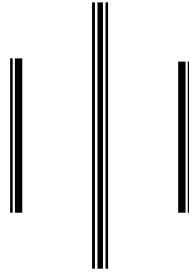


REVENUE GENERATION FROM VAT IN NEPAL



A

Thesis

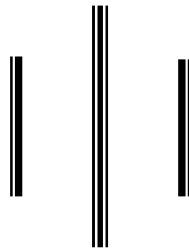
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SUBMITTED TO:

Office of the Dean

Faculty of Management

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In partial fulfillment for the requirements for the degree of Master of
Business Studies (MBS)

Nepalgunj, Nepal

August, 2010

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VIVA- VOCE SHEET

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And found the thesis to be the original work of the student written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for Master of Business Studies (MBS)

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Chairman of Research Department

Member (Thesis Supervisor).....

Member (External Expert).....

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DECLARATION

I hereby declare that the work reported in this thesis entitled "**Revenue Generation From VAT in Nepal**" submitted to Office of Dean, Faculty of Management, Tribhuvan University is my original work done in the form of partial fulfillment of the requirement of Master's Degree in Business Studies (M.B.S.) under the guidance and supervision of Mr. Shreebas Adhikari, (Lecturer) of Mahendra Multiple Campus, Nepalgunj.

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SHIVA JEE POUDEL

TABLE OF CONTENTS

	<u>Page No.</u>
Recommendation	i
Viva- Voce Sheet	ii
Declaration	iii
Acknowledgements	iv
Table of Contents	v-viii
List of Tables	ix
List of Figures	x
List of Abbreviations/ Acronyms	xi

CHAPTER- I

INTRODUCTION 1-7

1.1 Background	1
1.2 Statement of Problem	3
1.3 Objective of the Study	5
1.4 Significance of the Study	5
1.5 Research Methodology	5
1.6 Limitation of the Study	6
1.7 Organization of the Study	7

CHAPTER- II

CONCEPTUAL FRAMEWORK & REVIEW OF LITERATURE 8-59

2.1 Conceptual Review	8
2.1.1 An Introduction to VAT	8
2.1.2 Types of VAT	9
2.1.2.1 Consumption Type VAT	9
2.1.2.2 The Income Type VAT	9
2.1.2.3 The Gross National Product Type VAT	10
2.1.3 Method of Calculation of VAT	11
2.1.3.1 Addition Method	12
2.1.3.2 Subtraction Method	13

2.1.3.3 Tax Credit Method	13
2.1.4 Tax Inclusive Vs. Tax Exclusive Prices	18
2.1.5 Structure of VAT	18
2.1.5.1 Tax Base	18
2.1.5.2 Freeing From VAT	20
2.1.5.3 Tax-Exemption & Zero-Rating	21
2.1.5.4 Threshold	22
2.1.5.5 Tax Rate	23
2.1.6 Operation of VAT	24
2.1.6.1 Registration	24
2.1.6.2 VAT Account	25
2.1.6.3 The Practice of Self-accounting	26
2.1.6.4 Tax Invoice	26
2.1.6.5 Abbreviation Tax Invoice	27
2.1.7 Collection of VAT	28
2.1.7.1 Tax Computation	28
2.1.8 Tax Credit and Tax Refund	28
2.1.8.1 Enforcement	29
2.1.8.2 The Legal Provision	30
2.1.9 International Experience Regarding VAT	30
2.1.9.1 The Evaluation of VAT	30
2.1.9.2 The Implementation of VAT	31
2.1.9.3 The Momentum of VAT	32
2.2 Legal Provision Relating to VAT in Nepal.....	33
2.2.1 Structure of VAT	33
2.2.1.1 Rate Coverage & Threshold	33
2.2.1.2 Exemption	34
2.2.2 Operation of Vat	36
2.2.2.1 Registration.....	36
2.2.2.2 De-Registration	37
2.2.2.3 Tax Invoice	37
2.2.2.4 Abbreviated Tax Invoice	38
2.2.2.5 Debit/Credit Note	39
2.2.2.6 Sales in Foreign Currency	39

2.2.2.7 Purchase Book	40
2.2.2.8 Sales Book	40
2.2.3 The Tax Credit & Tax Refund	40
2.2.3.1 Conditions to Get Tax Refund	41
2.2.3.2 Goods on Which Tax Refund cannot or only partially be Claimed	42
2.2.3.3 The Tax Refund Process	43
2.2.4 Tax Assessment	44
2.2.4.1 Computer Assessment	45
2.2.4.2 Management Assessment	45
2.2.5 Collection of VAT	46
2.2.6 Provisions for Additional Fees, Interest, Punishment and penalty.....	46
2.2.6.1 Additional Fees under Section 19	46
2.2.6.2 Interest under Section 26	46
2.2.6.3 Punishment and Penalty under Section 29 (1)	47
2.2.6.4 Penalty for Transaction Carried out without VAT Registration	47
2.2.7 Provision for Appeal	47
2.3 Review of Related Studies	48
2.4 Thesis Review	57

CHAPTER- III

RESEARCH METHODOLOGY 60-61

3.1 Research Design	60
3.2 Nature & Sources of Data	60
3.2.1 Sources of Secondary Data	60
3.2.2 Sources of Primary Data	61
3.3 Data Processing Analysis Procedure	61

CHAPTER- IV

PRESENTATION & ANALYSIS OF DATA 62-85

4.1 Background	62
4.2 Analysis of Secondary Data	62

4.2.1 VAT Registration	62
4.2.2 Filing of Tax Return	66
4.2.3 Status of VAT Registrants.....	68
4.2.4 Composition of VAT Revenue	69
4.2.5 Collection of VAT.....	71
4.2.6 Revenue Mobilization from VAT and other Sources	74
4.3 Analysis of Primary Data	75
4.3.1 VAT-Administration	76
4.3.2 Accounting System	77
4.3.3 VAT and Applicability	78
4.3.4 VAT and Inflation	78
4.3.5 Small Vendors	80
4.3.6 Economic Growth	81
4.3.7 Illegal Trade	82
4.3.8 Tax Leakage	83
4.4 Major Findings	84

CHAPTER-V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

86-95

5.1 Summary	86
5.2 Conclusion	88
5.3 Recommendation	90

BIBLIOGRPAHY

LIST OF TABLES

<u>Table No</u>	<u>Name of the Table</u>	<u>Page No.</u>
2.1	The Method to Calculate VAT	14
2.2	Calculation of VAT Liability by Different Methods	15
2.3	Calculation of VAT Liability by Tax Credit Method	16
2.4	Calculation of VAT Liability under subtraction and Tax Credit Method...	17
2.5	VAT Burden under Tax Exemption	21
2.6	Burden of VAT under Zero-rated Tax	22
4.1	No. of VAT Registration	63
4.2	Composition of VAT Registrants	65
4.3	Status of VAT Return	67
4.4	Status of VAT Registrants	68
4.5	Composition of VAT	70
4.6	Collection of VAT	72
4.7	Calculation of Trend of VAT Revenue	73
4.8	Revenue Collection from VAT and other Sources	74
4.9	Effectiveness of VAT Administration in Nepal	76
4.10	System of Record Keeping	77
4.11	Applicability of VAT	78
4.12	Inflationary of VAT in Nepal	79
4.13	Enough ness of Present Threshold to secure the Small Vendors	80
4.14	Helpfulness of VAT to Economic Growth	82
4.15	Helpfulness of VAT to discourage to Illegal Trade	83
4.16	Leakages in VAT	84

LIST OF FIGURES

<u>Fig. No.</u>	<u>Title</u>	<u>Page No.</u>
4.1	No. of VAT Registration	64
4.2	Composition of VAT Registrants	65
4.3	Status of VAT Return	67
4.4	Status of VAT Registrants	69
4.5	Composition of VAT	70
4.6	Collection of VAT	72
4.7	Revenue Collection from VAT and other Sources	75

LIST OF ABBREVIATIONS/ ACRONYMS

VAT	-Value Added Tax
IMF	-International Monetary Fund
WB	-World Bank
GDP	-Gross Domestic Product
i.e.	– That is
GNP	-Gross National Product
NNP	-Net National Product
Vs	-Versus
UDCs	-Under Developed Countries
TPIN	-Tax Payer Identification Number
IRD	-Inland Revenue Department
FY	-Fiscal Year
FNCCI	-Federation of Nepal Chamber of Commerce & Industry
Rs.	- Rupees (Nepalese Currency)
MOF	-Ministry of Finance
A.D.	-Anno Domini
EU	- European Union
SAARC	-South Asian Association for Regional Co-operation
UN	-United Nations
T.U.	-Tribhuvan University

CHAPTER I

INTRODUCTION

1.1 Background

Taxation is the most effective and powerful tool reserved in the hands of government of a country. It is taxation, which invest paramount power in the government to hold over the economy of country. The major objective of taxation is to make fund available for the economic development and economic stability. A major part of government revenue comes from taxation is much better than external resource mobilization. It is better for developing countries to maximize revenue through domestic source, which is much safer and fruitful as well. Taxation not only contributes in economic development and stability but also helps equal distribution of national income of a country.

Taxes are usually classified into direct taxes and indirect taxes. There is a predominant role of indirect taxes in Nepalese tax structure. VAT system has been considered as an attractive alternative to exist as an indirect tax system spreading around the world. Although it is the youngest form of taxation which; was innovated in the second half of the twentieth century. It has been emerging as a main element of the worldwide tax reform, in every attempt of tax reform; VAT is now gaining the primary preference. (Bista: 1999)

For the replacement of sales tax, entertainment tax, contract tax and hotel tax, the government of Nepal has introduced VAT in 1997. Especially it is supplementary of sales tax or improving sales tax. The goods are passed through different channels (i.e. producer-agent-whole seller-retailer-consumer) by adding the value in each channel. In this process government charge 10% (13% from year 2003) on the added value that is called value added tax (VAT).

For example producer sold some cooker for Rs 500 each to the whole seller who sold it on for Rs. 800 by adding Rs. 300 extra charges and the retailer also sold it @ Rs. 1000 each to the customer by adding Rs. 200 each. In this process the government charges 13 % on added value in each stage that is called VAT. From this illustration, we find that producer pays Rs. 65 to the government. The difference excess amount between producer and whole seller is Rs. 300 then whole seller pays

Rs. 39 by subtracted already paid producer Rs 65 and like this retailer also should paid Rs 26 to the government.

VAT is a recent and an important innovation in the field of modern taxation system. After its origin in France, it gained worldwide popularity at the academic level as well as practical level. After France adopted VAT for the first time in 1954, the Ivory Coast adopted it in 1960 and then Senegal in 1961. Since 1967 onwards VAT gained worldwide momentum and as a result from that time to 2001, with the exception of 1974, 1978, 1979 and 1981, each year some or the other country has been adopting VAT. In Nepal VAT was introduced in mid-November 1997 as a major part of tax reform program and in the process of implementation various other reform-oriented activities have taken place. VAT was adopted after following preparations were made.

Preparation of VAT Act and regulation, establishment of an appropriate organizational structure and personnel system, computerization system, imparting knowledge regarding various aspect of this tax to potential tax payers and to various sections of the society, etc VAT is a modern tax that is based on the principle of self-assessment. VAT has done with administrative procedures such as taking approval of the price of the purpose of sales tax, submission of annual statement of accounts tax, assessment by the tax officer stamping of invoice, submission of the invoice at the tax office along with the tax returns.

VAT is the transparence tax system that is based on the taxpayer's transition. VAT is not only transparent in it but also demands transparency in other tax system as well. Unless such environment is created VAT cannot be implemented effectively. VAT is the youngest member of the sales tax family, which is broad based. Since the base of the VAT is extensive, under this tax resume more revenue can be collected through lower rates. The effective implementation of this tax can help in reducing the rates of custom duties and income tax along with reducing smuggling of imported goods and hence improves the balance of payment, reduces the unintended distortions, services horizontal equity in a greater degree and makes the tax system simple and natural. In similar manner VAT has many provisions to correct its regressive nature.

“VAT is levied on all goods and services, unless specifically exempt by the law and collected at different stages in the process of production and distribution.”

(Khadka, 2000:61)

VAT is new concept on collection revenue, which is recently innovated in the field of the taxation. Each step of the goods and the services are levied to tax on its added value. It covers the value added to each commodity by a firm during each stages of the production and the distribution and the VAT is forward completely to the ultimate consumers. In Nepal after several years' preparation the value added tax act was finally passed on parliament in December 1995. Even after the passage of the law there were a lot of constraint in introducing and implementing VAT in Nepal. The business community was against VAT and various groups carried out 11 days strike against VAT. The first two years of VAT remained very turbulent. Despite this entire VAT system has increased the motivation and dedication of people.

1.2 Statement of the Problem

Nepal's revenue mobilization could not gain momentum for a long time. It is unable to reach at least 12% of GDP. All the improvements required and known in customs excise duty, sales tax and income tax had already been put in place. The improvements identified by International Monetary Fund (IMF) and the World Bank (WB) had also been implemented. Still, the revenue mobilization cannot take any speed. Thereafter, new taxes were introduced instead to identifying problems with in the existing tax system and trying to rectify them. Where the revenue collection did not increase even after improvements in the prevailing taxes, it should have been understood that only an effective tax system is not adequate for Revenue mobilization but it also requires capable and motivated tax administration, honest taxpayers, as well as political commitment. But in our context, instead of finding solution to these, efforts were made to find a new tax system. VAT is one example. This was also natural at that time when VAT and its success were being widely discussed in the world, especially in the developing countries. The news that countries, implementing VAT were experiencing an encouraging level of increase in revenue collection was being relayed. Countries were competing with each other to implement VAT and in a short duration of time more than 125 countries had implemented VAT. Besides negative aspects of this tax was not coming from any of the country which implemented VAT Against this global scenario, Nepal had yet to implement VAT.

Since the prevailing tax systems were not able to increase revenue collection even with all the improvements put in place it was but natural to expect that Nepal would benefit from implementing the renewed VAT system. In this context, Nepal put forward the intention to implement VAT.

VAT was implemented after several preparations. Programs such as publicity, campaigns, workshops, training advertisements, publication of articles discussion on radio and television, commenced various booklets and other materials were published. In this process only the positive aspects of VAT were discussed and publicized. The negative aspects were not taken into consideration. So that shortcomings that can enter on the process of VAT implementation could not discuss. The tax system was explained in such a manner that it seemed to be the solution to all the problems related to revenue collection. People who expressed their doubts about the effective implementation of VAT were told that smuggling would automatically be uprooted, revenue leakage would automatically be controlled, exports would automatically increase and that revenue collection would increase so much that foreign aid would not be required with the implementation of VAT.

In Nepal, the full implementation of VAT till the retail level has crossed its six-year but still the revenue collection has not been able to increase as expected. VAT was implemented to replace then existing sales tax, contract tax, hotel tax and entertainment tax. Therefore, VAT should have been able to successfully displace the revenue that this sector had been paying in the past. In other words, the revenue collection from this sector has to increased manifold compared to the revenue collection in the past. Otherwise, there was no need to bring in a new tax system abolishing the old ones.

The revenue collections from the four taxes that have been replaced by VAT were a maximum of 35% and minimum of 33.2% of the total tax revenue. But after the implementation of VAT, the revenue received through this tax dropped to approximately 30% of the total tax revenue. {m.o.f.} This indicates that VAT collected less revenue than the four taxes that are replaced. Therefore, it can be said that there has been no real increase in revenue collection with the implementation of VAT. This proves that only a scientific and modern tax system is not sufficient to increase revenue collection. The present situation of VAT shows the need of understanding and commitment at general tax payers, political level, and

motivated tax administration, serious study of the negative aspects of the tax system and honest and earnest attempts and environment to tackle them in order to make any tax system revenue productivity. At present, Nepal has practiced a flat rate of 13% of VAT and the threshold level is Rs. 2 million on annual transaction. Now it is the time to review the exciting provisions, which are the subject matter of the studies. This study is concerned to know the trend of VAT collection and to project the VAT for the particular future period by knowing the trend and making the projection VAT implementation may become more effective.

1.3 Objectives of the study

The basic objective of the study is to analyze “Revenue Generation from VAT in Nepal” and specific objectives are as follows:

-) To analyze the status of VAT registrants
-) To analyze the composition of VAT revenue.
-) To analyze the applicability of VAT.
-) To examine the helpfulness of VAT on economic growth.
-) To study the contribution of VAT in revenue collection in Nepal.

1.4 Significance of the study

The implementation of the VAT has crossed its sixth years. VAT was expected to occupy an important part of Nepalese revenue. This study could be a great signification to identify and rectify the existing position of revenue collection through VAT and for the future implementation.

1.5 Research Methodology

• Research Design:

There are two types of research: i.) Descriptive ii.) Analytical. The study of VAT Act, VAT rules and regulations, government's plan etc. is done as a part of descriptive research. It includes the evolution and development of VAT. The study of

the literatures concerning the VAT system and the clarification of concepts associated with VAT are also conducted during the mean time of the research. Analytical research is conducted to analyze the trend and contribution of VAT in the government revenue of Nepal. It is done mainly through the secondary sources of data available from various publications. Therefore this research is designed descriptive as well as analytical research based on secondary sources of data.

•**Nature and Source of Data:**

Data needed in the studies are collected from the primary & secondary sources. Types of secondary sources of data consist of Inland Revenue Department, Central Bureau of Statistics, Ministry of Finance, Economic Survey and Budget speeches of various fiscal year, Nepal Rastra Bank Publications and other different reports and related published materials.

• **Data processing and analysis procedure**

The information received from the secondary sources of data is processed for tabulation and analysis. For the purpose of analysis, generally simple statistical tools are used as follows:

1. Simple Percentage.
2. *Analysis of Time Series.*
3. Method of least square.

1.6 Limitation of the study.

-) The study is based basically on the data of 8 years (1997/98 to 2004/05)
-) Most of the data in the study are used from the secondary sources & some from primary data.
-) The study is very specific on VAT.
-) The study has been performed with in limited time and resources
-) The study is basically centered in revenue generation from vat in Nepal.

1.7 Organization of the Study

The study has been divided into five different chapters. The first introductory chapter includes general introduction of the study, statement of the problem, objectives of the study and limitations of the study. The second chapter deals with the concept of VAT and the review of literature. The third chapter deals with the methodology employed in this study. The fourth chapter contains the presentation and analysis. The last, fifth chapter focuses the summary, conclusion and recommendation.

CHAPTER - II

CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE

2.1 Conceptual Review

2.1.1 An Introduction to VAT

Value added tax is a twentieth century innovation in the tax system. This tax is based on goods and services. It is also considered to be a tax that is based on consumption. Since this tax is based on consumption, the burden of this tax has to be born by the consumers. VAT is regarded to be a member of the sales tax family, since it is imposed on the sales of goods and services. This tax is levied on the value addition at each stage of economic activities from the time of production to consumption of all goods and services. Value addition implies the difference between the purchase and sales price that has been added. Value addition implies the difference between the purchase and sales price that has been incurred in labour, capital, etc. in relation to the production or distribution of goods and services. This also includes the profit amount that is due to the businessman for taking the risk. Therefore, value addition includes the entire expenses and profits incurred in the process of preparing the goods or services for sale after its purchases. Since VAT is levied only on the value addition made at each stage in the process of production and distribution, this tax system seems more neutral, efficient, elastic and fair and it is also said to be an improved version of the sales tax.

VAT is levied on sales of all goods and services excluding those that have been exempted by the law. Although the laws of different countries have a short or long list of tax-exempted goods and services based on the experience of the past tax system, economic condition, the revenue requirement, the standard of the accounting system, political and social will etc. VAT exemption is generally granted to those goods and services, which are administratively difficult to tax or on those goods and services that are of day-to-day basic necessities of a large number of people. It is also believed that the exemption list should be as short as possible in order to implement VAT more effectively.

VAT is levied on each level of sale from the production and imports to

distribution of all goods and services except exempt ones. But for those small businesspersons engaged in the sale of good and services below the specified threshold level, it is not mandatory for them to register under VAT. However they can register voluntarily. To keep small businesspersons outside the tax purview, a threshold has been specified under the VAT system. The wholesalers, retailers, dealers, or producers who sell goods or services below the threshold level do not have to be register under VAT and neither do they have to collect VAT on their sales.

2.1.2 Types of VAT

There are several bases to classify the different types of VAT. However, the Classification of VAT on the basis of the treatment of capital goods is much important. Considering the treatment of capital goods, the following classification has been made in board sense.

2.1.2.1 Consumption Type VAT

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

2.1.2.2 The Income Type VAT

The income type of VAT does not exclude capital purchased from firms from the tax base in the year of purchase. This variant, however, does exclude depreciation from the tax base in the subsequent years. Moreover, under this system, an excess of year-end inventory is included in the ax base while an excess of staring inventory over year-end inventory is excluded. The tax falls both on consumption and net

investment, and the conceptual tax base of this variant is the net national income. For this reason a comprehensive VAT of the income variety is equivalent to flat-rate integrated tax on corporate and personal income, with no exemptions or deductions other than those needed to measure income? Therefore, tax base is given as;

$$\text{Base of VAT} = \text{NNP} = C + I_n;$$

Where, C = Consumption; I_n = net investment

2.1.2.3 The Gross National Product Type VAT

Under this variant, capital goods purchased from other firms are not deductible from the tax base in the year of purchases. This variant does not allow the deduction of depreciation and gross investment, and the conceptual tax base of this variant is good domestic product. That is, base of VAT = GNP = C + I_g

Where, C = Consumption; I_g = gross investment

Thus, the variants of VAT differ depending upon the treatment of capital goods. The consumption variant excludes all capital goods purchased from other firms in the year of purchase from the tax base, but makes no allowance for depreciation from the tax base in the subsequent years. Both the income and gross national variants do not exclude the purchase of capital goods from the tax base in the year of purchase in that the income variant excludes depreciation from the tax base in the subsequent year while the gross nation product variant does not do so.

Among these three types of VAT the consumption variant has been widely used in several countries in Europe and elsewhere in recent years. The reasons for the popularity of this type are that this variant does not affect decision regarding investment and growth since it relieves from any tax burden. Since the consumption variant does not discriminate against capital-intensive techniques in favor of labour intensive techniques, there is no need for a firm to switchover from capital to labour intensive techniques. Hence, consumption variant is neutral regarding the production techniques. On the other hand the gross national product variant that it is unlikely to be widely used discourages firms to use capital intensive methods of production and

encourages using the labour intensive method, which do not involve frequent year-to-year fluctuations in physical volume of inventories. Moreover, the GNP type creates a substantial discriminative for saving and investment because of which it is not likely to family of any country (Khadka, 1989:4).

From an economic growth point both the income and gross product variants have an anti investment basis. The distinction between the purchase of capital goods and intermediate goods is not needed under the consumption types of VAT, which is essential under other two variants. The income type also needs the computation of depreciation in subsequent years, which further complicates administration. Thus, consumption variant is attractive from the point of tax administration. Even from the consideration of foreign trade, consumption variant is more attractive than the income variant since the former is compatible with destination principle and letter with origin principle. Thus, the consumption variant is most desirable than the other two variants in several respects.

VAT can also classify on the base of the vertical coverage through production and distribution stages. Under this classification extent of vertical coverage forward from manufacturing has more practical importance, which has three sub- divisions with different bases. Firstly, the value added principle may be used with in the manufacturing sector only, with tax applying to each manufacture on his value added but not by wholesalers, or retailers, except to a limited degree. Secondary, the tax may be extended through the last wholesale transaction usually called a pre-retail VAT. Lastly, VAT may be extended through the retail level from the earlier stage of production. This type of be extended through the retail level from the earlier stage of production. This type of VAT is known as comprehensive or full-fledged VAT. Under the same classification, next type is based on the extent to vertical coverage backward from manufacture. Under this type, VAT may be extended to all producers of basic raw materials including farmers. However, this type creates administrative difficulties due to the large number of small establishments and scattered units.

2.1.3 Method of Calculation of VAT

Value-added tax can be collected by using the different methods of computation; however the choice of the appropriate method depends basically on the type of VAT

employed and the principle under which VAT is adopted. The VAT can be computed by employing any of the three methods: i) addition method, ii) subtraction method, and iii) tax-credit method, among which the “last method has never been utilized” (Due, 1976:71).

2.1.3.1 Addition Method

This method is also known as the direct value-added computation method. Under this method the tax base is obtained by adding the incomes produced by the firm. In other words, the tax base is computed by adding the expenditure made by the firm to the factors of production employed in turning out the product, such as wage, rent, interest, royalties, profit etc. Thus, VAT under addition method is the function of the total factor payment as given by:

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

Where, W = wage, R = rent , I = internet, P = profit.

If the firm uses its own capital goods rather than purchasing it, this addition method captures the value added by the firm. The capital method is readily applicable to the income type of VAT includes the rewards to all factors as its base but clumsy for the consumption type of value-added tax (Musgrave and Musgrave, 1976:401). Virtually, no country uses the addition method, although, Argentina and Israel have applied it to selected economic activities, such as banking and finance, where value of inputs and outputs is difficult to measure (Conssen, 1992: 217, 218). From the practical point of view, this method is more complex to compute. It would be awkward to use the addition method to compute the base of the consumption type of value-added tax, since to the net profit figure there would have to be added depreciation and the excess of opening inventory over closing inventory (deducted, as a part of cost of goods sold, in computing net profits), with subtraction of capital goods purchased or produced within the firm and subtraction of an excess of closing inventory over opening inventory (Shoup, 1969: 258).

2.1.3.2 Subtraction Method

Under this method value added is determined as net turnover, which is obtained by subtracting the cost of materials from sales proceeds. Thus, VAT is levied on the amount; which is derived by subtracting purchase from sales as given in functional form: $VAT = f (SV-PV)$

Where, $SV =$ sales value, $PV =$ purchase value.

This method is appropriate for the consumption type of VAT that includes in its base the rewards to all traders.

2.1.3.3 Tax Credit Method

This method is also known as the invoice method in which, tax is levied on the total value of sales, and taxpayers are permitted to deduct from their gross tax liability the taxes already paid by them. Thus, in contrast to the subtraction method, which deducts purchasers from sales and levies taxes on the difference, tax on purchases is subtracted from the tax on sales under the tax credit method.

Whatever them method of calculation of VAT, the basis for VAT is the value addition that takes place at each level in the production and distribution process of goods and services. Value addition is the difference between the purchase and sale price of goods. For example, if a wholesaler purchases something from a producer at Rs. 100 and sells to a retailer at Rs. 130 then the value addition at the wholesale is Rs. 30 and it is on this amount the VAT is levied. The value addition that takes place at different levels of production and distribution can be further clarified by following example.

Let us suppose that a producer has imported raw materials at Rs. 50 from a foreign country to manufacture some goods. The producer than used the raw materials to prepare a finished product and sold to a wholesaler at Rs. 100, the wholesaler than sold it to a retailer at Rs. 130 and the retailer to the consumer at Rs. 130 and the retailer to the consumer at Rs. 150. Then for the purpose of VAT, the value addition at the import level is Rs. 50 in the production level it is Rs. 50 at the wholesale level Rs. 30 and at the retail level Rs. 20. These amounts are the basis for VAT and when applied at the rate of 10%, the VAT amount will be Rs. 5 at the

import level, Rs. 5 at production level, Rs. 3 at wholesale level, and Rs. 2 at retail level, amount to a total VAT of Rs. 15.

But calculating the value addition at each level of sale becomes difficult in the practical implementation of VAT. To avoid this situation, most countries adopting VAT, have introduced the tax-credit system to calculate VAT and than the value addition at each stage does not have to be calculated. According to this system the vendor should apply the specified VAT rate on the sale price and deduct from the amount thus collected the tax paid on purchases and imports and submit the remaining amount to the treasury. The concept of the principles of VAT is thus brought into practice through the medium of tax credit and tax is levied as per table 2.1.

Table2.1
The Method to Calculate VAT @ 10%

Production Distribution Level	Sale price	Value addition collected	Tax collected from sales	Tax incurred on Purchased	Actual Tax to be paid
Importer	50	50	5	0	5
Producer	100	50	10	5	5
Wholesaler	130	30	13	10	3
RETAILER	150	20	15	13	2
Total		150			15

In practice only the remaining amount after deducting the tax paid on purchases and imports from the tax collected from sales have to be submitted to the government. The result of this is the same as calculating the value addition at each stage and then applying VAT at the specified rate. Thus under the tax credit system, which is also referred to as the invoice system, value addition, is not calculated for purpose of VAT but the same result will have been obtained indirectly through tax credit.

Thus, the tax credit method has the following major benefits over the other two types of VAT computation. (i) In the tax credit method, tax liability is attached to transaction that makes it legally and technically superior, (ii) tax collection is easy, (iii) cross-checking is possible, (iv) it provides the benefit of catch-up effect that make under valuation and evasion impossible, (v) there will be no loss of revenue due

to the exemptions granted to the small traders (vi) it never demands for the calculation of value-added total tax (vii) liability entirely depends on the rate on the rate on the last stage, so rate differentiation is possible for the same revenue yield.

This mechanism is further desirable since it puts an equal burden of taxation on both imports and domestic products, irrespective of channels of distribution and proportion of value added at various stages. Thus, the tax credit method is desirable for several reasons and has been adopted by many countries of the world.

From the table 2.2, it is clear that VAT liability calculated by any of the three methods is same that is Rs. 400. In the table VAT rate is same that is 10% for all method for the sake of simplicity in calculation though 13% VAT is applied in practice. However, if there is rate differentiation in different stage VAT liability will differ for different method.

Table 2.2
Calculation of VAT Liability by Different Methods (10% VAT)

	Stage of production and distribution			
	Manufacturer	Wholesaler	Retailer	Total
A. Addition method				
a. Wages	1000	550	750	2300
b. Rent	300	150	150	600
c. Interest	150	100	50	300
d. Profit	350	200	250	800
e. Value-added (a+b+c+d)	1800	1000	1200	4000
f. VAT liability (10% of e)	180	100	120	400
B. Subtraction Method				
a. Sales	8600	9600	10800	29000
b. Purchases	6800	8600	9600	25000
c. Value-added (a-b)	1800	1000	1200	4000
d. VAT liability (10% of c)	180	100	120	400

C. Tax credit Method					
a. Sales		8600	9600	10800	29000
b. Tax on sales		860	960	1080	2900
c. Purchases		6800	8600	9600	25000
d. Tax on purchases	680		860	960	2500
e. Net VAT liabilities (b-d)	180		100	120	400

Note: All sales and purchases are exclusive of tax and figures are arbitrarily assumed.

Similarly 10 % VAT rate has been applied for the sake of simplicity in calculation though 13% VAT rate is applied in practice.

Although, the change in the VAT liability will be same under both the addition and subtraction, method, as there is same amount of value added at each stage of production and distribution. Assuming that the transaction (figures) presented in the table are for the economy as a whole in a specified period of time, a VAT of 10% rate gives Rs. 400 as tax under the first methods having the amount of value added Rs. 4000. In tax credit method, value added, as such is never calculated; however VAT liability exactly equals to that by other methods. Thus VAT is levied on the basis of value added but not directly. Calculation of VAT liability under the tax credit method is shown in table 2.3.

Table 2.3

Calculation of VAT Liability by Tax Credit Method (VAT rate 10%)

(Figure in Rs.)

	Stage production and distribution			
	Farmer	Manufacturer	Wholesaler/ dealer	Retailer
Types of product	Sugarcane	Sugar	Sugar	Sugar
Purchase value (a)	0	200	400	450
VAT paid on purchases (b)	0	20	40	45
Sales value (c)	200	400	450	510
Gross VAT liability on sales(d)	20	40	45	51
Net VAT liability (d-b)	20-0=20	40-20=20	45-40=5	51-45=6
Actual sales price (c+d)	220	440	495	561

Notes: Figures are estimated arbitrarily and both the sales and purchase value exclude tax liability. Similarly 10 % VAT rate has been applied for the sake of simplicity in calculation though 13% VAT rate is applied in practice.

Here, for the sake of simplicity, the purchase value of the farmer is assumed zero. As shown in the table 2.3, each seller calculates the gross tax by applying the giving tax rate to his sales value and then gets net VAT liability by subtracting the amount of VAT liability paid by seller at different stages equals to the gross VAT liability on sale with the same VAT rate as indicated in the table), as far as tax credit chain is not broken.

Unlikely the remaining two methods, in the tax credit method, there will be no change in total VAT liability by the rate differentiation in earlier stages, unless tax rate on last stage is changed. A 10 percent VAT rate through all the stages gives same VAT liability that is Rs. 40 under both the subtraction and tax credit methods. When the VAT rate is increased to 12 percent at manufacturing stage, remaining the same initial rate at all other stages, the tax liability calculated by subtraction method increased by Rs. 25 (that reached to Rs. 45). However, there is not any deviation on the total tax liability calculated by the tax credit method. This is clearly shown in the table

2.4.

Table 2.4

Calculation of VAT liability under subtraction and Tax Credit Method

(Figure in Rs.)

Production and Distribution Stages	Sales value (excluding VAT)	Value Added	VAT liability	
			Subtraction Method	Tax credit method
A 10 percent VAT at each stage				
Farmer	200	200	20	20-0=20
Manufacturer	300	100	10	30-20=10
Wholesaler	350	50	5	35-30=5
Retailer	400	50	5	40-35=5
Retailer	400	50	5	40-35=5
Total	1250	400	45	125-85=40

B. 12 percent VAT at manufacturing stage and 10 percent at all other stages				
Farmer	200	200	20	$20-0=20$
Manufacturer	300	100	15	$36-20=16$
Wholesaler	350	50	5	$35-36=-1$
Retailer	400	50	5	$40-35=5$
Total	1250	400	45	$131-91=40$

Note: Figures are arbitrarily assumed.

2.1.4 Tax Inclusive VS. Tax-Exclusive Prices

There are two alternative ways of applying the tax rate on prices. The tax may be applied to the figure of sales exclusive of tax, or inclusive of tax. If the tax is applied to the figure, after fixing the price of the product at first; the method is called the tax-exclusive prices. However, separate requirement of tax statement and the price of the product are not essential. But the tax-inclusive price requires the application of tax rate to the whole figure and further it demands the amount of tax itself into the tax base again. For example, with a 20 percent tax rate, the tax on an item selling for Rs. 100 net of tax will be Rs. 20 (before deducting tax paid on purchase) with the tax-inclusive method and Rs. 25 with tax inclusive method (since the tax element is itself subject to tax) France used the latter method for a long time but has recently moved to the tax-exclusive method in conformity with the EEC directive (Due, 1976:96).

The tax-exclusive method has a great advantage of simplicity and greater ease in forward shifting of the exact amount of tax. The effective tax rate is clearly revealed. The inclusive method is confusing and has no possible merit, except to yield more revenue at a given nominal tax rate. Thus, the tax-inclusive method is only to get greater yield with a lower tax rate, however neglected basically on the ground of administrative difficulty.

2.1.5 Structure of VAT

2.1.5.1 Tax base

Tax base may be defined as the sets of incomes and transactions on which

direct and indirect taxes, are levied. Tax base, in other words, is the total pool, in which the tax authorities can tap by levying a tax. Theoretically taxable base of VAT capture all types of expenditure on final consumer goods. High revenue productivity, one of the major features of VAT because of its broad base. The tax base of a VAT depends on its coverage, which means all kinds of goods and services or business transactions are included into the tax base. Taxable transactions and taxable persons both come into the coverage of VAT. Taxable persons are those who independently engage in supplying goods and services where taxable transactions are broadly the supplies made by the persons engaged in the industrial and commercial activities.

Tax base explains whether a VAT is levied on all goods and services or on some subset of such comprehensive base. The tax base for VAT can be broadly classified into following categories: (i) all goods and services, (G +S); (ii) goods and selected services, (G+St) ; (iii) goods only (G); (iv) consumption ©. If in the transaction of certain goods and services, zero-rated tax is levied then such goods and services or transactions are kept within the purview of VAT. That dealing is such transactions have to be registered under VAT and also fulfill all the other formalities that are applicable to other registrants of goods and service, (G+Cg); or consumer goods, selected services and capital goods (C+St+Cg).

Evidently, there is a wide diversity in the size of the VAT base across countries, but the general preference towards a broad-based VAT is clear. It is desirable to include all kinds of goods, services and business activities into the coverage of VAT so that all consumption expenditure comes under the taxable base of VAT. However, in practice, the base of VAT is not found so broad that it covers all the consumption expenditure. A tax based. A sales tax applied to one of few economic goods (resources) is considered 'narrow based', while one levied on wide range of goods in terms of the monetary value of purchased items and in terms of the number of units of the commodity purchased. The former is said to be *ad valorem* in nature and the latter is termed a specific tax. Broad based sales tax may be imposed at one or more than one level of economic activity and hence, they may be either single stage or multistage in nature. Value added tax along with the general retail sales tax and turnover tax come into the broad- based category of the sales tax.

Exemption, zero rating and the tax rate are the major components on which the base of a particular tax depends. In many countries, especially in developing

countries, taxing agriculture is not feasible on the administrative ground and economically undesirable on the equity grounds. So, agriculture is generally exempted which limits the tax base. Similarly, due to administration and equity reasons only some selected services such as electricity, telecommunication, hotels and restaurant, entertainment etc. are taxed. Further, the construction industry is also subject to exempt in some cases; however, the construction materials are taxed. Thus, many problems associated with the successful Implementation of VAT demands a lesser base and hence ultimately reduce the revenue productivity of VAT.

Legal provisions need to be made to determine the base for VAT in the case of goods and services where the gross selling price is unreasonably lower than the actual market price. In such a case the tax officials are authorized to determine the base of VAT on the basis of the market price. Such a provision is necessary in order to check tax evasion particularly at the last point of taxation. Basically, in the counties of EEC, the purchase is relived from the VAT while no allowance is made for depreciation on capital goods from the tax base in subsequent years. In general, the base for VAT on import is the sum of the import value determined for the purpose of customs duties, together with custom duties and other charges, if any, paid by the importer prior to the release of goods from customs custody. Different practices for determining the tax base in the case of goods and services delivered or rendered for no consideration. There is also a practice in some countries, such as Korea, of excluding from the tax base value of goods, which are damaged, broken or lost before deliver. Thus, tax base may considerably differ country wise depending upon the economic situation and policies of the country.

2.1.5.2 Freeing from VAT

Under the VAT regime, there is some provision keeping some special goods and services or transactions beyond the tax base. Such provision is imprinting from the view points administrative simplicity, equity and other economic reasons. In general there are three provision of freeing from VAT viz. exemption, zero-rating and threshold.

2.1.5.3 Tax-Exemption and Zero-Rating

Tax-exemption and zero-rating are the two popular methods of escaping from value added tax. But there is different between tax exemption and zero-rating under the VAT system the transaction of tax-exempted goods or services remains outside the purview of VAT. Those dealing is such transactions do not have to fulfill any formalities, including registering under VAT. However, such taxpayers do not have to collect tax on these sales and neither can they claim for a refund of the tax paid in purchases or imports. This means that the tax amount incurred on the inputs of tax-exempted goods and services goes to the consumer inclusive of the cost price. Table 2.5 illustrates this.

Table2.5
VAT Burden under tax Exemption

(Figure in Rs.)

Level	Sales price Exclusive Tax	Value Addition	VAT amount a					Sales price Including Tax
			On Sale S	-	On Purchase S	=	Actual tax	
Import	50	50	5	-	0	=	5	55
Production	100	50	10	-	5	=	5	110
Export	120	20	-	-	-	=	-	130

If on the transaction of certain goods and services, zero-rated tax is levied then such goods and services or transaction are kept within the purview of VAT. That dealing is such transactions have to be registered under VAT and also fulfill all the formalities that are applicable to other registrants. Such registrants have to collect VAT at the rate of zero percent on their sales and can deduct the tax incurred on their purchases. This means that the zero-rated goods and services do not bear the burden of VAT but should follow the all formalities of VAT. This becomes clear from table 2.6.

Table 2.6
Burden of VAT under Zero-rated Tax
(Figure in Rs.)

Level	Sales price Exclusive Tax	Value Addition	Vat amount a					Sales price Including Tax
			On Sales	-	On purchases	=	Actual tax	
Import	50	50	5	-	0	=	5	55
Production	100	50	10	-	5	=	5	110
Export	120	20	-	-	10	=	-10	120

Note: Figures are arbitrarily assumed.

On the tax exempted goods and services the output tax cannot be collected and not can the input tax be claimed, but the zero-rated goods and services a zero-rated tax is levied, which actually is equivalent to none, and the input tax can be claimed. This means that in the zero-rated goods and services there is no burden of VAT whereas in the tax-exempt goods and services although VAT is not levied on the sales, the VAT burden paid on the input remains. If it is necessary to free certain goods and service completely from VAT then the zero-rated tax should be applied but if on certain goods and services it is administratively difficult to apply tax then these should be given tax exemption. In the input of the letter certain tax amounts are incurred.

2.1.5.4 Threshold

Threshold in VAT is an upper limited beyond with VAT system is in operation. VAT is levied on each level of sale from the production and import to distribution of all goods and services except exempt ones. But for those small businesspersons engaged in the sales of goods and services below the specified threshold level, it is not mandatory for them to register under VAT. To keep small businesspersons outside the tax purview, a threshold has been specified under the VAT system. The wholesaler, retailers, dealers, or producers who sell taxable goods or services below the threshold level do not have to be registered under VAT and

neither do they have to collect VAT on their sales.

Thus, threshold is a kind of exemption, which is based on the amount of the transaction but not on the kind of goods and services. So the threshold must be set on the basis of the nature of the production and distribution system in a country concerned and the status of education and record keeping at various levels of volume among business firms. (Khadhka: 1996)

2.1.5.5 Tax Rate

VAT may be lived on single rate or multiple rates. The choice may be depends on economic nature and social will such as revenue requirement, equity consideration, administrative capacity, nature of product, direction and composition of foreign trade etc. Even through, as these aspects might conflict to each other and hard to achieve simultaneously. Indeed, the lower the VAT rates the higher the costs of VAT administration as a proportion of the yield and hence less productive will be the tax system. A single rated VAT is desirable in UDCs because it makes VAT less costly, easy to comply and administer.

The government can vary tax rates on social grounds and as the part of fiscal policy to increase or decrease spending. Under a multiple rated VAT, there is a need of classifying commodities into different groups according to their rates so that tax administration becomes more complicated. Further burden to the businessmen and the tax administration is created since businessmen have to keep separate records and have to provide more pieces of information while preparing their returns. It creates not only inconvenience but becomes unequal in effect wince a dealer may charge different rates on the same goods sold to the different buyers. Similarly, there is the possibility of a dealer charging a higher rates for goods subjects to lower rates and vice versa. The tax system with multiple rates is also economically inefficient. It results a considerable loss in revenue by providing the scope for taxation. Since an incentives is created to producers to substitute their resources from higher rated to lower rated industries to save the not tax liabilities even when other economic considerations do not justify such reallocation of resources.

The intended objectives of the multiple rates VAT can be achieved only when it is extended through the retail level, but it is very difficult to ensure that retailers can

apply more than one tax rate consequent complications for the operation of the tax are so great, in developing countries, as to lead to the conclusion that a uniform rate should be utilized, certainly if the tax extends beyond the manufacturing level. The Korean experience during the past ten years shows that practice is not as simple as theory. From the policy point of view, recent discussion concerning the VAT has revolved around three issues; (a) coverage of VAT, (b) the level and the structure of the tax rate, and (c) the treatment of small taxpayers. In general, suggestions to use differentiated multiple rates have been made to reduce the tax burden on low-income groups. Rate differentiation has been resisted on the grounds that multiple rates do not achieve redistribution objectives and actually complicate administration and compliance. Thus the introduction of VAT, especially, in developing countries is desirable with a single rate. After the adequate experience and preparation it can be extended to multiple rates to introduce progressiveness by adopting lower rate to the goods of the basic needs, medium rate to general type of goods and a higher rate to the luxurious goods.

2.1.6 Operation of VAT

2.1.6.1 Registration

Value added tax requires registration of vendors in tax authorities, which helps to develop master roll of taxpayers. Any business enterprises if they desire to register can register voluntarily. However, there is no compulsory to register for the small vendors who have an annual turnover below the threshold.

The registration procedure starts with a notice to the potential tax payer's extensive publicity campaign. Then registration forms are distributed so that the vendors will fill up to be a formal member of the taxpayers under the VAT system. Then the registration form is returned back to the VAT department and their coding is made. Thus registrants may be known about VAT in detail so an informative visit needs to be made and check whether the details provided by the taxpayers are correct or not. Although, all the vendors having the transaction of taxable capacity may not be registered so it is almost essential to make a Door-to door check, especially in developing countries. The newly hired staff of inspector and enforcement officers can be used for this purpose.

However, vendors may desire to come into the VAT net since an unregistered vendor can neither claim back input tax paid on his purchases nor collect output tax on his sales and hold it until it is required to be paid to the tax authorities. Further, as the traders do not want to appear excessively small in the eyes of their customer, they may intend to register. Vendors may hesitate to register due to illiteracy in developing countries. Hence, vendor can be attracted towards VAT registration by providing knowledge, careful checking and penalty system. Still there remains possibility that some vendors may register only in order to tax credit facilities and apply for cancellation of registration after taking advantages of the facilities, leading on the considerable loss of revenue. In order to check such practices some provisions needs to be made in the tax laws.

2.1.6.2 VAT Account

VAT is based on self-assessment system. Under the system, a taxpayer is required to keep a proper account of all his business transactions, which is subject to positive rate, zero rate and exemption.

Accounting here refers to a record of his business transactions. In the absence of such accounting system a businessmen is unable to keep an account of profit and loss incurred during the business period and is also unable to determine factors such as the status of the business the business obligations and the asset value. This hinders organized development of his business. Thus, these factors emphasize a need for a proper accounting of business transactions. Account with all supporting documents should be preserved for at least four years.

In order to collect taxes from the consumers while selling taxable goods or services, a businessman will have to register with VAT office. These registered businessmen, who as the agents of the government are required to keep proper accounts not only for themselves but also for the government. Under the VAT system, the tax personnel are not only concerned with the sales figure and tax amount shown by the tax-payers but also are concerned with the purchases related to the sales. During the tax credit and inspection, the tax personnel examine the purchases as well as the sales made by the businessmen and estimate the taxpayer's tax liability. To determine the tax to be paid by the taxpayer during a fixed period, the total sales

and purchase figure together with the relevant documents that support them are required. This calls for proper record keeping of the related invoices and declaration from in a chronological manner, apart from sales and purchases records. The use of invoices is as important for purpose of VAT as the record of the documents related to sales and purchases is for the purpose of accounting.

2.1.6.3 The Practice of Self-accounting

VAT is based on the basis of actual transaction. The businessman himself/herself knows best what transaction has taken place and at what cost. Since a tax payers has to maintain his/her own accounts based on the invoice issues at the time of purchase or sales of goods and services, the VAT accounting is also referred self-accounting system. In this system the purchase book and the sales book are considered main accounts. The accounting process of VAT commences with the sales or purchase invoices. Since the VAT system is process of VAT commences with the sales or purchase invoices. Since the VAT system is based on invoices, the account is maintained by entering the invoices pertaining to purchases into the purchase book and the invoices pertaining to sales into sales book. At a glance the VAT account can be referred to as a chorological entry of invoices. The concept of VAT was developed on this basis. According to the laws of different countries concept of VAT was developed on this basis. According to the laws of different countries worldwide, while maintaining accounts for the purpose of VAT, a taxpayer has to record complete details in relation to sales and purchases. The accounting system of VAT has been developed in such a way so as to case the taxpayer's liability assessing for filling tax returns and to ease the tax official audit of the taxpayer's transaction accounts.

2.1.6.4 Tax Invoice

While selling any goods or services, a taxpayer has to clearly write, "Tax invoice" on the first copy or on the title page of the invoice s/he issues. Three copies of the invoice should be made and the original copy should be given to the buyer, the second copy should be kept in a separate record to product when asked by the tax

officer, and the third copy should be maintained as record for the purpose of his/ her transactions. The invoice number, date of transaction, vender's identification number, name, address and the buyers' name, address and if registered the identification number should be written on the invoice. Similarly the particular of the items or services sold, the quality, and the price per unit sold also should be written. If discount has been given on the customer then the amount and rate of discount should be specified and after deducting the discounted amount form the total price, the tax amount at the specified rate should also be clearly stated. Only on the basis of such an invoice, registered buyers can secure the facility of tax deduction. Hence, while purchasing goods or services one should not forget to make an invoice.

Thus the tax invoice is a crucial document for VAT as it establishes the seller's liability for tax and the purchaser's entitlement or credit. A VAT registrant is required to issue tax invoice whenever a transaction that is above the minimum threshold, takes place.

2.1.6.5 Abbreviation Tax Invoice

A registered vender can sell his/her goods or services only by issuing an invoice as per the law. Not adhering to it will be considered a violation of law and will be punishable. Keeping in mind the welfare of small and retail vendors who deal in a variety of goods in small quantities, the provision to issue an abbreviated invoice, as per schedule 6 of the Regulation, instead of a tax invoice as stated above has been made. In such an abbreviated tax invoice, along with the invoice number and the data, the vendor's name address and the identification number should also be included. It should also state the particulars of the items or service sold its quantity, and the price per unit. If any discount has been given to the customer then the total price after deducting the discounted amount should be stated. In such tax invoice the tax amount cannot be seen as a separate entry but it is included in the price. On the basis of such an invoice a registered buyers cannot avail the facility of a tax refund. A taxpayer who wished to make use of such an abbreviated tax invoice while selling must take prior approval of the tax officer.

2.1.7 Collection of VAT

There are two major steps during the collection of VAT. (a) tax computation and (b) tax credit and refund.

2.1.7.1 Tax Computation

Among the three methods of VAT computation viz.: addition, subtraction and tax Credit method any one can be applied. However, the last one has been used Widely in most of the countries. Under this method, tax is levied on the total sales Of each registered vendor from which the tax paid on the purchases by the Vendor is allowed to subtract. The deduction of tax on purchases from the tax on Sales consists of tax base to be lived tax. The net liability of a vendor is calculated on the basis of the taxable period, not on the transaction basis.

Sometimes, a vendor's deductible input tax may exceed his output tax so that the Net VAT liability of the vendor will be negative. The contradicts to the general Logic that the output tax exceeds the input tax because the base of the former at A particular stage is greater by the amount of value added at that stage than the base of the input tax. In reality, not all the inputs purchased from other firms in a particular tax period are exactly converted into output in the same tax period. Conversely, not all the outputs in a taxable period are solely from inputs purchased in the corresponding period. The former case is responsible for arising the exceptional result that net VAT liability is negative. However, is such situation, tax administration must be more careful that whether the vender is trying to evade the tax.

2.1.8 Tax Credit and Tax Refund

Tax credit or detection and tax refunds are the main features of VAT. Under VAT, a registered tax-payer ahs to collect tax on his/her sales price at the specified rate and deduct the VAT paid on purchases and imports from the tax collected on sales and submit only the remaining amount to the government. This process of deducting the tax paid on purchases from the tax collected on sales is known as the tax credit. Such tax deduction can be made on the tax incurred on the imports and

purchase made in relation to taxable sales and include raw materials, auxiliary materials chemicals, packaging materials, goods imported or purchased for and resale, furniture, equipment, stationary, vehicles, computer, diesel telephone and taxes paid on other relevant imports or purchases.

Sometimes the tax paid on purchases or imports exceeds the total tax collected from sales. Such a situation arises generally in transactions on which a zero-rated tax is levied, for example in export since a zero-rated VAT is imposed on exports; it is equivalent to not changing tax at all. Therefore under such circumstances the tax paid in imports and purchases generally exceeds the tax payers have to be refunded the deference tax amount.

The calculation for tax credit and tax refund does not have to be done on every purchase. It can be done on the basis of tax period. For example, if a taxpayer's tax period is one month and his/ her one month taxable sales is Rs. 20,00,000 and the purchase and import is worth Rs. 15,00,000 then at the rate if 10% the individual should have paid the taxpayers has to deduct the paid tax of Rs.

1,50,000 from the collected tax of purchase is higher than the tax-collected from sales then the deference amount is refunded to the taxpayer.

2.1.8.1 Enforcement

Enforcement of VAT, is one of the major requirements for the successful operation of VAT, in the sense of ensuring that all firms returns file and pay tax to the government at given period of time. VAT system can be found more equitable along with the restriction for tax evasion when the enforcement of VAT is effective. Among the various techniques developed for the purpose of VAT enforcement, the most important is the requirement of adequate records keeping and preserving it for a long time (generally five years), and administrative power to review the records for the accuracy and fairness at y time. Power is granted to tax officials to inquiry, seize a check the records in the cases of suspected fraud. In such cases of suspected fraud, tax officials can enter and search the business premises. In addition to that, the tax liability of VAT payer when they suspect traders may have misr eported their tax liability or when returns are not presented at all registered firm with all firms registered that are required to so; a system for ascertaining failure to file and play;

techniques for resurging that the development as the non filers are called to file play; and method of doing with hard core delinquents. Enforcement requires an accurate up to data master file of registered firms with hardcore delinquents who fail to pay despite notice and visits Due (1976:160).

The basic problem arises with the firms who neither file the tax returns nor pay. However, the automatic penalty and interest charges which can be applied simply and quickly are highly effective in encouraging firms to file and pay on time. These penalties and interest charges are not criminal penalties but simply charges for failure to file and pay on time and are applied automatically without court action. Further, these are assessed at the time of the check for delinquents and are applied to the firms that have paid between the end of grace period and the cut off date as well as those that have not yet filed.

2.1.8.2 The Legal Provision

In the Value Added Tax Act 2052 and the Value Added Tax Regulation 2053 in Nepal various provisions have been made in relation to the accounts to be maintained by a taxpayer for the purpose of VAT. These provisions include aspects such as preparing invoices to filling tax returns. Since the process of VAT accounts begins from the issuance of invoices, a provision has been made under clause 14 of the Act for a registered person to issue an invoice to the seller while selling any goods or service and for the buyer to receive the invoice.

2.1.9 International Experience Regarding VAT

2.1.9.1 The Evaluation of VAT

VAT is the innovation of 20th century. VAT is the youngest member of the sales tax family. Dr. Wilhelm Simens in Germany first proposed the concept of VAT in 1919 A.D. During the World War I, when there was the scare of resources, the German government introduced Umsatzsteuer, a multi-stage sales tax as a temporary measure to mobilize the much-needed resources. During the world war the revenue thus generated was encouraging so the government did not abolish this system even after the world war was over. But under this tax system, tax was levied on the tax

inclusive total sales price at each stage in the production and distribution process and thus the problems of cascading and vertical integration started becoming evident and the German economy became deprived of the benefits of specialization and economy of scale. To resolve these problems, Dr. Siemens proposed tax to be levied only on the value addition each stage of the production and distribution process. The German government debated a lot on this and held many discussions, but since this was a totally new concept and has not been implemented anywhere in the world, the government was not confident about its implementation aspect. Hence, instead of adopting this new system it took measures to implementation aspect. Hence, instead of

adopting this new system it took measures to reduce the negative impacts of the multilevel sales tax system by reducing the tax rates. Professor Thomas S. Adams had suggested VAT in United States of America in 1921. The concept of VAT was developed further in 1949 by a mission assigned to propose reforms in the tax system of Japan under the chairmanship of Prof. Carl S. Shoup. The mission recommended the adaptation of VAT to replace the prevailing enterprise and turnover taxes that were causing undesirable and unintended distortions. To implement this tax, serious discussions were held and although even the law was passed by the parliament, owing to the newness of this tax and the lack of knowledge regarding its implementation, like in Germany, it was not implemented in Japan either.

Thus, although the concept of this tax was evolved in Germany and more detailed form was prescribed for Japan, no country adopted this tax system until 1953. Up to that time, VAT remained a topic of academic discussion.

2.1.9.2 The Implementation of VAT

After three and half decades of the evolution of the concept of VAT, France took the courage to put VAT into practice. France introduced VAT in 1954 at the wholesale level in the industrial sector. Up to 1959, this tax was confined to the boundary of France. In 1960 this tax was adopted by the Ivory Coast in 1961 Senegal followed suit and in 1967 Brazil and Denmark adopted this tax system. Thereafter, many countries started adopting this tax.

In the 1960s, in the process of establishing the European community (EU), the

policy to adopt a standard tax system among the member of the community was adopted. In this context, it was decided that all the member countries of the EU should adopt VAT by replacing their various types of indirect taxes. Since it Became a precondition to adopt VAT to become a member of the EU, the member countries started to introduce VAT into their tax system and gradually this became the standard tax system of the European community.

2.1.9.3 The Momentum of VAT

In the decade of the 1970s, VAT started to spread worldwide. Different countries of Asia, Africa, and North and South America started adopting VAT one after another. This tax system became a popular worldwide measure to bring about tax reforms and its adaptation soon gathered global momentum. This fact can be justified by the increase as follows in the number of countries that adopted this tax.

Year	Countries that have started adopting VAT
1954	France
1960	Ivory Coast
1961	Senegal
1967	Brazil, Denmark
1968	Germany, Uruguay
1969	Netherlands, Sweden
1970	Ecuador, Luxembourg, Norway
1971	Belgium
1972	Ireland
1973	Austria, Bolivia, Italy, United Kingdom, Vietnam
1974	Argentine, Chile, Columbia, Costa Rica, Nicaragua
1976	Honduran, Israel, Peru
1977	Korea, Panama
1980	Mexico
1982	Haiti
1983	Dominican Republic, Guatemala
1984	China

1985 Indonesia, Turkey
 1986 Morocco, New Zealand, Niger, Portugal, Spain, Taiwan
 1987 Grenada, Greece
 1988 Hungary, the Philippines, Tunisia
 1989 Japan, Malawi
 1990 Iceland, Kenya, Pakistan, Trinidad and Tobago
 1991 Bangladesh, Benin, Canada, Jamaica, Mali, South Africa, Egypt
 1992 Algeria, Armenia, Azerbaijan, Cyprus, El Salvador, Estonia, Fiji, Kazakhstan, Kyrgyzstan, Russia, Tajikistan, Thailand, Turkmenistan, Ukraine, Uzbekistan, Moldova
 1993 Burkina Faso, Czech Republic, Paraguay, Poland, Slovak Republic, Venezuela
 1994 Bulgaria, Finland, Lithuania, Singapore, Western Samoa, Madagascar, Nigeria
 1995 Gabon, Ghana, Switzerland, Zambia, Malta, Mauritania, Togo, Latvia
 1996 Albania, Guinea, Uganda
 1997 Barbados, Congo Republic, Nepal
 1998 Croatia, Mongolia, Sri Lanka, Tanzania, Vanuatu
 1999 Cambodia, Cameroon, Mozambique, Netherlands, Antilles, Papua New Guinea, Slovenia
 2000 Australia, Chad, Macedonia, Namibia, Sudan
 2001 Rwanda
 2002 Lebanon, India (proposed)

VAT has been spreading all over the world. Among the member of the SAARC

Countries, Pakistan adopted VAT in 1990.

Bangladesh in 1991 and Nepal 1997 and Sri Lanka introduced VAT in 1998. Between our two neighboring countries, China has been implementing this tax since a long and India has carried out a lot of work in relation to these taxes.

2.2 Legal provision relating to VAT in Nepal

2.2.1 Structure of VAT

2.2.1.1 Rate Coverage and Threshold

In Nepal VAT is levied on each level of sale from the production and import to

distribution of all goods and services except exempt one. But for those small business persons engaged in the sale of goods and services below the specified threshold level, it is not mandatory for them to register under VAT. To keep small businesspersons outside the tax purview a threshold has been specified under the VAT system, which is 2 millions annually in Nepal. The wholesalers, retailers, dealers, produces who sell goods or service below this threshold level do not have to be register under VAT and neither do they have to collect VAT on their sales.

Nepalese VAT is subjected to a flat rate of 13% but VAT is not applicable to all transactions. An annual threshold of Rs. 2 million in transaction has been specified for this purpose. In other words any business with annual transactions of less than Rs. 2 million need not be registered under VAT. However, a few transactions or goods and services are zero rated, provisions of which are made on appendix-2 of VAT Act 2052, which are given below.

-) Good and services purchased or imported by His Majesty the King, Her Majesty the Queen, His Majesty the Crown Prince, and other member of Royal family.
-) Exports of goods and services.
-) Goods or stores taken on board an aircraft, provided that the goods are taken on board, on aircraft or on flight for the export on destination outside the kingdom of Nepal.
-) Supply of goods and services to the persons outside the Nepal.
-) Imports of goods and services by accredited diplomats.

2.2.1.2 Exemption

There are two provisions related to VAT exemption: (a) by allowing to claim for tax refund of the tax incurred in purchased and (b) providing the facility to avail of the zero-rated tax.

The general practice to provide value added tax exemption is through refunds. However, under certain condition tax exemption is granted by providing the Facility to levy a zero-rated tax. It is the finance ministry that takes decisions regarding zero-rated tax facility and grand such facilities. When granting such facilities the program

invoice in relation to repeated exemptions is approved and sent by the Inland Revenue Department where in relation to big projects the district-based Inland Revenue Office has been granted the authority to approve the Performa invoice.

As per clause 25, tax refund is made to international missions, international organizations, organizations operating on the basis of multilateral agreements and the tax amount collected by mistake.

Zero-rated facility is granted in purchases made by His Majesty the King and Royal family. Establishing a zero-rated tax in export is the basic feature of VAT. The details regarding individuals and organizations that can avail the facility of zero-rated tax are given in schedule 2. Projects operating through foreign support to avail of VAT exemption the provision have to have been made in the agreement itself.

The details of goods and services that are exempted are given schedule 1, these are:

-) Basic agro-products such as paddy, rice, wheat, maize, barley, green and fresh vegetables, fruits, fresh eggs, herbs etc. but excluding food held out for sale by hotels, restaurants etc.
-) Goods of basic needs such as edible oil (produced only from local plant), piped water, fuel wood, coal, kerosene (except air fuel) and salt.
-) Live animals and animal products.
-) Agriculture inputs such seeds, manure fertilizer, soil conditions, agricultural hand implements and pesticides.
-) Medicine, medical and similar health services.
-) Education and educational training and services, which are not profit oriented.
-) Book, newspapers, press related equipments, press and publication.
-) Artistic and cultural goods and services.
-) Transportation services.
-) Personal and professional services provided by auditor's engineers, artists, sport men, writer, translator etc.
-) Other goods and services such as postal services, financial and insurance services, bank notes and cheque books, gold and silver, electivity raw wool.
-) Land and buildings

) Belting, casinos and Lotteries.

2.2.2 Operation of VAT

2.2.2.1 Registration

Suppliers of taxable goods and services are required to register under VAT. However, the vendors having the transactions of only exempted goods and services of falling below the registration threshold are not required to register in VAT system. That is to say, VAT is not applicable to all transactions. An annual threshold of Rs. 2 million in transactions has been specified for this purpose. In other words, any business with annual transactions of less than Rs. 2 million need not be registered under VAT. However, vendors having annual turnover below the registration threshold can register voluntarily.

Group registration is not allowed under Nepalese VAT. Similarly, there is not necessary to register the branch or division of any producer or distributor. VAT liabilities collected by such branched or divisions and calculated along with the head. Nepalese VAT follows the following registration procedures:

-) Fill in VAT registration application form.
-) In case of partnership, fill also next form designed for partnership firms.
-) Attach it with the copies of business and income tax registration certificates.
-) Submit it to the concerned VAT office so that office will be given a temporary certificate and allocates taxpayer identification number (TPIN) and forwards the details to the VAT department.
-) By processing the information, VAT department prepares a VAT certificate with TPIN and provides it to the concerned taxpayer through the corresponding VAT office.
-) Taxpayers have to display the original certificates at main place of his transactions and certificated copies at other places so that interested person can see easily.
-) In the process, taxpayer has to furnish information with 15 days, in case of changes in the information mentioned in the VAT application form.
-) Every taxpayer is requiring to mentioning the TPIN in the following

documents.

- Tax invoice/ abbreviated invoice
- Purchase and sales books
- Documents for the correspondence to the VAT office
- Documents related to income tax
- Documents relating to custom duties
- Documents relating to imports and exports and
- Documents relating to obtain a long from a bank or any financial institutions exceeding Rs. 1, 00,000.

2.2.2.2 De-Registration

A VAT registered firm can apply for deregistration under the following conditions.

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

However, if the firms have already been taken the tax credit facility, tax would be Determined on the stock and demand to pay to the VAT office.

2.2.2.3 Tax Invoice

While selling any goods and services, a taxpayer has to clearly write tax invoice on the first copy or on the title page of the invoice he/ she issues as per schedule 5. Three copies of invoice should be made and the original copy should be given to the buyers, the second copy should be kept in a separate record to produce when asked by the tax office, and the third copy should be maintained as record for the purpose of his/her transaction.

The invoice number, date of transaction, vendors identification number, name and address and buyers name address and if registered the identification number should be written on the invoice. Similarly, the particulars of the items of service sold, the quantity, and the price per unit should also be written.

If any discount has been given to the customer than the amount and rate of discount should be specified and after deducting the discounted amount from the total price, the tax amount at the rate of 13% should also be clearly stated.

Only on the basis of such an invoice a registered buyer can avail the facility of tax deduction. Hence, while purchasing goods or service one should not forget to take a tax invoice.

2.2.2.4 Abbreviated Tax Invoice

A registered vendor can only sell her/ her goods or services by issuing an invoice as per the law. Not adhering to it will be considered a violation of the law and will be punishable. Keeping in mind the welfare of small and retail vendors who deal in a variety of goods and in small quantities, the provision to issue and abbreviated invoice, as per schedule 6 of the regulation, instead of a tax invoice as stated above has been made. In such an abbreviated tax invoice, along with the invoice number and the data the particulars of the items or service sold its quantity, and the price per unit. If any discount has been given to the customer then the total price after deducting the discount amount should be stated. In such on abbreviated tax invoice the tax amount cannot be seen as a separate entry but it is included in the price. In the basis of such an invoice a registered buyer cannot avail the facility of a tax refund. A taxpayer who wishes to make use of such an abbreviated tax invoice while selling must take prior approval of the tax officer. However, while selling through such invoice the price should not exceed Rs. 5,000 in one invoice. But for vendors using a cash machine this rule is not applicable or they can sell goods exceeding the price of Rs. 5,000 using one invoice.

Rule 18 requires that those taxpayers issuing an abbreviated tax invoice should maintain their records as follows.

-) Copy of the original invoice.

-) If the transaction is carried out by maintaining a copy of the till role then the total for each day should be calculated and maintained.

2.2.2.5 Debit/Credit Note

As per the provision laid out in the value added tax law of Nepal when selling any product, even if the amount has not been received, the tax received, the returns and tax submission has to be based on whichever takes place first between the time of the transfer of commodities and the time when the invoice is issued. If a difference in the price quoted in the first issued invoice is detected later, then as per rule 20 the seller has to adjust the price by issuing a debit or credit note. If the price quoted on the first invoice is to increase then a debit note with the increased amount and if it is decreased then a credit note with the amount to be decreased should be issued. Rule 20 also requires that the notes issued should clearly state whether it is a debit note or a credit note and a monthly record should be maintained by illustrating the following.

-) Serial number and the date of issue
-) The seller's name, address and the identification number
-) The buyer's name, address and identification number if registered.
-) The serial number and data of the invoice associated with the transactions.
-) Particular of goods or service and the reason why the debit or credit was made.
-) The credit or debit amount.
-) The credit or debit tax amount.

2.2.2.6 Sales in Foreign Currency

If while making sales, the amount is received in convertible foreign currency from a customer, rule 21 of the VAT Act makes provision to state on the invoice the converted amount in Nepalese rupees based on the exchange rate fixed by the Nepal Rastra Bank on the day the transaction has taken place.

2.2.2.7 Purchase Book

Among the various popular accounting systems regarding the maintenance of accounts related to VAT purchase book is one. A registered taxpayer has to enter all his records regarding his/her imports or purchases of goods or services into the purchase book. When maintaining such records, the date when the goods or services are purchased, the invoice number and sellers' name and identification number should be entered in specified columns. Under the heading of total purchase value, sum of price of taxable imports and purchase price of tax exempted goods and services should be entered. Similarly under the heading of purchase value of non-taxable, the purchase of imports of goods and services as per schedule of the act and all purchases made from an unregistered person including purchase made through abbreviated tax invoices

2.2.2.8 Sales Book

The account in which a registered taxpayer maintains all his records regarding the sales of all his goods and services is referred to as the sales book. According to the definition given in the Value Added Tax Act, sale or supply refers to the sale, exchange or transfer of any goods or services by taking a return or a price. However, since it also refers to the act of giving permission to or taking up contracts related to the same, in all transactions the actual transaction price should be clearly included in the sale book.

2.2.3 The Tax Credit and Tax Refund

Tax credit refers to the legal process through which a taxpayer can deduct the Input tax or the tax incurred while purchasing or importing goods or services from The output tax he/she collects through sales. The most important and attractive feature of VAT is legal provision to deduct and refund taxes. Since there is provision for the business man himself/ herself to deduct the tax incurred in purchases from the tax collected from sales and submits the remaining output to the government there will be no increase in the cost price owing to tax and neither will there be the additional burden of levying tax on tax and this will automatically facilitated the habit

of issuing and receiving invoices. This processing is also called the In-built-mechanism of VAT because if purchases are made without taking invoice the tax incurred on goods or services can not be deducted from the collected tax amount and tax payer has to be bearing the burden of additional tax, which, in turn, increases the cost price and decreases the competitive capacity of the businessmen.

But if the tax paid on purchase is more than the tax collected from sales then the excess amount can be credited to the following tax period.

2.2.3.1 Conditions to Get Tax Refund

Tax refund can be obtained under the following four conditions.

(A) Tax Refund that can be obtained by a Regular Exporter

A taxpayer whose transactions comprise of more than 50% exports is called a regular exporter and she/he can claim for tax refund during each tax period. After the tax refund form as per schedule 10 has been filled and submitted at that Inland Revenue Office, the export transaction will be verified and a recommendation for refund is sent to the Inland Revenue Department. The department has specified the time period within which the refund should be made as 30 days. If the refund is not received within 60 days, the claimant can make an additional claim of 15% interest on the refund amount. In making refunds primarily, the following three documents are examined.

-) The specifications regarding purchase and imports.
-) The specification regarding exports; and
-) The specification regarding payments received through the banking Process.

(B) Refund of the Credit Amount that has been transferred for 6Consecutive Months

If the tax paid on sales cannot be adjusted over 6 consecutive months, then in the seventh months the taxpayer can claim for tax refund based on schedule 10. For this, all relevant documents for the entire period over which the refund is claimed

should be inspected and then a recommendation sent to the department of refunding. The department has to make the refunds within 30 days and if not refunded within 60 days, there is a legal provision for the amount to be refunded with interest.

(C) Tax Refunds Made to Diplomatic Missions

There is provision for two types of tax refunds for diplomatic mission and individuals. For imported goods, the facility to levy a zero-rated tax is made available right at the customs points and thus relieved from the liability of paying tax.

In the case of internal purchase made, the tax is refunded on the basis of a reciprocal agreement between two countries. As per clause 25 9i) of the VAT Act, such claims should be made through the foreign ministry to the tax refunded section of Inland Revenue Department by submitted the original Invoice as per 17. The office of the concerned section has to attest the copy of the invoice against the original and keep it and return the original.

(D) Tax refund to International Organizations and Projects Operated on The Basis of a Bilateral Agreement

If the UN organizations, international non-government organization and other foreign organization are undertaking activities for which an understanding has been reached with Nepal Government to exempt VAT then, on this basis, the tax paid on purchases can be claimed.

There is provision for such claims to be refunded once a claim as per schedule 18 is made by submitted the original invoices along with the receipt directly to the inland Revenue Department.

2.2.3.2 Goods on Which Tax Refund cannot or only partially be Claimed

Rule 41 of the VAT regulation has listed the goods on which partial tax deduction or no tax deduction can be made. As per this rule tax deductions cannot be made on the following goods:

- Beverages

- Alcohol or alcohol mixed beverages including beer
- Light petroleum for vehicles
- Entertainment expenses

But this limitation is applicable only for those registered as per clause 17. This is not applicable in case of diplomatic refunds as per clause 25.

The act and rules of VAT here made the provision for partial tax deduction in the case of certain goods. These goods and specified amounts are as follows”

- Only 40% of the tax incurred on automobiles can be deducted.
- Only 60% of the tax incurred while purchasing computers can be deducted.
- Only 3 or more wheelers have been categorized under automobiles.

Therefore, the tax incurred while purchasing motorbikes can be deducted in full whereas only 40% of the tax incurred in purchasing cars can be deducted. But if the registered person is dealing primarily in those goods on which tax can not be deducted or only partial tax can be deducted then she/ he can deduct the entire tax incurred in purchases and can also claim for the refund.

2.2.3.3 The Tax Refund Process

- The taxpayer should claim for refund using schedule 10.
- The refund claim should be entered onto the computer and a refund claim report should be prepared.
- For verification of the taxpayer’s transaction a copy of the refund claim report should be sent to the audit section. Since the total refund amount claimed as per schedule 10 goes directly into sundry creditors, if the recommendation amount after audit is less than the total amount claimed, then a letter should be written to the Inland Revenue Department to remove the difference amount.
- If the tax has to undergo a management assessment then it should be done immediately and entered onto the computer along with the TP payments.
- Together with appendix 1 the tax return batch should be sent to the inland Revenue Department.
- If the tax refund has to be rejected owing to lack of sufficient proof, then the taxpayers should be given a credit advice to move the credit to the following month

- and a reject batch should be prepared and sent to the Inland Revenue Department.
- Once the tax refund report along with appendix 1 is received t the tax refund section, it should be registered and sent to the computer section to examine.
 - The computer section should prepare a tax refund report and resent it to the tax refund report and resent it to the tax refund section by indicating the registration number.
 - Based on the tax refund report, the tax refund section should check the tax audit report and submit it for decision regarding whether to grant full or partial refund or to reject the claim.
 - If the refund claim has been only partially approved, then the tax refund section of the Inland revenue Department should issue a debit advice and TP notice and send those to the computer section for processing. The original file should be sent to the account section for payment of the remaining amount.
 - After preparing the voucher and the cheque on the basis of the account, the account section sends them to the computer section of entry. The computer section then reparse a refund close post report and sends the accounts back to the account section. The director of financial administration sings the cheque, which in the forwarded to the concerned Inland Revenue office.
 - The concerned Inland Revenue Office has to forward the cheque to the taxpayer and send the receipt to the account section.

2.2.4 Tax Assessment

Tax assessment is a process of determining the amount of tax any individual or company is liable to pay. This may be done by either of two ways. One is that the Taxpayer makes tax refund; listing their income from various sources any facts affecting their entitlement to tax allowances and then tax authorities make the actual assessments. The alternative method is self-assessment; besides supplying nformation's on their income and entitlement to allowance, taxpayers produce their own assessments applying the tax rules to their own figure. Then the tax authorities check these assessments.

Section 18 of the VAT act has required the taxpayer to submit tax return on self- assessment basis. Although the self-assessed tax return submitted by the

taxpayer is considered as final, section 20 has provided basic ground under which the tax officers may issue assessment order. The inspection reports of the business transaction submitted by the tax officers constitute one of such basic ground.

2.2.4.1 Computer Assessment

A VAT registrant will be termed as non-filer when he does not assess his income himself and does not file return within the specified time. After 45 days of the expiry of the tax period, computer print out the list of such non-filers and then a notice is given to each non-filer. Even after the issuance of the notice of non-filing, they do not file returns within the specified time the computer make a monthly or trimester assessment depending upon the status of particular taxpayers. The following procedure is carried by the computer assessment.

-) Find out the highest amount declared by the taxpayers in his return during the previous 12 months from the VAT payment.
-) If taxpayer has not filled any return, find the turnover amount state on the registration application. Divide this by number of filing period in the year and then multiply by the VAT rate.
-) Note the highest amount in (1) and (2) above.
-) Add the amount found in (3) to the 30 percent of itself to get the assessment amount.

2.2.4.2 Management Assessment

The tax officers do management assessment when a taxpayer receive updated information after submitted his return and informs it to the tax officers or in the case of those taxpayers where tax officers find errors during the tax audit. Management assessment is done through the following procedures.

-) The tax officer assesses the tax and determines interest and penalties.
-) The tax officer prepares management assessment on the monthly basis in case of compulsory registrants and on trimester basis in case of others.
-) Management assessment requires be batching and submitting to the computer

section.

- J VAT assessment will only normally extend back four year from the time the taxpayers is given a notice of assessment.

2.2.5 Collection of VAT

Through the following methods, VAT is collected by the VAT administration.

- J Tax officers are empowered to recover tax dues from the credit in a VAT debtor's accounts.
- J Tax officers also can issue to third parties who is indebted to the VAT debtor a demand for the payment of money owned by the third party to the VAT debtor.
- J Tax officer are also authorized to suspend the transaction of a VAT debtor.
- J Tax officers also can withhold import/export of VAT debtor.
- J Seizing or selling the property of the VAT debtor also can realize tax dues.

2.2.6 Provisions for Additional Fees, Interest, Punishment and Penalty

Any violation of the provisions of VAT act and rules shall attract additional fees under section 19; interest under section 26 and punishment and penalties under section 29.

2.2.6.1 Additional Fees under Section 19

The VAT of particular month has to be paid by the taxpayer within 25th of the following month. In the case of failure to do so, additional fee at the rate of 5% of the tax amount will levied up to the end of the subsequent months following the month of such due. Where the payment is still not being made within this period, an extra fee of 5% of the tax amount is payable up to that data shall be levied.

2.2.6.2 Interest under Section 26

Under section 26 (1), interest on dues amounts are imposed where any amount,

Including tax amount, is not paid within the stipulated time period. Sub-section (2) of the same section has specified the applicable interest rate of 15% on a regular basis. In respect to interest, it has been clarified that such interest shall not be levied on fines, additional fees and interests itself.

2.2.6.3 Punishment and Penalty under Section 29 (1)

Where the tax return is not filed in time as required under section 18, penalty of 0.05% per day of the tax amount or Rs. 1000 per tax period, whichever is higher shall be imposed under section 29 (1).

2.2.6.4 Penalty for Transaction Carried out without VAT registration

Where the tax officer has the reason to believe that a business is being carried out without registration, which otherwise requires registration as per section 23 and wishes to investigate, impending such act would attract penalty of Rs. 5000 per time under section 29 (1), clause 'h'. During such investigation, where it is proved that such business requires investigation but has been carried out without registration, a fine of Rs. 10,000 plus the tax amount for the tax period under section 29 (1)(a) would be attracted for violating section 10 (2).

2.2.7 Provision for Appeal

Under section 32 of the act, an appeal may be filed with revenue tribunal against

The assessment of tax determined by the tax officer or the punishment order as well as against the suspension of transaction order by the director general under section 30. For going in such appeal, as per section 33, deposit of an amount equivalent to 50% of the disputed tax amount and fine has to be placed or bank guarantee has to be furnished. Appealing in itself is a process of seeking justice against the disputable decision of the tax officer. The prevailing system of having deposit 50% of the amount asked for by the tax officer and the fine for the purpose of seeking justice is

unjust at in itself. In addition, the provision of imposing interest even on the cash deposited amount has simply become a discounting factor for any taxpayer to go into appeal.

2.3 Review of related studies:

Shoup Carl. S (1969) explains value added tax as the latest and probably final stage in historical development of taxation, which is based on goods and services. VAT is levied on the value added; the difference between the sales proceeds and the cost of the purchases from other firms. VAT is superior than turn over tax, the manufacture and the whole sale's taxes as it eliminates the uneven of these taxes.

A comprehensive VAT will have favorable impact on the economy and easy to administer. But it is inflationary in nature. Comprehensive consumption type of VAT is equivalent to a retail sales tax in its pure form except that the latter does not offer an option between the destination principle and the origin principle.

Shoup explains comprehensive VAT that covers all economic activities from the earlier stage of farming or mining right through the retail level. Among the types of VAT, he preferred consumption types of VAT and tax credit method for computation. VAT has more revenue productivity and transparent because of its self-enforcing feature. In addition, VAT can reduce it's regressively by providing zero rate and exclusion of transaction below certain threshold.

VAT is superior to turnover and retail sales tax, according to Shoup. However the choice between turn over tax and VAT becomes a matter of weighing the pros and cons of these two. Never the less, VAT requires careful implementation to bring the desired fruits. Basic accounting and efficient tax administration are lacking in developing countries, which create hurdles for successful implementation VAT.

A study paper presented by IMF (1973), on VAT in developing countries states that encourage by its success in European countries; many developing countries were attracted to VAT as a means of rationalizing their sales taxes and improving their revenue. Comparative analytical methodology was used to analyze the VAT structure of seven developing countries and it covers several issues such as revenues productivity, administrative difficulties and comparison of VAT with other sales taxes.

The study suggests for comprehensive and uniform coverage it makes it more neutral, more elastic and more revenue productivity was a very strong feature of VAT. Further more VAR provided ease in cross- checking, thereby leaving lesser ground for tax evasion, and superior to the retailer's sales tax because of its neutral nature. However, according to the study, the achievement of these benefits of VAT largely depended on the implementation aspect.

Due. John F (1976), "Value Added Taxation in Developing Countries" analyzed the various aspects of VAT in the context of developing countries. The paper covers the theoretical as well as implementation aspect of VAT.

Theoretical aspect:

The first part of the paper explains the theoretical aspects of VAT. The tax severs a distinctive feature of fractional impact without cascading features and it requires the value added at all stages of production and distribution.

The evaluation criterion of a tax should be based on the goals of the economy concerned and hence the criterion of taxation in developing countries is; a) maximum net contribution to economic development, b) minimum adverse impact on pattern and amount of resource allocation, c) simplification of tax administration procedures, d) favorable effects on income and wealth distribution and e) high revenue productivity.

Basically, VAT offers the advantages of the retailers. However, it is more complex levy and if carried through the retail level, involves far more tax paying firms than the manufactures sales tax. Hence, the choice of VAT should be made on the basis of production and distribution condition on the country concerned, revenue needs, and administrative qualifications and so on.

Universality and simplicity are the requirement for successful implementation of VAT while ad ministration makes the loss of some good features of VAT.

Implementation aspect

First of all the lawyers familiar with the tax jurisprudence must draft tax legislation. Registration of the business firms is a major issue that required door- to-door survey, and can be made more effective by employing honest and efficient

inspectors and enforcement officers. Tax returns having frequent intervals minimize the tax liability and smoothen the flow of revenue.

Computerized tax administration is a basis need of successful implementation of VAT it is beneficial to avoid small refunds when possible, by requiring the firm to carry forward the credit against its tax liability in successive periods. Separate manuals are desirable for audits and inspectors.

Musgrave, Richard A. And Musgrave, Peggy B. (1976), State that a sales tax may be imposed in either single or multiple stages. A properly implanted value added tax is equivalent to a corresponding single stage sales tax, from the economists' point of view.

Value added tax has come to be the basic instrument of tax coordination among

Common market countries, where it has replaced widespread use of turnover taxes. Base of a consumption type of value added tax is same as that of retail sales tax, differing only in the method of collection. Hence choice between the two must base on administrative convenience. Only the value added approach is feasible if a sales tax is to be imposed in net product.

Among the three types of VAT viz. GNP type and consumption type, the last one is most important from the practical point of view. It involves both efficiency and equity criterion.

Similarly, among the three types of computing base for VAT, the addition method is readily applicable in case of income type but clumsier for the consumption type of VAT. By making the tax credit for each firm contingent on presentation of the tax receipts made out to be the preceding supplier. The invoice method includes a self-enforcing element because each will demand copy of such a receipt. This method further constitutes an advantage of the value-added approach, especially in those where tax compliance is otherwise poor.

Goode (1984) describes VAT as the most important innovation in public finance. VAT applies to the value added at successive stage of production and distribution. VAT, a sales tax on consumption is fairer than an income tax because the later results double taxation of saving is unconvincing but the former lacks the progressiveness, which serves by the later.

Goode has pointed following advantages of VAT: a) it is broad-based and

relatively neutral, b) it avoids both simple cascading and cumulative taxation of goods of producers that are not physically incorporated in products, c) spreading the tax over the several stages of production and distribution is often considered an administrative advantage compared with collecting it all at one stage because enterprise has less incentive to evade tax, d) it generates the possibility of using information as a cross check on compliance with other taxes, particularly income taxes. Besides these, suitability of value added tax is questionable for countries where small enterprises are important, accounting is unreliable and administrative is weak.

Shoup (1989), in an article made an attempt to analyze the structure of the VAT and different policy issues relating to the developing countries. A VAT, covering all economic activities from the earlier stage of farming or mining right through the retail level is considered comprehensive. Consumption type VAT and tax- credit method for computation is superior. VAT is more revenue productive and serves self-enforcing feature, and proving zero-rated for foods and basic essentials can reduce its regress. VAT will have most favorable effect and it is relatively easy to administer. But it is inflationary because it must be recouped by firms through increase in price. In comparison with turnover tax and retail sales tax, VAT stands in the first position but it becomes a matter of weighing the pros and cons. Basic accounting and efficient tax administration are lacking in developing countries, which create difficulty for the successful implementation of VAT in such countries.

Tiwari (1990), in an article "Value Added Tax: Its prospects, Problems in Nepal and Suggestion" deals on historical background of Nepal's tax system and recommends VAT in Nepal pointing following advantages: a) it is based on the modern theories, b) less possibility of tax evasion, c) it has broad base so increase potential revenue yield, d) it has cascading effect, e) it has tax credit facility so gives incentives for producers, f) it would be based on computer system so it is easy to administer, g) it also increases income tax, consumption tax, and h) it is also more informative.

Examining the existing tax system in Nepal the following preconditions for VAT implementations in Nepal identified: a) invoice system must be made compulsory, b) all tax system should be computerized and a separate administration is needed, c) to introduce progressively and make balance primary products, transaction below certain limit and export should be exempted, d) VAT rate should be limited at

10%.

Intertemporal neo-classical tax model with a micro economic foundation is developed to analyze the incentive an effect of various taxes polices and their welfare implication. Employing the saving investment approach through mathematical tools, the relation of the international economic interdependence is shown.

The major findings of the study are that the removal of barriers to trade and Factors movement, unification of markets, development of new monetary arrangement and increased harmonization of fiscal policies and tax structure are all key factors in a process that is likely to affect the shape of globe economic for system for years in future.

Besides, they concluded that one of the elements for the movement towards tax Harmonization in the EC is convergence of various systems. Authors revalue the dynamic simulation that affects the tax charges on domestic and foreign levels of output, employment, investment, consumption and other key macro economic variables depend critically on the degree of substitution governing temporal and inter-temporal allocation as well as on the tax system. The policy of VAT harmonization may generate signification conflicts within the county and between the countries.

Experiences show that VAT contributes from 12 percent to 30 percent of total revenue in most countries, representing about 5 to 10 percent of gross national product. However, VAT is more complicated than other sales taxes from administrative point of view and substantial refunds can be involved. Further, collecting VAT and paying refunds make it inefficient.

The paper compares VAT and its most usually quoted alterative retail taxes in several respects and concludes the sales tax nor the VAT can tax the unofficial and black transactions and both are open to evasion by under recording sales. However, under valuation is more difficult in VAT. A VAT, covering all stages of production to the retail level and the services is more preferable.

Single rated VAT with only few exemptions and without zero rates makes it more regressive. However, VAT needs to be evaluated in relative sense or its regressive nature. Further, in trying to soften the regressively of VAT major distortions can be introduction. If VAT is replaced to get equal tax yield, relative piece may be increased, and it will have deflationary effect rather than inflationary if revenue is raised. A report prepared by a High Level Task Force headed by Prof.

Dahal (1993), reviewed Nepalese tax system and made some recommendations for the implementation of VAT in Nepal. The report mainly analyzed the magnitude of Nepal's tax system and emphasis for the need of tax reforms in Nepal. The report recommends VAT as a measure of long-term tax reform for the replacement of existing sales tax and small service based taxes.

The recommendation of VAT in Nepal is based on following facts; a) it broadens the tax base and hence increases the tax revenue, b) it is more transparent, elastic and prevents tax evasion, c) it promotes exports, d) makes the tax system more efficient. The study also suggests some factors that must be considered before implementing VAT, which are: a) price level b) equity and c) small transactions. More focus is given for necessary reparations to be undertaken before implementing VAT and a functional organizational pattern is recommended in the report.

Khadka (1996), in his paper "A VAT for Nepal" emphasis on the proposed structure, operation and administrative set up of VAT Nepal and necessary steps to be undertaken for its introduction. He concludes that Nepal should adopt the destination based consumption type VAT operated through the tax credit method. The introduction of this tax should be taken as a major part of the tax reform program, which will help to streamline the whole Nepalese tax system.

A detailed preparation should be considered as a prerequisite for the introduction of VAT and then structure and operation must be lunched educate the tax papers. Further an effective and efficient tax administration must be developed for successful implementation of the VAT.

Khadka further suggest that to create progressive tax system through commodity tax it is desirable to levy VAT with a single positive rate rather than complicate the VAT structure by introducing exemptions, zero rating and multiple rates. VAT registered vender should get VAT registration certificates, which must be prominently displaced in the public area a business. Due to several reasons VAT is expected to minimize the existing problem of understatement.

However, the possibility of understatement of the sales proc can not be eliminate under VAT and cross checking at the retail level is impracticable since the final purchase will have no incentive to insist on tax paid invoices. Existing sales tax and excise department should be recognized for VAT administration. The department should be responsible for general administration, policy research large taxpayer,

service, large tax refund, legal matters supervision and processing revenue data, with the field offices should be made responsible for registration, advice, troubleshooting, compliance and small refunds.

For the successful implementation of VAT, a VAT preparation and implementation team with specialized education, training and experience of tax system, tax laws, accounting and auditing system should be created to make recommendation on various aspects of VAT, make necessary preparation for an early introduction of this tax and to help the sales tax and excise department to implement VAT effectively.

Nepal Chamber of Commerce (1997), in a study analyzed the possible effects of VAT on the Nepalese economy. The major observations on VAT found by the study are as follows: a) adverse effect on price level, b) increase in prices would discourage import business and re-exported of imported goods, which reduce the revenue from import tax, c) the account keeping requirements of VAT would increase the tax compliance cost and cost of doing business that would affect the small traders adversely, d) domestic production will be affected negatively as VAT abolishes the protection policies, e) VAT widens the gap of income distribution, f) it will affect overall revenue collection negatively, and g) because of inefficient revenue administrative VAT cannot implement successfully. So a haste decision should not be made to implement VAT in Nepal.

Jyoti, Roop (2001), in an article “Value Added Tax in Nepal Analysis and Suggestions” writes introduction of VAT in Nepal as an innovative and fundamental reform, which has been felt since a long time. In the initial stages, business community had opposed the implementation of VAT because of not due to its weakness or any difficulty arising out of it. It was because of the years of Harassment from the tax administrations, and fear that the revenue employees would make decisions on their own will and collect taxes.

He points following basic conditions for success of VAT in Nepal; a) an acceptance of actual invoice value and b) acceptance of self-assessment. A simple and quick mechanism of tax refund VAT has many special characteristics, among which the following are the main: a) revenue employees have minimum discretionary power b) honest taxpayers to not need to have much contract with the tax

administration c) taxpayers have to comply honestly due to the self-enforcing mechanism of VAT.

Because of these characteristics of VAT will automatically decrease the possibilities of tax evasion tendencies and vice versa increase that revenue productively. His comments lack of invoicing to invoicing without the correct value and lack of effective implementation of the VAT threshold are the two main issues that are obstructing the proper implementation of the VAT in Nepal. The successful and appropriate implementation of VAT will give support to other taxes as well. Moreover it can play important role in the proper and suitable development of the markets economy.

He suggests the following steps should be taken in order to effective implementation of VAT and to establish it as the main source of revenue for the development of the economy a) the VAT administrators must mainly concentrate on accurate and compulsory invoicing at all stages including in retail sales level b) effectives steps must be taken for implementation the threshold c) by changing income tax rate the attention of the revenue administration and the taxpayers must be taken away from the income tax and drawn towards VAT d) along with he establishment of accurate invoicing, the custom duties must be gradual decreased e) the VAT refund system must be made more effective in order to refund tax without delay f) policies that go against the basic principle of VAT and harass the taxpayers must not implement.

VAT would make it possible to broaden the tax base, to eliminate the tax cascading, to create an investment friendly tax system, to have a simple and modern tax system that exempted and basic goods from taxation and finally to increase revenue. She suggests organizing functional lines along VAT department, computerized tax administration under which easy to monitor the performance, help to establish accountability and to reduce collusion between the tax payers and tax officers.

This, together with a strong management would also reduce the revenue leakages. Establishing resource group of staff, efficiency in information to taxpayers and taxpayer services are some basic compliment for successful implementation of VAT. The focus will to have remains on transparency, fairness and timely and quality production in administration instead of simple collection.

Khatiwada, Yubraj (2001), in his article “The First years of VAT” writes the need of introduction VAT in Nepal. VAT was implemented by replacing and integrating the sales tax in order to make sales tax proportionate, practical, and based on transaction, simple, to reduce the tax rate, to bring the value addition at each level of transaction into the tax and to broaden the tax base.

VAT is a tax that is based on goods and services. This tax is levied on the value

Addition at different levels of business transactions. Hence, accurate information regarding how much business was transacted and how much value addition took place is necessary. To effectively implement VAT it is compulsory to issue and receive invoices in every business transaction and requires cooperation of all concerned sections. During the course of 4 years of implantation of VAT various problems arises, however, the progress in revenue collection and the increase in the number of registered taxpayers are encouraging.

Dahal, Madan Kumar. (2001), in his article “A Few Words About VAT” writes VAT is a most scientific, innovative and powerful tax with built-in quality of universal application for both developed and developing economics. The biggest virtue of VAT is that it is revenue buoyant and highly instrumental for resource mobilization especially in an economy with an acute shortage of resources. Nepal has entered into a major global tax system with the introduction of VAT. VAT is an account-based tax that leads to transparency and accountability both on the part of taxpayers and collector.

Open boarder, non-monetized economy, non-issuance of invoices etc are major problems that would marginalize the prospects for resource mobilization in Nepal. This calls for introduction stringent regulations to deal with delinquency of tax, maintaining records properly and improving efficiency of VAT administration. The success of VAT will have significant bearing on the economy of Nepal.

Shrestha, Rabi Bhakta (2001), in his article “VAT a Challenge” argued VAT implementation as a success of Nepalese government and points following flaws in the implementation aspect of VAT a) special attention has not been directed towards encouraging the taxpayers while implementing the new tax by the administrators, b) hesitation on the part of new taxpayers to come under the tax net due to the distortion created because of the discretionary powers vested in the rules and regulations of

VAT Act, c) creation of an atmosphere of fear among the businessmen owing to having to undergo unnecessary complications in the name of auditing, d) lack of timely resolution of the problems that have emerged in relation to customs valuation, illegal transactions, billing, tax refund etc e) lack of seriousness towards the suggestions presented by the businessmen.

2.4 Thesis Review

Subedi (1997), in his dissertation concludes the VAT is necessary in the process of tax reform. The existing tax system being inefficient and less productive needs to be modernized. A successfully implemented VAT would be the best alternative to make the source of revenue mobilization, momentum and elimination other regressive nature of existing tax system.

VAT would generate more revenue with less distortion and will unify members of taxes producing vary low amount of revenue because of its broad coverage. In Nepal, VAT is desired to achieve the goals of neutrality, revenue productivity, and fairness in nature. So VAT should be implemented in Nepal only after full and adequate preparation.

He has pointed inefficient tax administration as a challenging issue for successful implementation of VAT in Nepal. The existing sales tax administration is not capable to handle VAT. The other problems are lack of transparency and accounting system, lack of sufficient knowledge about VAT illiteracy and lack of public awareness.

The existing tax evading practices also seems a serious problem. Therefore, more advantages of VAT can be achieved only if it is extended to retail level but the extension of VAT to a retail level is impracticable and impossible in Nepalese context. The study suggests a moderate single rated VAT.

Sharma (1998), in his dissertation entitled “Value Added Tax in Nepal, Issue and Options” states defects of existing sales tax as narrow base, inefficiency to generate revenue distortion character, weak administration and corruption. The study focused on the different aspects of VAT such as issues concerning applicability effects on economy, revenue productivity.

Study considers adaptation of a full fledged VAT would make tax system more

productive and elastic by widening the tax base and it would be less regressive than existing sales tax. However, the applicability of VAT in Nepal is a big challenge because of a) lack of administrative capacity b) unorganized business structure; practice and distribution system c) existence of open border d) under-valuation e) misunderstanding between government and private sectors f) political issue g) self-subsistence nature of the economy.

The study states VAT produces favorable effects on balance of payments, collection of income tax, import duties. VAT broadens the tax base; lessens the corruption, illegal trade and tax erosion. Thus VAT will make the business sector more competitiveness and productive. Because of provision of tax-free for small transactions VAT gives the incentives to the traders to split threshold limit, which makes the business sector fragmented and less efficient. Thus the study concludes that VAT is not fully applicable in Nepal.

Bista (1999), in his research concluded, "VAT is applicable and feasible in Nepal. The study favors VAT in Nepal for several reasons: effective revenue mobilization, industrial development, strengthen the administration, transparency and avoidance of all tax loopholes. Public awareness relating VAT and effective administration are essential prerequisites in the preparation and successful implementation of VAT.

The scope of VAT in Nepalese economy is very broad because it mobilizes the additional resources by broadening the tax base, by checking the existing tax loopholes, and it ultimately creates positive impacts on macro economic variables which help to accelerate and sustain the economic growth. VAT narrows the tax base. VAT being account based, invoice based, and record based checks the tax loopholes such as undervaluation, non-recording, unauthorized trade. Further VAT serves the vertical equality.

Laudari (2001), in his dissertation analyses the problems and prospects of VAT in Nepal, basically on the theoretical aspect. In the current status of decreasing revenue from custom duties due to the liberal economic policies, importance of VAT is growing for resource mobilization. The contribution of taxes, which VAT is, is gradually declining.

From the field survey, the study concludes VAT having positive effect in the nation economic growth. The study found the major problems associated with the

VAT system to the business houses is account keeping and billing. Weakness of VAT administration, lack of motivation, service minded attitude and dishonesty in VAT officials. VAT system, the best and advanced fiscal tool in theoretical sense, could not yielding the expected result in Nepal because of the lack of strong and honest tax administration, lack of motivation and service minded attitude among tax officials, lack of the co-operation of business community, lack of coordination between tax collectors and tax payers, lack to strong political commitment and weak public consciousness.

Neupane (2004) in his thesis entitled “A study on effectiveness of VAT in Nepal” has analyzed the present position of VAT in Nepal, effectiveness of VAT and problem in the implementation of VAT in Nepal. The major findings of his study are:

- VAT is superior to other types of sales tax like MST, WST, and RST.
- VAT is applicable to Nepalese economy.
- VAT is most costly system than previous tax system because of illiteracy and family

based business. KC (2005) in his thesis entitled “VAT in Nepal; past and present” analyze the change in revenue structure after and before implementation of VAT, contribution of Vat in total revenue GDP and tax revenue and forecast the number of tax payer for 10 years. He used the various statistical tools to analyze data and Concludes that:

- VAT has not achieved its target to increase 0.25% GDP per year because of various complexities and problem in tax system.
- VAT is in second position after custom duty in indirect tax.
- In Nepalese tax structure indirect tax is more important than direct Tax in revenue generation.
- There is no significance change in revenue before and after the Implementation of VAT.
- The scenario of tax registration trend is normally satisfactory.
- The proportion of VAT collection is higher in import than in Domestic.
- Projection of VAT for 10 years shows the optimistic future.

CHAPTER III

RESEARCH METHODOLOGY

3.1 Research Design:

There are two types of research: I. Descriptive and II. Analytical. The study of VAT Act, VAT rules and regulations, government's plan etc. is done as a part of descriptive research. It includes the evolution and development of VAT. The study of the literatures concerning the VAT system and the clarification of concepts associated with VAT are also conducted during the mean time of the research. Analytical research is conducted to analyze the trend and contribution of VAT in the government revenue of Nepal. It is done mainly through the secondary sources of data available from various publications. Therefore this study is based on descriptive as well as analytical research.

3.2 Nature and Sources of Data:

secondary & Primary sources of data are collected for the study. The collection is done in accordance to the availability and usefulness of it during this study.

3.2.1 Sources of Secondary Data:

The secondary sources of data are collected from various books, dissertation, publications, journals, reports, newspapers etc. The major sources are as follows:

1. Annual Reports of Inland Revenue Department, Ministry of Finance.
2. Economic surveys and budget speeches, Ministry of Finance.
3. Publications of CEDA, Tribhuvan University.
4. Rajaswa, Revenue Administration Training Center, Kathmandu. Official website of Inland Revenue Department: www.ird.gov.np.
5. Official website of Ministry of Finance: www.mof.gov.np.

6. Various magazines, newspapers, journals and souvenirs.

3.2.2 Source of Primary data

Primary data were collected through questionnaire, dialogues and direct Discussion. Fifty questionnaires were distributed, only forty-five questionnaires were collected. Among them some responses were not clear for the purpose of analysis. The incomplete and unclear questionnaires are included in this study. The questionnaire includes the question relating to:

- VAT administration
- Accounting system of the businessman
- VAT and its applicability in Nepal
- VAT and inflation
- Small vendors who are not well organized and ignorant about VAT
- Economic growth
- Illegal trade
- Effect of VAT on tax leakage

3.3. Data Processing and Analysis Procedure:

The data and information collected through secondary sources are first processed for tabulation. Data are tabulated into various tables according to the subject in order. It is then presented and analyzed in descriptive way. They are analyzed using suitable statistical tools. The statistical tools used for the analysis are as follows:

- i) Simple Percentage.
- ii) Graph
- iii) Bar diagram method of least squares

CHAPTER IV

PRESENTATION AND ANALYSIS OF DATA

4.1 Background

Primary data were collected through questionnaire, dialogues and direct discussion. Fifty questionnaires were distributed, only forty-five questionnaires were collected. Among them some responses were not clear for the purpose of analysis. The incomplete and unclear questionnaires are not included in this study. Secondary data are collected from books, journals, newspaper, several government publication and financial reports to find current information about VAT. All primary as well as secondary data are presented and analyzed to find out the Effectiveness of Value Added Tax.

4.2 Analysis of Secondary data

Indirect taxation is one of the major sources of revenue mobilization. In fact, VAT was introduced so as to mobilize more revenue by broadening the tax base and controlling the tax evasion. To make an assessment of the present position of VAT in Nepal, it can be reviewed in terms of the followings:

- Registration
- Filing of VAT return
- Status of registrant
- Composition of VAT revenue
- Collection of VAT revenue
- Revenue mobilization from VAT than other sources.

4.2.1 VAT Registration

All supplies dealing with taxable goods and services of annual turnover Rs. 2 million (threshold) are required to register under VAT act, and collect VAT. It is

however, not necessary for them to register if they deal with only tax exempt goods and services. Similarly, small vendors falling below the registration threshold are also not required to register for VAT.

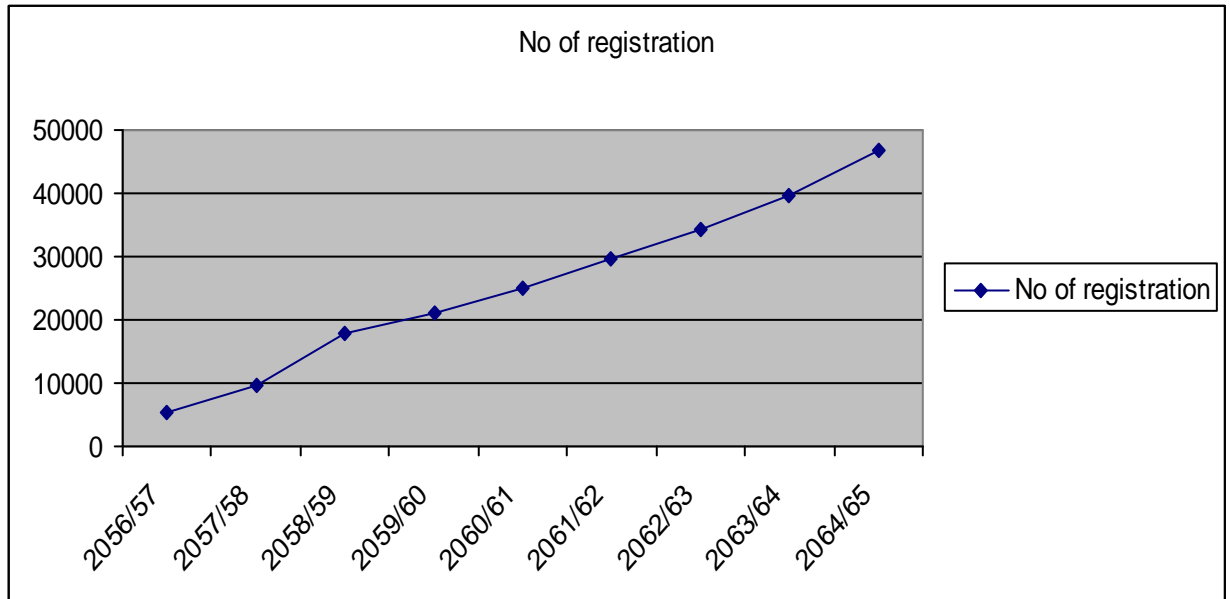
The existing level of threshold is Rs. 2 million per year. In the case of importer having annual commercial imports below Rs. 20,00,000 are not required to register for VAT. Traders dealing with the mixed supplies also are required to register only when the transaction of taxable supplies exceeds the registration threshold. However vendors below the registration threshold can register voluntarily. There is no system of group registration under the Nepalese VAT system. Similarly the Nepalese VAT act does not allow branch or divisional registration system. The following table presents the number of VAT registrants in the previous nine financial years.

Table: 4.1
No of VAT Registration

Year	No of registration	Growth rate
2056/57	5251	
2057/58	9692	0.8457437
2058/59	17947	0.8517334
2059/60	21093	0.1752939
2060/61	25149	0.1922913
2061/62	29472	0.1718955
2062/63	34174	0.1595413
2063/64	39776	0.1639258
2064/65	46831	0.1773683

Source: MOF

Figure: 4.1



As stated earlier, the number of registrants was 2320 at the time of introduction of VAT. The number of VAT registrants reached 5251 at the end of fiscal year 2056/57. The registration in VAT is increasing trend. The number of tax payer increased by 84.57% in fiscal year 2057/58. Similarly, the number of tax payer increased by 85.17%, 17.53%, 19.23%, 17.19%, 15.95%, 16.39% and 17.74% in fiscal year 2058/59, 2059/60, 2060/61, 2061/62, 2062/63, 2063/64 and 2064/65 respectively.

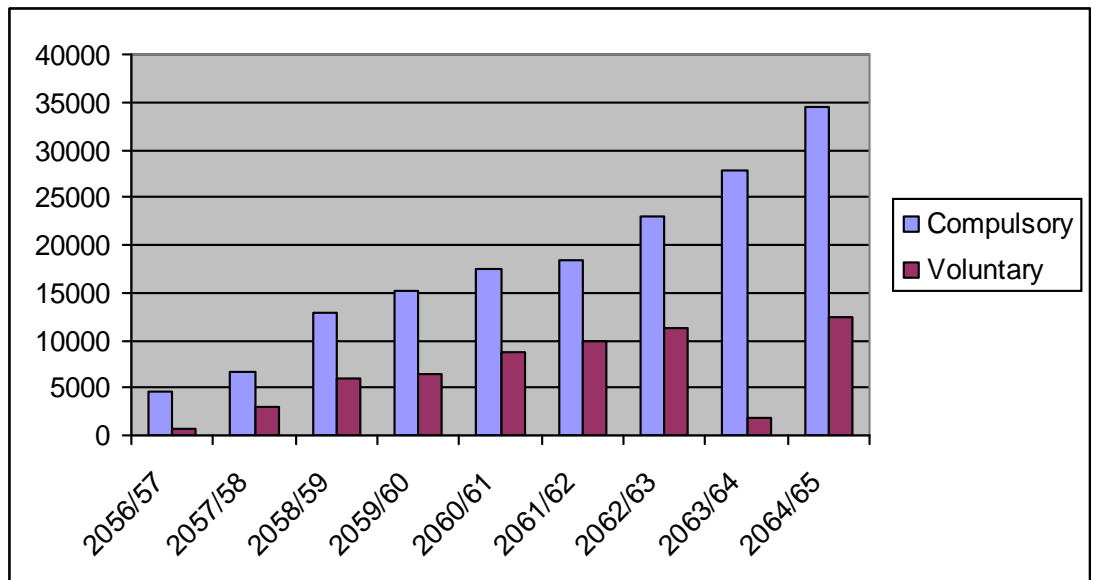
From the above table, there is large number of businessmen registered in the VAT. We see the number of increasing registrants every year. From the above table, we can say that the numbers of registrants are increased but the growth rates of the registrants are decreasing trends from FY 2058/59. The above figure of registrants also comprise of voluntary registrants. Taxpayers have also registered voluntarily because they enjoy some advantages if registered. Government bodies are required to purchase from registered vendors in case of purchases exceeding a Certain amount. The following table shows the ratio of compulsory and voluntary registrants of VAT.

Table: 4.2
Composition of VAT Registrants

Year	Compulsory	Voluntary	Total	Ratio
2056/57	4642	609	5251	88:12
2057/58	6613	3079	9692	68:32
2058/59	12884	5920	17947	67:33
2059/60	15248	6533	21093	70:30
2060/61	17577	8645	25149	67:33
2061/62	18441	9913	29472	65:35
2062/63	23016	11158	34174	67:33
2063/64	27916	1860	39776	70:30
2064/65	34527	12304	46831	74:26

Source: MOF

Figure No: 4.2



The table and figure shows that the number of compulsory as well as voluntary registrants is increasing every year. The composition of the compulsory and voluntary registrants is lowest in the FY 2056/57. In the FY 2056/57 the ratio of compulsory and voluntary registrants is 88:12. The composition of registrants of both compulsory and voluntary is volatile. The composition ratio range from 88:12 to 74:26 from fiscal year 2056/57 to 2064/65.

In Nepal, the number of VAT registrants (compulsory , voluntarily) are being increased continuously due to the several reasons like,, knowledge about VAT, demand of VAT-bill by customer, and use of government facilities, etc. The continuous increase in VAT registration affects positively to the economy of nation. Such as; adequate fund collection for government as a tax, price stability in the market and discourage of illegal business.

4.2.2 Filing of Tax Return

The taxpayers are required to submit their returns within 25th day of the expiry of expiry of tax period, which is one month in the case of compulsory registrants and four months of voluntary registrants. This means compulsory registrants have required submitting these tax returns, every month while voluntary registrants have to submit their returns for a period of four month.

The tax return shows a debit, credit or zero. Debit returns are those returns in which the taxpayers have to pay net VAT to the government. Such a situation occurs when the tax collected by taxpayers on his sales is higher then the tax paid by him on these purchases. Since, generally sales are higher than purchases. Most returns are expected to show Debits. Credit returns are those in which the tax payers have negative tax liabilities, i.e. where the government owes money to the taxpayers. Such a situations arises when the input tax is Higher than output tax. Such a situation may arise when taxpayers build up their inventories or when outputs are zero-rated, such as exports. It is not unnatural to expect some credit returns under the VAT system. Zero returns are also possible. This happens when input tax and output tax are equal. The taxpayer I required to submit a zero

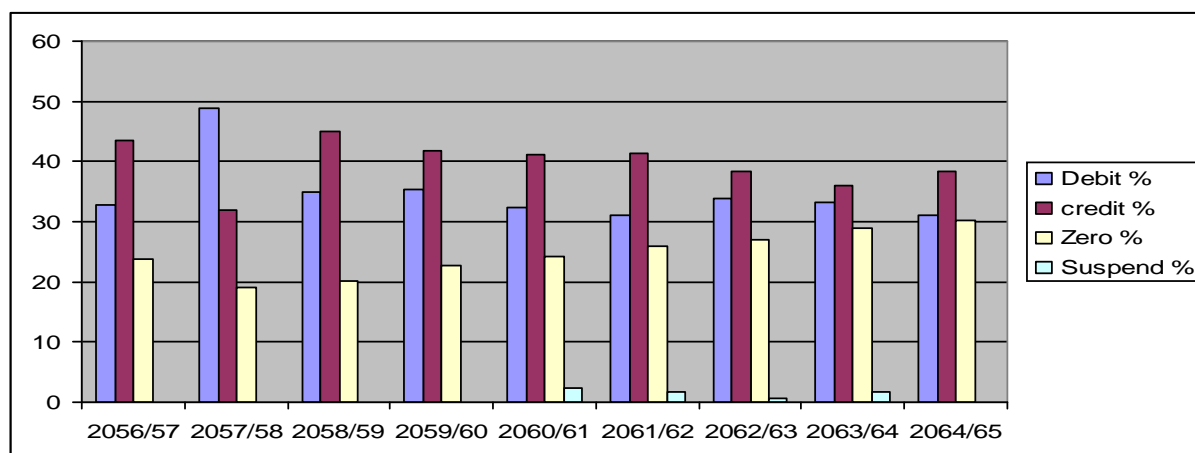
return even if there were no transaction in the tax periods.

Table: 4.3
Status of Vat Return

Year	Types of Return									
	Debit		credit		Zero		Suspend		Total	
	Rs.	%	Rs.	%	Rs.	%	Rs.	%	Rs.	%
2056/57	1654	32.7	2204	43.57	1200	23.72	0	0	5058	100
2057/58	4510	48.87	2950	31.98	1767	19.15	0	0	9227	100
2058/59	6027	34.91	7766	44.97	3475	20.12	3	0.02	1727	100
2059/60	6975	35.39	8250	41.86	4471	22.68	14	0.07	19710	100
2060/61	6936	32.3	8844	41.19	5207	24.25	486	2.26	21473	100
2061/62	7178	31.06	9533	41.36	5972	25.85	396	1.72	23079	100
2062/63	8483	33.87	9625	38.42	6783	27.08	158	0.63	25049	100
2063/64	9478	33.2	10260	36	8271	29	516	1.8	28525	100
2064/65	10449	31.06	12882	38.3	10139	30.14	163	0.04	33633	100

Source: MOF

Figure No: 4.3



In Nepal, the number of credit returns is rather high for several reasons. Some taxpayers are in the credit position due to the provision for input tax claims on stock held at the time of registration. Of the total returns in 2064/65 about 31.06 percent were debits. This was small percentage as compared to the world standard. Zero returns constituted about 30.14 percent in the FY 2064/65. This rather a high percentage. The number of suspended returns was 0.4 percent in the FY 2064/065.

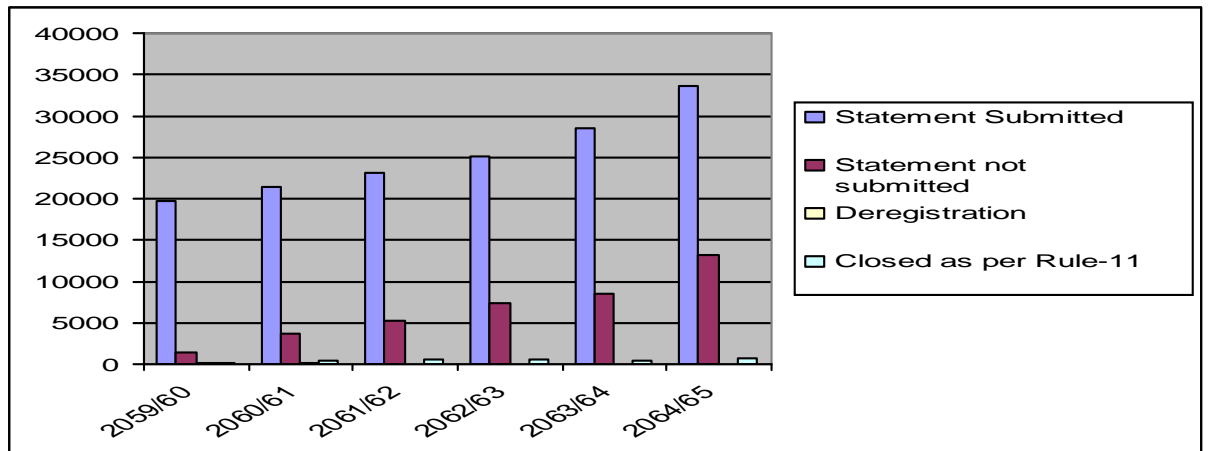
4.2.3 Status of VAT Registrants

Table: 4.4
Status of Registrants

Year	Total Registrant	Statement Submitted	Statement not submitted	Deregistration	Closed as per Rule-11
2058/59	17947	17271	676	-	-
2059/60	21093	19710	1383	170	172
2060/61	25149	21473	3676	80	360
2061/62	29872	23099	5255	18	531
2062/63	34178	25049	7322	30	570
2063/64	39776	28525	8492	30	445
2064/65	46831	33633	13198	36	647

Source: MOF

Figure No: 4.4



From the above table and figure it is clear that as the total no of registrant is increasing likewise the no of registrant submitting statement, not submitting statement and closing business as per rule-11 is also in increasing trend. Registrants, deregistration from VAT is in decreasing trend which shows the good prospects of VAT in future.

4.2.4 Composition of VAT Revenue

Total VAT collection can be divided in to two parts. One is domestic and other is import. Currently, about one-third of total VAT revenue comes from domestic products and two-thirds from imports. The taxpayers are allowed to claim VAT paid on imports credit or import is considered as a negative VAT. Tax payers deduct the VAT paid on imports at

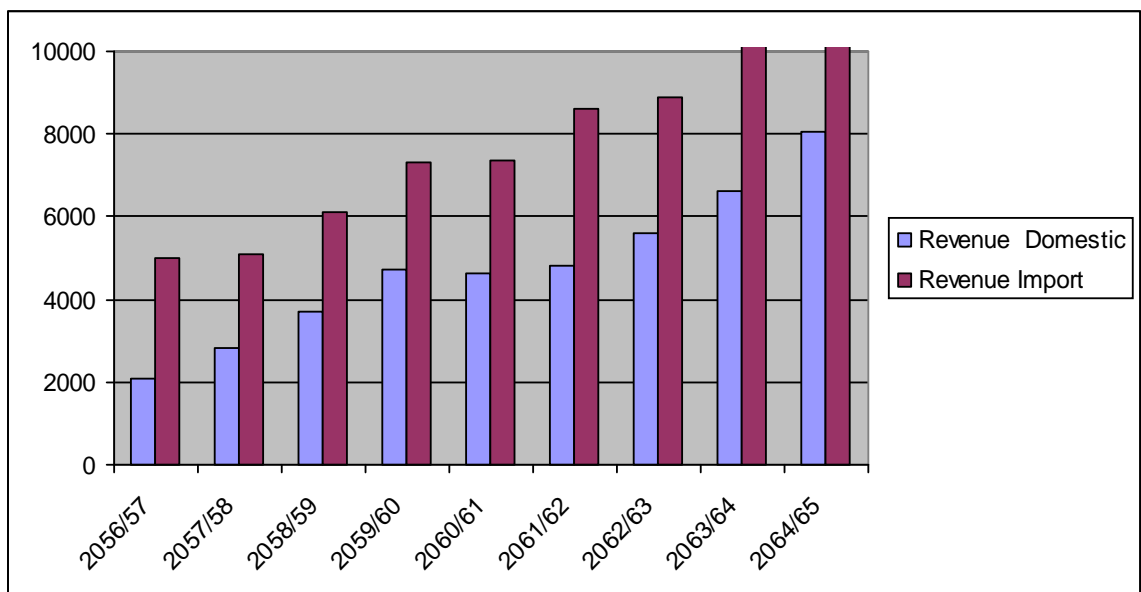
the custom points from the VAT collected on their sales and remit the balance to the government. The share of import VAT is likely to decrease in the year to come. The composition of VAT revenue of the six fiscal year tabulated as shown below:

Table: 4.5
Composition of VAT

Year	Revenue		Total	Ratio
	Domestic	Import		
2056/57	2100	5020	7120	29:71
2057/58	2810	5070	7880	36:64
2058/59	3720	6130	9850	38:62
2059/60	4744.72	7303.04	12047.76	39:61
2060/61	4608.37	7339.58	11947.95	39:61
2061/62	4819.61	8629.51	13449.12	36:64
2062/63	5604.12	8874.77	14478.89	39:61
2063/64	6624.33	12270.29	18894.62	35:65
2064/65	8057.43	13888.57	21946.01	37:63

Source: MOF

Figure No: 4.5



The above table and figure show that the share of domestic VAT in the fiscal year 2056/57 was 29 percent and 71 percent share was custom point on imported goods. The share of domestic VAT is increasing trend but in fiscal year 2061/62, it is decreased by 3 percent and again increased to 39 percent in fiscal year 2062/63. And it again decreases to 37 percent in fiscal year 2064/65. Remaining percentage of VAT collection was from imported goods. On the conclusion, the share of domestic VAT is slowly increasing from the FY 2056/57.

The VAT revenue of imported goods has dominancy on total VAT revenue. And the domestic VAT revenue is not satisfyingly increasing due to the several reasons as unfavorable business environment, low level of investment on production on luxurious goods and unavailability of raw material from the production within the country. This situation affects on economic development of the country.

4.2.5 Collection of VAT Revenue

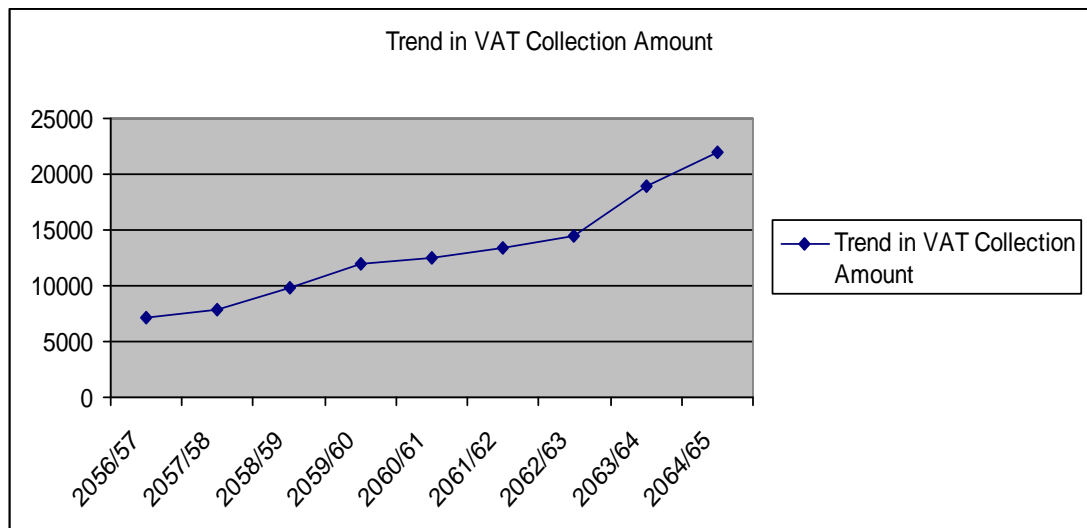
VAT plays a significant role for the collection of Inland Revenue. VAT generated Rs. 7120 million in FY 2056/57. This was increased by 10.67 percent in the fiscal year 2057/58 to Rs. 7880 million. Rs. 9850 million revenue was generated in FY 2058/59 representing an increase of 25 percent on the previous year. And the revenue reached to Rs. 21946.01 in fiscal year 2064/65 as shows in the table below.

Table: 4.6
Collection of VAT

Year	Trend in VAT Collection	
	Amount	Growth Rate
2056/57	7120	-
2057/58	7880	0.106742
2058/59	9850	0.25
2059/60	12047.76	0.223123
2060/61	1947.95	-0.00828
2061/62	13449.12	0.125642
2062/63	14478.89	0.076568
2063/64	18894.62	0.304977
2064/65	21946.01	0.161495

Source: MOF

Figure No: 4.6



The table and figure indicates that the growth rate of VAT collection is gradually increasing rate in each fiscal year. In the beginning year it had 11 percent increasing rate

and second year it went up to 25 percent. So it shows that satisfactory trend of VAT revenue, but fiscal year 2060/61 the increasing rate of VAT was negative. In the FY 2061/62 the growth rate of VAT is 12.56 percent i.e., the collection of VAT is satisfactory. The increasing trend is decreased to 7.66 percent in fiscal year 2062/63 and again increased to 16.15 percent in fiscal year 2064/65.

The collection of VAT revenue is in increasing trend. This becomes possible due to increase in the number of VAT registrants and some improvement on VAT administration and government policy. This helps to collect funds for development of nation i.e. the collection of VAT is satisfactory.

Method of least square.

This is the best method of obtaining the trend value. It provides a convenient basis for obtaining the line of best fit. The line of the best fit is a line from which the sum of the deviations of various points on either side is zero.

Let the straight line be $y = a + bx$

Where, y = dependent variable which gives trend values.

a = a constant indicating y-intercept for a given straight line.

b = a constant indicating slope of the trend line or annual rate of growth.

Table : 4.7 Calculation of trend of vat revenue{million}

Year(t)	Vat revenue(y)	$x = (t - 2060)$	x^2	xy
2056	7120	-4	16	28480
2057	7880	-3	9	23640
2058	9850	-2	4	19700
2059	12047.76	-1	1	12047.76
2060	1947.95	0	0	0
2061	13449.12	1	1	13449.12
2062	14478.89	2	4	28957.78
2063	18894.62	3	9	56683.86
2064	21946.01	4	16	87784.04
total	$\sum y = 107614.35$	$\sum x = 0$	$\sum x^2 = 60$	$\sum xy = 270742.56$

Since, $x \neq 0$, we have

$$a \times \frac{y}{n} = \frac{107614.35}{9}$$

$$a = 11957.15$$

$$\text{And } b \times \frac{xy}{x^2} = \frac{270742.56}{60} \Rightarrow b = 4512.376$$

From (i), the required equation of the trend line is $y_c = 11957.15 + 4512.376x$

Now, the yearly growth of VAT revenue $b = 4512.376$ (million)

4.2.6 Revenue Mobilization from VAT and other Sources

VAT is an indirect tax. Indirect tax is the major source of revenue collection. In the developing countries, VAT has contributed to increase the revenue of the country. So that VAT was introduced to mobilize more revenue. VAT has contributed more revenue than the other source like income tax, excise duty, vehicle tax etc.

The table and figure below shows the contribution of VAT and other taxes.

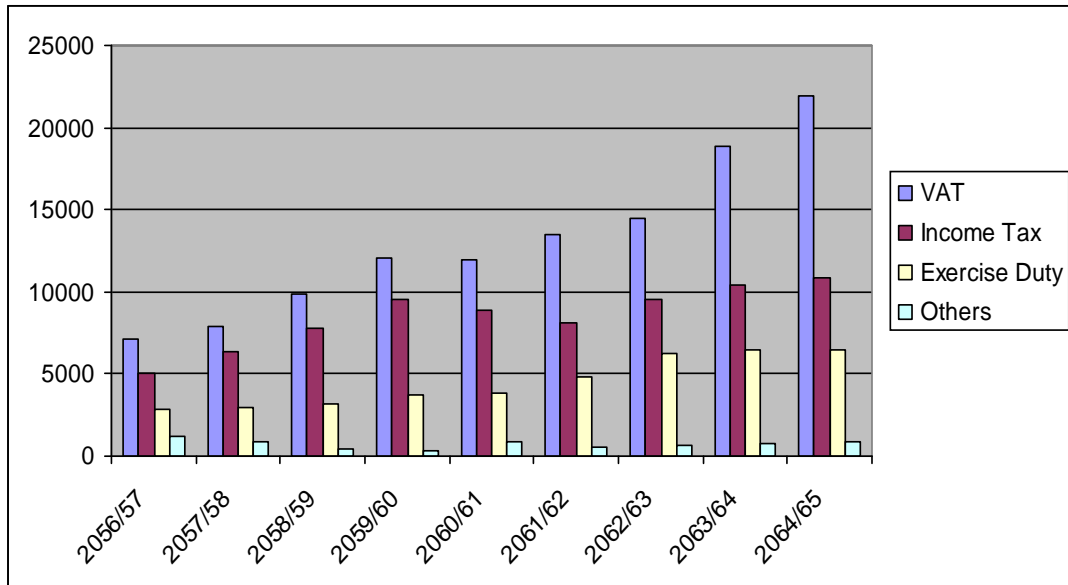
Table: 4.8

Revenue Collection from VAT and other Source

year	Sources				
	VAT	Income Tax	Exercise Duty	Others	Total
2056/57	7120	5070	2890	1240	16320
2057/58	7880	6390	2950	880	18100
2058/59	9850	7820	3130	400	21200
2059/60	12047.76	9540	3770	330	25687.76
2060/61	11947.95	8919.68	3807.73	862.32	25537.68
2061/62	13449.12	8059.58	4785.24	559.48	26853.42
2062/63	14478.89	9514.78	6226.72	700.58	30920.97
2063/64	18894.62	10452.63	6446.5	758.99	36552.74
2064/65	21946.01	10896.44	6512.22	846.64	40201.31

Source: MOF

Figure No: 4.7



VAT has the largest share in the revenue generation of the country. The share of the VAT in FY 2064/65 is 53.47 percent. The share of the income tax, excise duty and other taxes in the FY 2064/65 is 27.10 percent, 16.20 percent and 2.11 percent respectively. Thus, VAT is the main source of the revenue collection. The share of VAT in the revenue collection is continuously increasing.

4.3 Analysis of Primary Data

Nepal has different kinds of problem, constraints and challenges in all sectors such as administrative, political, geographical, social, and economic and others. Nepal is still facing it. But Nepal has not achieved a satisfactory level of the economic growth.

VAT is considered to be the best fiscal tool; practically it is also proved that it has many shortcomings. VAT influences the level of economic activities and other variables like price, wages, foreign trade etc. directly or indirectly. Bu the various effects of VAT are difficult to assess. The primary data are conducted about the following areas related with VAT.

) Vat administration .

-) accounting system of the businessmen.
-) Vat and its applicability in Nepal.
-) Vat and inflation.
-) small vendors who are not wellorganized and ignorant about vat economic growth.
- Illegal trade.
- Effect of vat on tax leakage.

4.3.1. VAT-Administration

VAT is more demanding than sales tax system. VAT would bring more vendors in to the tax net. Consequently, the file return tax payers will increase. This would necessitate more personnel. VAT requires a modern, effective and efficient administration. The question is designed to show the efficiency of Nepalese VAT administration which is shown in the table below.

Table 4.9
Effectiveness of VAT Administration in Nepal

Respondents	No	Result		
		Yes	No	Needs some improvement
Tax office/ Experts	4	4	0	0
Businessman	20	4	4	12
Customer	16	4	6	6
Total	40	12	10	18
%	100	30	25	45

Source: MOF

The above table is shows that the respondents argue about 45 percent are able after some improvement of the administration, 30 percent of respondents argued with the able

to handle. The 10 percent of respondents argued inefficiency of Nepalese VAT Administration. On the conclusion we can say that training must be provided to tax Officials to expertise them in the field of VAT.

4.3.2. Accounting System

Despite a picture of Nepal, there are many people who are illiterate, farmers, and small vendors. They are not well organized. The business sector is dominated with small vendors. Small vendors are not keeping systematic accounting records because record keeping is costly and lack of knowledge. Most of small vendor's businesses are family based business. The systematic and large scale business is keep systematic accounting records both manual and computerized. The systems of record keeping of the businessmen are shown in the table below.

Table 4.10
System of Record Keeping

Response	No of Respondents	%
Manual Accounting	22	55
Computerized Accounting	8	20
Both	10	25
Total	40	100

Source: MOF

The analysis of the table, the records keeping activity are manual, computerized and both. The most of the businessmen (55 percent) used to keep their account by manual. Only 20 percent of the organizations keep their account by computer. And 25 percent of the organizations keep their account by both manual and computerized. This study shows that Inland Revenue Department should be developed and effective invoicing and recordkeeping computer programme and provided particularly to retailers at nominal cost.

4.3.3 VAT and its Applicability

Focus on the ever increasing resource gap in the government finance of Nepal and series of tax reform in the world, there is a considerable relevance substituting value added tax in the place of the import/manufacturing level sales tax in Nepal. The question is designed to present activities of respondents about VAT is applicable in Nepal or not with tax officer/experts, businessmen and consumers. The responses are presented below.

Table 4.11
Applicability of VAT

Respondents	No	Result	
		Yes	No
Tax office/ Experts	4	4	0
Businessman	20	11	9
Customer	16	10	6
Total	40	25	15
%	100	62.5	37.5

The above table shows that 62.5 percent respondents are positive in applicability of VAT. The total 40 respondents, 62.5 percent agreed that VAT is applicable in Nepal. From the responses of the respondents, Value Added Tax is applicable in the Nepalese economy.

4.3.4. VAT and Inflation

VAT is an inflationary tax in nature i.e., it raises, the prices of goods and services and Hardening life more. These are the fears and voices against VAT. Theoretically, VAT

which replaces another indirect tax would only have a slight effect on prices. VAT does not necessarily add extra burden to the consumers. This tax replaces other forms of tax including sales tax. Again if a VAT replaces another type of general sales tax, the general price level could be zero or very small either way if it replaces corporate income tax that has not been reflected in prices. We might expect the price level roughly equal to the VAT, if an accommodation monetary policy is followed. Beyond on time rise in prices, there seems little reason to expect the VAT to trigger an inflationary spiral unless most wages are rightly indexed to cost of living data and again monetary policy is accommodation.

This question is designed to present activities of respondents about VAT is an inflationary tax or not. The responses are present below.

Table 4.12
Inflationary of VAT in Nepal

respondents	No	Result	
		Yes	No
Tax office/ Experts	4	0	4
Businessman	20	12	8
Customer	16	10	6
Total	40	22	18
%	100	55	45

Source: MOF

The above table shows that out of the total respondents 55 percent thought that VAT does not create inflation and 45 percent argued that VAT is inflationary. The tax officer/experts are not believed about inflation by VAT. The consumer and businessmen believed that VAT causes inflation in Nepal.

4.3.5 Small Vendors

There are many illiterate, farmers and small vendors in Nepal. The small vendors are not well organized. The business sector is dominated with small vendors. The assumption is that small vendors should be many and its role should be inevitable and dominant to the business structure of developing countries. So we have a figure, that is small vendors are many in Nepal. The inclusion of small vendors into tax net is implemented. The tax base is much more possible to be broadened and widened. But its implementation is not free from the problems, which are in general. First, the small vendors, being illiterate and ignorant about VAT second, the operation of VAT administration will be complicated and costlier regarding the VAT enactment. Third, the growth of tax leakage and corruption is continuous and will be in future. Therefore, the concept of threshold is applied to tackle such kinds of problems by avoiding adverse effect on the revenue accumulation and also on the business of small vendors. If the turnovers of small vendors are below the fixed threshold, the small vendors have legal exemption from VAT registration. If not the small vendors must legally register the VAT office for the VAT purpose.

The question was asked with the aim of find out the present threshold is enough to secure the small vendors. The result is presented below.

Table 4.13
Enoughness of Present Threshold to secure the Small Vendors

Respondents	No	Result	
		Yes	No
Tax office/ Experts	4	4	0
Businessman	20	10	10
Customer	16	12	4
Total	40	26	14
%	100	65	35

Source: MOF

From the above table, 65 percent of the respondents were satisfied on the present threshold but 35 percent of the respondents argued that the present threshold is not Enough to secure the small vendors.

4.3.6. Economic Growth

The cross-section data from low and middle income countries in Asia display at best, a Weak correlation between the improvement ability to raise revenue and economic Growth. In this sense, other factors i.e. saving, investment, entrepreneurship, labor force, natural resources and fiscal and monetary policy are the direct agents for economic growth. Among them taxation is a tool of the fiscal policy, but a tax certainly influences over these agents and ultimately for economic growth. VAT in this concern influences the economic growth of the country. Naturally, the imposition of taxes however introduces economic distortions and dead weight loss. A VAT reduces purchasing power of the people directly and induces prices of the goods and services equal to the amount of the tax imposed indirectly. In this sense a VAT reduces saving, investment and ultimately reducing economic growth. Moreover it should be evaluated that, does a VAT distort more than its alternatives? We will find the answer 'No' VAT is proved most efficient tax in comparison to their indirect taxes, since it is neutral among the methods of production, distribution and consumer choices. VAT may not distort entrepreneur's decision and investment and ultimately economic growth. Although, the VAT as other taxes may destroy savings but it can also be argued that VAT being consumption related tax it should discourage unnecessary consumption resultantly improving saving behaviors. Moreover, VAT rebates producers' goods and services from its tax base resultantly encouraging investment and production. Similarly, VAT is also considered neutral among labor and capital investment creating less distortion. Thus VAT induced less distortion and higher economic growth.

Table 4.14
Helpfulness of VAT to Economic Growth

Respondents	No	Result	
		Yes	No
Tax office/ Experts	4	4	0
Businessman	20	15	5
Customer	16	10	6
Total	40	29	11
%	100	72.5	27.5

Source: MOF

Among the 40 respondent, 72.5 percent respondents believed that VAT helps to economic growth of Nepal. On the other hand 27.5 percent respondents argued that VAT only does not help to economic growth in Nepal.

4.3.7. Illegal Trade

In Nepal, a few types of smuggling or method of evasion of import duties can be Identified. The custom officials may not record imports because they are transported covertly with or without the complicity of custom officials through the official part of Entry. Secondly, goods may come through the custom cheek point, but they are false Counted or miss-use of official authority.

It is difficult to generalize what happens to illegal trade under the VAT regime. However, it can be argued that the present pattern of illegal trade would change \and th e present level of illegal trade should decrease rather than increase under the VAT regime. It is because the adoption of VAT would make the sale of illegally imported goods difficult. Marketing smuggled goods would be a difficult task because ther e is a danger of being caught up. If administration works efficiently and fairly, the level of illegal trade must decrease; there is no evidence to prove that the i8llegal trade would increase the

represent level.

The question was asked with the aim of finding out the VAT has been discouraging the illegal business or not. The results presented below.

Table 4.15
Helpfulness of VAT to discourage Illegal Trade

Respondents	No	Result	
		Yes	No
Tax office/ Experts	4	4	0
Businessman	20	15	5
Customer	16	14	2
Total	40	33	7
%	100	82.5	17.5

Source: MOF

From the above table shows that 82.5 percent respondent believes that VAT has been

Discouraging illegal business. But out of 17.5 percent respondent argued that VAT can Not control illegal business. VAT is one of the fiscal tools to control the illegal business and generates more revenue to the government.

4.2.14 Tax Leakage

Tax leakage, one of the burning challenges, untitled to the administration. It is visible and invisible existed in Nepalese tax system still now, it is a problematic issue. Tax revenue has been flowing out through tax leakage since a long time back. If tax leakage is neutralized, the tax revenue will definitely multiple. When it is sin reality, it will be a plus point tote national economy. The main objective of VAT is to tackle the existed tax leakage so as to increase the revenue collection.

The question is designed to show the VAT has been leaking in Nepal or not. The result is presented below.

Table 4.16
Leakages in VAT

Respondents	No	Result	
		Yes	No
Tax office/ Experts	4	1	3
Businessman	20	10	10
Customer 16	10	6	
Total	40	21	19
%	100	52.5	47.5

Source: MOF

From the above table shows that among 40 respondents, 52.5 percent respondents argues that VAT has been leaking in Nepal. But out of 47.5 percent respondent are not accept the VAT leakage in Nepal.

The VAT would broaden the scope from many administrative hassles her requirements of maintaining records, inspection and audit system many be misused by tax person seeking unnecessary benefits. On the other hand, VAT provides mo re chances of direct contacts between the taxpayers and tax personnel. Since direct contacts and dealing facilities collusion mal practice and misuse of power, tax evasion would be easier under the VAT.

4.4 Major Findings

The major findings of the study have been divided in parts a) findings from secondary data analysis and b) findings from primary data analysis.

A) From Secondary Data.

) No. of VAT registrants is in increasing trend reached up to 46831 registrants in F/Y. 2064/65 from 5241 is F/Y2056/57.

- J Compulsory registrant is more than voluntary registrant in every reviewed year.
- J While analyzing the tax return credit return is highest followed by debit return and zero return.
- J No. of registrants submitting their statements is high in comparison with registrants not submitting their statements.
- J Currently VAT revenue from import dominant VAT revenue from Domestic. About 1/3 of total VAT revenue comes from domestic products.
- J Amount of VAT revenue is in increasing trend and reaches to the height of Rs.21946.01 Million in FY 2064/65 from Rs.7120 Million in FY.2056/57.
- J Among the source of revenue VAT has dominant all other sources of revenue collection i.e. Income tax, exercise duty, and others.

B) From Primary Data

- J 1. 45% of the respondents agree Nepalese VAT system is efficient but only after some improvement.
- J 2. 55% of respondents keep manual accounting where as 20% keep computerized accounting system.
- J With regard to applicability of VAT, 62.5% respondent showed positive response in applicability of VAT. 6. 72% of respondents argue VAT help in economic growth here as 27.5% are against of it.
- J 55% of respondents agree VAT as a tool of inflation even though, tax officers and Experts do not argue VAT as inflation.
- J Most of the respondents (i.e. 65%) have agreed that present level of threshold i.e. Rs.2million is enough to secure small vendor.
- J 72% of respondents argue vat helps in economic growth where as 27.5% are against of it.
- J VAT discourages illegal trade. 82.5% of respondent accept this view.
- J There is a small difference in view on leakage of VAT in Nepal.52.5% respondent has accepted and 47.5% respondent has rejected it.

CHAPTER V

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

VAT is a recent and an important innovation in the field of modern taxation System. VAT is a tax that is based on goods and services. The base of VAT is the value addition that takes place during process of production and distributions. Since this tax is based on consumption, the burden of this tax has to be borne by the consumer.

VAT is based on self-assessment system. Under the self-assessment system, a taxpayer is required to keep a proper account of all his/her business transactions. Therefore, the tax returns filed by the taxpayers by assessing his/her tax liability has to be accepted by the tax administration not only in principle but also in practice. VAT has done away with administrative procedures such as taking approval of price for purpose of sales tax, submission of annual statement of accounts, tax assessment by the tax officers, stamping of invoices, submission of invoices at the tax office along with the tax returns, etc.

VAT is a transparent tax-system that is based on the taxpayer's transaction. VAT is not only transparent in itself but also demands transparency in other tax system as well. Unless such an environment is created VAT cannot be implemented effectively. In order to implement this tax system effectively the income tax on the basis of negotiations schedule must be replaced by the provision to levy custom duty on the actual transaction value and acceptance of VAT accounts for the purpose of Income tax.

In order to make VAT effective, it is essential to create an environment in which invoices are issued properly, accounts are maintained accurately, tax is based on transactions, there is acceptance of taxpayer's correct accounts, and a fair competition among industrialists and businessmen is established. Until and unless such a situation is created, VAT implementation will not be an easy job and pressure will be created in some or another way.

While comparing VAT with other form of sales tax, it is so far superior on many grounds such as economic efficiency, revenue productivity, and administrative simplicity. However retail level sales tax is only the nearest

competitor of VAT extended through the retail level and both will generate equal revenue with similar coverage and rates. If VAT can be implemented effectively along with its different provisions like exemptions, threshold, zero-rating, it will be more equitable. Avoidance of pyramiding and cascading effects and providing cross auditing, self-policing and catch-up effects are the most favorable features of VAT which makes it superior even than retail sales tax.

Naturally, to introduce new systems replacing old one would be surrounded many complications and oppositions even if the new one is improved one. The same condition was of the VAT. Because of these and many other reasons before introduce any new system it will be better if it is implemented after adequate preparations. The implementation of VAT does not seem effective in Nepal till now as the gap between the potential and actual VAT is large and widening every year at the constant rate of 10 percent. Lack of proper practice of invoicing, following the less efficiency of tax authorities, lack of conscious consumers, effective implementation of threshold, lack of coordination between custom and VAT related offices. Corruption, lack of transparency is other threat for effective implementation of VAT.

As the public conscious level is very low, businessmen are cheating consumers charging high prices in the name of VAT. Businessmen also cheating the government, as they are not issuing proper bills in their sales and hence do not pay real VAT amount. It was expected that after the implementation of VAT, problems of tax evasion, undervaluation would be automatically abolished as it is transparent and all transactions would be recorded in computer. But the existing large amount of unauthorized trade to/from India has been posing a great threat due course of VAT implementation. The smuggling of goods and services are creating loss of revenue. On the one hand it is not coming through custom point and on the other hand it discourages the genuine traders and loss of revenue.

If provisions of zero-rate is to be removed and all sectors including agriculture is to be brought under VAT, net adequate revenue could be mobilized through VAT which would be necessary for all economic as well social welfare program and the Nepal could be independent for growing expenditure needed for development activities.

5.2 Conclusion:

The ultimate objective of any tax policy in developing countries like ours is a) to increase the growth rate in a relatively short period to the maximum possible extent. b) to have built in –flexibility into the tax structure and to provide maximum revenue productivity continuously and consistently with optimum growth rates. c) to act as an instruments for combating inflationary pressure in the initial stage of economic development and. d) to remove the inequality of income and wealthy in society.

The above mentioned economic indicators show that our economy is passing in low level of equilibrium trap. To escape from this trap it needs huge amount of investment in economic and social overheads. Because of low income and low marginal propensity to save there is a little scope for voluntary saving and investment. External source of financing would reduce the capital formation at the time of repayment of principle and payment of interests. Thus, in this context taxation have vital role to give the movement to the economy. But analyzing the revenue and expenditure of Nepal, there seems a trend of persisting resource gap along with the huge amount of saving-investment and export-import gaps.

Regarding the current status of domestic revenue mobilization, it has not been able to support fund for foreign aid and loans. Similarly it is also insufficient for meeting day to day expenditure of government. So that the government has to depends on external sources of financing and other inflationary financing, which are not desirable from welfare and other grounds. This proves that the government is getting bigger without better and which causing fiscal crisis in the economy.

In the process of tax reform VAT has introduced in the year 1997 in Nepal expecting to give speed for revenue mobilization, by creating good environment for taxpayers and authorities. VAT was expected to have high revenue productivity due to its boarder coverage and base. Elimination of economic distortions caused by tax system, elimination of cascading and pyramiding effects, certain of competitive business environment, strengthen the foreign trade etc. were other spares of VAT that were expected to fulfill after implementation of VAT. VAT has crossed ten years of its implementation. But could not get expected results, which are getting in other countries that are implementing VAT.

It was not unwise to expect revenue performance at least as much as the growth rate of GDP from VAT. In the context of Nepalese economy, performance of VAT revenue does not seem satisfactory. The contribution of VAT revenue as percent of GDP remained less than 3 percent after the implementation of VAT and the performance does not show improving. The revenue performance of taxes which were replaced by VAT was even more than the replaced taxes with respect the GDP over the five years of VAT implementation. This indicates that there is still many challenges and needs more efforts to make the VAT success.

The structure of VAT in Nepal is designed not below than the line of the threshold level in the world; however it is not truly applied in real practice. The revenue potential of VAT, with the existing structure and without considering the trade that are going from illegal ways, is more than 1.5 fold of the actual revenue yield. Considering the present economic conditions, growing needs of government expenditure, other source of domestic revenue, negative impact of external sources of revenue, present status of VAT, it seems most essential to rethink about VAT threshold, VAT rate, list of exempted goods and sectors etc.

Theoretically VAT is modern and in general, the best form of sales tax, but all its negative and positive aspect mostly depends upon the implementation aspect. The administrative capacity of the tax authorities, the level of awareness of general public and taxpayer, honest and loyal tax collectors, nature and status of development etc. are the prerequisite to make the VAT effective. Without all these and other any prerequisites none can analyze and comments either the VAT suits the economy or not because the economy can not experiences all the aspects of VAT. Thus the study concludes that there is immense scope of VAT in Nepalese economy, which can give right direction to the tax revenue and can be a perennial source of domestic revenue. If the VAT is to be implemented effectively, it will not so far to meet our objectives of taxation as well

Development, which the study mentioned above. This can be claimed after looking the figure of potentiality of VAT revenue. But the present situation of VAT is not according to our expectation and the requirement of the economy. Inefficient tax authorities, low level of public and tax payers awareness, insufficient and inefficient manpower, lack of IT system, lack of research on about the weakness of existing VAT system, low level of implementation of findings of scholars, lack of political

commitment, absent of proper mechanisms for monitor and audit, etc are creating hardness and obstacles on the path of VAT implementation. Because of these the Economy is unable to experience positive impact of VAT.

5.3 Recommendations:

In order to give notion for the Nepalese tax, government decides to implement VAT in Nepal, as an improved and scientific tax and implementation of VAT has crossed its ten years. In due course ups and down appeared. To make VAT as a perennial source of revenue many preparatory programs were lunched in different levels and places. VAT Act, Rules and Regulations have been framed in line of international standard and its preparation had been made comprehensive and much more extensive. Since VAT is a modern tax, it demands modernization in all spares to give output as expected. If we implement a scientific tax like VAT but all our behaviors, attitudes and thinking remain pragmatic then it produces less output. Therefore to achieve result according to our expectations from VAT, it is essential to change our attitudes and behaviors towards VAT. Moreover the study indicates following recommendations that should be adopt to get results as expected from VAT.

1. Lack of clarities in the tax laws and regulations are the great issues within the businessmen and industrialists. They are arguing that the language used in tax laws and regulations are very complex. They feel that there is lack of clarity and often full of discrepancies and many interpretations can be made out of same law. All this leads to loss of business confidences and shift of investment from good infrastructure projects and value added to business requiring small investment that are short gestation periods and short live. This further leads low productivity, low production, low base for tax and low tax revenue. Government is not devoting its efforts towards the promotion of industrial sector properly. Because of revenue oriented nature and outlook of Government business that provides more revenue and does well has been shifting on low productive areas where no tax is imposed. This result contracting the base of tax.

To remove such ambiguity government should take some steps immediately.

The principle of no taxation without representation should be strictly observed. The change in the tax rates or base of valuation of commodities should be strictly based on the provisions of laws but not on circular, ordinance or executive order. The VAT Act should be adjusted with the legal provisions made through the annual finance bills. IRD should simplify the language for clarity thereby reducing ambiguity in the tax law. The computation of taxable products and transactions should be done in accordance with the provisions of the VAT Act.

2. Human resource is the prime factor for sustainable development of any faculty. But human resource that is needed in the tax system does not seem adequate in Nepalese context. This is the main problem of tax authorities. The Inland Revenue Department should give thrust for manpower development with reference to IT, subjective knowledge of tax, laws, auditing and accounts, training, and observation/study. The department urgently requires support for manpower development especially through providing training and workshops both for senior and junior staff with in and outside the country. Tax expert should be prepared and they to get chances to gain knowledge of tax system, audit, tax laws, investigation techniques practicing in other countries too, by providing training, interaction etc. programs. Human resources development is also necessary to support the enforcement activities. Human resource development is also significant for sustainable quality services that could be possible through improving curricula by the Public Service Commission. A separate entrance examination is highly essential for those aspiring for revenue service before the final examination
3. There is a crisis of confidence between the government and private sectors .Without close cooperation between these two sectors, VAT cannot be implemented effectively. There were made many agreements between the private sector and the government but they are not seen in the practice. Person of each are blaming to the person of another. There is a loss of revenue due to the understated value by the taxpayers on the one hand and on the other taxable value is arbitrarily fixed by the tax payer. Hence, it is necessary to co-operate the private sector with the government through the civil society, FNCCI and other

different associations.

4. There is a huge scope for Institutional and Infrastructure reforms. The level of skills and knowledge of the staff at the revenue office should be enacted by continuous training programs. Good governance should flow from top to bottom. Existing excess, inefficient and unproductive staff in the various tax offices should be replaced by highly qualified, professional staffs that have adequate training in revenue system
5. To improve the capacity of the Department of Revenue Investigation is the need of the hour. Thus Department of Revenue Investigation has been assigned a crucial role to fight unauthorized trade and control revenue leakages. This department is not functioning as per the expectation. There is speculation that this organization might go under the control of Prime Minister Office or merge with the Commission for The Investigation of Abuse Authority. Thus, there is an urgent need to clarify the status of Department of Revenue Investigation
6. It is essential to improve the status of Revenue Training Center. The Revenue Training Center is not working as per the aspiration of its establishment. The main motto of this center is to organize training program on the tax system. In recent years, the status of this center has been relegated to a dumping side for the personnel at MOF. This kind of organization has great significance for developing excellence of those in revenue services. Thus there is a need to activate the institution in its fullest capacity.
7. Even if the VAT system is based on the computerized system the data arrangement is not so good. It is necessary to develop and expand the networking of database and information system at all levels. VAT would be successful only if there is perfect computerized system. Therefore it is necessary to promote IT in tax system so that the exiting problems such as under-invoicing, non-issuance of bill, improper education of taxpayers, and enforcement of law would be automatically solved. Infrastructure development is also required especially for the maintenance of IT. In addition, information campaign should

be intensified through opening website, organizing seminars, conducting training programs and advertising on media.

8. Monitoring system in the VAT is not so effective. So that taxpayers are encouraged for tax evading practices. Many businessmen don't issue invoices and most of other issue improper invoices. This in not only contrasting the tax base and thus losses in the tax revenue but also results inequity since those who issue proper invoices might feel discriminated. So this system should be checked through an effective monitoring system
9. Many businessmen having taxable transactions are still beyond the tax net so the enforcement should be made more effective and voluntary compliance should be encouraged. The level of voluntary compliance could be raised through a set of promotion and regulatory measures including positive and services minded attitude of the tax personnel, rationalization of tax structure simplification of tax procedures and forms, strengthening tax administration, conducting audit and investigation in an effective manner, and penalizing those who break the rules. The procedures regarding registration, collection, interest, penalty, audit and appeal should be simplified and improved.
10. Tax system can be rationalized by lowering the level and number of tax rates. Thus it is necessary to lower the import duties on some selected items to discourage smuggling and under valuation.
11. The existing long open border is the main cause of smuggling and undervaluation in the boarder sides. So open boarder should be systematized to a greater extend.
12. Threshold and tax refunds are two possible gates for tax evasion. An effective and efficient tax auditing, investigation and monitoring system should be developed. Refund system should be made simple and effective and the period of such refund should be minimized

13. The existing exemption has a broad coverage and it should be minimized successively. However, some exemptions are unavoidable due to administrative complexity and equity perspective. Exemption will have an impact not only on revenue but also on economic efficiency and administration. So exemption should be minimized gradually and the existing threshold should be reviewed when all the traders having taxable transactions are into the VAT net and administration is capable to handle.
14. To make the VAT as a nations pride needs an urgent efforts toward improving VAT system and administration in Nepal through (a) changing the environment (b) changing the administration and (c) changing the tax law and regulations.
15. Since the implementation of VAT has already crossed ten years, policy makers should examine sector-wise and commodity-wise and probe the source of tax revenue leakages and should make tax policies accordingly. As the VAT collection from manufacturing sector is satisfactory (i.e. more than 5 percent of GDP), there are no huge leakages of revenue in that sector. This proves that the manufacturing sector is relatively transparent. policy makers should give proper attentions toward other sectors namely distribution and service sectors rather than it. Therefore the study recommends changing the tax strategies for manufacturing sector. We can make this sector better off without making revenue collection worse off or keeping existing proportion of revenue constant, which automatically improves the performance of VAT. For that manufacturing sector should relieve from the custom duties. Custom duties for the import of raw materials and final products should be reduced considerably, which makes this sector competent. This is also justifiable in the context of globalization, and the relative contribution on VAT at percent of GDP.

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