and other trading partners put furthermore pressure for the reduction of tariffs in Nepal. Also as Nepal had been a WTO membership, it would be necessary to lower the overall level of import tariffs. In this context, it was necessary to levy a board based tax like VAT as an alternative tax system to import tariffs to generate more revenue.

At the same time, the VAT system promotes the interchange of information between the other tax systems, particularly trade taxes, as customs information is

required to determine the validity of input tax credit claimed. VAT should not only been effective instrument to generate substantial revenue at customs points, but also help streamline tax policy in general VAT has a natural link with the income tax.

VAT system has refund facility also which encourage business man for investment. Under this system the consumers know the amount of tax contributed by them. So it is more transparent than other tax system.

In summary, VAT needs to be introduced for

- Develop VAT as a main source of revenue collection
- To make tax more scientific & modernize.
- To make internal tax system more transparent.
- To broaden the tax base.
- To avoid cascading effects on tax.

2.1.9 Preparation for VAT implementation in Nepal

VAT as a new & advance form of sales tax, public should know about VAT. And it should be remarkable & profitable to the government. To achieve the target of revenue from VAT which are expected by government, government need some preparation for its introduction & awareness to public, its registration procedure, administration & its implementation sector as a whole. The preparations for the implementation of VAT in Nepal are described in the following points.

2.1.9.1 VAT law and VAT system

Value Added Tax is not a new tax for Nepal. It is a substitution of sales tax. It has replaced some of already existing taxes i.e. sales tax, hotel tax, contract tax and entertainment tax, even Value Added Tax is just a substitution of sales tax, long process & preparation was need to implement it effectively.

The Value Added Tax preparatory work has been progressive since September 1993. The Value Added Tax law was drafted in 1994. It was discussed in depth at several stages within Value Added Tax Task Force with the secretary of the Law Reform Commission and the various groups. It was reviewed by Value Added Tax steering committee. The draft was sent to various business group including the Federation of Nepal Chamber of Commerce and Industry (FNCCI) & Nepal Chamber of Commerce (NCC) for their comments. While this was a good beginnings of seek the opinion of the private sector on the proposed Value Added Tax law before its approval by the parliament, no written comments were received from the private sector on draft VAT Act¹.

The Value Added Tax Bill was presented to the parliament on 3rd December 1995. It was referred to the finance committee where it was discussed 24,25 26th December 1995. The Finance Committee sent the bill to the parliament on 27th December 1995 together with its report for amendments to a few provisions. The Lower House of Parliament passed the bill on 30th December 1995 and Upper House Parliament on January 1996. The Value Added Tax act received the Royal seal on 20th March 1996².

After that the Value Added Tax regulation were drafted in July 1996. Like the Value Added Tax Act, the regulations were discussed at different stage. They were sent to the FNCCI for comments. As in the case of Value Added Tax Act, no comments were received from the private sector on the Value Added Tax regulation on 27th of January 1997. The operational manual was initially drafted in 1996 and was finalized in the fall of 1997. Government of Nepal approved the operational manual on 21st September 1997. The manual has been prepared in nine volumes, covering all aspects of Value Added Tax from the law through to investigation of offenses. They are (a) organization & management (b) charging & accounting for Value Added Tax (c) Value Added Tax registration (d) collection & enforcement (e) Payment of claims for refund (f) verification & audit (g) fraud investigation (h) Valued Added Tax computer system and VAT act & rules³.

¹Rup Khadka,, "Value Added Tax in Nepal", USBPD, New Delhi

²Rup Khadka, "Value Added Tax in Nepal", USBPD, New Delhi

³Rup Khadka, "Value Added Tax in Nepal", USBPD, New Delhi

2.1.9.2 VAT Registration

The vendor engaged in business of taxable goods exceeding Rs. Two million in turn over for the previous twelve months or the next three months must be registered for Value Added Tax. The vendor who make the transaction below the threshold (i.e twenty lakhs) need not to register but if he/she wants then can be a voluntarily registrants. After registration they have to issue VAT bill & must keep purchase & sales record as certified by VAT office. Business houses are required to inform the Value Added Tax office before 15 days about any changes in the nature/objective of business and should inform within seven days incase of transfer of business. Business house should deposit the net VAT payable amount within 25 days of the closing of each month to Inland Revenue Department. Voluntarily registrants can submit the record to VAT office with in four months & two months period is given for hotel & tourism sector.

2.1.9.3 VAT education program to tax payers

In the early days of VAT implementation, politician, business man, industrialist feel Value Added Tax as a complicated tax. So VAT administration has adopted different measures to raise public awareness about Value Added Tax. Before & after implementation o Value Added Tax, tax officer make visit of tax payers transaction site to make familiar about implementation Value Added Tax. In the middle of 1997 VAT office try to make public awareness through advertisement, several articles related to VAT were published, various VAT related videos (i.e. introduction of VAT, impact on price, registration, VAT formalities & billing) were produced, posters & hoarding board were produced and posted in the main business cities. In this context 2057 B.S. 30th Bhadra -4th Asoj “VAT Saptaha” was celebrated. During this period people were aware by playing prerecorded message on Value Added Tax through loudspeakers in the major business centers. In order to give the idea of the structure and operating of Value Added Tax, comprehensive Value Added Tax education program was launched. Seminar & public speeches

were organized at various places for various groups. For eg. interaction program on Value Added Tax were held with the FNCCI, NCCI & many District Chamber of Commerce and Industry, commodity association & professional organization. Similarly, Value Added Tax presentations were made at program arranged by different organization, including various training centre, universities, campuses, school & rotary club. Various slogans like 'Let us pay VAT & become a part of a nation development', 'Let us give & take invoice', 'Lets make VAT success were developed and distributed. Various training was given to tax payers to provide practical knowledge of Value Added Tax such as taxable goods & services issuance of invoice etc.

2.1.9.4 Administration & Training

In the context of implementation of Value Added Tax sales tax department and excise duty department has changed into VAT department in 1st Shrawan 2053 B.S. New staff and office structure was organized for Value Added Tax. Section & sub section like large taxpayers section, tax operation section, taxpayers service department, tax refund, tax audit & investigation section, tax law and system section research department, appeal section have been created and responsibilities has given to different department.

In order to give information about VAT to tax officer various program have been launched. Before its implementation simple orientation training was given & after implementation of Value Added Tax, special training related with Value Added Tax registration, VAT collection, VAT refund, account & records, audit was given. Similarly, seminars were organized to detect problem and collect the suggestion from tax exports to reduce error.

2.1.9.5 Computerization

Value Added Tax department feels the essentiality of computerization to make VAT more effective. It was decided to computerized VAT department first regarding registration, return, collection payment, audit & penalties, decentralized

data entry and processing. First Lalitpur office was selected and similarly then Kathmandu VAT office was selected next. These two offices contribute about tax payers and they collect more than half of total domestic revenue. The decentralize data processing has been running smoothly in both of these offices. In the second phase, VAT office located outside the Kathmandu valley were selected for decentralized data entry & processing system & now all VAT offices are fully computerized. In this decentralize computer system, VAT offices enter data, correct them before they are posted and transmit them electronically to the VAT department in batches⁴.

But VAT offices cannot correct posted data if to do so they have to ask department to correct it. The department does authorize updates of posted data. But if taxpayers' debit or credit amount is in the sundry account only the department can remove it from there in the request of VAT office. The department also handles diplomatic refunds and refund closing. Information system was also developed in order to monitor regularly regarding registration, statement of Value Added Tax, payment of VAT, VAT refund, VAT calculation etc. The taxpayers who did not submit VAT statement and pay the VAT on time will be monitored regularly. Similarly, different reports regarding VAT are send to taxpayers through computer⁵.

2.1.10 Basic features of Nepalese VAT system

VAT gets the popularity all over the world. Many countries are levied this tax system. In Nepal it also becomes the familiar with in the short period because of its transparency, revenue generation, broaden tax net, exemption, zero rating etc. The Basic features of Nepalese VAT system can be pointed as follows.

⁴Rup Khadka, (2061 B.S), "Nepalese VAT System", P.48.

⁵Rup Khadka, (2061 B.S), "Nepalese VAT System".

2.1.10.1 VAT Rate

The rate for VAT will be decided by related Finance Act, Finance ordinance, 2062 has prescribed the rate as 13% based on single rate system. Theoretically & practically the rate of VAT may be classified into two rates. They are :

Single VAT rate

It means a VAT of which tax rate is fixed only at one number for all level including the wholesaler, the producer & the retailer. Nepal has single VAT rate system. Most of the countries applying this rate because of its simplicity. This type of VAT rate is easily understood by customers, trader & others. It also makes reduces the cost of VAT administrative officers.

Multiple VAT Rate

Under this more than two kinds of VAT rate one applied which are fixed on the basis or the commodities and the service nature.

As well as single VAT rate, multiple VAT rate is widely implemented in the world especially for strong progressive & also for higher rate of revenue collection. This type of VAT rate helps to bring equity by making higher tax burden to the higher income class & lower tax burden to the lower income class. Export and few transaction or goods & services are zero rated and some goods & services are tax exempted or free from tax.

2.1.10.2 Exemption

Exemption means an exclusion of a certain kinds of business transaction or a person (engaged in supplying goods & services) from the tax net. An exempted person does not have to fulfill the formalities eg. registration, keeping account, issuing invoices & filling of returns which are required by VAT. In other words an exempted person or business does not have to deal with the VAT administration &

pay tax. Similarly VAT administration has nothing to do with the exempted person or business⁶.

2.1.10.3 Zero rating

Zero rating means taxing goods or services with zero rate. If zero rating is granted for a particular goods, the goods is technically taxable & the tax payer supplies of goods is required to fulfill all the formalities like that of a regular tax payer with or difference that the supplier of zero rated goods is not required to pay tax and he is allowed to claim back the tax, if any on his purchases. For eg. if exports are zero rate, the exporter is able to get the refund of the tax on his purchases which he has used for producing the export items⁷.

So the person or business lies on the category of rating should fulfill the formalities as done by taxable person to claim refund the tax amount that he paid on his purchases. It applies only to exports & certain export related activities.

2.1.10.4 Threshold

Small vendors having an annual turnover up to certain amount are not required to register under VAT. The mount fixed for this purpose is known as threshold.

A threshold would keep off traders from VAT who sells below the prescribed level. A threshold applies to taxable supply & there is an option to register voluntarily in VAT. A threshold is provide because the compliance costs of the small business as a percentage of sales are proportionately much higher than the administrative cost of collection VAT from small traders is relatively high in relation to the additional revenue raised from them.

⁶Rup Khadka, (1997), "VAT and its Relevancy to Nepal", Ratna Pustak Bhandar, Kathmandu.

⁷Carl S Shoup, (1998), "The VAT & Developing Countries", Research Observer :Vol No.2, July, Washington D.C.

2.1.10.5 Taxable Value

Taxable value is the object in which VAT is levied. Except otherwise provided in Act, the following amount included in taxable value.

- The amount of all expenditure related to transportation & distribution, which was borne by supplier with transaction and profit etc.
- Excise taxes and all other taxes but excluding the tax imposed under the act.
- Taxable value doesn't include the amount of discount, commission or other similar commercial rebate.
- The taxable value of any goods & services exchange or bartered shall be equal to market value of goods & services.
- The taxable value for imported goods shall be its customs value including transportation, insurance, flight, commission of agent & other persons, plus customs duties, countervailing duties plus any other taxes except VAT
- If value of goods & services found to be much lower than the prevailing market value, taxable value will be equal to market value of goods & services.
- The taxable value of goods & services supplied for partial consideration shall be equal to market value.

2.1.10.6 Place of Supply

Under the Nepalese VAT system the place of supply is defined as follows:

- For moveable goods, the place of goods were sold and transferred.
- For immovable goods, the custom point where goods enter in Nepal
- In case of service when services are provided.

2.1.10.7 Time of Supply

Under Nepalese VAT system, the time of supply is defined as the earlier of following:

- When an invoice is issued by a supplier.

- When a supplier supply his goods & services.
- When the supplier receives a consideration for goods & services.
- In case of continuous service such as telephone, when the invoice is issued.
- For partial payment of installment system the time of supply shall be earliest day, which payment, is made.

2.1.11 Functions of Value Added Tax

For the effectiveness of VAT implementation, it is necessary to maintain accounts & records properly. VAT department has designed the invoice format & vendor should issued same format to the consumers. VAT office has defined the registration & return procedure. After VAT return filed, VAT officer need to audit & investigate it. And VAT office may charged against the businessmen if there is any mistake or evasion.

2.1.11.1 VAT Invoice

VAT invoices are the initial documents for VAT control and are most essential under VAT system. Every registered vendor or producer should issue VAT invoice on sales/supply of material & service. The invoice should be made out in the prescribed form.

2.1.11.1.1 Tax invoice

Invoice prescribed in Annexure 5 written clearly " Tax Invoice" on the top of invoice should be issued by VAT tax payers while selling goods/services, in three copies-the 1st copy to be issued to the buyer, 2nd to VAT office (as demanded) and the 3rd will be the office copy. It contains the invoice number, date of transaction, vendors identification number, name, address and the buyer's name, address & if registered the identification number should be written on the invoice. Similarly, a description of items or services sold, type of transaction, quality, quantity, price per unit sold, rate of VAT & the amount of payable excluding

VAT, the value of any goods or services provided in part exchange, rate of discount offered, the total amount of tax charged & total amount charged including VAT. Only on the basis of such an invoice a registered buyer can avail the facility if tax deduction. Hence while purchasing goods or services one should not forget to take a tax invoice.

2.1.11.1.2 Brief Tax Invoice

In case of retail trade (upto Rs. 5,000 per transaction), brief invoice as prescribed in Annexure 6 can be issued with the permission of VAT office. Brief Tax Invoice does not require the name, address, PAN no. of buyer & even the full description of goods.

2.1.11.1.3 Debit/Credit Notes

Debit/Credit note can be issued within the fiscal year if any change occurs in sale or purchase amount. Debit/Credit Note should mention the following :

- a) Serial number
- b) Date of issue
- c) Suppliers' name, address, VAT registration number
- d) Buyer's name, address, VAT registration no.
- e) Related Tax Invoice no. & date.
- f) Transactional details with reasons
- g) Amount of Debit/Credit Note
- h) VAT amount

The accounts for the Debit/Credit notes should be maintained on a monthly basis. Without Debit/ Credit Notes sales return, purchase return cannot be established.

2.1.11.2 Accounts

The business should maintain sales & purchase books for accounting purposes. These books are required to be certified by the Inland Revenue office before use. The above books of account must mention the following

1. Date of transaction

2. Amount
3. Party's VAT registration no.
4. Party's name & other transactional matters. If not certified and / or not maintained for 6 yrs a penalty of Rs. 10,000 per occurrence can be levied.

The regular process of maintaining the subsidiary books for the purchase & sales affected by organization is important for VAT account also.

a) Purchase Book

All the purchases/inputs are recorded in the purchase book. this book can be formatted as per the schedule 8 of VAT Act. From this book transactions are posted to the purchase book to be maintained under the VAT Act. As back up documentation, all the original tax invoices received on purchase, import documents etc, should be filed in a separate file. Copies of the same should be kept a documentary supports for the financial accounting purpose.

b) Sales Book

The sales book is maintained to record the sale of goods & services. The actual transaction price should be clearly included in the sales books. This book should be formatted as prescribed by schedule 9 of VAT Act. As backup documentation, third copy of the tax invoice is kept in a separate file.

If separate purchase & sales book are maintained for financial accounting & VAT purposes, reconciliation between the two records (as per financial accounts & as per VAT account) should be done on a monthly basis. The various amount shown by the VAT books should also be confirmed with the amounts in the general ledger.

c) VAT Accounts

It is the monthly summary record of the purchase & sales books. It should be maintained as prescribed in schedule 7. It shows how much is the total monthly tax

paid on purchase, tax collected from sales & how much the tax amount paid to government & how much to be refunded by the government to the tax payers.

So generally the VAT related account would be :

1. VAT receivable account - for recording the input tax paid to the time of purchase.
2. VAT payable accounts- for the amount of VAT collected on sales.
3. VAT setoff accounts- for the month end adjustments to find out the net VAT payable for the month.

2.1.11.3 Records

Records to be maintained by retailer who issues Brief Invoice :

- a) Duplicate copy of the issued invoice
- b) If adding cum Billing Machine is used, records of the daily totals.
- c) Accounts of each transaction, including the VAT involved.

Recording of transaction for VAT purposes

- a) VAT accounts-purchase & sales details(a per annexure 8 and 9)
- b) Business dealing documents, cash receipts and payments.,
- c) Records of VAT invoices issued.
- d) Records of VAT invoiced received.
- e) Imports /export related documents.
- f) Credit Note/Debit Note & related documents.

In addition to the above, copies of the monthly returns should be kept in a separate file. Inland Revenue Office has the right to inspect & audit these documents within six years of the end of the fiscal year. Therefore, the documents must be preserved for at least six years.

2.1.11.4 VAT Registration

Under the VAT Act 2052 Sec 9, small retailer/dealers/manufactures those annual (in last 12 months) sale volume is less than the threshold limit or regarded as a non taxable exempt taxable person are not required to register under the VAT. This act

has fixed this threshold as Rs. 20 Lakh. Before starting any business making or intending to make taxable supplies exceeding or expected to exceed two million rupees in turn over (not profit) for the previous twelve months or the next three months, the person must register for VAT. Small vendors, who have previously been non taxable, shall apply for registration with in 30days of the date on which their annual turnover reaches the threshold at 2 million rupees. Also a person who imports into the kingdom of Nepal goods valued at one hundred thousand rupees or more per annum for commercial purpose shall have to register.

However, any people carrying out small transaction have the possibility to be registered voluntarily. And only a registered person can deduct input VAT or have input VAT credit.

In case of non taxable and exempt taxable persons

The VAT Act sec5(3) and schedule-1, contains a number of possibilities according to which supplies of goods or services under specific provisions are considered to be non taxable or exempt from VAT. Persons making such non taxable or exempt supplies cannot be registered for VAT & cannot deduct input VAT or claim a refund.

In case of private persons

Private persons are not taxable persons according to VAT & they cannot be registered for VAT & cannot deduct input VAT or claim refund.

In case of employees

Income from employment is not subject to VAT

Procedures of VAT registration

Submit application before starting any business transaction if a new business is going to be established. With the application the copies of business & income tax registration certificate should be attached. Upon the inspection of application &

further information registration will be made & VAT certificates with TPIN number (Tax Payers Identification Number) will be given within 30 days from the date of application. Some rules for VAT registration are as follows:

- No need to register under VAT if the transaction (purchase the goods or services other than as included in Annexure 1 of the Act) in the last 12 months are less than Rs. 20 lakh.
- If within the next 3 months the transaction of 12 months are likely to reach over Rs. 20 lakh, the business firm should apply for registration within 90 days.
- If the total year-to-date transaction reach to RS. 20 lakh as on any date, the business house should apply within 30 days for VAT registration. Transaction refer to the sales or purchases of goods & services.
- Business houses are required to inform the VAT office before 15 days about any changes in the reformation mentioned in the VAT application form.
- Business houses are required to inform the VAT office within 7 days of the transfer of business.

Table 7
Trend of VAT Registration.

Fiscal Year	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
No. of new VAT registrants	3146	4056	4723	4302	5602	7055
Total no. of VAT registration	21093	25149	29872	34174	39776	46831
% of change	14.91	16.12	15.81	12.58	14.08	15.06

Source: Annual Report 2006/2007, IRD

The table reveals the number of VAT registration from the period of 2000/2001 to 2005/2006. In fiscal year 2000/2001 the VAT registration number reached upto 21093. This year new VAT registration number was 3146. In fiscal year 2001/2002 new VAT registrants was 4056. It makes total 25149. And it was 16.12 % change than before. In the year 2002/2003 the total VAT registrants reached to 29872. This year the number was increased by 4723. In fiscal year 2003/2004 the

increment of VAT registrants was slightly decreased. This year only 12.58% increased in the number of 29872. So the total number reached to 34174. In 2005/2006 the increment changed by 15.06 percentage and total number of VAT registrants reached to 46831. From this table we can analyze that the increment in VAT registrants was not so satisfied.

Deregistration

A VAT registered firm can apply for deregistration under the following condition:

- In case of an incorporated firm, if the incorporated firm is closed down, sold or transferred, or if incorporated firm leases to exist by means.
- In case of personal ownership, if the owners die.
- In case of partnership firm, if it is dissolved.
- If a registered person ceases to be engaged the taxable transaction.
- If a registration is done in error.

**Table 8
Trend of VAT Deregistration.**

Fiscal Year	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
No. of VAT Deregistration	342	440	549	600	475	683

Source: Annual Report 2006/2007, IRD

Table 8 shows the trend of VAT deregistration from fiscal year 2000/01 to 2005/06. In 2000/01 the number of VAT Deregistration are 342 which increased to 440 in 2001/02. The number is increasing each year. In 2005/06 the no. of deregistration are reached to 683. It may be because of little knowledge of threshold limit & registration procedure of VAT.

2.1.11.5 Tax plate

In order to inform public the status of the registered taxpayer automatically, each registered tax payer is required to display the tax –plate which is visible from outside in the premises of the taxpayer. The size and the color of the tax plate should be as follows:

- A. The size of the tax plate should be 30 cm long and 10 cm width.
- B. Information to be shown on the tax plate
 - (i) Permanent Account Number (PAN)
 - (ii) Taxpayer's Name.
- C. The tax status of the taxpayer will be identified on the basis of the following background and the color of the tax plate:-
 - (i) Bush green background and letters in white color : VAT registered tax payers.
 - (ii) Lemon yellow background and letters in black color: Tax payers dealing in VAT able goods and services but whose transaction is the below threshold i.e. Rs. 2 million per year.
 - (iii) Signal red background and letters in red color: Tax payers dealing in non VAT able goods and services.

2.1.11.6 Return

In Nepal, compulsory registrants are required to submit their returns within twenty five days of the expiry of tax period of every month. Therefore compulsory registrants have to submit their return every month. Such return shall have to be submitted whether or not a taxable transaction was carried out in that months. In the case of voluntary registrants, they have to submit their return for period of four months. But the hotel & restaurant can submit their return within two months.

Debit Return

Debit returns are those returns where tax payers have to pay tax to the government. Such situation is arises when vendor's output tax is higher than input tax. Since generally sales are higher than purchases most returns then expected to show debit.

Credit Return

Credit returns are those returns where government has to pay money to taxpayers and this situation arises when tax on purchases is higher than tax on sales. This

situation may arise when tax payers build up their inventory or when outputs are zero rated, such as exports.

Nil or Zero Return

Zero returns are also possible. If a tax payer's inputs taxes and output taxes are equal, then taxpayer need not pay tax and government also not liable to return the amount to taxpayer. Even if there were no transaction in a tax period tax payers are required to submit zero return.

2.1.11.7 Non Filing

Every compulsory Value Added Tax registrants has to submit return to government within twenty five days of expiry of four month. If vendors don't submit or file their return in given specified tax period such tax payers are termed as non filer. The Inland Revenue Department prints out the list of non filers after forty five days of the expiry of the tax period and then VAT office gives notice to each non filer. If any do not file return within the specified period even after the issue of the notice on non filer the VAT office makes a monthly or trimester assessment, depending upon the state of a particular tax payer then charge a penalty.

**Table 9
Trend of VAT Return Filing**

Fiscal year	VAT Returns Filler									No. of Non Filer
	Debit return		Credit return		Nil return		Suspended return*		Total Filler	
	No.	%	No.	%	No.	%	No.	%		
2000/01	6975	35	8250	42	4471	23	14	0.07	19710	1383
2001/02	6936	32	8844	41	5207	24	486	2.26	21473	3676
2002/03	7178	31	9553	41	5972	26	396	1.71	23099	5255
2003/04	8483	34	9625	38	6783	27	158	0.63	25049	7322
2004/05	9478	33	10260	36	8271	29	516	1.81	28525	8492
2005/06	10449	31	12880	38	10139	30	163	0.48	33633	13198

Source: Annual Report 2006/2007, IRD

**Note: Suspended Return- filed but not identified.*

Table of trend of VAT returns filling shows the number of return filing. From this table we observe that credit return is very high in comparison with debit return. In 2000/2001 debit return was 35%, which fell down to 32% in FY 2001/2002, it again falls down to 31% in FY 2002/2003 and it rise up to 34% in 2003/2004, it again falls to 31% in 2005/2006 . It shows that debit return is decreasing.

Credit return is rather high in comparison with debit return. It was 42% in FY 2000/2001. Then it decreased to 38% in FY 2003/2004 and remains same 38% in FY 2005/2006.

Nil return was 23% in FY 2000/2001 and it increased 26% in FY 2002/2003, again it rise upto 30% in FY 2005/2006. It shows it has increased highly in 2005/2006 due to inadequate control of tax administration.

Suspended return was 0.07% in 2000/2001 then it rise upto 2.26% in 2001/2002, it falls and reached to 1.71% in 2002/2003 and in FY 2005/2006 it reached 0.48%. It is not good of being high suspended return rate. Seeing above table VAT return filing is not so satisfied.

The number of credit returns is high because some taxpayers are credit position due to the provision for input tax claims on stock held at the time of registration. The VAT act provided to claim an input tax credit on stock maintained at the time of registration which was provided twelve month prior to the date of VAT registration. Another reason is, tax payers were given and opportunity to declare their old stock at the current market value paying 2.5% VAT at the time of declarations of stock. They were allowed 10% of stock declares value was provided to tax credit from output tax. Most of businessmen have misused this provision by declaring maximum stock than actual stock. Now it becomes a strong instrument for to do illegal business for taxpayers. Therefore there should be made active audit and investigation department to obtain effective result from the VAT.

Occasional stock checking, auditing, minimum stock declaration policy can discourage such type of cheating.

Number of non filer has also shown in above table. Non filer is also increasing. In 2000/2001 the number was 1383 and it increased to 3676 in FY 2001/2002. In FY 2002/2003 it rise upto the number 5255 and it reached to 13198 in FY 2005/2006. The main reason of increasing number of non filer is excluding of small trader especially small contractors. And in Nepal small traders are very high in number. And another reason is VAT registrants may not able to submit a return in time due to various internal and external problems. The office wise non filer can be shown in Annex 1 very clearly.

2.1.11.8 Tax Assessment

Tax assessment is a process of determining the amount of tax, any individual or company is liable to pay. Value Added Tax is self assessed tax. The amount of needed Value Added Tax payment is determined by tax payers themselves applying the tax rule to their own figures. Tax payers may file the wrong returns for the purpose of tax evasion. So the assessment again checked by the tax officers if there is any mistake or not

VAT officer can assess tax within under the noted circumstances.

-) Non submission of returns in time.
-) Furnishing of incomplete return
-) Return having misrepresentation
-) When the tax officer has sufficient reason to believe that tax burden is shown lower than actual and
-) When the tax officer has sufficient reason to believe that there is under billing.

In such cases, VAT official may have to prepare a tax assessment. Such assessment could be Computer assessment or management assessment.

Computer assessment

The computer print out the list of non filer after forty five days of expiry of tax period and then VAT office gives notice to each non filers. If any do not file return within the specified period even after the issue of the notice on non filer, the computer makes a monthly or trimester assessment, depending when the state of a particular tax payer. The process regarding computer assessment is designed in the following way.

- a) Find out the highest amount declared by the taxpayer in his tax returns during the previous twelve months from the VAT payable.
- b) If a taxpayer has not filed any return find the turnover amount stated on the registrants application. Divide this by the number of filling period in the year then multiply by the VAT rate.
- c) Pick the highest figure in (a) or (b). Add the number found in (c) to the 20% or 30% of itself to get the assessment amount.

Management assessment

The tax offices do management assessment when a tax payer receives updated information after submitting his returns and informs it to tax officers or in the case of that taxpayer, where tax officers find errors during the tax audit. The management assessment is done through the following procedure.

-) Tax officer assessed tax & determines interest and penalties.
-) Tax officer prepares management assessment on a monthly basis in case of compulsory registrants & on trimester basis in case of others.
-) Management assessment must be batched and submitted to the computer system.
-) VAT assessment will only normally extend back four years from the time the taxpayer is given a notice of assessment.

2.1.11.9 Collection of VAT

If tax payer does not file his return within the specified period, tax office may collect the tax by using any or all of the following methods.

-) By seizing moveable or immovable property of tax payer.
-) By off setting the amount, if any, to be refunded the tax payer.
-) By withholding export/import other transaction of taxpayer.
-) By processing the taxpayer's by fixed & current assets.
-) By deducting from band account
-) By suspending the transaction of tax payer.
-) By deducting the amount payable to taxpayers by government officers to government owned enterprises.
-) By collecting the pre approval of the taxpayer, the amount of 3rd party owes to the taxpayer.

Tax officers can collect tax arrears within six years of such arrears become due.

2.1.11.10 Tax Credit

The main feature of Value Added Tax is tax credit facility. But this facility is only for the VAT registrants. Under the Value Added Tax, taxpayer collects the VAT amount while selling goods. And taxpayers will have to pay only those VAT amount which remains after deducting his/her VAT incurred on purchases from the collection of VAT on selling goods. So tax payers can claim the amount on VAT amount paid by them. It is necessary to meet the following condition for tax credit facility.

-) Purchased goods and services should be purchased for taxable transaction
-) The VAT registrants should be issued valid invoice.
-) The claim for deduction must be made within one year of the date of invoice.

Full credit facility will be given to those businesses whose purchases are fully taxable. In case of mixed transaction i.e. both taxable and non taxable then

business man allowed to credit in only taxable purchases and sales. In case of partial use (i.e used goods for personal and business purpose) only partial input tax credit can be taken.

2.1.11.11 Tax Audit

VAT audit is based on the principle of self assessment by tax payers which is a totally a new concept in the Nepalese tax administration. Under sales tax system, no audit was carried out for the sales tax purpose. Tax payers were required to get their price approved and annual assessment was done by sales tax officer in a superficial way. Under income tax also tax is assessed largely the bases of best judgment of the officers.

But audit incase of Value Added Tax, a tax audit and investigation section has been created in the VAT department and VAT offices and auditors position has been created in the VAT department. Similarly, a large tax payers division has been created in the VAT department to deal particularly with the audit of large taxpayers. They have been given basic and advance account and audit training.

A special enforcement task force under strengthening revenue program was established to conduct investigation tax audit for assessing properties, making search and seizure and for procuring goods under invoiced. Administrative review in the cases related to income tax and Value Added Tax without deposit to safeguard the interest of tax payers. Arrangement has been made to decide upon the application within sixty days and notify the tax payer. In order to make tax audit simple, transplanted, quick and effective and to avoid delays and unnecessary hassles, tax payers intimated of the selection for tax audit. Arrangements was be made to complete tax audit within three months of the selection. A tax audit manual developed to make the process of tax audit transparent as well. Chartered accounts firms registered to accelerated tax audit system was introduced.

2.1.11.12 Tax Investigation

Monitoring committees were established for checking illegal imports in boarder areas and mobilized more effectively in the fiscal year 1996/97. In the fiscal year 1999/2000, joint revenue team from Inland Revenue Office, department of tax and department of VAT was formed to consistently monitor the market price indices and other information trace the revenue leakages and track down the culprits. Suggestion for reforms as pointed out in the report of the parliamentary joint committee, 1999 on the investigation of revenue leakage, were implemented. Inland Revenue Department activated to begin process for necessary actions in fiscal year 2000/2001. The Abuse of Authority Investigation commission had also been approached for their indulgence . Revenue surveillance force was fully empowered to effectively control smuggling and leakage of revenue through timely reforms in its organizational structure. Jointly conduct on the spot investigation and audit by department of VAT department of taxation in order to prevent revenue leakage by controlling acts like concealing of income or evasion of tax and activities helping to evade tax. Likewise, system of investigation and field audit of tax returns by the team of experts by visiting taxpayers' premises was expanded. Inland Revenue Department provide more authority in special vigilance in the revenue leakage of customs, VAT and income tax, collecting information on tax evasion and take necessary action in coordination with respective department, and surprise inspection of internal transportation with an arrangement of rewarding persons providing information on tax evasion. Power of audit and inspection is mentioned in VAT act sec 23.

2.1.11.13 Tax Refund

VAT Act has made provision regarding tax refund also. The registered businessmen are entitled to recover the tax paid on their purchases from the VAT collected from sales. If the tax on sales is less than the tax on purchases, the person claims a refund for the difference. According to Section 17 of the Act, a registered person can offset the amount of tax he has collected against the tax he had paid or

due in importing or receiving goods or services related to his own taxable transactions.

And Section 24 of the Act, said that if a registered persons offset for a month exceeds tax liability for that month, this exceed may be offset against any outstanding amount. The remainder of the exceed offset may be available as an offset for the next month.

If the taxpayer remains in credit there after for a continuous period of six months he can file a claim for a lump sum refund, using Schedule-10. The refund is made within 30 days from the receipt of the refund claim. If the tax payers didn't get refund after 60 days of the application submitted for refund, he can get 15% interest per annum on the claimed refund amount. The following situations are tax refund:

Refund to Exporters

Regular exporters, i.e. a registered person whose export sales for a month are 50 percent or more of his total sales for that month, can file a claim using Scehdule-10, for the refund of the amount of the remaining exceed after offsetting any outstanding amount. A regular exporter can file a claim each month. Export sales are zero rated, there is not tax due such sales, exporter may have huge credit tax amount.

Refund to Non-exporters

A registrant may have excess credits even if he is not an exporter. In this case, he can carry forward his excess tax amount till continuous six months or more. Such a situation may arise in the case of new business, an inventory building up or the purchase of large capital assets. If a registered person remains in credit for a period of six consecutive months he may submit an application for refund of VAT to the concerned VAT refund offices.

Refund to Diplomats

Accredited diplomats, as others, will be charged VAT on purchases of taxable goods and services in the local market. They are, however, entitled to claim tax credit on purchase. Diplomats may claim for refund through diplomatic mission. Claims must be made within three years from the date of transaction. They must attach the original tax invoices as well as a copy of the invoices to the refund claim. Imports by accredited diplomats are zero rated. This means that accredited diplomats do not have to pay VAT on their imports.

Refund to Tourist

Refund is also provided to the foreign tourists who visit Nepal. They have to pay VAT on their purchases but they get their money paid for VAT back. In such case, they can get their refund from the Tribhuvan International Airport after showing purchases, completed “Tourist Application for VAT Refund” form certified by the Custom Officer to the VAT Refund Office. VAT Refund only applies to goods taken out of Nepal within 60 days from the date of purchase. And person departing via land route also do not qualify for VAT Refund⁸.

Refund to foreign aided projects

Any person or organizations employed in carrying out a project in the kingdom of Nepal under a bilateral or multilateral agreement for which the Ministry of Finance has approved tax exemption may make a claim for refund of tax paid by them on purchases or imports made for the project as per the Bill of Quantity.

The procedure for refund will depend on the status of the person or organization. If the person or organization is registered for VAT the claim will be made on monthly or 6 monthly basis in accordance with the procedures fix

⁸web site: http://vat_refund.htm

for other registered tax payers. If the person or organization is not registered for VAT, the person or organization will be required to make a claim on Schedule -18. The claims must be made within three years from the date of transaction.

2.1.11.14 Provisions of Penalty

1. Business unit should apply for registration before starting a business. Non-compliance with this provision will attract a penalty of Rs. 10,000.
2. If tax invoice is not issued for any taxable transaction, a penalty of Rs. 5,000 will be charged U/s 29(1)(b). If an invoice is raised without proper VAT registration, the VAT department can levy a penalty of 10,000 plus VAT on that sale.
3. A taxpayer who fails to use registration number or to clearly display the registration certificate or to inform the changes, if any, regarding business transactions within 15 days of such change, such tax payer is liable to pay Rs. 1,000 for each offence.
4. If account books are not maintained properly, penalty of Rs. 10,000 & on non allowing the books for inspection, Rs. 5,000 per occurrence U/S 29(1) (c) will be levied.
5. On violation of the VAT laws, a penalty of Rs. 1,000 per occurrence is charged.
6. If the taxpayers does not pay a tax in time then 10% of tax payment amount will be charged.
7. As per Sec.29(2) in following cases 100% of VAT or six months' imprisonment or both will be charged.
 - (a) Tax evasion by maintaining fraudulent accounts.
 - b) Evasion of VAT by any reason.
 - c) Non registered dealer acting as a registered dealer.
 - d) Doing business during the order of suspension periods.
 - e) Non-allowing to purchase the under invoiced goods.
 - f) Tax payer found to have issued an invoice by under invoicing.

2.1.11.15 Provision of Reward

VAT law had made the provision of reward for the purpose to control the revenue leakage by making public participation. VAT office will give reward to those people who provided the information regarding the evasion of VAT. As per law a person who gives information with evidence showing that a taxpayer has evaded or attempted to evade all or some portion of tax is rewarded with the amount equal to 20% of the amount of tax collected on the basis of that information. If there is more than one information, the allotment of reward between or among them may be as determined by the Director General.

2.1.11.16 Appeals

A taxpayer may not always agree with the assessment made by the tax officer. In that case, tax payer may file an appeal to the revenue tribunal within thirty five days against a tax assessment or a penalty order by a tax officer or an order by the Director General relating to the suspension of his place of transaction. Before filing appeal the tax payers must deposit the disputed amount of the assessed tax due, the rest of the amount of 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.

2.1.11.17 VAT Administration

The success and effectiveness of a VAT in Nepal depends upon its strong enough capability for an effective operation. And VAT administration is responsible for it. It is responsible for the execution of the program work assessment, taxpayer's education, registration, assessments, collection and the rectification of taxpayer's education, registration, assessment, collection and verification of taxpayer's book and records.

The greater preparation is needed to increase implementing capability of administration. The present VAT administration may be simplified into two functional head as department and offices. So department and field officers under

this department and offices under this department are responsible for administrating VAT. In absence of a technical component, honest and dedicated administration the expected smooth working of a VAT becomes really a myth and fully VAT advantage can't be achieved.

They have to conduct a survey on potential taxpayers from time to time so that potential taxpayers may not remain outside the tax net. VAT offices are also responsible for enhancing the compliance level of the taxpayers and are to be involved in tax audit and investigation. For this it required skillful personnel for successful implementation of the VAT. It is a great responsibility of tax administration to avoid undesirable effect in society.

But the government is not serious in depth attempts have been made for solving the grass root problems. There is only lecture system, preparation is confirmed only to giving lecture. Many issues regarding the design of VAT and its implemental have not been solved. No satisfactory way is launched for the treatment of small players. Threshold limit is arbitrarily fixed. The problem of compliance and prevent evasion in the VAT remain the same. The administration has not given a success attention toward the development of good information system, technical database inspection and auditing system. Thus tax investigation and audit should be effective in order to make taxpayer more careful in fulfilling their duties. VAT administration is still weak and least attractive for the personnel. Most of officer engaged in the VAT administration are not motivated. Due to lack of motivation many officials are not actively engaged in the implementation of VAT. So to motivate them special package should be introduced.

Spot checking unit & warehouse checking unit should be formed to present any kind of illegal trade and under invoicing problems. Physical stock verification of inventories against invoices and checking carrying goods on road should be made effective to protect illegal goods being supplied.

2.1.12 Problems of VAT/Issues on effectively implementation of VAT

VAT is superior tax than other forms of sales taxes but it does not mean that it is the best one. It has also drawback, some problems or issues on its implementation if other factors are unsuitable. The actual implementation of VAT in many developed as well as developing countries show that there are many difficulties in apply the full VAT principle.

Administrative capability, stage of economic development, business structure, political issue, cooperation between private and government sector are the main problems to implement VAT system in Nepal. They arises side effects of implementation VAT & make difficulties to achieve principle merits of VAT .These problems can be reduced productive capacity of taxation. Thus there should be carefully analyzed of these problems to get expected result.

1. There has not been provision of a group registration. Thus, companies with in a group are required to register separately. Registered companies are required to levy VAT on inter company transactions and fulfill all VAT rates, leading to increase compliance in both such system should be reviewed.
2. A tax period is one month which increase both collection & compliance cost. So a tax period should be two months in the place of one month. This provision will partly reduce the problem of credit sales.
3. Bad debts & insolvency provision should be carefully handled. It loops holes for tax avoidance. So no provision has been made for the bad debt & insolvency relief.
4. There is provision for the carry forward of excess credit for six months. Due to the non availability of immediate input tax claims, foreign company may be discourage from sheeting up their subsidies in Nepal. So, such system should be immediately reviewed.

2.1.12.1 Small Traders.

Small traders dominate the trading activities of the country. Thus, it becomes most prominent issued of implement VAT. The size of retail business in Nepal is so large. They are scattered through out the country which make difficult to bring them into tax net.

Actually the amount of VAT is collected when the product reach on the hand of ultimate consumer & the retailers is the one who deal with consumer. So if retailer is excluded from tax net then erosion is made easier and great revenue loss may results. Therefore, it is very essential to include small traders or retailers into the VAT. But it is virtually impossible to include all small traders because of the administrative & tax compliance problems. Small traders have no systematic account recording; goods and services are sold and purchase without invoices. They are illiterate, ignorance and no practice of systematic record keeping. On the other hands inclusion of small traders increases the number of tax payers & it becomes complexity for weak Tax administration to registration; accept return verification, control evasion, inspection and auditing of taxpayer. The cost is a proportionately more than revenue.

2.1.12.2 Tax Evasion

Tax evasion is a great challenging issue to make VAT effective and successful implementation in Nepal. But weak implementation, poor administrative capability, political interfaces, corrupted mind personnel of VAT offices are the considerable reasons for widen tax evasion.

A VAT brings large number of tax payers into tax net & the tax liability would be distributed among the many less sophisticated and difficult to control group like including illiterate, unorganized retailers. It becomes a great difficult to control and deal with them. Most of them could not present required formalities that are necessary to summit VAT offices. VAT system needs expert and efficient personnel. But Nepal administration can't produce such type of staff. Most of them

are not well motivated and corrupted. Inspection and special checking stock verification are the duty of tax inspectors at related field have done not fairly. Therefore most of businesses are relaxing from these weaknesses of tax administration.

Most business man has been evading VAT by non registration at related office in name of small vendors who are liable to register. Some businesses have shown their turnover below threshold limit for purposes reduce liability. They can evade tax by under reporting of sales and purchases. Another common idea to evade tax in Nepal is unrecorded trade. Due to weak administration, a channel of unrecorded trade is developed and made a large amount of revenue loss in the system of VAT. Vendors don't show their record of some purchases and claim no credit. Such goods are purchased and sold with full trade value added but without any invoice and record. Traders are collecting VAT from the consumer by fake invoice and pocket large amount of profit. So the authorities should check inventories and warehouses stock to catch these evasions.

The effectiveness of Value Added Tax is mostly depending upon accurate invoice. Under billing, not issue invoice and lack of proper invoice are the greatest problems of Nepalese VAT system. Most of retailer don't issue invoice, because they don't themselves get proper invoices from the supplier. Such a system began at the import stage. They produce fake invoices for customs purposes showing value much lower than the price they have paid. By doing this, they pay less import duty, Value Added Tax and local development fee at the custom point. Since, this record is the basis for income tax assessment purpose. They also pay low income tax due to low valuation at the import point. Under billing and non billing would be at the manufacturing, wholesale and retail level also.

2.1.12.3 Consciousness of people

Value Added Tax is transparent in which every consumers know the amount they have paid for but such transparency will be useless until people themselves would be aware and conscious about their duties and rights. VAT system will not be successfully implement if people do not feel that they should pay to the government and there contribution are really goes on right way through right person .For this first of all public should be aware that they should take a VAT bill for every taxable transaction. But consumers rarely have such interest. Consumers purchase goods without invoice. And it will be the great opportunity for seller to evade tax to do cross check stage.

Therefore unconsciousness of people about tax is the great problems to implement VAT effectively.

2.1.12.4 Open Boarder and batter System

Because of the open boarder people freely move from India and china to Nepal. There is no legal bar and passport system between India and Nepal. People of India and Nepal can easily enter into each the nation. Often people of both countries go to boarder town of other country to buy their need because there is no need to pay custom duty for the good, which they have brought for personal use in limited quantities. However, many businessmen misuse such facility and they take a chance of smuggling the business in border side. They follow illegal ways to sell goods in cheap price at Nepal boarder side.

Such type of illegal unrecorded and partly recorded trade is difficult to catch by the administration. If administration finds out such kind of trade, then corruption, bribery and other malpractices further rises. In such condition the self-policing, feature of VAT and catch up effect also would not work and it becomes a great threat to success of VAT.

The trade between Nepal and Tibet is based on batter system. There is no system of invoices of goods purchased from the Tibet. Lack of invoice most of transaction are out of the tax net.

2.1.13 Government effort on VAT implementation

As we know tax is the main source of government revenue. Especially VAT has been introduced as it is the best form of indirect tax collection. So to prove it, government needs more effort on its implementation sector.

2.1.13.1 Consumer consciousness upahar program

Implementation of VAT will not be successful until consumer will aware of VAT. The main basis of Value Added Tax is the system of issuing and receiving invoices in the sale of goods and services. So consumer should be aware of taking bill compulsory. But there is still lack of this practice. Consumers think that they have to pay additional 13% if invoices are taken so they avoid taking it. And by doing this tax goes only in the taxpayers pocket and VAT can't be collected fairly. It also prevents fair competition between businessman and the professional.

So in order to encourage billing system and thereby improve the tax system and motivate the consumers to take bills on the purchase of goods and services and motivate the sellers to issue bills on the sale of goods and services, a conscious consumer lottery program has been introduced since Magh, 2060. Government has launched this lottery program with the slogans of “Jagaruk Upabhokta Ka Lagi Subarna Abasar” i.e. “Golden Opportunity for Aware Consumers”. Under this program Nepal Government provides upahar to those consumers who take the bills while purchasing goods. The upahar includes cash prize on the basis of presented bill.

Consumer can involve in this program by submitting purchased bills and get upahar coupon from coupon counter prescribed by the government. All types of bills except the purchase of vehicle (excluding bicycle) and star hotel will be

allowed to participate in the program. However, bills issued in the name of government authority, public enterprises, local level authorities and diplomatic missions and the bills issued by the public enterprises will not be entertained in the program. One coupon will be provided for total bills of Rs.1000. And the government collects all those bills, draw the lucky consumer's coupon number and award them by cash prize.

Provision of Cash Prizes to Consumers

First winner – 1 person Rs. 1,00,000

Second winner – 5 persons. (Rs. 20,000 each) Rs. 1,00,000

Third winner – 10 Persons (Rs. 5,000 each) Rs. 1,00,000

Consolation prize – 20 persons (Rs. 5,000 each) Rs. 1,00,000

Total Rs. 4,00,000

The prize will be declared once a month on the basis of coupons distributed in that month.

Provision of Cash Prizes to Sellers

In order to motivate the sellers to give bills to the buyers, those sellers whose invoices have enabled the cash prizes to the consumers will also get the following cash prizes:-

First winner – 1 seller Rs. 25,000

Second winner – 5 sellers (Rs. 5,000 each) Rs. 25,000

Third winner – 10 sellers (Rs. 3,000 each) Rs. 30,000

Consolation prize – 20 sellers (Rs. 2,000 each) Rs. 40,000

Total prize amount is Rs. 120,000

Procedures of conducting lottery program

IRD will print lottery coupons with serial numbers of two copies. A separate number will be marked in each coupon. One coupon will be issued to the purchaser after receiving the purchase bill of Rs. 1,000 and a copy will be retained by the contractor conducting the program. For instance, if a consumer submits 2

bills containing the purchase of Rs. 600 each, he will receive one coupon and will be eligible to get another coupon in each additional amount of Rs. 1,000. However, surplus amount will not be entertained for the purpose of competition once coupons are issued after submission of the bills. The bills worth less than Rs. 250 will not be entertained in the program.

This upahar program proved very effective. To get the cash prize consumer started to take a bill. The table of progressive report of upahar program are shown below.

Table 10
Progressive report of upahar program

Month	Coupon		
	No. of distribution	Submitted bill amount (in akh)	No. of bill submitted
2062 Bhadra	24507	251	4252
2062 Aswin	22613	226	3950
2062 Kartik	-	-	-
2062 Mangsir	29419	213	4848
2062 Poush	44837	565	5689
2062 Magh	40258	416	4698
2062 Falgun	69214	708	5798
2062 Chaitra	56946	572	4189
2063 Baisakh	37148	373	2197
2063 Jestha	89556	980	4926
2063 Ashadh	113921	1135	5933

Source : Annual Report 2006/2007, IRD

Above table shows the progressive report of upahar program launched in 2062 and 2063 B.S. In 2062 Bhadra 4,252 bill was submitted which consisted of Rs. 251 lakhs. In Aswin 3,950 bill amounting Rs. 226 lakhs was submitted. But in month Kartik due to our two great festivals Dashain and Tihar this programe was stopped. And again the program launched on Mangsir and collected 4,848 number of bill amounting Rs. 213 lakhs. Upto Falgun the number of submitting bill was

increasing. In Falgun 2062 the number of bill submitting reached 5,798 which consist of Rs. 708 lakhs. But in 2063 Baisakh it was heavily decrease and reached to 2,197 bills amounting Rs. 373 lakhs only. It was heavy decrement in comparison to the previous year. This situation was occurring because of political revolution. In 2063 Jestha the number was dramatically increased to 4,926 which consist of amounting Rs. 980 lakhs. In 2063 Ashadh it progressively increased to 5,933 bill amounting Rs. 1135 lakhs. It shows that this program was very effective. So this type of program should run in upcoming years also.

2.1.13.2 Information and Technology

For the effective and scientific tax administration the proper application of information & technology is very necessary. IT makes work faster, accuracy and transparency. VAT office is trying to bring different technology system to make minimize in tax evasion and tax corruption.

Electronic Cash Register (ECR) & fiscal printer:

VAT office found that supermarket leakage the tax using under billing system. Super market issues the bill of product from the computer to its customer. But at night they change the product amount in computer and show less tax to the VAT officer. So to reduce this kind of evasion VAT office is planning to bring ECR technology. VAT officer set/lock this software/program in the hard disk of computer. Once it locked the businessman can't change the figure of amount in the computer. And if VAT officer has any doubt in the return filed by businessman, they will take out the hard disk and tally it with the return submitted by businessman. But most of the businessmen are raising voice against of this system.

e-filling :

One of the main reasons of corruption in tax is frequently visiting the tax officer to the business house in the context of collecting VAT and for VAT auditing. So to minimize the meeting between VAT officers and businessman government bring

e-filing system. Businessman can file the VAT in the internet. Through this VAT officer can check the tax by sitting in the VAT office.

More over VAT office is planning to set the box (like post box) outside the business house for the purpose of minimizing tax corruption. Businessman will drop the VAT amount in the box and VAT officer will pick out that box so that VAT officers need not to meet businessman for the tax collection.

As all we know that information & technology can bring the big change so vastly. It makes the world so narrow. Advance technology is coming day by day. We should cope up with it otherwise we will be always at backside. VAT office also needs to update its information & technology section as per time requirements. Now it is a time to bring advanced technology to make its implementation section more effective.

2.2 Review of Related Studies

In research under the title of " Tax Reform in Singapore", ⁹Glenn Jenkins and Dr. Rup Khadka have made an effort to assess the VAT in Singapore, which was in effect since 1993. According to the authors, Singapore put forward the VAT/GST in order to make Singapore's economy internationally competitive. In this direction, the government formed the task force committee for the tax reformation & they recommended that the government must shift from direct to indirect taxes as its main source of revenue.

Ministry of Finance (1995), ¹⁰conducted a study by preparing a 'Task Force'. After studying for six months by the member of task force. It mainly analyzed the magnitude of the Nepalese tax system and recommended various measures for tax reforms. The study find out:

1. VAT is necessary to increase revenue collection by making the system efficient.
2. It discourages the tendency of tax evasion
3. VAT would be the vest alternative for generating more revenue
4. A special consumption tax on luxuries should be introduced as a supplementary tax for the VAT.

This study reveals that there is no possibility of any other great measures to introduce a tax rather than introducing VAT in Nepal.

A study made by Nepal Chamber of Commerce (1997), ¹¹analyzes the possible effects of VAT on Nepalese economy. They have made some observations which are:

1. Adverse effect on price level
2. Increase in the price of imported goods would hit the import business and re export of imported goods leading to decline in the revenue from import tax.
3. The account keeping requirement of the VAT would increase the tax compliance cost & cost of doing business; it would adversely affect the small traders.

⁹Glenn P. Jenkins, and Rup Khadaka, , "Value Added Tax Policy & Implementation in Singapore," *International VAT Monitor* (Vol 9, No.2), Singapore, 1998.

¹⁰Ministry of Finance (1995), *The Report of the Taxation System Re-Observation Task Force*.

4. VAT would be unjustifiable on social ground, it would worsen the income distribution.
5. Avoiding of protection policy under VAT makes the adverse effects on domestic production
6. Negative effects in revenue collection because the present administration is incapable for handling VAT. That's why there is a chance of failure of VAT in Nepal.

The study suggested that a practical VAT on some commodities should be implemented on experimental basis to know its pros & cons after that a fully VAT may be considered.

Dr. Rup Khadka, ¹²"VAT is a 20th innovation in the tax system. This tax is based on goods & services. VAT is regarded to be a member of the sales tax family since it is imposed on the sales of goods & services. Since VAT is levied only on the value addition made at each stage in the process of production & distribution, this tax system is more neutral, efficient, elastic & fair & is also said to be improved version of sales tax.

So this is reformed sales tax that avoids cascading effects and provides tax credit facility as facility of refund.

Chandra Mani Adhikari, ¹³"In VAT system producers, distributors & people providing services charge VAT for the product or the services sold or provided and then claim a refund of VAT paid on the goods or services purchase to make these sales. The difference between the VAT collection on sales and the VAT charged in purchase determines the amount that registrants must remittance or the amount that may be claimed as a refund. In other words if the tax on sales is more than the tax on purchases the person remits the difference in treasury. If the tax on sales is less than the tax on purchases the person claims a refund for the differences."

¹¹Nepal Chamber of Commerce (1997), "Study Report on Possible Effects on VAT on different Areas.", Nepal Chamber of Commerce, Kathmandu.

¹²Rup Khadka, (2001), " VAT: The concept International experience Tax System in Law Developing, P.92

¹³Chandra Mani Adhikari, (2003), "VAT in Nepal," P4

Chandra Mani Adhikari, ¹⁴ " VAT is a scientific indirect tax system. It levied on value added of goods & services. Value added means the value of difference between purchasing cost & selling cost. That means VAT is collected from each & every distribution stage from production to final sales to consumers. Each distribution stage collects VAT from the value added at its own stage. So it broadens the tax net by including all importer, exporter, wholesaler & retailer. It intends to collect tax on consumption by end users. It avoids cascading effects having tax credit facility & improved form of sales tax."

Arjun Dhakal (2000),¹⁵ in his dissertation analyzed the Nepalese tax structure and potential revenue of VAT in Nepal. He has provided the following conclusions. Theoretically, VAT is the attractive alternative of sales tax on the ground of revenue productivity, supporting economic growth, export promoting, price stability & neutrality on production & distribution etc. Further 'cross checking' & avoiding cascading effects has made VAT 'mile stone' in the history of reforming of the indirect tax. He has found that even VAT has high revenue potential power, it is difficult task to achieve both efficiency & equity objective under the consumption levy' practically it is going to become 'hot milk in mouth' due to inefficient tax administrators. So only introduction of VAT is not acceptable, VAT itself has great need of reforming for the Nepalese context.

Kul Prasad (2002),¹⁶ in his dissertation concludes that adaptation of VAT in Nepal is both a compulsion & a necessity. The revenue collection from other source such as income tax, custom duties & excise duty are drastically decreasing or remaining unchanged. So to get the pace of revenue generation, VAT is an appropriate path or element. The implementation of VAT will help to reduce the burden of foreign debt & will provide a great relief to our future generation. He also concludes that to achieve full merits of VAT it requires the awareness towards responsibility & accountability in every section of the economy as well as honesty & confidence between the business community & administration.

¹⁴Chandra Mani Adhikari, (2003), "Karko Sathi," P.2

¹⁵Arjun Dhakal, (2000), "VAT and its Revenue Potential in Nepal," A Dissertation Submitted to the central Department of Management, T.U.

¹⁶ Kul Prasad Prasai, (2002), "VAT in Nepal; Theory & Practice", A dissertation submitted to the Central Department of economics, T.U.

Rabin Kuninkel (2004),¹⁷ in his thesis written that the main reason behind introduction of VAT in Nepal are :

1. To increase revenue mobilization by broadening the tax base
2. To make tax system neutral & efficient
3. To establish a fair & transparent system & to promote economic growth.

He find out VAT contributes more than 40% to indirect tax. He also find out many problems regarding implementation of VAT such as lack of trained & qualified administrator, lack of awareness, lack of coordination between tax payer & collector. And he emphasized on tax education (esp. VAT). He also concluded that effective implementation of VAT is both a compulsion & necessity. If happened so VAT can able to contribute towards the economic development of country.

Laxman Kandel (2004),¹⁸ in his dissertation finds that Value Added Tax puts greater significance in revenue mobilization in Nepal. But VAT system in Nepal from its inception has been facing innumerable problems, which curtails its merits. So government needs to take necessary steps to sort out emerging problems of VAT. He suggests that it is time of action and improvements for effective and successful operation of VAT in Nepal for further perspective as well as present needs of economic development.

Dan Kumar Khadka (2005),¹⁹ in his dissertation studied that VAT is currently well received by the consumers as well as business & industrial communities of Nepal. The no. of VAT registration has been increasing gradually reaching about 25,000 in the span of last five years & expected to reach more than 30,000 in the fiscal year 2003/2004. VAT system has no weak provisions. It is one of the best models in the world. But still it is facing numerous problems in its operation. So the government needs to full cooperation from the tax administration, tax payers & business man as well as consumers in its efforts to generate more revenue.

¹⁷Rabin Kunikel, (2004), "Effectiveness of VAT in Revenue Collection in Nepal," A Dissertation Submitted to the Central Department of Management, T.U.

¹⁸ Laxman Kandel (2004), "Revenue Collection from VAT in Nepal; Its problem and Prospects" A Dissertation submitted to the Central Department of Management, T.U.

¹⁹Dan Kumar Khadka, (2005)," VAT System in Nepal," A Dissertation Submitted to the Central Department of Management, T.U.

2.3 Concluding Remarks

Now we are on the tenth year of VAT implementation. During this period of tenth year many studies & research by institution, researchers, experts & students have been made. At initial stage of VAT introduction MOF, NCC and their affiliated body were in the front line of opposition. But government, some experts put the positive views toward VAT implementation and at last it was introduced & still survive. Different study done by T.U. students put further effort to make analyze its important, problems & prospectus. All of them suggest the following things to the government to implement VAT effectively in Nepal:

1. The government should pay attention to design the strong tax administration.
2. The government should invest its funds to produce skilled and trained manpower.
3. The government should design some special projects to provide various educational programs to get people informed about the VAT system.
4. There should be the good cooperation between tax administration and businessmen.
5. Information & technology should be updated as per time requirements.

This study has been made to put more highlight on VAT by analyzing the implementation of VAT & its contribution to the government revenue in Nepal. This study is slightly different than the former studies because the study mainly focuses in examine the implementation of VAT & find out its contribution to government revenue. It also observes the government effort to make it more effective with the help of empirical investigation mainly conducted to Kathmandu

& Lalitpur. So the objective of study & inclusion of new data, statistics & information make the study difference than former studies.

Chapter III

Research Methodology

Introduction

This study tries to examine the status of Value Added Tax implementation in Nepal and its contribution to government. To achieve this objective research methodology has designed in this study. Both primary as well as secondary sources of data are used to conduct this study. Opinion survey was adopted while collecting primary data to find out the views of respondents representing different groups related to value added tax. For conducting opinion survey questionnaires were developed and distributed to different groups of people. This chapter contains research design, population & sample, data collection procedures and data analysis.

4.1 Research Design

Most of the information of the study was concerned with past phenomena of the performance either they were numerical or theoretical. So it can be regarded as historical research design. Opinion & view of different professional & expert was collected and on this basis this study's objective were analyzed & described VAT. So it follows descriptive research design too. This study has been made on primary as well as secondary data basis form different resources.

Primary sources will be questionnaire method. And secondary sources are collected from:

1. Published report, articles, dissertation concerned subject.
2. Various books written by tax officers & scholars.
3. Publications & annual report of department of taxation.
4. Published document of national planning commission.
5. Different publications of central beauro of statistics.
6. Newspapers, magazine & journals of accountancy.
7. Publication of previous VAT Department.
8. From different web site related VAT

The collected information & data are tabulated as per requirements of study.

3.2 Population and Sample

In order to get benefit from this study, 45 questionnaires were distributed. Respondents included in the sample are carefully selected by consultation with tax experts, businessman and customers. Distribution was done personally through field rather than sending by any means to get accurate and actual information in time. The following table shows the groups of respondent and the size of the samples.

Table 11
Groups of respondents and size of samples from each group.

S.N.	Group of Respondents	Sample size
1	Tax experts/Officers	10
2	Businessmen/Trades	15
3	Consumers	20
Total		45

3.3 Data Collection Procedures

The data required for the study were collected by visiting Inland revenue department, VAT project & other concerned offices. Some facts were also collected from published articles leaflets, magazines & book provided by offices.

3.4 Data Analysis Procedure

Data received from primary and secondary sources were firstly tabulated into separate format systematically in order to get the desired objective. After that these data are analyzed. For the purpose of analysis generally simple statistical tools have been used which are simple percentage method, Rank, least square method, correlation & regression, graphs, charts and diagrams.

Chapter IV

Data Presentation and Analysis

4.1 Revenue collection from VAT

Value Added Tax is the best and advance form of sales tax. It broadens the tax net. It avoids cascading effects. And it is expecting that it will minimize the tax evasion. So government is expecting more revenue from it. The trend of revenue collection from VAT is presented below

Table 12
Trend of revenue collection from VAT

Fiscal year	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
Revenue collection from VAT	12047760	11947955	13449123	14478896	18894627	21946014
% of change	22.34*	-0.83	12.56	7.66	30.5	16.15

* data from previous year

Source : Annual Report 2006/2007, IRD

Above table shows the revenue generation from Value Added Tax. In Fiscal year 2000/2001 Rs. 12047760 thousands of VAT was generated which was increased by 22.34% as previous year. In Fiscal year 2001/2002 it reached upto Rs.11947955 thousand and which was decreased by 0.83% to previous year. But again it increased by 12.56% in fiscal year 2002/2003 and reached upto Rs. 13449123 thousands. This table shows more VAT collection was made in 2004/2005. In this year VAT reached Rs. 18894627 thousand and was increased by 30.50% to previous year. Though the trend of revenue collection from VAT is fluctuating. The collection trend of revenue through VAT is not so bad. It is expected that VAT will generated more and more revenue in the days to come when it is implemented effectively.

Diagram 1

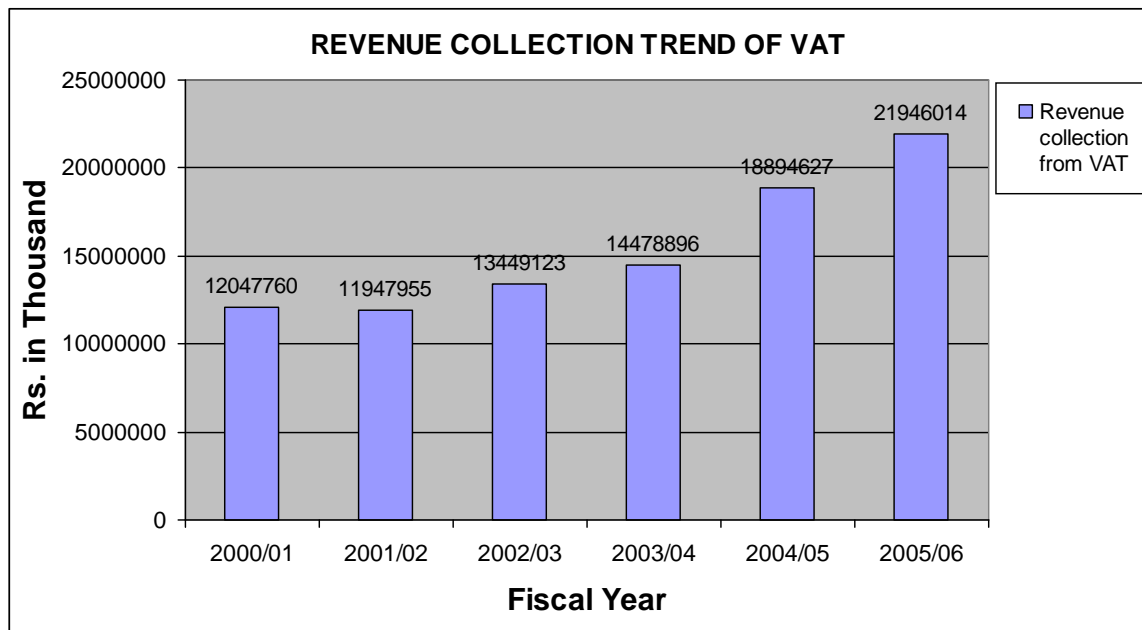


Diagram 1 show the fiscal year in x axis and amount of revenue in rupees in y axis. Each bar in this diagram shows the amount of revenue collection that year. The diagram denotes increasing trend of revenue collection from VAT. In fiscal year 2000/01, revenue was Rs. 12047760 thousands and it reached upto Rs. 21946014 thousands in fiscal year 2005/06.

4.2 Contribution of VAT to total revenue

Value Added Tax is the best form of sales tax which is neutral regarding method of production and helpful in generation of more revenue collection. Because of its broad coverage, neutrality, transparency and fairness, VAT will generate more revenue with less distortion. The percentage contribution of VAT in total revenue is shown below in the table & present it in the diagram.

Table 13
Contribution of VAT to total revenue

(Rs. in '000')

Fiscal year	Total revenue	Revenue collection from VAT	% of VAT contribution to total revenue
2000/01	48893600	12047760	23.64
2001/02	50445500	11947955	23.68
2002/03	56229800	13449123	24
2003/04	62331000	14478896	23.22
2004/05	70122700	18894627	26.94
2005/06	71733127	21946014	30.59

Source : Annual Report 2006/2007, IRD

In fiscal year 2000/2001 VAT revenue was Rs. 12047760 thousand which was 23.64 percentage contributions to total revenue and it was increased to Rs. 11947955 thousands which was increased by 23.68 percentage in fiscal year 2001/2002. In fiscal year 2002/2003 VAT revenue made 24 percentage contributions to total revenue as collected Rs. 13449123 thousands. More contribution was made in the year 2005/2006. This year VAT was collected Rs. 21946014 thousands as increased by 30.59 percentage to previous year.

Diagram 2

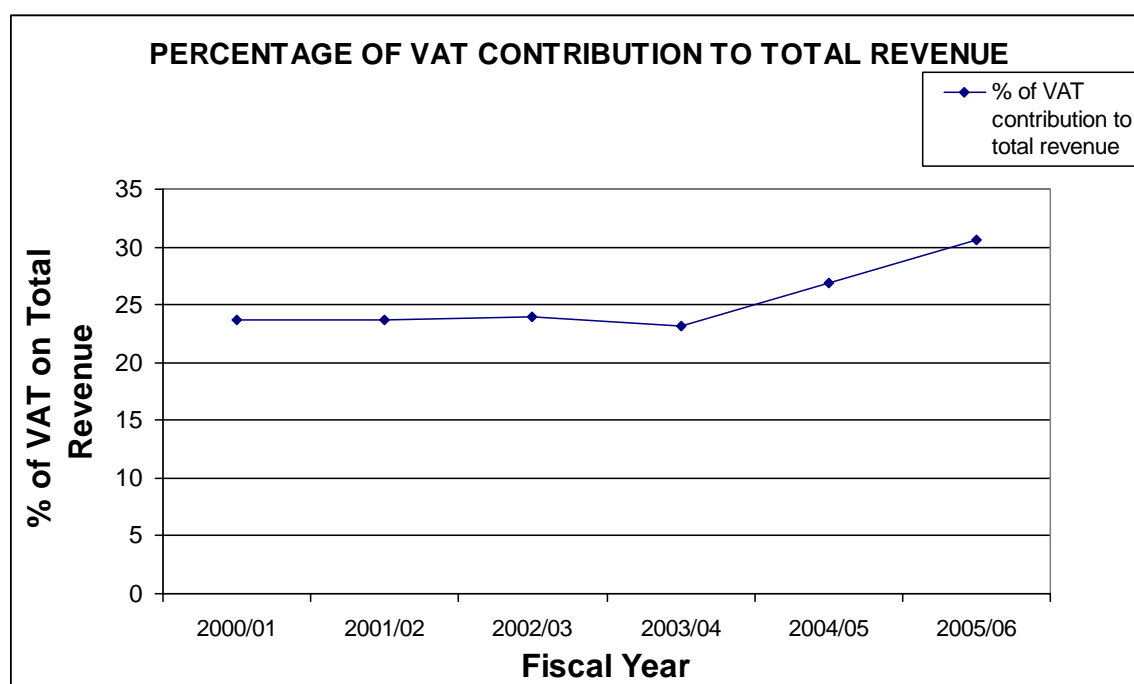


Diagram 2 represents the % of VAT contribution to total revenue. In this diagram fiscal year is presented by x axis and % of VAT on total revenue is presented by y axis. The line indicates that contribution made by VAT to total revenue is likely constant for the certain year and after that VAT made little bit high contribution to total revenue.

4.3 Composition of VAT Revenue

The revenue collection from VAT can be divided into two major components as domestic and imports. Domestic VAT is divided into three parts; Manufacturing, distribution and service sectors. Import Value Added Tax is collected at the point of custom.

Table 14
Composition of VAT Revenue

(Rs. in '000')

Fiscal Year	Total VAT revenue	Domestic product		Imports	
		Amount	%	Amount	%
2000/01	12047760	4744720	39.38	7303040	60.61
2001/02	11947955	4608373	38.57	7339582	61.43
2002/03	13449123	4819610	35.83	8629513	64.16
2003/04	14478896	5604123	38.7	8874773	61.29
2004/05	18894627	6624333	35.05	12270294	64.94
2005/06	21946014	8057438	36.7	13888576	63.28

Source: Annual Report 2006/2007, IRD

Above table shows that in fiscal year 2000/2001 the share of domestic products and imports in total VAT revenue was 39% and 60% respectively. That contribution was slightly decreased to 38% in domestic and imports was slightly increased to 61% . In Fiscal year 2001/2002 share of domestic was decreased to 36.7% and imports made contribution of 63.28% of total VAT. This analysis shows that share of VAT from domestic has been gradually decreasing and contribution of import revenue is increasing. In aggregate imports made a large contribution to total VAT revenue in comparison with domestic product.

Diagram 3

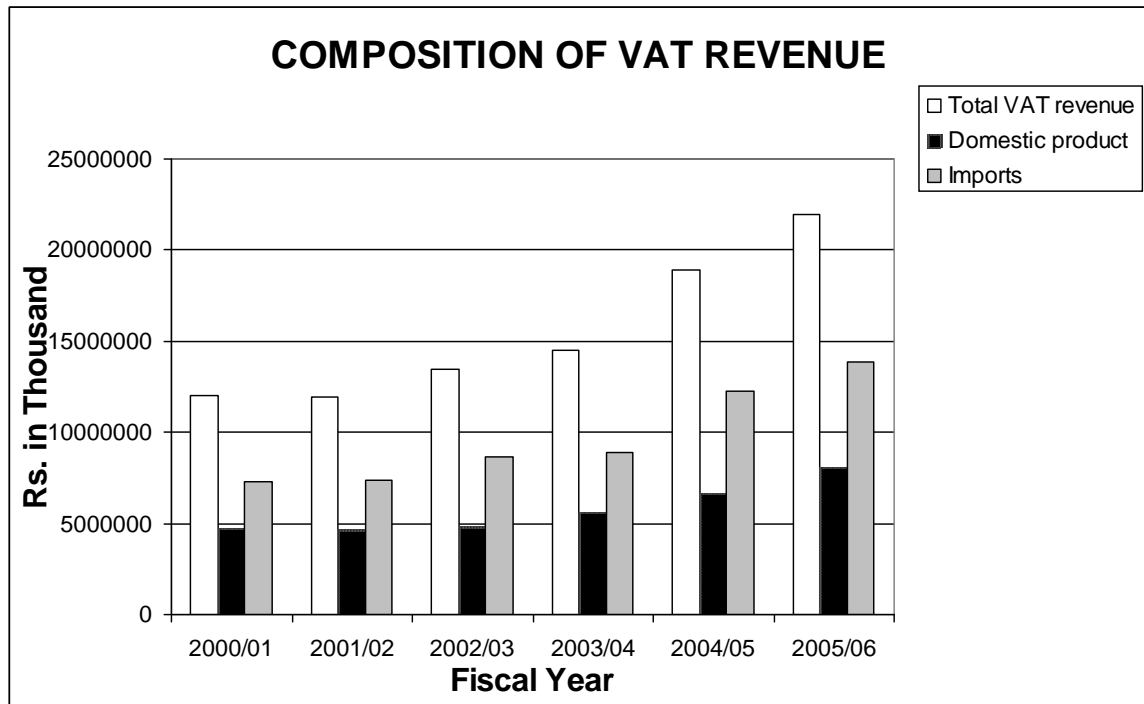


Diagram 3 shows three colors bars of white, black & gray and the colors represents total VAT revenue, domestic product & imports respectively. x axis represents fiscal year and y axis presents amount of revenue in thousands. Here revenue from domestic product is in the constant trend from fiscal year 2000/01 to 2002/2003. From 2003/04 it starts to increase revenue and in fiscal year 2005/06 it generates more revenue. Similarly revenue from imports is in slightly increasing trend. The increasing trend is little bit faster in 2004/05 & 2005/06.

4.4 Share of VAT revenue to Total Tax

The share of VAT revenue to total tax is limited to 47% from 2000/2001 to 2002/03. Then the percentage increased to 50 next year. In 2005/06 the share of VAT increased to 54%. This can be shown from the following table & diagram.

Table 15
% of VAT revenue collection on total tax

(Rs. in '000')

Fiscal year	VAT revenue Collection	Total tax collection	% of VAT revenue on total tax
2000/01	12047760	25690000	46.89
2001/02	11947955	25537690	46.78
2002/03	13449123	26853442	50.08
2003/04	14478896	30920989	46.82
2004/05	18894627	36552762	51.69
2005/06	21946014	40202336	54.58

Source: Annual Report 2006/2007, IRD

Above table shows the percentage contributed by VAT to total tax. In fiscal year 2000/2001 The total tax collection was Rs.25690000 thousands in which VAT contribution was 46.89%. In 2001/2002 the total tax collection was Rs. 25537690 thousands where as VAT revenue was Rs.11947955 thousands which was 46.78 %. So improvement was not satisfied this year in comparison to previous year. But in 2002/2003 the % was increased and reached to 50.08%. In 2003/2004 % of VAT contribution was decreased to 46.8%. Then again it increased to 51.69% and the increase continued to the fiscal year 2005/06. This year the percentage of contribution was 54.58%. From this analysis we can say that increment of % contribution is in tortoise pace.

Diagram 4

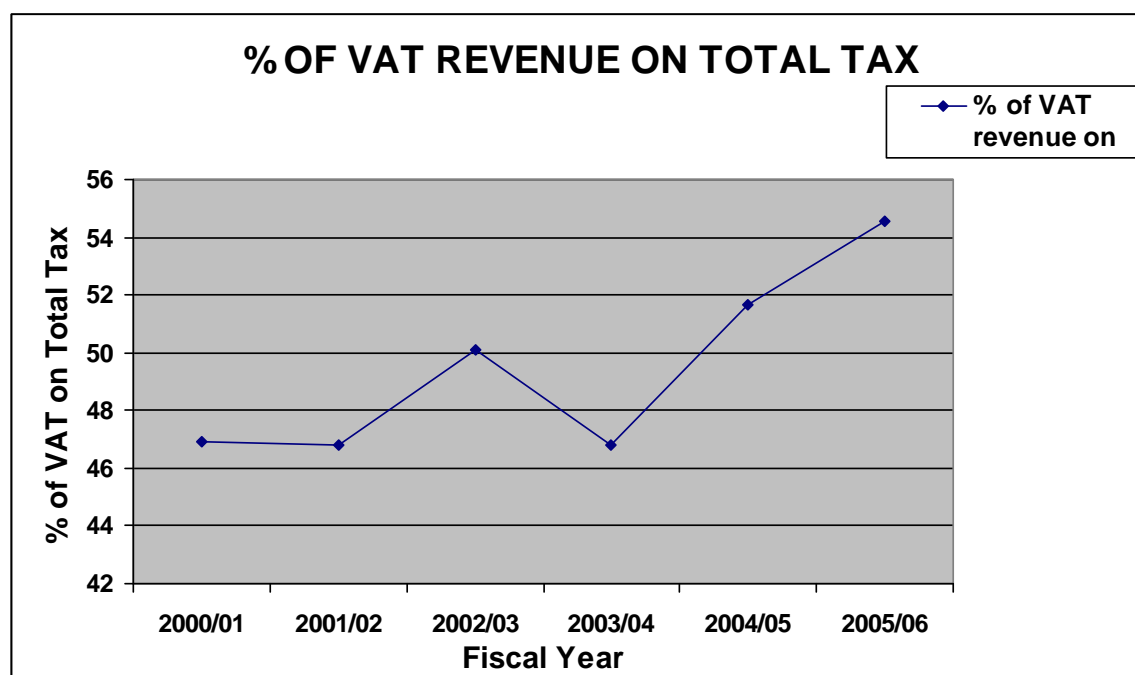


Diagram 5 is the line diagram representing % of VAT on total tax. x axis represents fiscal year and y axis represents % of VAT on total revenue. In this diagram we can see that the line is straight in first two year. That means VAT can't improve than before. Then the line goes upwards in fiscal year 2005/03 and it goes downward in 2003/04. It indicates that % contributed by VAT to total revenue is not so satisfied that year. But again the line goes upwards fast and reached to the highest.

4.5 Share of VAT revenue to Indirect Tax

VAT contributes more than 70 % to the indirect tax. Here indirect tax includes only value added tax, excise duty & means of transportation tax. The table and graph of percentage contributed by VAT on indirect tax is given below.

Table 16
Percentage of VAT revenue collection on Indirect Tax
(Rs. in '000')

Fiscal year	VAT revenue Collection	Indirect tax	% of VAT revenue on Indirect tax
2000/01	12047760	16147760	74.60
2001/02	11947955	16618010	71.81
2002/03	13449123	18793847	71.56
2003/04	14478896	21406207	67.63
2004/05	18894627	26100125	72.36
2005/06	21946014	29305887	74.88

Source: Annual Report 2006/2007, IRD
(Here Indirect tax includes only Value Added Tax, excise duty and means of Transportation tax)

Above table represented the percentage of VAT revenue contribution on Indirect tax. In fiscal year 2000/01 The indirect tax was Rs.16147760 thousand in which VAT contribution was 74.60%. It was slightly decreased in fiscal year 2001/02 and 2002/03. These year VAT made only 71% contribution. Again the contribution was decreased to 67% in fiscal year 2003/2004. But In fiscal year 2004/05 the total

indirect tax collection was Rs. 26100125 thousands in which VAT contribution was 72.36. This was increased to 74.88 % in fiscal year 2005/06.

Diagram 5

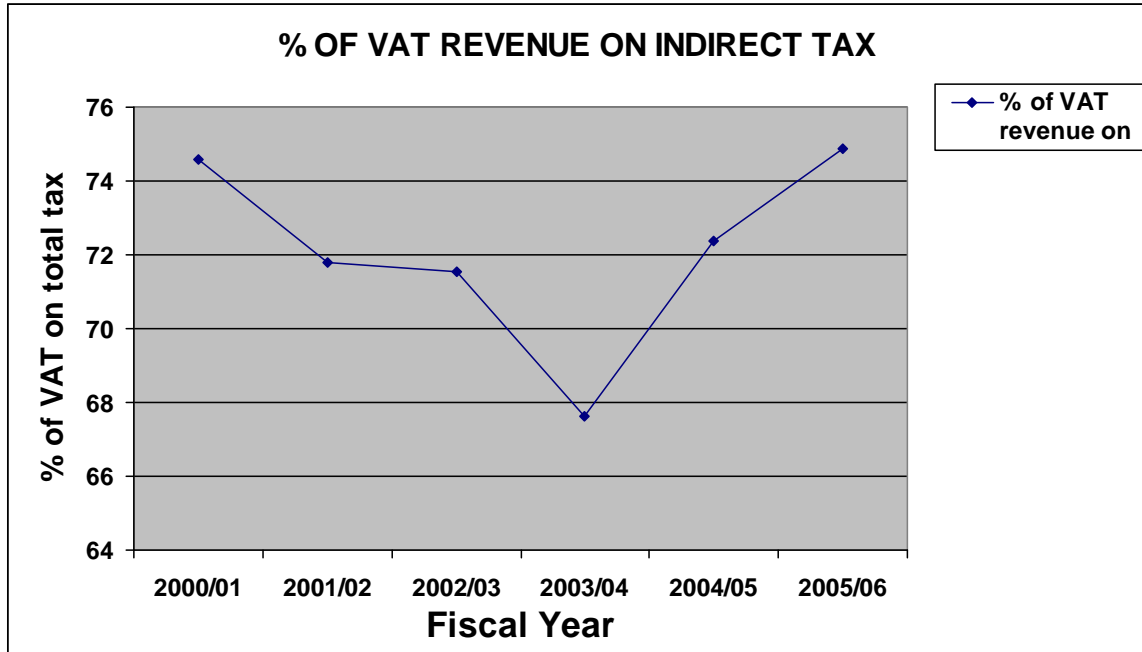


Diagram 5 is the line diagram representing % of VAT revenue on indirect tax. Here y axis represents % of VAT on total tax & x axis presents Fiscal year. The line goes downward first then takes straight route. Again it goes downward and then it grows upward continue. It shows the % contributed by VAT on total tax is so much fluctuating.

4.6 Composition of Indirect Tax

Indirect tax is the main source of revenue collection. Because people don't feel burden to pay such type of tax. Each & every people are compelled to pay this type of tax. Table and graph of composition of indirect tax is shown below. Here indirect tax includes value added tax, excise duty and means of transportation tax only.

Table 17
Composition of Indirect Tax

(Rs. in '000')

Fiscal year	VAT	Excise Duty	Means of Transportation Tax	Total
2000/01	12047760	3770000	330000	16147760
2001/02	11947955	3807730	862325	16618010
2002/03	13449123	4785244	559480	18793847
2003/04	14478896	6226724	700587	21406207
2004/05	18894627	6446503	758995	26100125
2005/06	21946014	6512225	847648	29305887

Source: Annual Report 2006/2007, IRD

In the above table we can see that the amount of VAT, excise duty and means of transportation tax is in increasing trend. Contribution of VAT to the total indirect tax is more than other tax. So more revenue can be collected through VAT if it is effectively implemented.

Diagram 6

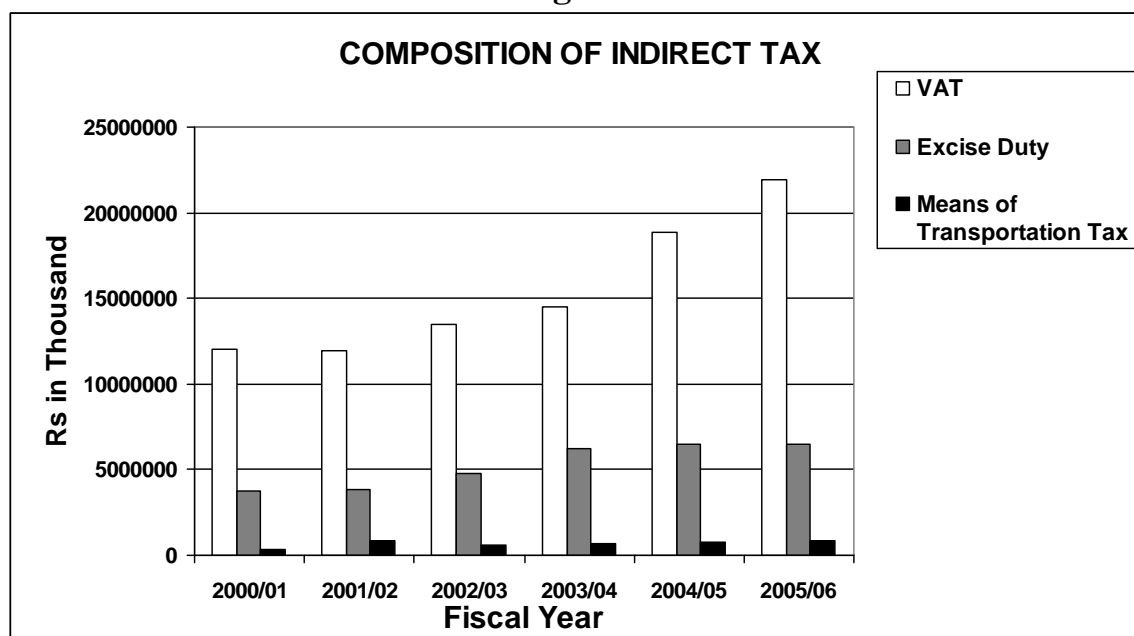


Diagram 7 represents the composition of indirect tax. Three colors of bar diagram show the collection of VAT, excise duty, means of transportation tax. In x axis we can see fiscal year and in y axis, Rs. in thousands. We can see from the diagram that among the three bars VAT generates more revenue.

4.7 Trend of VAT collection

As VAT becomes the main source of indirect tax collection, government should meet the target point of VAT collection. And we can see that government is enabled 90% success to meet the target. We can analyze it more from the following data & diagram.

Table 18
Trend of VAT Collection

Fiscal Year	(Rs. in '000')		
	Estimated	Achievement	% Achievement
2000/01	13500000	12047760	89.24
2001/02	14750000	11947955	81
2002/03	13730050	13449123	97.95
2003/04	15503500	14478896	93.39
2004/05	16950000	18894627	111.47
2005/06	23650000	21946014	92.79

Source: Annual Report 2006/2007, IRD

The above table shows the percentage of achievement in comparison with target revenue. In fiscal year 2000/01 estimated revenue was Rs.13500000 thousands where as achievement was Rs.12047760 thousands. This year VAT got success to achieve 89.24% in comparison to its target revenue. In 2001/02 the achievement was 81% which was great falls than previous revenue. In 2002/03 the percentage highly increased. This year 97.95% achieved which was nearly of 100%. In 2004/05 VAT collection was success over its estimation. This year estimated revenue was Rs.16950000 thousands and VAT was collected Rs.1889462 thousands i.e. 111.47% revenue was achieved. This ear VAT revenue was very satisfied. But in fiscal year 2005/06 Percentage again decreased to 92.79. Anyway overall it can say that more than 90% revenue was collected in comparison to its target.

We can present this table by the diagram also.

Diagram 7

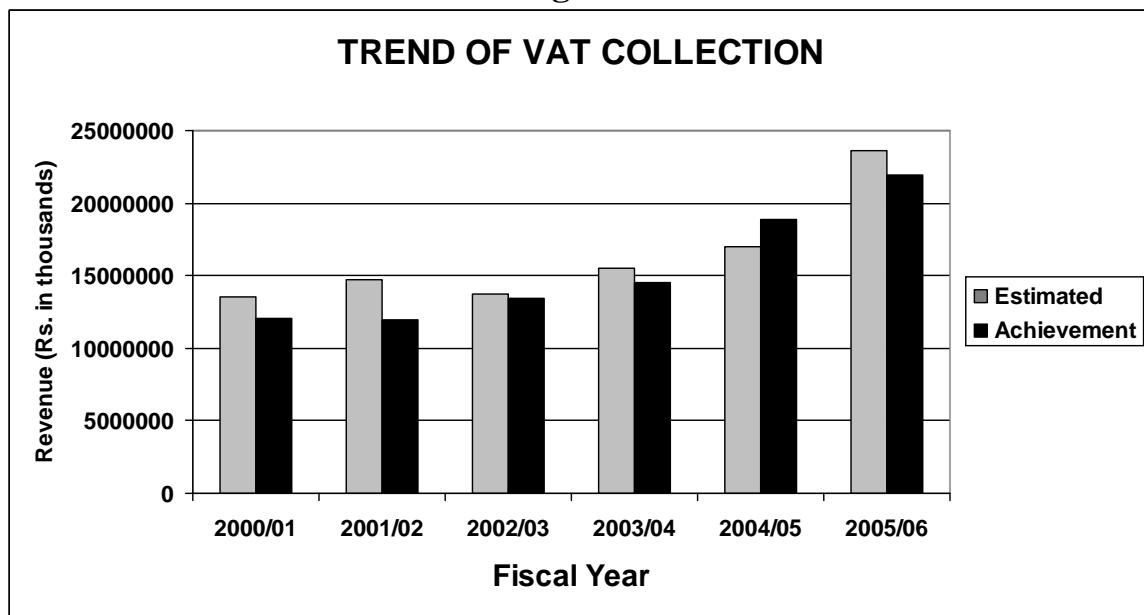


Diagram 8 shows the trend of VAT collection over the six years. x axis represents fiscal year and y axis presents revenue in thousands. From this bar diagram we can see that more than 90 % VAT office meet the estimation. In fiscal year 2004/05 VAT collection was made more than estimation.

Data analysis by using Least Square Method

The arithmetic mean and standard deviation with their coefficient of variation of revenue target and achievement for six years period from 2000/01-2005/06 are calculated in appendix no. 4 summarizes below.

Particular	Estimated Revenue	Actual Revenue
Mean	1635	1545
S.D.(Σ)	346.21	371.71
C.V.	21.17	24.05
r = 0.92		

This analysis shows that the actual and target revenue seems fluctuate from year to year. The standard deviation and coefficient of variation is higher in revenue achievement than the estimate. The figure of r shows that there is positive

correlation between estimation and actual revenue. It means if the presentation of actual and target revenue continues, the actual revenue will increase in the same ratio of target revenue.

The calculation of Mean, Standard Deviation, Coefficient of Variation and Correlation are shown in Appendix No. 4

Least square method can be used to analyze the trend of actual revenue to estimate the possible revenue figure for a given time of year. Least Square Method will show the relationship of times (year) and actual revenue.

Fiscal year 2002/2003 is assumed to be base year, straight line trend $y = a + bx$
The value of a & b is calculated in Appendix no.4(a) which is 1545 & 431.84 respectively. Thus , $y = 1545 + 431.84x$

The trend line shows the positive revenue figure and the revenue will increasing by 431.84 every year.

The estimated revenue for 2006/07,

$$\begin{aligned} y &= 1545 + 431.84 \times 4 \\ &= 1545 + 1727.36 = 3272.36 \end{aligned}$$

If other factors remain same direction as previous year, the actual revenue collection for fiscal year 06/07 will be Rs. 32723600 thousands.

4.8 Percentage contribution by VAT to GDP

VAT gave more than 3% effort on the GDP. If VAT implementation section becomes more effective there will be less tax evasion and smuggling. If happened so then the collection will contribute more than 5% to its GDP. The percentage contribution by VAT to GDP over six years is shown below.

Table 19
Percentage of VAT revenue to GDP

(Rs. in '000')

Fiscal year	GDP	VAT Revenue	% of VAT revenue
2000/01	409250000	12047760	2.94
2001/02	404482000	11947955	2.95
2002/03	468920000	13449123	2.86
2003/04	472424000	14478896	3.06
2004/05	504101000	18894627	3.75
2005/06	582950000	21946014	3.76

Source Annual report of IRD

Above table shows the contribution made by VAT to GDP. In fiscal year 2000/01 the GDP is Rs. 40925000 thousands where as VAT revenue is Rs. 12047760 thousands on which VAT made 2.94 percentage contribution. Similarly in 2001/02 VAT made 2.95% contribution to GDP. In fiscal year 2004/05 and 2005/06 VAT contributes 3.75 percentage and 3.76 percentage respectively. It shows that VAT revenue is increasing each year.

The above figure in the table also can be shown in the following diagram.

Diagram 8

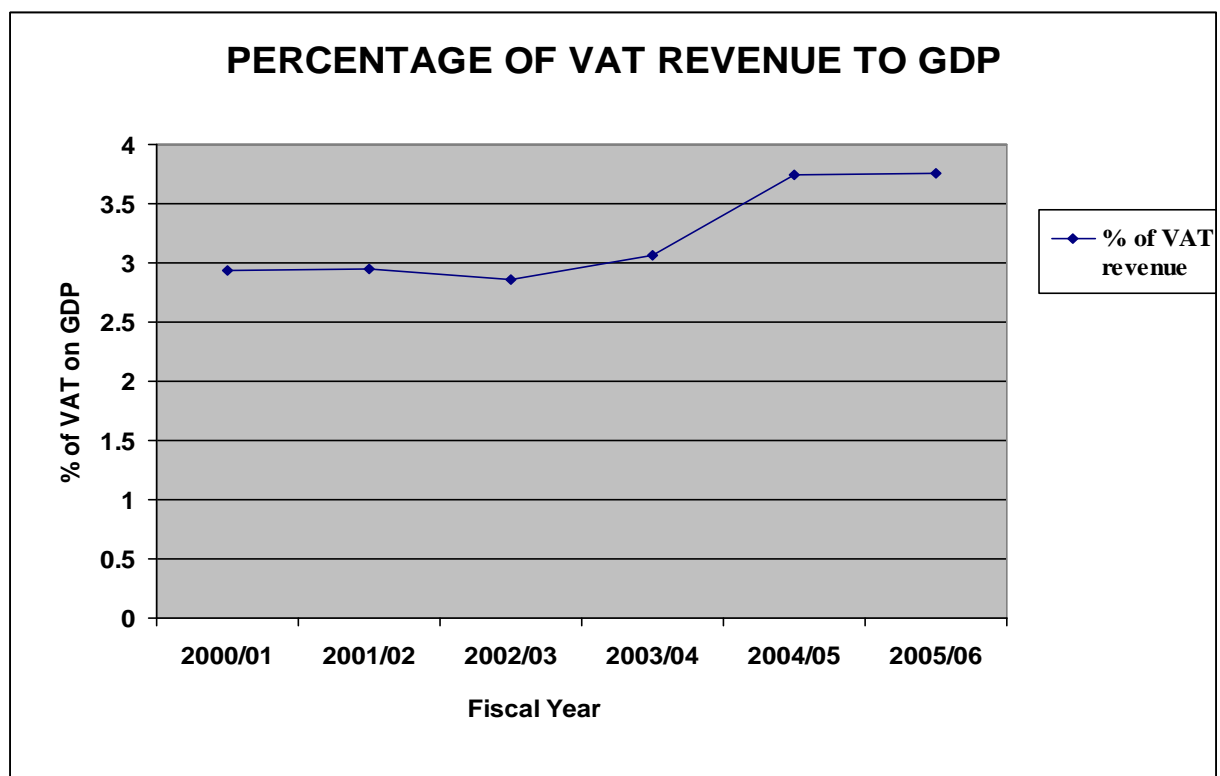


Diagram 9 shows percentage of VAT revenue to GDP. It is a line diagram representing x axis by fiscal year and y axis by % of VAT on GDP. The line slightly goes upward and downward over 4 years i.e. upto 2003/04. After that the line took high movement to upward.

4.9 Results of Primary data analysis

As I have already written that in early period VAT was imposed by Nepal government against of strong opposition of business man. So it was not easy task to implement it successfully. Despite all this VAT was survived. VAT is currently well received by the consumers as well as business and industrial communication. In such situation empirical study is done to know the views of persons of different field of different aspects of VAT. The sample of this survey is given below.

Table 20
Sample size of Field survey

S.N.	Group of Respondents	Sample size
1	Tax experts/Officers	10
2	Businessmen/Trades	15
3	Consumers	20
Total		45

Source: Field Survey

The results have been presented below

Q. No. 1 Do you know about Value Added Tax?

To implement Value Added Tax system effectively it is necessary that all the consumers, tax experts/officers and business man should know about Value Added Tax. All should know at least about its meaning and purpose of implementation. Views on its awareness about VAT can be shown in the following table.

Table 21
Respondents views on Value Added Tax

Respondents	Yes		No		I don't know	
	No.	%	No.	%	No.	%
Tax experts/Officers	10	100	-	-	-	-
Businessmen/Trades	15	100	-	-	-	-
Consumers	20	100	-	-	-	-
Total	45	100	-	-	-	-

From the study we can say that all the respondents know about VAT. They hear the word VAT. It shows that government is success to introduce VAT among people.

Q No. 2 Is VAT appropriate tax system for Nepal?

Value Added Tax system is considered as the reform tax system of the 21st century, which has already been implemented popularly in more than 135 countries in the world. But is it really appropriate tax system for Nepal also? Views on this question are presented below.

Table 22
Respondents view about the suitability of VAT in Nepal

Respondents	Yes		No		I don't know	
	No.	%	No.	%	No.	%
Tax experts/Officers	10	100	-	-	-	-
Businessmen/Trades	12	80	3	20	-	-
Consumers	14	70	3	15	3	15
Total	36	80	6	13.3	6	13.3

From the study it is clear that almost 80% respondents agreed that VAT is appropriate for tax system. 100% of each of tax officers is in favor of this question and 80% & 70% of businessmen and consumers accepted VAT as an appropriate

tax system for Nepal. It shows 30% of consumers are against of it. It means VAT office need to show more transparency on this tax system.

Q No. 3. Is threshold limit keeps VAT effective?

For VAT registration threshold limit is two million rupees. Any businessmen making or intending to make supplies exceeding or expected to exceed 2 million rupees in turnover (not profit) for the previous 12 months or the next 3 months must register for VAT. Also a person who imports into the kingdom of Nepal goods valued at one hundred thousand rupees or more per annum for commercial purpose shall have to register. But if a Nepalese vendor has a taxable turnover not exceeding 2 million rupees within the last 12 months or otherwise is regarded as a non taxable or exempt taxable person will not need to be registered.

The views of respondents regarding this context are shown below.

Table 23
Respondents view on threshold limit

Respondents	Yes		No		I don't know	
	No.	%	No.	%	No.	%
Tax experts/Officers	10	100	-	-	-	-
Businessmen/Trades	10	66.6	5	33.3	-	-
Consumers	10	50	2	10	8	40
Total	30	66.6	7	15.5	8	17.77

From the study it is clear that almost 66% respondents are satisfied with the current threshold limit. And some of the respondents i.e. 33.3% of businessmen and 10% of consumers are against of it. And 17.77% of consumers are unknown about it.

Q No. 4 Do you think is billing system effectively implementing?

Value Added Tax system is based on billing system. So VAT will not get succeed until its effective billing system. Views on billing system are shown below.

Table 24
Respondents view on billing system

Respondents	Yes		No		I don't know	
	No.	%	No.	%	No.	%
Tax experts/Officers	4	40	6	60	-	-
Businessmen/Trades	8	53.33	7	46.6	-	-
Consumers	8	40	8	40	4	20
Total	20	44.4	21	46.67	4	8.88

As the table shown above, only 40% of tax experts think that billing system is effectively implementing. 53.33% of businessmen and 40% of consumers think that billing system is effectively implementing. That means only 44.4percent of respondents are agree with effective billing system and 47% of respondents said that government is failure to implement effective billing system. So from the analysis we can say that VAT administration department need to monitor strongly in this aspect.

Q No. 5 Will price rise due to VAT system?

In the beginning time of VAT introduction many tax officers, businessmen and consumers thought that VAT rises the price. It became the big debate between tax experts and businessman. If consumers say for VAT bill then shopkeeper replied that if bill taken then price will rise. So most of consumers didn't take a bill because of fear of price rise. From the field survey, following results is found out.

Table No. 25
Respondents views on price rise due to VAT

Respondents	Yes		No		I don't know	
	No.	%	No.	%	No.	%
Tax experts/Officers	2	20	8	80	-	-
Businessmen/Trades	5	33.3	10	66.6	-	-
Consumers	12	60	6	30	2	10
Total	19	42.2	24	53.3	2	4.44

In the above table, 80% of tax experts are known that VAT doesn't rise the price. 10% of businessmen said that VAT doesn't rise the price and only 30 % of consumers know that VAT doesn't rise the price. i.e. 60% of consumers thought that price rise due to VAT. In summary, 42% of respondents are in favor of price rise due to VAT and 53.33% of respondents are against of price rise due to VAT. From analysis we can say that Most of the consumers, businessmen and even the tax officers still clearly don't know about the VAT. So VAT education to all people is needed.

Q No. 6 What do you think about upahar program?

VAT is now steps on its 10th year of its implementation. But still most of businessmen & consumers are not aware of it. They are not taking it as their responsibility. They feel it as a burden. Moreover they think that VAT rises the price of product, it is not appropriate for consumers, consumers are exploiting in the name of VAT etc. So to get out from such type of mirage and with a purpose of spread awareness about VAT, government launches the upahar program for the consumers.

Table 26
Respondents view regarding upahar program

Respondents	Awareness program		To make billing system effective		Control over tax evasion	
	No.	%	No.	%	No.	%
Tax experts/Officers	2	20	7	70	1	10
Businessmen/Trades	7	46.6	8	53.3	-	-
Consumers	6	30	11	55	3	6.6
Total	15	33.3	26	57.7	4	8.88

In the table shown above, 20% of tax experts/officers, 47% of businessmen and 30% of consumers said that the lottery program is to give awareness to people. Where as 70% of tax experts/officers, 53.3% of businessmen and 55% of consumers gave view on lottery program is to make billing system effective. Only 8.8 % of respondents are in favor of control over tax evasion through upahar program. That means most of respondents i.e. 57.7% said that upahar program is helpful tool to make billing system effective. And they all are on behalf of operation of such type of encouraging program.

Q No. 7 Do you think VAT office is successful to get expected revenue?

In the context of Nepal, government expenditure is always increasing but the revenue collection is not increasing as required to finance the government expenditure. Now VAT becomes the part of government revenue. Theoretically VAT is the best form of taxation but practically its success depends on its collection. Collection views upon this regards are shown below.

Table No. 27
Respondents view on VAT collection

Respondents	Yes		No		I don't know	
	No.	%	No.	%	No.	%
Tax experts/Officers	3	30	7	70		
Businessmen/Trades	6	40	5	33.3	3	20
Consumers	6	30	8	40	6	30
Total	15	33.3	20	44.4	9	20

From the table, 30% of tax experts/officers, 40% of businessmen/trades and 30 % of consumers said that VAT office is successful to get expected revenue. 70% of tax experts, 33.3% of businessmen and 40% consumers gave view on that VAT office is not success to collect revenue from VAT as they expected. Where as 20% of businessmen and 30% of consumers couldn't say anything on this aspect. From this survey we can analyze that most of respondents i.e 44.4% of respondents are not satisfied with VAT collection. As per the tax officers VAT as the best form of tax collection, it should meet the expected line. Most of respondents are quite unsatisfied on its collection. It may be because of low efficiency on billing system, less control over tax evasion etc. From the table we can say that most of people are expecting more from VAT.

Q No. 8 What are the major problems of VAT in Nepal (Please rank)

VAT regime is extremely challenging in a burgeoning economy like Nepal. Resistance from the business community, ignorance of general people, lack of skilled and trained manpower, smuggling and under valuation are the major problems for implementing VAT to make compromises on various aspect of VAT which has weakened the process of its implementation right from beginning.

**Table 28
Respondents view on major problems of VAT in Nepal**

Problem	No. of Respondents	%	Rank
Lack of awareness	45	28.82	1
Lack of skilled & trained manpower	45	8.88	4
Improper billing system	45	24.44	2
Tax evasion	45	13.33	5
Smuggling & under valuation	45	17.77	3
Feel tax as a burden not responsibility	45	6.76	6

From the above table we can say that the most important factor of problem in VAT implementation is Lack of awareness. Among the total 28.82% of respondents gave rank first to this problem. In second, respondents rank improper billing system. 24.44% of respondents said that the second problem is improper billing system. 17.77% of respondent ranked smuggling & under valuation problem in third. Similarly, they ranked lack of skilled & trained manpower, tax evasion and feel tax as a burden not responsibility to fourth, fifth and sixth. So VAT office must give attention on awareness of VAT to public and proper billing system. Effective monitoring should be done time to time to find out smuggling and tax evasion and should take a strong step to control over it.

Q No. 9 Who plays an important role in successful implementation of VAT?

For the successful implementation of VAT each & every sector should play an important & fair role. VAT can't get success until it gets fair support by people involved from production to distribution level. Views over role play by public for VAT success are shown below.

Table 29
Respondents views on role play for successful implementation of VAT

Respondents	Consumers		Tax officers		Businessmen	
	No.	%	No.	%	No.	%
Tax experts/Officers	6	60	2	20	2	20
Businessmen/Trades	8	53.3	3	20	4	26.67
Consumers	9	45	4	20	7	35
Total	23	51.11	9	20	13	28.8

From the table, 60% of tax officers, 53.33% of business and 45% of consumers said that consumers play an important to make VAT successful. 20% of tax experts, 20% of businessmen and 20% of consumers give credit to the tax officers for making VAT successful. Similarly 20% of tax experts, 26.67% of businessmen and 35% of consumers give the credit to businessmen for making VAT success. From the table analysis we can say that VAT office should give first priority to

consumers. They are the actual payers. So consumer awareness and their satisfaction should be considered first. Businessmen and tax officers also need to be honest. Businessmen deposited tax amount paid by consumers to VAT office. And it is collected and audited by VAT officer. So all should bear their responsibility with honesty.

Q No. 10 How can we make the consumer encourage in the VAT program?

The real VAT payer is consumer. They should feel that they should pay tax to government. The VAT will fully effective if consumer take bill in his purchase of every taxable transaction. Before the consumers put their step on purchase they should have make up their mind of obtaining VAT bill, but consumers rarely have such interest. And businessmen get opportunity for tax evasion. So government need to encourage people to take a bill. A question was put with the respondents to seek the answer that how can consumer will be encouraged in participating VAT And the result has been shown below.

**Table 30
Respondents view on launching the program to encourage the public**

Respondents	Education		Lottery system		Reward	
	No.	%	No.	%	No.	%
Tax experts/Officers	3	30	5	50	2	20
Businessmen/Trades	4	26.6	8	53.3	3	20
Consumers	5	25	10	50	5	25
Total	12	26.6	23	51.1	10	22.2

From the table we observe that most of respondents, more than 50%, accept that lottery system will be the effective tools to make encourage the consumers in participating VAT program. 50% of tax experts, 53.3% of businessmen and 50% of consumers are in favor of lottery system. 30% of tax experts/officers, 26.6% of businessmen and 25% of consumers gave the view on education. And 22% of respondents said that reward should be given to encourage consumers in VAT. So government should continue to the upahar/lottery program.

Q No. 11 What factors helps to promote smuggling business?

Nepal has long open boarder with India and China. People of India and Nepal can easily enter into each the nation. Often people of both countries go to boarder town of other country to buy their need. They need not to pay custom duty for the goods they have bought for personal use in limited quantity. However, many businessmen misuse such facility. The views regarding this aspect are collected in the following table.

Table 31
Respondents views on reason for smuggling business

Respondents	Open boarder		High profit		Feeling of price rise due to VAT		All	
	No.	%	No.	%	No.	%	No.	%
Tax experts/Officers	4	40	3	30	-	-	3	30
Businessmen/Trades	4	26.6	7	46.6	-	-	4	26.6
Consumers	8	40	6	30	2	10	4	90
Total	16	35.5	16	35.5	2	4.44	11	24.4

Above table shows that open boarder and high profit is the main reason for smuggling the business. 35.5% of total respondents are agreed that due to the open boarder and chance of earning high profit people smuggle the business. 10% of consumers also agreed that feeling of price rise due to VAT may be another problem to promote smuggling. And 24.4% of respondents said that these all three factors are the reason for smuggling the business. So it is a time for VAT office to take the action against it. Otherwise we have to face a great lose.

Q No. 12 How can we make return process easier?

Return filing in time is one of the indicators of effective VAT implementation. It will make easy to calculate the VAT revenue. Compulsory registrants are required to submit their debit return or credit returns within twenty five days of the expiry

of tax period of every month. In the case of voluntary registrants, they have to submit their return for period of four months. The hotel & restaurant can submit their return within two months. But the businessmen make delay to submit the return. It is due to the VAT officer inefficiency. So the question put toward the respondents to know about making return process easier.

Table 32
Respondents views on return process

Respondents	Computerized		Add manpower		Time frame		All	
	No.	%	No.	%	No.	%	No.	%
Tax experts/Officers	3	30	3	30	2	20	2	20
Businessmen/Trades	6	40	4	26.6	5	33.3	-	-
Consumers	8	40	5	25	3	15	4	20
Total	19	42.2	12	26.6	10	22.2	6	13.3

From the above table it is clear that 42.2% of respondents are agreed that computerized system should be improved first. Man power also need to add. 26.6% of respondents are in favor of adding manpower. 22.2% of respondents are said that time frame should be checked out. 33.3% of businessmen said that time frame should be extended. The time given to the businessman for the submission of return is not enough. It should extend. So VAT office should consider on all these aspect

Q No. 13 Please suggest for the effective implementation of VAT

Many respondents wrote that billing system should be effectively implemented. Consumer awareness is also a must. There should be introduced effective education program for the awareness of taking and giving bill through advertisement so that all people feel paying tax is the responsibility towards nation. Lottery program should be continued. Government should take step to

reduce tax corruption. Reward should be given to the honest tax payer and tax officer. Registration, return and refund process should be easy & simple. High penalty should be charged at spot if it is found that businessmen are cheating. Encourage the businessmen also for giving bill to the consumer in every purchase even if consumer didn't ask for a bill. And moreover government should invest tax in public interested area. This will encourage paying tax to the government. VAT administration should be actively involved in VAT implementation.

4.10 Major Findings

On the basis of results from primary data analysis the major points can be drawn which are as follows:

VAT is the best form of indirect tax. And it may be the best source of government revenue to meet the government expenditure.

Most of respondents are not satisfied with the threshold limit. They are viewed that it should be extended.

Almost 50% respondents have complain that billing system is not effective. So to make VAT success, billing should be fair first.

55% of respondents thought that price will rise due to VAT & due to this consumer are unwilling to accept bill. That means they have still lack of knowledge of VAT mechanism & its transparency.

Almost 60% of respondents are in favor of upahar program conducted by VAT office to aware the public about VAT. It is the most effective way of introducing VAT to mass.

Lack of awareness, improper billing system, under valuation of bill, smuggling at boarder side is the major problems of VAT.

Most respondents are not satisfied with the preparation work of the government to create favorable atmosphere to implement VAT.

80% respondents agreed with the statement –VAT is an appropriate tax system for Nepal. And it would be fruitful if implementation sector is effective.

To achieve the potential benefit from VAT it should be effectively implemented. After analysis of data collected from IRD, we can say that VAT collection is not so bad. VAT collection is in increasing trend. It may be the great contribution source to government if we can increase the effectiveness of VAT through tax education, minimize tax evasion & corruption, and increase administrative capacity & improvement of information & technology.

Chapter V

Summary, Conclusion and Recommendation

5.1 Summary

Tax is a compulsory contribution from person to the government to defray expenses incurred in the common interest of all without reference. Tax becomes the main source of revenue of the state. Tax has very prominent role in a country's revenue collection. In every country the largest part of government revenue is raised through taxation. It can be classified into direct and indirect tax in the basis of its nature. Value Added Tax can be taken as the latest innovation in the field of indirect tax. It is considered as the reform tax system of the 21st century, which has already been implemented popularly in more than 135 countries in the world. Value Added Tax is a fee that is assessed against business by a government at various points in the production and distribution of goods and services. In addition to consumers, persons involved in commercial activities are affected by VAT. A person means an individual, firm, company, association, cooperative, institution, joint business, partnership, trust, government body or religious organization. It must be paid by every company that handles a product during its transition from raw materials to finished goods. The real VAT payer is the consumer not the producer. It is a tax on trading transaction. It is a modern tax system which enables to efficient collect system, to increase efficiency and to reduce tax evasion.

The concept of Value Added Tax was innovating by Dr. Wilhelm V. Siemens of Germany in 1919. But France became the first implementer of Value Added Tax. France implemented Value Added Tax in 1954 covering only in the industrial sector. This country 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 Asia, Vietnam was the first country to introduce this most scientific tax system. This country adopted VAT in 1973. The trend being VAT popular was

increasing all over the world. Pakistan was the first adaptor of VAT in SAARC countries. It implemented VAT in 1990. India introduced VAT first as Modified Value Added Tax (MOD VAT) in 1996. But actually in India, VAT replaced sales tax on 4th January 2005.

In Nepal Value Added Tax Act was enacted by 1995 and started to implement only at 16th November 1997. In fact the implementation of Value Added Tax was not easy in the initial days. It was a great matter of debate. A large number of traders and business community are against of Value Added Tax. The FNCCI, NCC and their affiliated bodies were in the front line of opposition. Despite all this, Value Added Tax was introduced and survived because of its leading to transparency and accountability both on the part of tax payers and tax collectors. Now a days the number of VAT registrants is increasing. Up to Fiscal year 2005/2006 VAT registrants were 46, 831.

Value Added Tax replaces the old sales tax, contract tax , hotel tax and entertainment tax. Value Added Tax Act classifies goods 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 13% based on addition of value of goods and services at each stage in the process of supply and delivery of goods and services. Value Added Tax is the youngest member of sales tax family.

The business with an annual taxable turnover of more than 2 million rupees and belonging to a conglomerate which has an aggregate annual taxable turnover exceeding 2 million rupees can register for Value Added Tax. In the VAT system, producers, distributors and people providing services raise VAT on the products or services sold or provided. The difference between the VAT collected on sales and the VAT charged on purchases determines the amount a registrant must remit or the amount that may be claimed as a refund. In other words, if the tax on sales is more than the tax on purchases, the dealer/businessman remits the difference. If

the tax on sales is less than the tax on purchases, the dealer may carry forward this credit to the next month. There are categories of persons and organizations which are not required to collect VAT nor allowed to claim a refund of the VAT they have paid in producing their goods and services for sale. These would include unregistered small suppliers, that is, persons with annual sales of taxable goods and services of Rs. 2 million or less. But even such people can voluntarily register for VAT purposes.

The main reason of introducing Value Added Tax is to generate more revenue by broadening the tax base, to promote economic development, to become less dependent on international trade taxes for the revenue in future. And it is necessary to introduce Value Added Tax to make tax system more scientific, transparent, fair tax system and so on. Despite having too many challenges it succeeded in generating reasonable revenue. It contributes more than 45% to indirect tax and more than 25% contribute to total revenue. So VAT really proved that it is one of the most important part of government revenue.

Although VAT revenue has been increasing but it is still unable to achieve its potential because of various problems and challenges relating its implementations. Value Added Tax faces lack of proper invoicing system, lack of required number of qualified trained tax administrations, lack of coordination between tax payers and collectors. Among of them the great major problem is the lack of people awareness about VAT. So to enhance VAT revenue there is a need to tackle above problems and challenges.

5.2 Conclusions

Economic development is one of the most important indicators of developed country. Each and every country wants to be developed and no doubt tax is the main source of making the country economically strong. Our country Nepal is economically weak due to its more expenditure than its revenue collection. So for more revenue generation tax system should be effective, simple and transparent. Value Added Tax is one of them. It is introduced to increase revenue collection by broadening tax net, eliminating cascading effects, reducing tax evasion and creating investment friendly tax system. It is universally accepted as modern, advanced, simple and transparent tax system. It is regarded as the tools of more revenue collection than sales tax.

We cannot increase revenue through direct taxation due to small scale and undeveloped structure of business and industries. More revenue collection is possible through direct tax. And Value Added Tax is the best form of indirect tax. VAT plays great role in the revenue mobilization in Nepal. The reason behind VAT system, it makes transparency in all kinds of transaction, helps to make a wide area of tax and discourage tax evasion. So it is needless to say that VAT is the most important source of the government revenue. So adoption of VAT for Nepal is both compulsion and a necessity. It is a general, broad based consumption tax assessed in the value added in the goods and services. It applies more or less to all goods and services that are bought and sold for use or consumption.

In the context of Nepal, Value Added Tax is now on the 10th year of its implementation and during this period revenue collection from VAT is not so bad. Theoretically it is the best reform of tax system and practically its success depends upon the environment provided for it. From data we observed that VAT revenue collection is increasing every year. It intends to meet the expected revenue. VAT office is achieving more that 90% of its expectation. If VAT is effectively implemented then non other tax will collect revenue more than VAT. VAT does not give the tax burden to one level or one person. It is levied in each level and

paid by each person engaged in each level. So investors will be encouraged. And the result is good impact on the economic condition of Nepal.

Empirical findings also show that VAT is an appropriate means of tax collection. All the people are in favor of its implementation. They start to believe that VAT can generate more revenue. At present the issue has become the effective implementation of Value Added Tax system in Nepal. It is not matter that VAT should be removing but the implementation aspect should be managed properly. Every group relating to Value Added Tax need to take it as a serious matter. The success of Value Added Tax depends upon its sound implementation. And for its sound implementation, good environment is must. But as we know that Nepal has facing so many problems and challenges on its implementation aspect.

Empirical finding shows that the major problem of VAT is lack of public awareness and improper billing system. People don't feel that bill must be taken. They are in illusion that taking VAT bill means pay more. Even the wholesaler & retailer said the same things that issuing VAT bills means charging more prices. They are cheating to the consumer knowingly and unknowingly. So first consumer needs to be aware about it. They should force seller for correct VAT bill. Under invoicing is another problem. Other problems are; lack of full support and commitments from the politicians and other government sector, instable government, lack of skilled, trained and honesty manpower, improper account keeping, weak administration etc. Most of people do not consider the tax as their responsible to the nation. They feel it as a burden. So tax education to public is also necessity to feel them paying tax is a responsibility towards the nation.

For business, government needs to make registration, return filing and refund process simple. Government should bring the clear VAT laws and rules, effective and efficient administration. VAT office should create the environment of cooperation between tax payers and tax officers. Government should take a strong action to control the tax evasion, smuggling in border side and corruption.

Responsibility and accountability in every sector is its basic requirements well as honesty and confidence between business people and tax administration is must. The government must be curative. Unnecessary hindrances in tax system should be eliminated. It is a time for action and improvement for effective and successful operation of VAT in Nepal to achieve the line of economic development.

5.3 Recommendation

Recommendation to make Value Added Tax more effective in the future, which could be useful to concerned authorities relating to Value Added Tax while reforming Nepal's VAT system are pointed out below.

Tax net should be extended to small traders and retailer to increase the taxable amount of Value Added Tax.

Due to geographical barriers many businessman are still beyond the tax net. So the government should provide services to their approach. So they can come under the tax compliance.

VAT is self assessment tax system. And many businessmen have misused this facility. So effective investigation program should be conducted.

High penalty should be charged to control tax evasion.

Spot checking, highway checking, ware house account checking and mobile checking unit should be formed to prevent smuggling business..

It is mandatory for government organization, NGO & INGO to buy from VAT registered sellers. But effective implementation of this mechanism must be required.

Tax education program should be given through radio, television, newspaper, hoarding board, posters, pamphlets, leaflets etc.

Effective tax checking and auditing program should be conducted.

Registration process, return filing and refund process should be easy, simple and fast.

VAT administration should be efficient. VAT officers should be well trained, honest, dedicated, service minded attitude, ability to handle tax matters. For obtain these qualities under VAT staff government should give required computer training, account training, skill development training motivation program etc., and launch reward program to the honest personnel would be advantage.

Refund system should be easy, simple and should complete without delays.

Market monitoring should be done to control over fraud and tax evasion, illegal business, smuggling. For this human resource need to be added.

Government should take a strong action over the tax evader so that others will discourage for tax evasion.

Encourage consumers and sellers for giving and receiving bills through upahar lottery program.

VAT law and system should be transparent, fairness, timely and quality production.

The existing long open boarder is the main reason of smuggling. So gradual regulation of all imports specially those from India must be established.

There should be coordination between businessmen and VAT officers.

Advance account software, which is capable to reduce tax evasion and under invoicing, should be introduced.

Incentive mechanism should be developed for regular and honest tax payers.

Tax collection period should be extended so that tax payers will have enough time to filing their return.

Businessmen and tax collectors should have the commitment to contribute towards the performance of the country. So they have the campaign against the tax evasion and tax avoidance which will certainly increase the national revenue.

Bibliography

1. Adhikari, Chandra Mani, (1999), "Taxation in Nepal: Planning and Management", Shristi Publication, Kathmandu
2. Adhikari, Chandra Mani, (2003), "Karko Sathi", Makalu Books & Stationers, Kathmandu, Nepal
3. Charles, P. Kindle Berger and Bruce, Herick (1977), Economic Development, McGraw-Hill Kogakusha Ltd., New Delhi.
4. Dahal, Madan Kumar. (1993), "Future of the Nepalese Economy: Economic Nationalism Reconsidered", NEFAS, Kathmandu, Nepal
5. Dahal, Madan Kumar (1984), "Measuring the Burden of Taxation" Rajaswa. vol.4 No-2 Revenue Administration Training Centre, MOF 159-167
6. Dhakal, K.D. (2057 B.S.), "Income Tax and House and Compound Tax Law and Practice", Kamal Publication.
7. Dhungana, Yadav Prasad (2001), Value Added Tax and its Legal scrutiny, Business Age, Vol. 5, England.
8. Gerald, M. Meier (1995), Leading Issues in Economic Development, Oxford University Press, Delhi, India
9. Glenn P. Jenkins, and Rup Khadka, "Value Added Tax Policy & Implementation in Singapore," International VAT Monitor (Vol 9, No.2), Singapore, 1998.
10. Goode, Richard (1986), "Government Finance in Developing Countries", Tata McGraw Hill Publishing Co. Ltd, New Delhi
11. Graham Bannock (1986), Vat and Small Business: European Experience and Implications for North America, National Federation of Independent Business Washington D.C.
12. Higgins, Benjamin (2001), Economic Development: Problems, Principles and Policies, Universal Book Stall, New Delhi.

13. Kandel Pushpa Raj (2004), Tax Laws and Tax Planning in Nepal, Second Edition, Buddha Academic Publishers and Distributors Pvt. Ltd., Kathmandu, Nepal
14. Khadka, Rup, (1996), “ A VAT for Nepal”, International VAT Monitor, volume 7, No.3, International Bureau of Fiscal Documentation, Amsterdam
15. Khadka, Rup, (2061 B.S), "Nepalese VAT System”
16. Khadka, Rup, (2001), "Value Added Tax in Nepal”, USBPD, New Delhi
17. Khadka, Rup, (2001), " VAT: The concept International experience Tax System in Law Developing
18. Lent, E. George (1973), The Value Added Tax in Developing Counties, Staff Paper, Vol. XX:2, IMF
19. Mallik, Vidyadhar, (2001), Rationalization of Establish Inland Revenue Department, (Nepali) Rajaswa Year 21, Vol. 2 Kathmandu. Revenue Administration Training Centre MOF, 1-7.
20. Ministry of Finance (1995), “The Report of the Taxation System-Observation Task Force”.
21. Nepal Chamber of Commerce (1997),”Study Report on Possible Effects on VAT on different Areas.”, Nepal Chamber of Commerce, Kathmandu.
22. Shoup, Carl S. (1998), “The VAT & Developing Countries”, Research Observer :Vol No.2, July, Washington D.C.
23. Silwal, N.P. (2000), “Value Added Tax: A Nepalese Experience”, Kathmandu.
24. Subedi, Babu Ram, (1998) Applicability of Value Added Tax in Nepal, Kathmandu, Brikuti Academic Publication.
25. www.ird.gov.np
26. www.vat.com

WB = World Bank
WLST = Wholesale Level Sales Tax
WTO = World Trade Organization

