

# **CHAPTER – ONE**

## **INTRODUCTION**

### **1.1 General Background**

Nepal is a pre-dominantly agriculture based economy, situated in the southern part of Asia. It is a small land locked country located between two large and rapid growing countries India and China. Out of total population, 81% is based upon agriculture which contributes about 39% to the total G.D.P.

Nepal is one of the poorest and least developed countries in the world. The major portions of population live in village and most of them are below the poverty line. The role of government is still vital to build up infrastructure, provide social services and alleviate object poverty.

Government revenue plays a vital role in the rapid economic development programmes to solve these challenging tasks. Government expenditure is increasing day by day. For meeting day to day expenditure, government requires some source of revenue.

Revenue from a country may be from internal sources and external sources. Internal source constitute own tax revenue and external sources include foreign aids and loans. Such external sources are uncertain, inconvenient and not good for healthy development.

Taxation is the most effective and powerful tool reserved in the hands of the government of a country. The major objective of taxation is to make fund available for the economic development and economic stability. It also helps equal distribution of national income of the country.

Tax is usually classified in to Direct Taxes and Indirect Taxes. Direct Taxes comprise of Income Tax, Property Tax, Land Revenue Tax, Vehicle Tax etc. These taxes are directly imposed on a person or an organization that bears the tax burden ultimately.

Indirect taxes comprises of Excise Duty, Custom Duty, Sales Tax, Entertainment Tax, VAT etc. These taxes are shifted to other people; the ultimate tax is borne by the ultimate consumers. In a developing economy like Nepal, Indirect Tax plays a vital role as compared to Direct Tax. In Nepal, Import Duty used to be a major source of government revenue till the government adopted liberalization policies, which led to the drastic decrease in import tariff and ultimately in the government revenue; hence, the government revenues had to be recouped by increasing the revenues from other sources of Indirect Taxes.

Presently, VAT is the most important and reliable source of revenue for the government. Earlier there used to be Sales Tax, which was collected at the import/manufacturing point leading to narrow tax base. Also, tax evasion was rampant. Hence the need to introduce a more scientific taxation tool was felt and thus VAT came in to implementation in Nepal.

Value Added Tax (VAT) is an indirect tax and definitely a new concept as compared to other taxes. VAT is the youngest and the most emerging tax. It is not an additional tax for tax payers but it is levied in place with most improvised from of Sales Tax, Contract Tax, Entertainment Tax and Hotel Tax. As the name suggest, under VAT, Tax is imposed on the value added by a firm through its production and distribution activities. Value added implies the difference between the purchase price and the selling price. Thus, value added includes the entire expenses incurred in the process of preparing the goods for sale after purchase plus the profit margin. Unlike in sales tax, tax is imposed on each stage like import, production, wholesale distribution and retail distribution. Thus the taxability at each is based on the value added difference (the value of the output less the value of the inputs).

Government of Nepal implemented VAT at the beginning of F/Y 2054/055. Now VAT has completed more than 10 years of its implementation.

## **1.2 Focus of the Study**

The study is focused to analyze the Nepalese VAT system with problems, prospects and suggestions

The main focuses of the study are on the following aspects:

- a.) Why is it necessary to implement VAT in Nepal?
- b.) Describe replacing taxes to VAT with problems and causes of replacing and the relationship between tax system and price of final goods as well as export turnover.
- c.) What is contribution in total revenue?
- d.) Role of VAT Department or government in VAT collection.

## **1.3 Statement of the Problems**

The world is now stepping towards the 21<sup>st</sup> century. But in Nepal, resource mobilization is still poor that does not cover the growing expenditures because of deficit financing and external loan.

If we look at a glance to the budgetary system of Nepal, we can find a significant resource gap. The financial expenditure of the Nepal Government has been increasing at a faster rate than increase in revenue. Every year the resource gap is increasing at a faster rate due to the slow increase in the rate of revenue to fulfill the expenditure requirement. The resource gap was Rs. 13842.20 million in 1995/96. It further widened to Rs. 17667 million in 1999/2000 in 2001/02 it had become Rs.22940.70 million. [Economic survey 2003/04 Ministry of Finance, GON]

Nepal's lower revenue mobilization is due to the poorly designed and defective tax system where the taxes are less productive, less responsive and distorted. It is expected that VAT would be a major instrument to avoid deficit financing. In an attempt to reform the existing tax system, the government had adopted VAT in Nepalese tax system. In Nepalese tax structure, sales tax was found to suffer

from very low tax base, cascading effect and distortion effect but VAT is considered as the best from of sales tax with merits of self policing, catch up effect, broad base etc. So VAT was the best replacement for Sales Tax to mobilize internal resources through effective structure, which is also considered as the optimal solution of resources gap and high dependency on foreign aid.

In the earlier stage of introduction of VAT in Nepal, it had triggered a lot of debate among the businessmen and government regarding its good and bad effect. There had arisen various issues on design of VAT, its administrative operation and applicability and its effects on different segments of society. A careful examination of these issue and imperative analysis is necessary to implement VAT successfully in coming days. So it is a time to evaluate the Nepalese VAT by identifying its present problems and analyzing future prospects, not only from theoretical aspects but also from the practical experience, which is the subject matter of this study.

#### **1.4 Objectives of the Study**

The general framework of the study is to examine the various problems of Vat and suggest the useful alternative solutions to the wide range of these problems. However, specified objectives of this study are:

- a.) To identify current problem and future prospects of VAT in Nepal.
- b.) To examine the importance of VAT in revenue collection.
- c) To collect relevant options of businessman, tax officials and consumers on different aspects of VAT.
- d) To find out why it is necessary to implement VAT and to evaluate the effectiveness of VAT during the last 10 years of its implementation in Nepal.
- e.) To suggest remedies and recommendations for successful implementation of VAT in Nepal.

### **1.5 Limitations of the Study**

There are some limitations regarding this study, which are as follows:

- a.) The extent of this study is based on the availability of reliable data and sufficient literature.
- b.) Due to time constraint and other difficulties field survey is done in Kathmandu area of our country.
- c.) Major data used in this study is secondary data while primary information is gathered from Tax Officers, Tax Experts, Businessmen, Traders, Tax Payers and Consumers.
- d.) Opinions of the people have been taken as sense of truth, which may not be correct at all the time due to changing trends of thinking of people.
- e.) Only 7 years data are taken for the study.
- f.) This study is limited to Nepalese laws, rules and regulations.

### **1.6 Significance of the Study**

This study has tried to make a comparison between Sales Tax and VAT. It has tried to identify the limitations of Sales Tax with analysis of the problems and causes for implementation of VAT as a replacement of Sales Tax, Hotel Tax and Contract Tax. This study also shows the relationship between the tax system and price of final goods as well as export turnover.

In context of Nepal, Vat has completed more than 10 years of implementation. Vat has been perceived as effective tool for mobilizing internal sources more effectively. Many people are still ignorant about the concept of VAT and it is believed that VAT increases the price of goods/services. In such a situation, the need of the study of Vat arises. Tax evasion habit of the people is rampant in Nepal. VAT has been perceived to be a tax reform system. This study holds significance to those people who intend to know more about VAT and how VAT has been perceived by the Nepalese People.

## **1.7 Research Methodology**

The research study is focused particularly on the analytical and descriptive type. In the context of Nepal, the study is to be theoretical because Vat is a new tax system in Nepal. The study has tried to analyze and describe the survey results and the survey opinions of different respondents regarding various aspects of VAT. In short, the study has followed the analytical descriptive research design which has been supported by the following factors:

### **1.7.1 Nature and Sources of Data**

The primary as well as secondary sources of data have been collected in order to achieve the real and fact result. The major sources of data are as follows:

#### **A. Primary Sources of Data**

The primary data have been collected from those respondents who are representing from various sectors i.e. Tax Administration, Tax Experts, Businessmen/Traders and Consumer.

#### **B. Secondary Sources of Data**

Secondary data has been collected through book, journals, newspaper reports, dissertation etc. The major sources of secondary data are as follows:

- i. Economic survey and budget speeches MOF, GON.
- ii. Annual Reports of IRD, MOF and GON.
- iii. Published documents of National Planning Commission & NRB.
- iv. Economic survey of MOF, GON.
- v. Book related to VAT and VAT administration.
- vi. Other relevant records and data including useful websites.

### **1.7.2 Area/Sampling/Population**

The area of present research work is particularly in Kathmandu. The research person including Tax Experts, Tax Officer, Businessmen/Traders and Consumer, etc., have been taken as its population by using the purposive sampling methods. Total size of the study is 100%. Out of which 5% Tax

experts, 15% Tax Officers, 30% Businessmen/Traders and 50% are Consumers.

### **1.7.3 Methods of Analysis**

The conceptual frameworks of the VAT in the context of our country, Nepal and its impact in the different fields that are indicators of the economy have been theoretical analyzed. Analysis has been done on the basis of the data collection.

### **1.8 Structure of the Study**

The study will be organized in to five chapters each devoted to some aspects of the study.

Chapter 1: Introduction

Chapter 2: Review of Literature

Chapter 3: Research Methodology

Chapter 4: Presentation and Analysis of Data

Chapter 5: Summary, Conclusion and Recommendations

## **CHAPTER - TWO**

### **REVIEW OF LITERATURE**

## **2 An overview of Nepalese VAT**

### **2.1 Adoption of VAT in Nepal**

After the transition of democracy in 1990, the government launched a reform program to promote modern market oriented economy, while maintaining sound macro-economic policies. A major structural reform initiate then was to introduce VAT system in the country. This kind of political acceptance to introduce VAT was a milestone in tax reform process. The government adopted a policy of adopting VAT in eight fifth year plan (1992-1997). Similarly, the 1993/94 budgets stated that VAT would be introduced within a year or two. VAT steering committee and VAT Taskforce were formed in 1993. As a part of its liberal economic policy, HMG asked donors to study VAT system. The technical assistance of the Harvard Institute for Internal Development (HIID) under the USAID financial assistance took up the study. This assistance was suspended in 1995, resumed in 1996 and continued until 1997. HMG started exploring donors for the continuation of VAT programs. The Danish International Development Agency (DANIDA) accepted the government's request and pledged to support VAT project. The DANIDA has been extending technical assistance since 1997. Afterward, VAT steering committee was reconstituted in 1995; VAT Act was passed in 1995 by the parliament. Meanwhile, the Department of Sales Tax was renamed as the Department of VAT in 1996. It had the full responsibility to administer VAT system. VAT interaction and training programs were organized by the representatives of the Federation of Nepal Chamber of Commerce and Industry (FNCCI), Nepal Chamber of Commerce (NCC), journalists, parliamentarians, Institute of Chartered Accountants in Nepal, Businessmen and several other professional groups.



As VAT law was designed to handle a single standard rate, the multiple rates of Sales Tax were unified in 1996 at 15% from the rate of 10 and 20%. Again some more training, interaction programs, information campaigns, meetings, etc. were held to convince people about the introduction of VAT system. VAT Taskforce was set up with members from VAT administration, FNCCI, NCC and consumer forum. The cabinet approved VAT regulation in 1997. The national VAT steering committee, consisting of representatives from HMG/N, FNCCI, NCC and donors was formed. Another VAT task force was formed with members from HMG/N, industry and commerce sectors. Besides VAT Act and Regulations, the Ministry of Finance (MOF) approved nine volumes of manual in 1997. In a run up to the budget for the FY 1997/98, the government decided to convert hotel tax into the Sales Tax and the rate of tax was also reduced to 10% from 15%. Despite opposition from the international monetary fund (IMF) of such rate reductions, as there was a significant revenue risk associated with the rate reduction, HMG went ahead with its agenda. The HIID had made a study, meanwhile, about an appropriate rate of VAT. The study had recommended 15% as a revenue neutral rate. At the time of announcing its budget for the FY 1997/98, the government did not agree to the recommendation. Similarly, exemptions of the Sales Tax were not brought in line with what was listed in VAT Act, 1995.

The final date for the introduction of VAT was set for November 16, 1997 and came into practice. The existing Sales Tax act 2023, hotel tax act 2018, contract tax act 2023 and entertainment act 2017 were repealed along with the implementation of VAT. Soon after its going into live, something went wrong. Despite all preparations, the introduction phase ran into many problems. The business community staged protests. Several rounds of negotiations were held to reach in an amicable settlement. Such negotiations with Businessmen resulted into poor implementation. The sentiments of the whole business communities were divided between "No VAT and Yes VAT". The most significant of all events at that time was vertical separation between FNCCI and NCC staffs. The Traders dominated the NCC. The FNCCI were the

umbrella body but they were also apprehensive of the full-fledged implementation of VAT. The whole environment was poisoned. The process of implementing a full-fledged VAT was thus slowed down. Considering the situation, VAT technical group was formed in order to solve VAT implementation problems. Several new provisions relating to VAT were introduced through the finance bill 1998. In July 1998, the situation becomes so bad that the survival of VAT was put on stake. HMG compromised in number of areas including slowing down in registration, raising thresholds, more exemptions etc. that is known as "point's agreement." In this process the basic spirit of VAT was destroyed. So were the revenue potentials. VAT is supposed to be neutral, broad based and transparent tax system. But when government entered into negotiations with business communities, the spirit of VAT was diluted to a large extent. In the name of negotiations, everything was destroyed except the name of VAT. Again, several proposals were introduced in VAT through 1999/2000. Budget and the finance bill in order to create a congenial atmosphere for the smooth implement to VAT through a notification in 1999. To sum up, in pursuit of this policy, which has been world wide movement, HMG/N has made several policy announcements, laid down several laws, farmed many task forced, produced volumes of reports. It will remain true for future too.

In fact, the implementation of VAT was not easy in the beginning years. It was a matter of great debate. A large number of Traders were against VAT. Policy makers and bureaucrats were not bothered whether VAT would yield a positive or regressive one. Now, the situation has changed. VAT has just completed its 10 years of implementation. Despite some short comings, the overall functioning of VAT, so far is satisfactory.

## **2.2 Design of VAT Law and VAT System.**

The VAT law was drafted in 1994. It was discussed in depth at several stages within VAT task force with the secretary of the law reform commission and the various groups. It was reviewed by the VAT steering committee. The draft was sent to various business groups, including the federation of Nepal Chamber of Commerce and industry (FNCCI) and Nepal chamber of commerce (NCC) for their comments. While this was a good beginning to seek opinion of the private sector on the proposed VAT law before its approval by the parliament, no written comments were received from the private sector on the draft VAT act.

The VAT bill was presented to the parliament on 3 December 1995. It was referred to the finance committee where it was discussed 24, 25 and 26 December 1995. The finance committees send the bill to the parliament on 27 of December 1995 together with its report for amendments to a few provisions. The lower house of parliament passed the bill on 30<sup>th</sup> December 1995 and upper house on January 1996. The VAT act received the royal seal on 20<sup>th</sup> March 1996.

After that, the VAT regulations were drafted in July 1996. Like the VAT act, the regulations were discussed at different stage. They were discussed at different stage. They were sent to the FNCCI for comments. As in the case of VAT act no comments were received from the private sector on the VAT regulations. Cabinet approved the regulations on 27 of January 1997. The operational manual was initially drafted in 1996 and was finalized in the falls of 1997. HMG approved the operational manual on 21 September 1997. The manual has been prepared in nine volumes, covering all the aspects of VAT from the law through investigation of offenses. They are as follows

- (a) Organization and management
- (b) Changing and accounting for VAT
- (c) VAT registration
- (d) Collection and enforcement

- (e) Payment of claims for refund
- (f) Verification and audit
- (g) Fraud investigation
- (h) VAT computer system
- (i) VAT act and rules.

### **2.3 Reasons for the Growing Popularity of VAT**

VAT is one of the forms of Sales Taxation. VAT has been proposed for reforming existing taxes like as turnover tax as well as it has been developed for economic growth by generating more revenue than other existing Sell Taxes, Hotel Tax, Contract Tax, Entertainment Tax and Air Flight Tax etc. Many countries have introduced VAT (more than 125 countries) and other are in the implementation process.

Alan A. Taif (Value Added Tax Administrative and Policy issues, IMF, Oct 1991 p.1) "pointed mainly three groups of reasons to adopt a VAT: revenue, neutrality and efficiency. Certainly, these groups of the characteristics of an ideal tax system". Another feature of an ideal tax system is equity. VAT is more equitable in the sense that it falls equally on all goods that gather a different proportion of value added at various stages. Further more, VAT is favored from an administrative point of view.

Clue and Friedlander (Government Finance Economics of the Public Sector, 1981. 7<sup>th</sup> Edition, P. 420) evaluated the value added form of Sales Tax which offers several potential advantages important:

1. For many countries the possibility of avoiding the adverse consequence of the turnover tax, without concentrating the impact of the tax at any one stage in production and distribution. The value added tax produces no economic distortions or loss of efficiency if properly designed. The advantages of the retail Sales Tax are fully

attained; yet a large portion more than half on the revenue is collected at pre-retail levels. This is of no great importance in the untied states but is of great merit in many countries; in which retailing is small scale and excluding producers strongly resist paying taxes.

2.                   The greater case in excluding producer's goods from tax. As explained below, a Sale Tax should in principle apply only to purchase for consumption use under other forms of Sales Tax exclusion of sales for business use requires check upon both the seller and the customer. With the VAT all sells among business firm are taxable the purchase takes credit for the tax paid on purchaser not upon the supplier. The difference should be exaggerated, as there still remains the problem of determining the firm has actually used the goods for business or personal use. But the check may be some what easier. In practice, Value Added Taxes free far more business purchases from tax than do the typical retail Sales Taxes.

3.                   The cross audit check tax reported as paid by one firm to its suppliers for which it takes credit against its own tax liability should appear as tax paid to the government by the supplier. This cross check is not automatic but it can be made, by auditors or ultimately by computers. Some what similar checks are made under retail Sales Taxes if there is doubt about the correctness of the sales reported by a retailer check is made upon the retailers purchase records and if necessary, with the retailer's suppliers. But the cross check is easier with the Value Added Tax.

As mentioned above shortly, VAT offers more advantages with comparing turnover, manufacture, wholesaler and retailer tax system. But all the merits would not be attached in the VAT however there are two folds of everything viz. Advantages and disadvantages.

## **2.4 Reasons for Adopting VAT in Nepal.**

Apart from worldwide recognition of VAT, Nepal's case represents some specific reasons (importance) for adopting VAT. They are as follows:

### **1. Revenue Enhancement:**

The first and foremost reason for adopting VAT in Nepal was to develop a stable source of revenue by broadening the tax base to meet the growing revenue need of the nation. Generally, tax base under VAT is broadened in two ways: *firstly*, by formulating a modern tax law based on wider coverage of goods and services; *secondly*, by increasing the transparency in transaction at all levels of Tax Administration. As VAT covers extensive goods and services, the tax base is much broader. Even a small rate of tax can provide very high yield of revenue. There is no doubt that revenue can be maximized through a system of (VAT) tax, which has low rate but high yield. VAT is workhorse to provide such growth in revenue. That's why, there was no choice but to introduce VAT in Nepal to generate revenue required for improving its deteriorating macro economic performance. Since the economy is in serious need of revenue mobilization, VAT system was a natural choice to enhance the revenue productivity of the country. VAT is a very scientific and transparent tax that will definitely enhance revenue collection. In every country, where it has been implemented properly VAT has proven itself as a revenue productive tax.

### **2. Tax Reform:**

Another most important reason behind introducing VAT was to reform the existing tax policy. A good tax policy has several features. Out of them, important ones are simplicity, elasticity, broad base, low rate, transparent, easy to administer, fair etc. which the existing system was lacking. Except VAT, all taxes by design have narrow base. Narrower the tax base, higher will have to be

the tax rate. Higher tax rate leads to tax evasion. Nepal, by adopting VAT has tried to overcome this problem.

"The government of Nepal does not have the option of doing nothing major changes must be made in order to make tax administration fair, efficient and effective. The hostility, harassment and corruption that currently exist between the tax office and the business community must end if Nepal is to have a modern tax reform. The business people want the system changed and willing to pay a reasonable tax but they want the system treasonable tax but they want the system transparent and fair."

A modern efficient and neutral tax like VAT was therefore referred to get rid of past anomalies. The adoption of a modern VAT system thus was a part of an overall tax reform package. The implementation of VAT in Nepal is also expected to establish an account based modern transparent tax system.

### **3. Administrative Efficiency**

The tax system of Nepal seriously lacks administrative efficiency. The general impression is that the administration is indifferent, inefficient and corrupt. Widespread use of discretionary measures and lack of transparency in a day-to-day administration have resulted into arbitrary tax assessments, harassment of genuine tax payers and provide opportunities for corruption. It is therefore, necessary to effect changes in all aspects of taxation i.e. policy, laws, procedures and administration, in order to implement tax reform in a meaningful way.

The way VAT operates influences the working of all other taxes. Operation of VAT, thus, transforms other tax administration. Since the implementation of VAT renders transparency at all levels and enhances tax compliance, administrative efficiency in tax system will be ensued. Experiences have proved that the success of any tax system depends entirely on administration.

"The introduction of VAT provides an opportunity to sweep away the cobwebs and revamps a substantial part of the tax administration"

#### **4. Global Economy:**

Globalization has forced many governments to change their economic policies, including tax policies, in the recent years. "The emergence of multi-lateral institutions like general agreement on tariff and trade (GATT.) Or World Trade Organization (WTO) has necessitated a member country to reduce customs duties at par with international community leading to competitive trading. In the same way, scarcity of finance and need to attract international fund to meet development needs has forced countries to consider their tax policy. Any reduction in prevailing rate of taxes would invariably require same amount of revenue from other sources of tax. In this respect, VAT is considered an alternative to make up for the revenue loss from the reduction in other taxes. In other words, against the phenomena of global tax rate reduction, VAT has been taken as the most effective and powerful tool to rationalize Internal Tax rates and safeguard revenue.

Our economy needs a tax policy package to increase the gross domestic product (GDP) size and to mobilize internal resources. In the context of globalization especially with respect to south Asian free trade area (SAFTA) and GATT/WTO provisions, tax rates are supposed to be drastically lowered to make them compatible with globalization. This is a major challenge to Nepal's tax system in the context of sustainable internal resource mobilization that will decline with the new tax regime.

#### **5. Donors preference**

In the present day context, economic development is one of the formidable challenges for developing countries like Nepal, where infrastructure development is very poor. The developing countries are in dire need of funds



to initiate development countries are in dire needs of funds to initiate development project for national development almost 85% of Nepal's development financing is met by foreign loans, grants and aids. Donor countries would like to see that enough effort is put to mobilize internal resources so that the government is able to match the development financing. In developing countries like Nepal, the possibility of getting foreign aid is backdrop: donors find it difficult to convince their government for more financial aids.

A poor country like Nepal is not in a position to ask for more development aid on the grounds of poorness. The change in the structure of foreign aid of Nepal over years itself reveal this fact. Many countries are now competing with the same amount of fund not in terms of poorness but in terms of fiscal prudence. This has put pressure in each government to keep their economy in order so that fiscal disciplines are maintained. One way of achieving this goal is possible only by mobilizing higher internal resources. In the country in question cannot mobilize domestic resources than the changes of getting higher foreign aid are becoming slim day by day. The IMF under its Enhanced Structural Adjustment Finance (ESAF) program has put the implementation of VAT as conditionality. The HMG/N, thus, adopted VAT for domestic revenue mobilization, which will definitely fulfill the donor's preference too.

## **2.5 Basic Features of Nepalese VAT System.**

While Nepal has adopted a conventional VAT. Similar to that implemented over 125 countries around the world; it has injected some special features in to VAT system to make it uniquely Nepalese. Some of them are as follows:

- The adoption of consumption type of VAT.
- The computation of VAT through tax credit method
- the principle of destination

- The provision of exemption and zero rate goods and services.
- The application of VAT to all business turnovers through the retail stages i.e. broad base.
- The allowance of tax credit for taxable supplies including the zero rate supply
- The facility of tax refunds
- The use of single positive rate at 13%
- The level of threshold of Rs. 2 millions.

## **2.6 Existing Problems in the Implementation of VAT in Nepal**

Theoretically, value added tax is considered to be the best fiscal tool; though partially, it has many problems. VAT system entered in to 10 years of its implementation in Nepal, but implementation of VAT is not proceeding at desired pace. It is facing many problems and challenging in effective implementation. In spite of the most popular fiscal tool, Nepal is still facing number of challenges like poor administration, political instability, mal-practice, corruption etc. These existing challenges in the implementation of VAT in Nepal are explained below:

### **1. VAT Billings:-**

Since VAT is based on bill system, the issuance of proper bill is very important for the successful implementation of VAT. In other words, the success of VAT depends on bill issuance by Traders and compulsory receipt of bill issuance by customers. In case of Nepalese market, billing system is not effective and still not improved. So the widespread proactive of not issuing VAT registered bill while selling goods is still on impediment in the effective implementation of VAT. Even after 10 years of implementation of VAT, Consumers are unaware of the significance of billing system. The system of asking for bills while

purchasing goods has not developed so far despite government's commitment and efforts. Due to the lack of public awareness about billing system, very few people ask for bill for their purchases.

The proper issuance of bills has remained a major bottleneck. The revenue generation is not meaningful because the potential revenue is severely lacking due to the non-operation or ill operation of billing system in most of the registered firms. Businessmen registered in VAT offices, holding VAT certificate, fulfill just formalities but avoid issuing bill for every transaction. Besides that, most of the firms do not issue bills. They issue parallel bills, loose bills and make parallel accounts one for the tax purpose and other for business purpose. Consumers too are not much interested in taking bills since VAT amount is extra charged if they demand for bill. If any consumer asks for bills, they would charge 13 % more as VAT on top of the price. Then, generally Consumers do not ask for VAT bill, either they take cash memo or a purchase note. The people, who demand for VAT bill, feel harassed.

Furthermore, the major problem associated with VAT is the lack of compliance on the part of Businessmen with the billing requirements. Businessmen hardly issue bill to Consumers though it is mandatory under VAT act. If customers insisted, they would charge extra money. Such practice has discouraged the customers to demand VAT bill. Similarly, low valuation of imported goods at the customs is another major obstacle in the successful implementation of VAT and is the root cause of the failure of the billing system. If this provision could not take place in practice, the effectiveness of VAT always remains questionable. Until the bills are not issued, VAT cannot be effective. This is the great challenge of VAT in Nepal.

## **2. Narrow Tax Base/Coverage:**

The base of VAT is narrow, both legally and administratively. For example, several sources of income including agriculture, export, capital gains, dividends fringe benefits etc. still have deliberately been kept out of VAT net. Exclusion of agriculture, the biggest sector, alone cuts the tax base by almost 40% of GDP. An attempt was made to limit the number of exemptions under VAT until the introduction of VAT, but the number of exemptions increased substantially after the implementation of VAT. Many exemptions, deductions and rebates are granted under the Industrial Enterprises Act. Similarly, large numbers of exemptions are granted under the customs duties. Similarly, high exemptions are granted under the house and land tax. Excise duties currently levied only on domestic products, keeping imports outside the excise net. Almost 70% of the economic activities that account for GDP are virtually out of the tax net. Economic activities brought under the tax net are also not tapped effectively due mainly to the lack of strong political commitment and weak tax administration. This has been reflected in the low number of taxpayers and low revenue collection.

## **3. Smuggling, Under Valuation and Unauthorized Trade:**

Nepal has long open border with the both neighboring countries India and China. However, the border with China is not being a serious problem due to the geographical inconveniences caused by the mountain area. There is no easy way to pass through the Chinese border and hence level of illegal trade is negligible. But the open border with India is being most challenging issue and problem is still alarming. People of the India and Nepal may easily enter one another's country and buy goods not paying customs duties for personal use. However, major problem is due to the large volume of smuggling and under valuation transaction by business enterprises, rather than consumer. Once the goods are entered into the country by an under valued billing, VAT revenue along with customs duties is lost and that can not be catch up in successive

stage of distribution. Similarly, the goods, which are entered through the illegal route, remain completely beyond the VAT net. Thus, a major problem for effective implementations of VAT is created by a large volume of smuggling and under valuation while importing goods from India. Beside that, there is not any measurement of unauthorized trade between Nepal and India. Many Businessmen have claimed that only a little amount of goods from India come through customs. So it seems, unauthorized trade is very much organized and systematic in the border area.

#### **4. Weak Tax Administration:**

An effective and efficient administration is crucial for the proper implementation of VAT. But in Nepal, VAT administration is still in traditional nature and corruption is being a major problem. Transparency is being only a nice slogan but lacking in real field. Tax officials are not given specialized training on various aspects of taxation. Some of the Tax Officers are still not familiar with the basic and essential concepts of VAT and even new entrance to the tax administration are directly posted to field officers without being given any basic training for their jobs. There is lack of adequate auditors, treaty negotiators and trained personnel on various aspects of taxations. There is also no system of performance- based evaluation of the tax officials for promotion to higher levels. Due to the weak tax administration, there is a big gap between legal system and its actual operation. Besides that, administrative inefficiency is another most serious problems for implementing VAT for effective implementation, qualified, intelligent, well-trained manpower are necessary. Many Businessmen are illiterate and cannot prepare their accounts properly and they are facing many problems while maintaining accounts. So tax administration must provide basic ideas to the Traders and co-operate private Traders.

## **5. Weak Public Consciousness Level:**

Public consciousness is a basic element that should be at higher level in the people so that the government policy and program can be guided at the right direction for achieving objectives of any government policies and programs. In the context of Nepal, it has a poor public consciousness has been misinterpreting and also misguiding VAT to the people by saying that VAT certainly raises the price level of goods. But there is no voice against such misguidance and misinterpretation. The Consumers, who are really interested to make the VAT effectively successful, want to get VAT bills on their purchases but they are not getting such bills from the business community. Most of the Consumers do not demand VAT bills when they are asked by the Businessmen to pay a 13 % more amount to get VAT bills. But they do not know the fact that Businessmen are covering the VAT amount into the price of the product indirectly. Thus, by non-issuing proper bills, Businessmen are cheating revenue to the government as they are collecting VAT amount from Consumers indirectly so far as the Consumers remain unfamiliar with the different theoretical aspect and existing rules and regulations of the VAT, the problem will remain in existence. Thus, very weak public consciousness level about VAT is being one of most significant problem, for the proper implementation of Nepalese VAT system. A successfully effective VAT will be the result when issuance of invoices is effective through high level of public consciousness.

## **6. Geographical Barrier:**

Geographical situation of our country has created an important issue about the applicability of VAT in Nepal. The land distribution seems to be extremely unequal. Such geographical condition has arisen several problems in the path of application of VAT in Nepal. In the remote areas where the people must bear the burden of higher prices of commodities due to services rendered by porters, animals and air transport. Besides these, the burden of VAT is higher in the remote areas than in other accessible areas, which is clearly inequitable and

unjustifiable. So the higher price level of commodities discourages completely the VAT. In spite of that, there are small –scale business activities in the remote areas. The revenue collection in such areas would be negligible amount as compared to collection cost. Therefore, the high collection cost does not permit VAT to be applicable in some of the districts in Nepal. Similarly, controlling and monitoring system of VAT in far and remote areas is not easy due to the lack of transport, communication etc. It is difficult to control the many functions of VAT like inspections, audit, tax refund, penalty and appeal in the remote area due to the lack of adequate Tax Officers.

## **2.7 VAT and its Prospects in Nepal**

Though VAT, at present, is still facing problems, these problems can be overcome if VAT is implemented honestly and effectively and this will help to change the whole revenue structure of the country. For this, if the government has to take strong action against any one who does not comply by its regulations, it should not hesitate to do so. But as the first and foremost step, the government officials must show their integrity to implement VAT. The following can be the measure to make VAT a success in Nepal.

### **1. Creating Public Awareness about VAT:**

In Nepal, the main glitch in the VAT system is the lack of the public awareness. Many people are still not clear about the concept of VAT. Even after 10 years of its implementation, the working of VAT and its effects are still unclear to them. The culture of asking for bills while purchasing goods tax not developed so far. Until the bills are not issued, VAT cannot be effective.

At the time when VAT was introduced, the government had launched campaigns through TV, radio & newspapers to educate the public. The efforts to educate the public should be continuous. At present, the Inland Revenue Department through the media has been creating awareness

among the Consumers on their need to ask for the invoice for purchase. The advertisements and hoardings have been quite successful in convincing the customers of their rights and how the vendors have exploited them. Thus, the vendors will be bound to issue invoices.

## **2. Educating Taxpayers:**

Strong voices against VAT have been raised by the business community right from the beginning. This is natural because first of all, people try to resist changing and the second reason is that most of the Businessmen do not keep proper accounts and most of them evade taxes which are against the principle of VAT.

The business community or the taxpayers should be educated regarding the merits and demerits of VAT. For this, frequent interactions and a special education programme can be launched. Call centers should be set up to provide information on various aspects of VAT.

## **3. Decreasing the Custom Duties:**

The problem of under invoicing to a great extent can be solved by the reduction in the rates of custom duties and increase in the exemption limit of income tax. Accurate invoicing is likely to take place only if the government pays heed to the pleas of the taxpayers.

## **4. Simplifying the Refund System:**

The tax refund is the basic essence of VAT. The refund system, if improved, can do wonders with the VAT system. Delays in the refund of tax should be avoided in order to impart confidence in the VAT system. Boringly, people would object to VAT if refunds are not made timely by the tax authorities.



Even now, the question that arises is "why is the number of refund claims so low as compared to the potential number of refund claims?"

The reason may be any of the following:

- Taxpayers do not have confidence in the refund system since they already have faced a lot of hassles in the past while trying to get the money back.
- Taxpayers do not want their records to be audited due to the fact that they have not been maintained properly.
- Taxpayers do not have enough knowledge about the refund system.

Making due refund claims is the right of the taxpayer and making the refund system systematic and easy is the duty of the Tax Officers. Only by making the refund system simple will the appropriateness of the VAT system and its credibility increase. However, the Tax Officers should be equally cautious to detect fraudulent refund claim made.

## **5. Increasing Administrative Efficiency:**

Improving the administrative capability is the key requirement to ensure that VAT achieves success. VAT system requires extra skills and knowledge, especially for auditing and investigation purposes. Comprehensive training should be imparted to tax officials which covers everything from theoretical aspects of VAT, operational issues, interpretation of VAT law, rules and regulations, registration procedures, filing returns and payments, compliance, tax payers services, tax credit, auditing and investigation skills, general knowledge of computers, spot observations and interaction with the Businessmen.

## 2.8 Review of Literature

Undoubtedly, this study is not totally new. So many studies have been done about VAT; however, I hope that it will do a new study on its own area. For this purpose, available literatures have been collected. First of all, this study focuses what are the problems and prospects of VAT in Nepal. Secondly this study focuses why it is necessary to implement VAT in Nepal and what its contribution in revenue. Previous research work have not felt on this context although theoretical way becomes in similar but it also differs due to the administrative way, geographical condition, fiscal policy of government and last but not least is due to the concept and behavior of business and industrial sectors.

### 2.8.1 Conceptual Framework Review from books

Narayan P. Silwal, in his book "Value Added Tax" A Nepalese experience (1999) has expressed his practical experience about VAT. The book covers all aspects of VAT. In writer's word "VAT is an all stages not cascading tax system. It extends to al levels of production and distribution. Similarly it covers all stages and services. Any discrimination in taxing goods or services or exempting any of them renders VAT ineffective." The book mostly concentrates on Nepalese tax system. The book clearly analyze why the government of Nepal introduced VAT. HMG announced retail level Sales Tax at the rate of ten (10%) percent covering a whole range of goods and services. But now VAT is charged at the rate of 13% at each level. There was no procedural to administer it. When Sales Tax was introduced in Nepal, literacy level was just meager and billing and record keeping was fanciful. In this situation, required revenue cannot take place which in turn into the development expenditures. So that, a modern, efficient and neutral tax like VAT was therefore, preferred to get rid of past anomalies.

**The writer expressed a version by borrowing HMG declaration that – "The government of Nepal doesn't have the option of doing nothing; Major changes must be made in order to make tax administration efficient and effective. The hostility, harassment and corruption that currently exist between the tax office and the business community must end if Nepal is to have a modern tax system, the businessman wants the system changed and willing to pay a reasonable tax but they want the system transparent and fair."**

**Mr. Silwal suggests that factors affecting VAT design take also into consideration. A poorly designed VAT accompanied by weak administration would just drain the treasury. So almost care is necessary while designing a VAT. According to him, the following facts were considered while designing a VAT in Nepal.**

- i) Tax base issues.**
- ii) Rate structure issues.**
- iii) Exemption issues and**
- iv) Threshold issues.**

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

**Dr. Rup Bahadur Khadka (1994) an expert of Nepalese tax system, in his book entitle "VAT in Asia and the Pacific Region" writes – VAT is the most recent innovation in the field of taxation. It is levied on the value added of goods and services. The tax is broad based as it covers the value**

added to each commodity by a firm during all stages of production and distribution.

This book has covered all aspects of VAT including the nature of VAT, reasons for the growing popularity of VAT, development of VAT etc. This apart, the report examines the structure and operation of VAT in the Asian Pacific countries, which also explores the possibility of introducing VAT in Nepal. Probably he is the person of observer of VAT aboard and the firstly proposed VAT for Nepal with micro studied of Nepalese economy and system.

Dr. Rup B. Khadka (1994) in his book 'Nepalese taxation: A path for Reform, Dr. Khadka has reviewed the development of Nepalese tax system, analyzed its existing problems and studied the feasibility and possibility of tax reform. He lights on the domestic and international economic scenario. Then he states that in Nepal, tax reform has become necessary and possible due to both internal and external factors. Further, economic reforms, including tax reforms, have been taking place very rapidly in south Asian countries including India, Pakistan and Bangladesh and the export pressure in other countries including Nepal. In context of Nepal, he states, 'the forging clearly indicates that the Nepalese tax system doesn't satisfy the criteria of a good tax system. Moreover, poor enforcement has only served the distorted Nepalese tax system doesn't satisfy the criteria of a good tax system. It is therefore, necessary to rationalize the structure and operation of the Nepalese taxes and strengthen the tax administration.

Dr; Rup B. Khadka (2000) in his latest book "The Nepalese tax system" points out the need to introduce VAT in Nepal. In his book, there are several reasons to introduce VAT in Nepal. One of the important reasons

was to develop a stable source of revenue by broadening the tax base. Moreover, Nepal will help to become less dependent on international trade taxes for its revenue in the future. Since it will not be in a position to levy import duties on trade that take place within the South Asian Association for regional co-operation (SAARC). After The Implementation of the South Asian Free Trade Arrangement (SAFTA). Nepal has applied for the member of the world trade organization (WTO), which will also have to be considered in this context.

Margaret Nicholson (1989) explains value added tax is added tax is a tax on the supply of goods and services which is eventually borne by the final customers but it is collected at each stage of the production and distribution chain. Value added tax, which is generally abbreviated to VAT, is charged on the supply both of goods and of services by firm who are registered and taxable for VAT. VAT is an indirect tax charged as a percentage of the selling price on certain services and commodities. The percentage rate is set by the government and is changed free time to time via the budget. Registration of VAT is compulsory for persons and firms whose turn over is in excess of the "threshold limit."

VAT is levied on the basis of value added to the value of a product at each stage of its sale in the process of production and distribution. In other words, it is assessed at each stage only on the increase in the value of a commodity since the last transaction.

Accounting skills, Margaret Nicholson (Mac Millan education) Ltd., 1989:123)

VAT in its comprehensive form is a tax on all goods and services (except export and government services). Its special characteristics being that it falls on the value added at each stage from the stage of the product to retail stage.

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

**David N. Hyman (1972)** in the book "the economics of government actively" opines that the VAT is simply multi-stage Sales Tax which exempts the purchase of capital goods and service from the tax base. By exempting capital outlays at the time of purchase consumption type of VAT provides a kind of investment tax credit incentive.

A value added tax is a tax assessed at each steps of the production and distribution process, levied on the difference between purchase cost of an assets and the price at which it can sold (the amount of value added on it). Tax is added tax product's price each time it changes hands until delivery to the consumer takes place, when the final tax is paid.

In the book "Government Finance In Developing Countries" **Richard God** describes VAT as the most important tax innovation of the second half of the 20<sup>th</sup> century and it is classified as a form of Sales Tax on consumption. The tax applies to the value added at production and distribution that is to sales precedes less purchase of material input and certain services.

### **2.8.2 Review from Articles, Journals**

**Dr Rup B. Khadka (1993)** as a research fellow at Phillips University, Marburg, Germany, in his study on a "Revenue of the Nepalese Sales Tax"

states that it is therefore, necessary to introduce a full fledged VAT in order to streamline the Sales Tax system in Nepal. Briefly discussing the Sales Tax system of Nepal, its history and needs to introduce VAT in Nepal, the study points out the weakness of Nepalese Sales Tax system i.e. inefficient, tax evasion on sales, inequitable and complex. So, he includes a chapter "Move towards a VAT and states" the import/ manufacturing level Sales Tax gained same features of a value added tax in Nepal in 1985 when, an advanced Sales Tax system in the place of suspension system was introduced.

**Dr. Rup B. Khadka (1995)** Published an article on "Probability of VAT in Nepal" reached a conclusion that a VAT, theoretically, is the best alternative to remove limitations of present Sales Tax system of Nepal. He further adds. "The merits of VAT don't appear voluntarily. For this, implementation aspect of VAT must be efficient. The implementation aspect of the tax depends on the capacity of the tax administration, co-partnership of taxpayers, accounting system of the business sector and political confidence etc. So, it needs full preparation before introducing VAT in Nepal.

**Dr Rup B. Khadka (1996)** has developed his experience and knowledge achieved in the study tour in Germany into the small booklet named as "A report on the German tax system study tour" in order to distribute its lessons and usefulness. This book covers all useful discussions held in Germany with policy makers and tax administrations as well as the tax payer on the various related topics. Besides, the study observes the tax administration, training center, tax rates, the existing tax system and the distribution of collected revenue. In relation with VAT, the government of Germany includes VAT as a shared tax. In this category, the collected revenue from the various tax systems is distributed among the different levels of the government. VAT is imposed on the value added at all stages of production, import and distribution. The revenue received from the VAT tax by the state government is distributed on

the basis of population. Further more, when data becomes available, a sound policy can be formulated and a tax system be made on the basis of the result of introduction of VAT in Germany "When introducing VAT, the number of tax payers will increase significantly and will be difficult to do all the work manually such as checking whether the tax payers have submitted the tax forms or not or, paid the tax or not whether the interest is paid or not. It is essential to introduce a computer system, which is suitable to the country even though the standardized system developed in countries.

**Dr Rup B. Khadka (1996)** in his paper "A VAT for Nepal" focused on the purposed structure, operation and administration set up of a VAT for Nepal and necessary steps to be taken for its early introduction. In its purposed structure, the coverage of VAT should be made as broad as possible covering all business transactions. Exemption should not be granted unless there is a specific reason to do so, such as administration and equity. Zero rating should be limited to exports, and tax rate should be single to avoid complication and inefficiencies in collection.

The purposed operation of VAT requires that the tax payers above a threshold limit should be registered, the vendor should issue an invoice for each sale, keep a clear account of his purposes and sales (separate accounts for zero-rated, exempted and positive rated goods) and VAT liability should be calculated of its taxable Sales Tax credit method should be used as a method of computation of the tax, and tax payment and refund period should be of one month. The present Sales Tax and excise department should be restructured drastically to administer a VAT. Officer level posts should be increased considerably and extensive training should be provided including the operation of computer system. A VAT implementation team including experts and persons from every field should be set up. A detailed preparation should be considered as a pre-requisite for the introduction of VAT. A comprehensive VAT education programmed must be launched to educate the tax payers.



In a research under the title of "tax reforms in Singapore" Glenn Jenkins and Dr. Rup B. Khadka (1998) has made an effort to assess the VAT in Singapore, which was in effect since 1993. This working paper carries the successful story of VAT introduction and implementation in Singapore to be a good lesson for the non-VAT countries and VAT countries. According to authors, Singapore put forward the VAT/GST in order to make Singapore's economy internationally competitive. In this direction, government of Singapore formed a task force committee for the tax reformation. The committee recommended that the government must shift from direct to indirect taxes as its main sources of revenue.

The research paper concluded that Singapore would be facing the problem of an aging population. In such a situation, income taxes will put a greater burden on a smaller group of younger, working Singaporeans; this might inhibit growth and enterprise. It is therefore, necessary to introduce a broad based tax like GST/VAT to distribute the burden of taxation among a larger section of the population, GST is a tax on consumption and several features. It relieves investment and saving from the tax burden and rewards enterprise and strengthens economic resilience GST relieves exports commodity taxes through the zero rating mechanism.

Since, VAT is a fairer tax and is levied on a large section of the populations, including the self-employed; it is less affected by economic cycles. GST provides more stable, sources of revenue than many other taxes. The main objectives of Singapore to introduce VAT are to make its economy internally competitive, to promote exports and to develop a broad based and more stable source of tax revenue.

**Dr. Govinda B. Thapa (1994)** made an effort on "Value Added Tax into Nepalese Context." he applied the theoretical methodology and deal with theoretical issues. The conclusion derived was "considering the present condition of Nepal facing government expenditure, low revenue effort, high

dependency of foreign loan, and need of more economic growth of the economy and because of low revenue potentiality from direct taxes there is a prompt need to improve the Sales Tax of Nepal. But there is less chance to mobilize more revenue through existing form of Sales Tax. In this context, there is no any other alternative except introducing VAT in Nepal.

The government of India in 1978 appointed L.K. Jha as the chairperson of the committee to examine "the adaptation of VAT at retail level" such as committee was called Jha committee. After study, Jha committee presented the report in which the VAT was rejected by saying no need to adopt comprehensive VAT because of administrative constraints, constitutional problems and revenue consideration. But Jha committee concludes VAT can deliver better satisfactory solution of excise duty. It means VAT should be applicable at manufacturing level.

In a study held in 1973 on "Value Added Tax in Developing Countries" Georg E. Lent Milka Caranegra and Michael Guerard State that", following the adoption of value added taxes by western Europe countries, many developing countries have been giving increased attention to this form of tax as a means of rationalizing their Sales Taxes and improving their revenue."

The study was purposed to examine the applicability of VAT in developing countries" after the empirical study of VAT structure of seven countries i.e. Brazil, Ecuador, and Ivory Coast. The Malagasy Republic Morocco, Senegal and Uruguay in 1973 and draw the principle features of VAT in developing countries. Applying comparative analytical methodology and covering the issue such as revenue importance of the VAT, problems of administration, comparison of the VAT with other forms of Sales Tax, only with a comprehensive and uniform coverage it is possible to achieve a truly neutral Sales Tax i.e. VAT.

On "Key questions considering value added tax for central and eastern European countries." **Prof. Sigbron (1992)** developed a model for central and eastern European countries, on the base of the observation on the value added

tax in EC and OECD countries. In this article, he states that it requires nearly complete overhaul of the tax system and in most contrives the introduction of VAT is considered a corner stone of the necessary tax reform. "In addition, he describes that this form of taxation is worldwide, apart from that of transaction based, accounts controlled VAT in the market economy based on the free enterprise and pricing system." At last, he has concluded that on appropriate VAT for central and eastern European countries has proceeded from the widely agreed promise that the tax should be used almost exclusively to generate revenue for government budget in as neutral and administratively feasible manner as possible, while the income tax can be employed to achieve distribution objectives and excise and imports duties to attain allocate goals", the focus of the VAT should be on revenue."

**Due and Meyer (1998)** examine the VAT in Dominican Republic. The VAT in Dominican Republic was in effect from November 1983. However, the general reaction towards the tax was hostile from the business sector. Labor union as well as political parties opposed the tax. Much of the complain rose from increased record keeping requirement because the commercial sector of the economy was dominated by small and medium sized business. The other main objection was due to the belief that VAT was responsible for increase inflation but the inflation was due to other reasons. There was a general agreement that the enforcement of the tax hadn't been adequate mainly because of lack of personnel. Evasion was wide spread, many firms failed to register. The overall evolution of the tax in the country, therefore, remains rather negative. While the tax has brought additional revenue, the inadequate enforcement and failure to extend it to the commercial sector as planned, and the use of make shift, distorting system in the latter have resulted in serious failure to attain have resulted in serious failure to attain the advantage of a complete value added tax. The experience of the country with the tax provides a warning to other developing countries not to attempt to use a value added tax provides a warning

to other developing countries not to attempt to use a value added tax extending beyond the import and manufacturing sectors without careful consideration of the ability of the wholesale and retail sector to operate the tax, and general attitude of these sectors towards the tax.

**Ahmand and Lucflow (1989)** identify the alternative tax reform packages on VAT for Pakistan keeping the distributional consequence in consideration. The authors have their own method for the tax reform analysis. In the first step, they describe the existing taxes and then, examine the consequences of the tax changes (and thus price changes) on households, resulting government revenue and also implications for production. They analyze and compare the consequences of different options such as the single rate VAT with selective exercise and some exemptions (Or zero rating) and multiple VAT rates. The reform with equal revenue and the reform with additional revenue as well as the production implications of tax reform are also considered. The work shows that instrument can be designed to increase revenue and at the same time, protect the poor. A value added tax supplanted with selective excises would have made Pakistan's tax system more buoyant and reduced the production distortions inherent in Pakistan's current tax system and not at the expense of the poor.

**John F Due and Francies Greany (1991)** wrote a successful story VAT in Trinidad and Tobago. VAT of general type, made effect in Trinidad and Tobago in 1990. Development of VAT was carefully planned and it went through the several phases from 1986 to 1989. The tax performance committee was established in 1987. The first task of the committee was to review the current tax system and develop a preliminary recommendation in direction of reform. The studies showed that the existing tax system was an urgent need of revision for several aspects. The value added tax was put forward as an alternative. Further, the issue such as choice of rate structure, exemption, tax administration etc. was resolved or the final adaptation of VAT. The structure

of VAT was crafted in final report after the careful examination of several issues including revenue and equity with development of analytical models. After so many detailed works, it was finally drafted and passed by the legislation in 1989.

The VAT was well received and also welcomed by the business community. One year experience showed that the operation was reasonably satisfactory. It yielded the previously expected and forecasted results. For its success, there were several reasons such as careful planning of tax structure and administration, a close cooperation between the government and business sector, the extensive publishing programmed, the co-coordinated reform in purchased tax and income tax, and selection of competent persons in the key positions. There were several things can be taken as suggestions from Trinidad and Tobago for the introduction and operation of VAT in other developing countries as well.

**Binguang Hsiung (1991)** has made an effort to assess the VAT in Taiwan, which was in effect since 1986. According to her, the VAT in Taiwan was implemented in order to increase the competitiveness of exports and improve the efficiency of business tax structure. VAT had replaced business receipt tax, stamp tax and commodity tax which constituted 28% of total tax revenue. The impact of VAT showed that the business tax revenue increased considerably although the reform were aimed to be revenue neutral. Adoption of VAT did not cause price fluctuations. Another surprising impact of VAT was that the revenue from the business income tax increased significantly immediately after the adoption of VAT. This may be attributed to the cross-checking procedure provided by VAT. As for exports, there did not seem to be a direct link between VAT and exports since exports are influenced by a number of factors. The tax fell heavily on the public sector business and they were more affected by VAT than the private sector business. Generally, it can be said that the VAT system tremendously improves the efficiency of tax collection. However, there

are some rooms for improvements especially in administration. The experience of Taiwan has attested to the superiority of VAT in taxing business activities.

**Shahabuddin M. Hossain (1995)** investigates income distributional implications of different VAT schemes in Bangladesh in his paper "the equity impact of value added tax in Bangladesh." Applying the method developed by alameda and stern and using the data of household consumption expenditure and input output table, the results obtained indicate that a revenue neutral uniform VAT is regressive (relative to pre- reform situation) in its impact on the income of different households. The paper also explores the income distributional impact of an alternative policy package, and the welfare consequences of the alternative package are found to be superior to those of uniform VAT. The findings of the study suggest that, among different possible VAT schemes, a selective VAT with exemption core zero rating) and additional exercise is clearly preferable than to a complete uniform VAT if the distribution issues are of dominant concern in tax reform.

In an article on "the value added tax and developing countries", **Carls S. Shoup (1998)** points out that "a VAT is tax on the value that a business firm adds to things it buys from other firms in producing its own products. A VAT is comprehensive if it covers all economic activities from the earlier stage of farming or mining right through to the retail. The speed with which the VAT has spread around the world is unmatched by that of any other tax in the modern time, VAT reduces vertical integration because of its nature, which is taxed on the value added but not on turnover. VAT offers more revenue and coverage than other forms of Sales Taxes. It exempts exports well. Considering the problem of deducting the capital goods, consumption type of VAT is superior to other forms. In calculation, tax-credit method is the universal one. In the VAT system, the taxpayer's responsibility spread much better exempt's producer's goods. VAT is more revenue productive, self – enforcing and if foods and basic necessities are to be zero-rated regressively may be reduced,

similarly, on the other hand, its complexity is difficult both in the case of compliance and administration or collection, inflationary in nature, more problematic in developing countries and its regressivity is also pointed out.

**Jantshcer and Silvani (1991)** who have extensive first hand knowledge of VAT in Europe, Latin America and Asia, presented their research paper entitled as "The guide lines for administering a VAT" in the seminar on "the value added tax in Asia" organized by IMF and UNDP. For effective and proper administering a VAT, they emphasize registration and taxpayers identification, invoicing and book keeping requirements and the collection function, including the role of electronic data processing.

### **2.8.3 Reviews of Master's Degree & Thesis**

**Sharma, Chintamani (1998)** examine several aspects of VAT administration such as its problems, constructions, possibilities, operation and other aspects. In his dissertation, he has found the following findings:

- Most of the Traders and businessman are lacked with the minimum concept of VAT. They are mainly facing pricing, billing and accounting problems.
- An adequate VAT education programs are not conducted and VAT administration has also facing lack of administrative personnel.
- The relation between government and business community is broken, which has been barrier to implement of VAT successfully.

His suggestion to the government to implement VAT successfully in Nepal as follows:

- The government should pay attention of design the strong administration.
- The government should try to produce gazette manpower and to train them well.

- The government should launch comprehensive educational program.

At last, he concludes that VAT requires the strengthen administration for its effective and efficient implementation.

**Ghimire, Lalmani (1998)** in his dissertation "value added tax : key issue in Nepal" explains great importance for the effective implementation of VAT administrative capability in Nepal. Organizational structure, audit and inspection system, reward and punishment, political intervention, selection of skilled and experienced manpower are needed to improve for effective implementation of VAT. VAT considered as a board based tax and potential advantages of it can be attained fully if the tax is extended through retail level. For the period of time he suggested to improve following aspects:

- ii) Administrative power and creditability.
- iii) Identification of taxpayers.
- iv) Registration
- v) Education programs
- vi) Incentives for small trades.

He also fined some difficulties in implementation of VAT in Nepal. This area:

- i) Rate structure.
- ii) Small Traders in large proportion.
- iii) Lack of accounting records.
- iv) Illiteracy and high compliance cost.
- v) Existence of open broader.

He suggests that, strong administration, educational program, registration program, existence training program, technical data base system. Combination of various revenue offices, high level VAT implementation term, co-ordination of VAT department, close co-operation between government and private sector



etc able essential pre requisites for the successful implementation of VAT in Nepal.

**Bista, Raghu Bir (2000)** in his research, focused the need of VAT for Nepal for several reasons. They are effective revenue mobilization, industrial development, story administration, transparency and avoiding all tax loopholes. VAT helps to reduce the resource gap by broadening the tax base and mobilizing additional resource by controlling tax, leakage, smuggling, unofficial trade and corruption through transparency and account based cross checking. Positive and favorable effects of VAT on all sectors can be aligned only if government can operate the VAT administration with effectively and efficiently in his dissertation, found the following findings:

- The Sales Tax system is failure to several cases: narrow tax base, inelasticity of tax rate, incapable and weak administration tax leakage, corruption and political intervention. So, the entire tax reform is needed.
- A VAT is account based, invoice based and record based: it checks the tax loopholes such as under valuation, non-recording and unauthorized trade. It discourages such issues and problems existed in the Sales Tax system.
- VAT mobilizes the additional resources and the rest of internal resources by broadening tax base and by discouraging the existing tax loopholes.
- For implementation of VAT, the public awareness level relating VAT and VAT administration should be good and it is a pre-requisite in the preparation of VAT.

VAT administration should be strong and efficient in order to implement properly. But in Nepal, VAT administration has been facing the problems like corruption, incapability, inefficiency, delaying, ineffectiveness, inadequate physical environment, unexpended employee and weak organizational set up.

**Dhakal Arjun (2002)** in his dissertation analyzed the Nepalese tax structure along with the basic emphasis and historical background and potential revenue of VAT in Nepal. The increasing trend of resource gap of Nepal is forcing the country to debt trap situation. Domestic resource mobilization through the properly designed tax system is the best way to up lift the situation. In this process, Nepal is adopted the destination based, consumption type VAT operated by tax credit method, VAT encourages investment, supports economic growth and keeps price stable. Exemption and zero-rating reduced the regressively of VAT, however, it makes the administration complex. The study found that VAT is unable to complete the existing Sales Tax mainly due to the minimum use of invoice by sellers and as well as having no interest to obtain invoices by purchasers. Elasticity and buoyancy of Nepalese tax system are very low. Further, they are decreasing in recent years. VAT, more attractive from the theoretical as well as empirical aspects, is being, hot milk in mouth from practical viewpoint mainly due to the inefficient tax administration. Hence, the introduction of the VAT is not the fulfillment of the requirement and VAT system itself has a great need of reforming in the Nepalese context.

## **2.9 Review Gap**

10 years have already been passed since VAT came into operation but very few studies had undertaken on the topic of VAT in Nepalese context and most of the studies were related with theoretical aspect. In this study, the researcher try to evaluate Nepalese VAT by identifying existing problems in major market area of Kathmandu city by conducting field survey, in order to know same how about the practice experience of VAT. Further, an attempt has been made to analysis revenue pattern of VAT in government revenue and overview of the future prospect as well. So, the study will be fruitful to the interested person parties, students, professor, government and businessman for academically as well as policy prospects.



## **CHAPTER - THREE**

### **RESEARCH METHODOLOGY**

This chapter is devoted to the research methodology applied in the study for, the achievement for desired objectives. Both primary as well as secondary sources of data are used for to conduct this study. Opinion survey technique was adopted while collecting primary data to find out the views of respondents representing different groups related to value added tax. This opinion survey was adopted to find out the practical aspect of VAT. While conducting the opinion survey, questionnaires were distributed to the Tax Experts, VAT Officers, Businessmen and Consumers in the sizeable manner.

#### **3.1 Research Design:**

To achieve the stated objectives of descriptive research as well as analytical research has been carried out in terms of role of VAT in generating government revenue in Nepal. For an empirical research, an opinion survey has been conducted. The options of various hundred respondents associated with distinct denominations (groups) i.e. tax administrations, Tax Experts and tax payers were collected through structured questionnaire with reference to VAT system of Nepal, major problem of VAT system, remedy to minimize corrupt practice existed in Nepalese VAT administration, cause of ineffectiveness of VAT administration, the most important factor for effectiveness of VAT including necessary suggestion for achieving effectiveness of VAT in Nepal. Hence, the research methodology followed in the study can be termed as survey cum analytical and descriptive research design.

### 3.2 Population and Sample Size

In order to benefit this study, 100-sample size from Kathmandu is selected. Persons included in the sample are carefully selected by consultation with Tax Experts, professor and judgment of the researcher. The respondents have been divided into four groups. The following table shows the group of respondents and the size of samples.

**Table: 3-1**

#### **Groups of Respondents and size of samples from each group**

<b>Serial Number</b>	<b>Group of respondents</b>	<b>Sample size</b>
1	Tax Experts	5
2.	Tax Officers	15
3.	Businessmen/Traders	30
4.	Consumers	50
	<b>Total</b>	<b>100</b>

### 3.3 Source of data

Both primary as well as secondary source of data have been collected in order to achieve the real result from this research. All the possible and useful data as far available have been collected. The major sources of data are as follows:

**a) Primary data:** The major tools used for the collection of primary data are distribution of a questionnaire to a responsive of persons. A set of questionnaire was developed and distributed to the selected respondents in order to get accurate and actual information. The questionnaire was distributed to different tax group i.e. Tax Experts, Tax Officers, Businessmen and Consumers. Tax Experts and Tax Officers are selected from tax department,

various sectors of Tax Officers in Kathmandu and Ministry of law and justice, reputed lawyers, auditors, and intellectuals who have knowledge and ideas about VAT tax payers i.e. Businessmen and Consumers are selected from different manufacturing company, trading company, department stores shopping center, finance company etc.

**b) Secondary data:** The secondary sources of data are the information serviced from books, journals, newspapers, reports and dissertations etc. The major service of secondary data is from economic survey, and budget speeches. Ministry of finance, publication of CEDA, Tribhuvan University, reports and records of department of taxation, ministry of finance, dissertation related to VAT projects, publication of VAT department, economic review and indicators from Nepal Rastra Bank, world development report, publication of VAT department, economic review and indicators from Nepal Rastra Bank, world development report, published documents of Nepal Rastra Bank and national planning commission, books related to VAT, national news paper, journals, souvenir and news magazines, other relevant records and data related to his studies.

### **3.4 Data collection Procedures**

A total 100 sets of questionnaire were distributed to selected respondents in order to get actual and accurate information. Distribution work is done personally rather than sending by any means to get accurate and actual information in time.

### **3.5 Data processing and Analysis procedure**

The information revived from primary and secondary sources is firstly tabulated into separate formats systematically in order to achieve desire objectives. After that these data are tabulated and analyzed. For the purpose of

analysis generally simple statistical tools have been used which are simple percentage methods, ranking methods, graphs, charts and diagrams.

### **3.6 Weight of Choice**

The questionnaire asks for either to give responses on different views or to tick the best one or write their opinion.

### **3.7 Limitation of the Study**

To keep the research work feasible, to keep study in track, to go according to plan, budget and time constraint, the researcher has to barricade the research from some limitations, the major limitation of the study are as follows:-

1. The extent of this study is best on the availability of reliable data and sufficient literature.
2. Due to some constraint and difficulties, field survey is done in Kathmandu area only.
3. The sample in small size in study may not fully represent Kathmandu city as a whole.
4. Opinions of respondents have been taken as sense of truth, which may not be correct at all the time due to changing trends of thinking of peoples.
5. The reliability of the study depended to a large extent on the reliability of secondary data.
6. The reliability of data is not examined.

Despite these limitations, lots of efforts are made to make this study more accurate.

## CHAPTER - FOUR

### DATA PRESENTATION AND ANALYSIS

#### 4.1. Working of Value Added Tax

VAT is based on the principle that each producer or distributor adds value to the materials he has purchased and it is this added value, which is taxed at each stage of the distribution chain. This is explained below:

**Table: 4 - 1**

**VAT Collection at Different Stages**

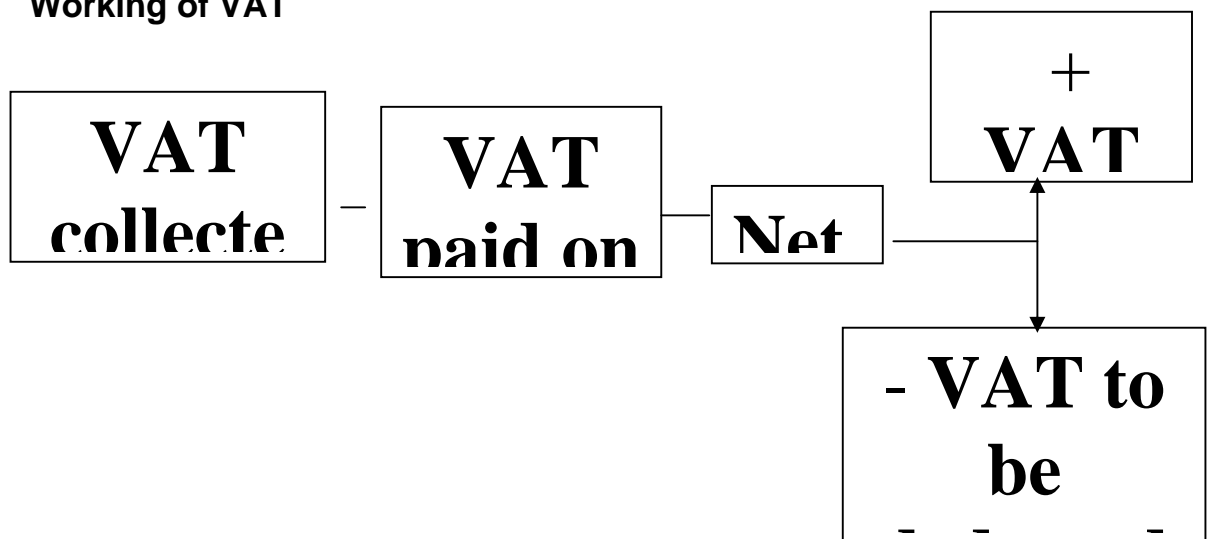
<b>Channel</b>	<b>Cast price exclusive VAT (Rs)</b>	<b>Value added (Rs.)</b>	<b>Selling price before VAT (Rs)</b>	<b>VAT (Rs) 13%</b>	<b>Selling price with VAT</b>	<b>VAT payable to Govt. in each level (Rs.)</b>
<b>Imported Price</b>	100.00	-	-	13.00	-	13.00
<b>Importer producer</b>	100.00	20.00	120.00	15.60	135.60	2.60
<b>Producer-wholesaler</b>	120.00	15.00	135.00	17.55	152.55	1.95
<b>Wholesaler-retailer</b>	135.00	10.00	145.00	18.85	163.85	1.30
<b>Retailer-consumer</b>	145.00	5.00	150.00	19.50	169.50	0.65
<b>Total VAT collection from different stages</b>						<b>19.50</b>



As per the above table the importer add Rs. 20.00 to the purchase price for which he pays net Rs. 2.60 to the government, the producer adds Rs. 15.00 to the purchase price for which he pays net Rs. 1.95 as VAT, the wholesaler adds Rs. 10.00 for which he pays Rs. 1.30, the retailer add Rs. 5.00 for which he pays Rs. 0.65 as VAT.

Under VAT System, those Businessmen who have registered in VAT, they charge VAT on the products which they sell and after that they claim a refund on the goods or services purchased to make sales. The difference between the VAT received on sales and the VAT paid on purchases determines the amount the registrant has to pay to the government or claim as a refund. In other words, if the VAT collected on sales is greater than the VAT paid on purchase, the person remits the difference and if the VAT on sales is less than the VAT on purchases, the person claims a refund for the difference.

#### Working of VAT



So it becomes clear that the registered Businessmen must collect and remit VAT on their taxable transactions. These registrants are entitled to recover the tax paid on their purchase. This recovery or refund of VAT is called input tax credit.

## **4.2 Revenue Structure of Nepal.**

Tax revenue is one of the principle sources of the government revenue. It is compulsory contribution imposed by a public authority, irrespective of the exact amount of service rendered to the tax payers in return. It covers theoretically and practically includes following heads such as persons, organizations, business firms and even foreigners who are doing business of consuming goods or using service in Nepal.

In the fiscal trend of Nepal, tax revenue structure is a combination of two tax title. They are namely Direct Tax and Indirect Tax. The average share of Direct Tax revenue in total tax revenue is 30.31 % and share of Indirect Tax revenue is 69.69% (Share of Value Added Tax in Total Indirect Tax is 74.34%). The percentage share of Direct Tax in GDP is almost 2.30 % and Indirect Tax in GDP is almost 5.30 %. In current year 2006/07 trends

***(Source: Annual Report 2006/07, Inland Revenue Department, Kathmandu)***

In developed economic like USA, UK etc Direct Tax plays a leading role for the internal resource mobilization where as in developing countries like Nepal, Indirect Tax plays pioneering role by dominating Direct Tax with very limited tax base and narrow coverage, Direct Tax in Nepal seems too less effective to mobilize the domestic resources. Although, it is an inevitable instrument of the fiscal policy and hence, it must be designed and practiced properly. In general, revenue productivity of direct tax goes on increasing as the economy of the country grows over time. If the economy growth increases, per capita income per annum of that country will automatically raise. In depth it means that he/she possesses the ability to pay direct tax. Thus, the magnitude of direct tax goes up and substitutes in the place of indirect tax's magnitude. Direct tax in Nepalese economy is composed of different taxes namely Income Tax, Land Tax, Property Tax, Wealth Tax and Interest Tax, tax on registration.

In the current situation, Income Tax is one of the major sources of Direct Tax. Nepal is levying four different types of Income tax. Its categories are Individual Income Tax, Corporate Income Tax, House Rent Tax, and Interest Tax, on the other side Property Tax is another major direct tax. It includes Land Revenue, Bhumikar, House and Land Registration and House and Land Tax.

Nepal depends heavily on the indirect tax rather than the direct tax because there is not any good alternative especially for the optimum level of revenue mobilization; on hand and on the other hand, wide spread poverty, heavy dependency on agriculture, snail's pace industrialization, low level income and wealth and very wretched administration. Since 1951, indirect tax had grown rapidly and speedily. As indirect tax was effectively and proper, its tax mobilization was quickly boosting. So most of the developing countries mobilizes it effectively and properly of the domestic resources.

The major component of indirect tax in Nepalese tax structure constitutes custom duty, excise duty, VAT and other tax. Custom duties are composed mainly import duties and export duties. Other component of indirect tax like Sales Tax, entertainment tax, hotel tax, air flight tax, contract tax and other tax contribute very nominal share because they are included in VAT since 1997. Others form of indirect taxes includes remission of Indian excise duties, road bridge tax and other taxes. The average contribution of custom duties in total in-direct tax is 31.73%. The share of VAT to indirect tax is 50.72% and the share of excise duty to in-direct tax is 17.55%.

*(Source: Ministry of Finance and Economic Survey, 2006/07)*

Like tax revenue, non tax revenue is another source of the government revenue in the structure. It is not imposed compulsory by public authority to the taxpayers, fees, fines; penalties, dividend, interest, sales of goods and service etc are the base of non-tax revenue.

The composition of non-tax revenue in Nepalese tax system is of the following factors such as charges, fees, fines, forfeitures, receipts, from sales of commodities and services, dividends, royalty, sales of fixed assets, principle and interest payment etc while there is some scope of generating more revenue through the rationalization of non tax sources, particularly improvement in pricing policies and operational performances, these sources can not be used effectively as a revenue raise since most of these sources are lived not for revenue purpose.

*(Source: "Khadka Rup B. 2002 Nepalese taxes system" Sajha Prakasan, Kathmandu).*

#### **4.3 VAT Registration:**

The operation of VAT in Nepal is started by addressing the Sales Tax registrants to register in the VAT department. The registration is compulsory for these business enterprises, which have taxable transaction and taxable capacity, however the Traders falling below the threshold limit can register voluntarily under the existing Sales Tax system, there were nominal registrants but VAT was in existence. In the other word we can say registration is required for any business.

- With an annual taxable turnover of more than 2 million rupees.
- With monthly turnover of more than 2 lacs.
- With any person's electricity & house rent expenditure Rs.1 lacs yearly.

Now days, the number of VAT registrants increased significantly. However, when VAT was introduced in 1997/1998, there was strict opposition from the business community so VAT could not be implemented in full form, But after adjusting different provision and aspects of VAT, business community and the government reached to and a common agreement in 1999/2000. There after, VAT was implemented in its full form so that the number of VAT registration highly increased in the fiscal year 1999/2000. The trend of the VAT registration is shown in the following tables.

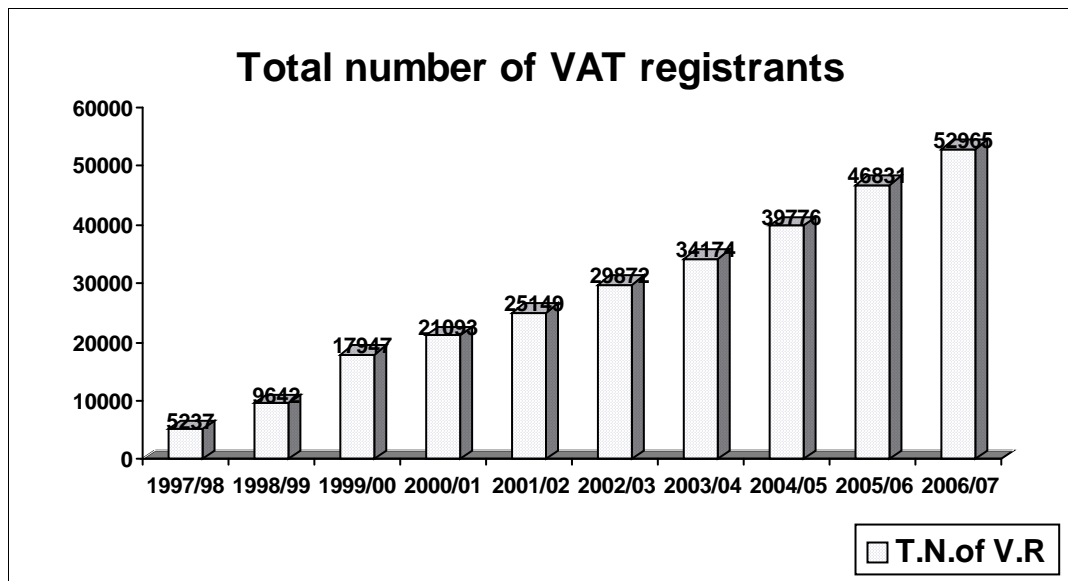
**Table: 4 - 2****Trend of VAT Registrants**

<b>Fiscal year</b>	<b>No. of new VAT registrants</b>	<b>Total no. of VAT registrants</b>	<b>Increasing %</b>
1997/1998	5237	5237	-
1998/1999	4405	9642	84.11
1999/2000	8305	17,947	86.13
2000/2001	3146	21093	17.53
2001/2002	4056	25,149	19.23
2002/2003	4723	29,872	18.78
2003/2004	4302	34,174	14.40
2004/2005	5602	39776	16.39
2005/2006	7055	46831	17.74
2006/2007	6134	52965	13.10

*(Source: Annual Report 2006/07, Inland Revenue Department, Kathmandu)*

The table shows that the total number of VAT registrants in the fiscal year 1997/98 was 5237 and it was reached 8305 in the F/Y 1999/00. After this year registration trend was quite slowly go up. Because of the lack of VAT knowledge, economic condition, political issues and disability of proper guidance from the government and related institutions. But during the 10 years period, the number of registrants increased from 5237 in the F/Y 1997/98 to 52965 in the F/Y 2006/07. This figure shows that the trend of VAT registration is impressive.

Figure: 4 - 1



#### 4.4 Share of VAT Revenue in GDP

The percentage contribution of Value Added Tax in GDP is presented in table below:

**Table: 4.3**

##### **VAT Revenue as Percentage of GDP**

**(Rs. in millions)**

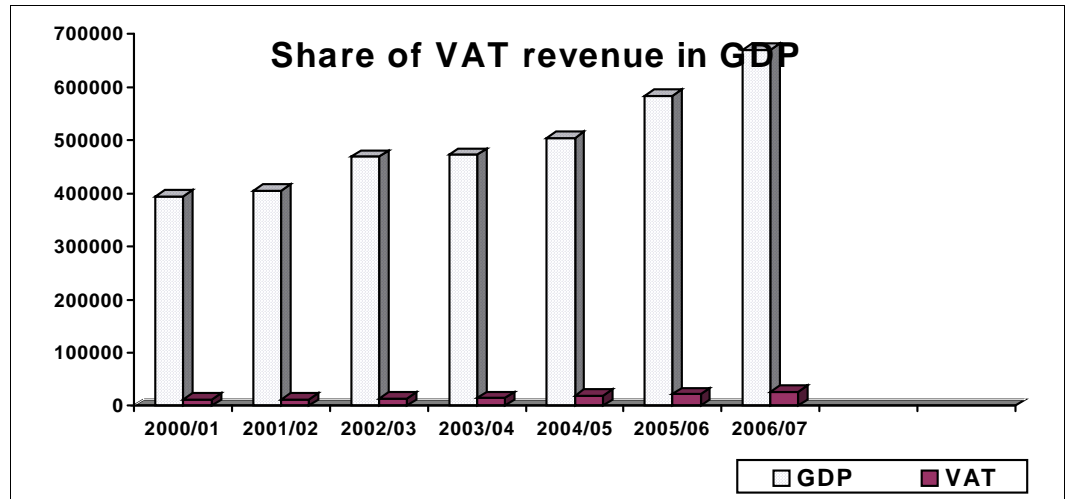
<b>Fiscal Year</b>	<b>Gross Domestic Product (GDP)</b>	<b>VAT Revenue</b>	<b>Percentage of VAT revenues</b>
<b>2000/01</b>	393566.00	12.047.76	<b>3.06</b>
<b>2001/02</b>	404482.00	11947.95	<b>2.95</b>
<b>2002/03</b>	468920.00	13449.12	<b>2.87</b>
<b>2003/05</b>	472424.00	14478.90	<b>3.06</b>
<b>2004/05</b>	504101.00	18894.62	<b>3.75</b>
<b>2005/06</b>	582950.00	21946.00	<b>3.76</b>
<b>2006/07</b>	670588.70	26704.18	<b>3.98</b>

*(Source: Annual Report 2006/07, Inland Revenue Department, Kathmandu)*

As shown in the above table, it is clear that the share of VAT in the GDP in Nepal is very low and it is below 4% through out the seven years period. From the F/Y 2000/01 to 2006/07 VAT revenue of Nepal as percentage of GDP is revenue 3.06 to 3.98 with no higher fluctuations.

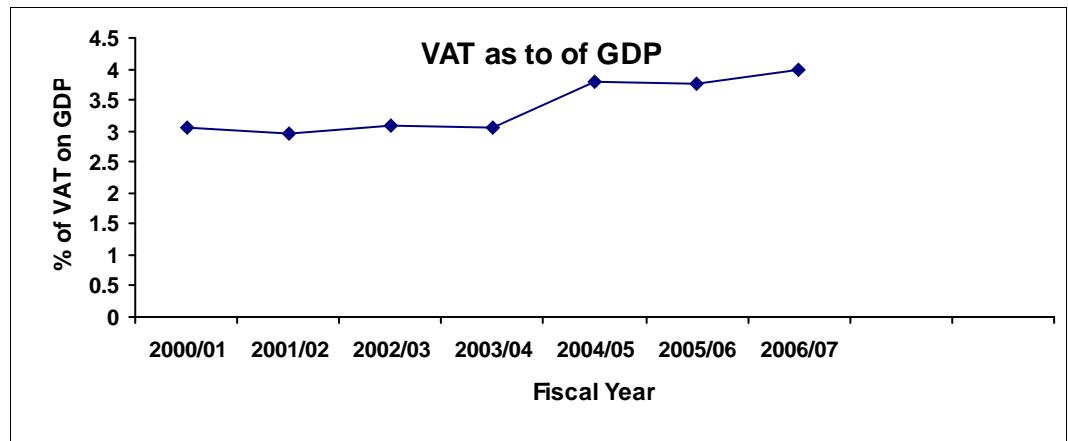
In the F/Y 2000/01 to 2002/03, it has decreased to 3.06 % to 2.87 % because of various reasons like as low purchasing power of customer, inflation, political, issues, disability of proper guidance from the government and related institutions. And the F\Y, 2003/04, 2004/05, 2005/06 and 2006/07 reached to 3.06%, 3.75%, 3.76 % and 3.98% respectively.

**Figure: 4 - 2**



**VAT as Total GDP**

**Graph: 4 - 1**





#### 4.5 Share of VAT Revenue in Total Revenue

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

**Table: 4. 4**

##### **VAT Revenue as percentage of Total Revenue**

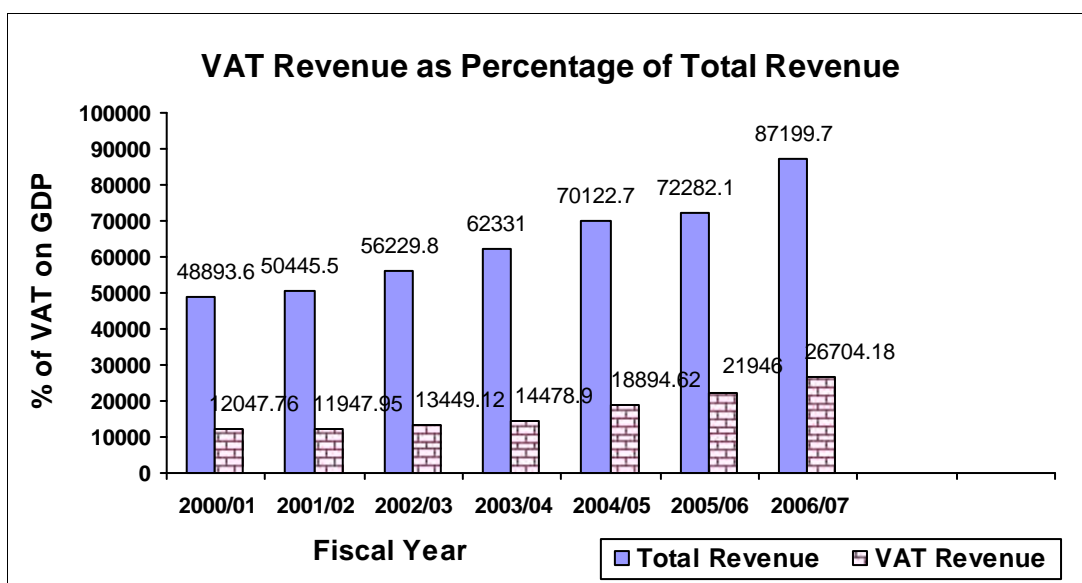
**(Rs. in millions)**

<b>Fiscal Year</b>	<b>Total Revenue</b>	<b>VAT Revenue</b>	<b>Percentage of VAT revenues</b>
2000/01	48893.60	12050	24.64
2001/02	50445.50	11947.90	23.68
2002/03	56229.80	13449.10	23.92
2003/05	62331.00	14478.90	23.23
2004/05	70122.70	18894.60	26.95
2005/06	72282.10	21946.00	30.36
2006/07	87199.70	26704.18	30.62

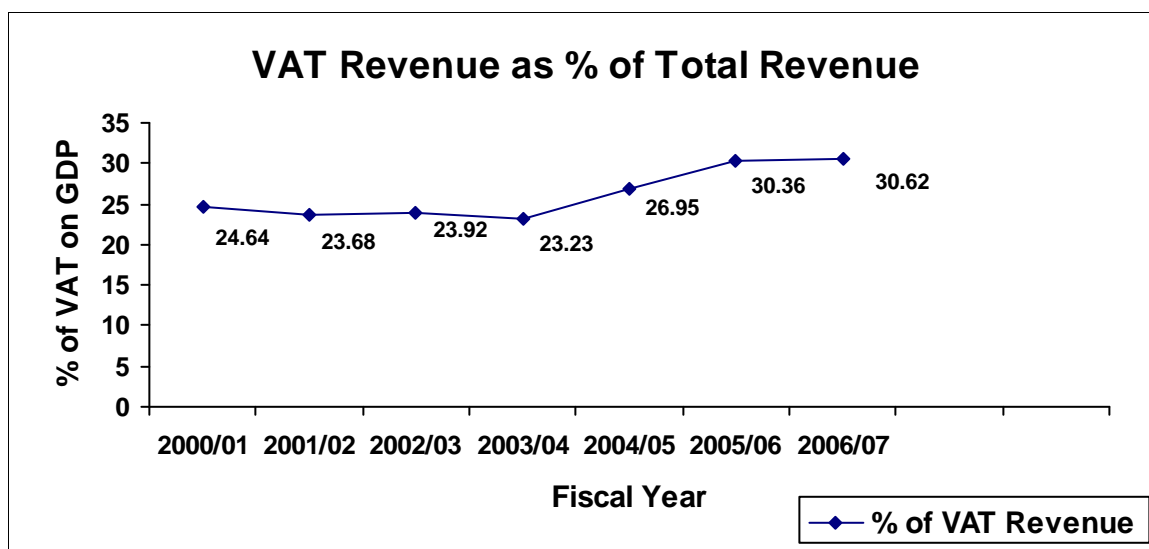
*(Source: Annual Report 2006/07, Inland Revenue Department, Kathmandu)*

From the above table, it is clear that the share of VAT revenue in total revenue lies between 24.64% to 30.62 in last seven years of history. Through, out the seven years period, percentage of VAT revenue is in increasing trend but in F/Y 2003/04, the percentage rate of VAT is in decreasing trend corresponding to the last F/Y 2000/01. In the F/Y 2004/05 it is increased by 3.72% and again in F/Y 2005/06 increased by 3.41% and F/Y 2006/07 VAT revenue increased by 0.26%.

Figure: 4 – 3



Graph: 4 – 2



#### 4.6 Share of VAT Revenue in Total Tax Revenue

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

**Table: 4 - 5**

##### **VAT Revenue as Percentage of Total Tax Revenue**

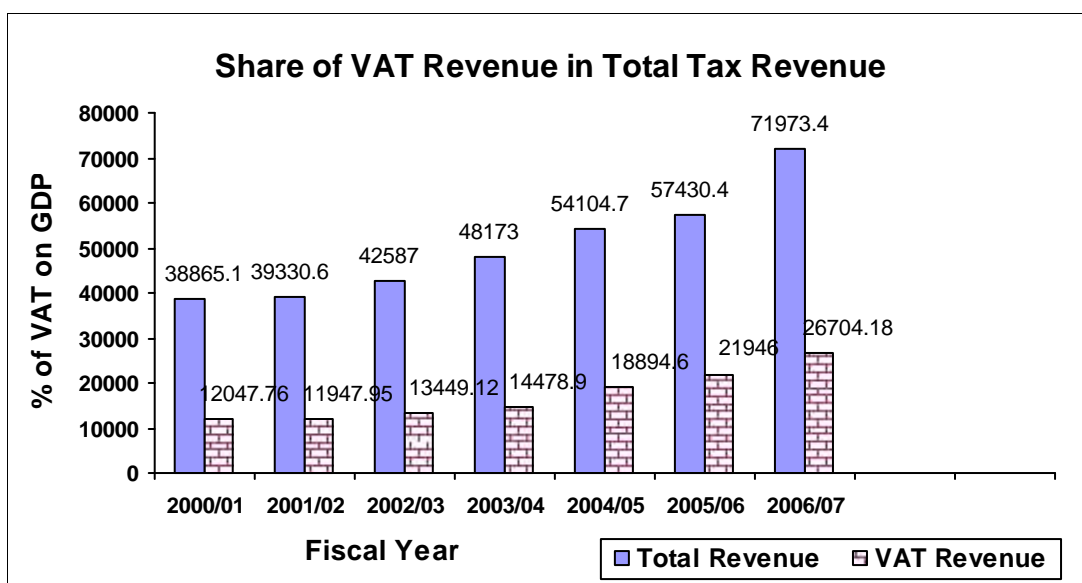
**(Rs. in millions)**

<b>Fiscal year</b>	<b>Total Tax Revenue</b>	<b>VAT Revenue</b>	<b>Percentage of total tax Revenue</b>
2000/01	38865.10	12047.76	31.00
2001/02	39330.60	11947.95	30.38
2002/03	42587.00	13449.12	31.58
2003/04	48173.00	14478.90	30.06
2004/05	54104.70	18894.60	34.92
2005/06	57430.40	21946.00	38.21
2006/07	71973.40	26704.18	37.10

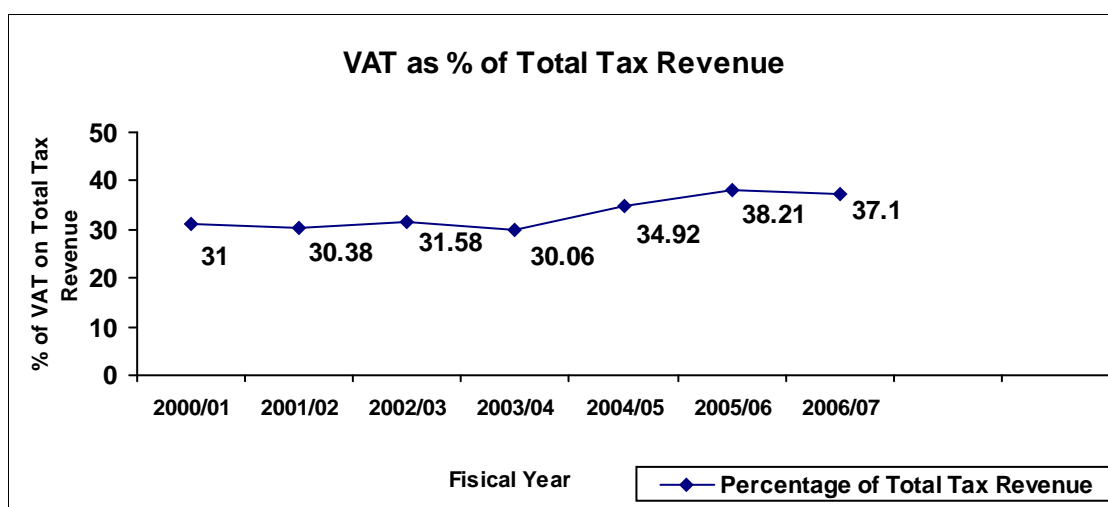
*(Source: Annual Report 2006/07, Inland Revenue Department, Kathmandu)*

As indicated in above table VAT revenue was 31% of total tax revenue in F/Y 2000/01. During the last seven year, the percentage trend of VAT revenue to total tax revenue is in increasing trend but in the F/Y 2001/02, 2003/04 and 2006/007 were decreased to 30.38%, 30.06% and 37.10% respectively. The share of VAT revenue in total tax revenue lies between 30.06% to 38.21%, in above last seven year of period. It is clear that the VAT revenue with comparison to total tax revenue has been increasing continuously.

Figure: 4 – 4



Graph: 4 - 3



#### 4.7 Share of VAT Revenue in Total Indirect Tax Revenue

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

**Table: 4 - 6**

##### **VAT Revenue as percentage of Total Indirect Tax Revenue**

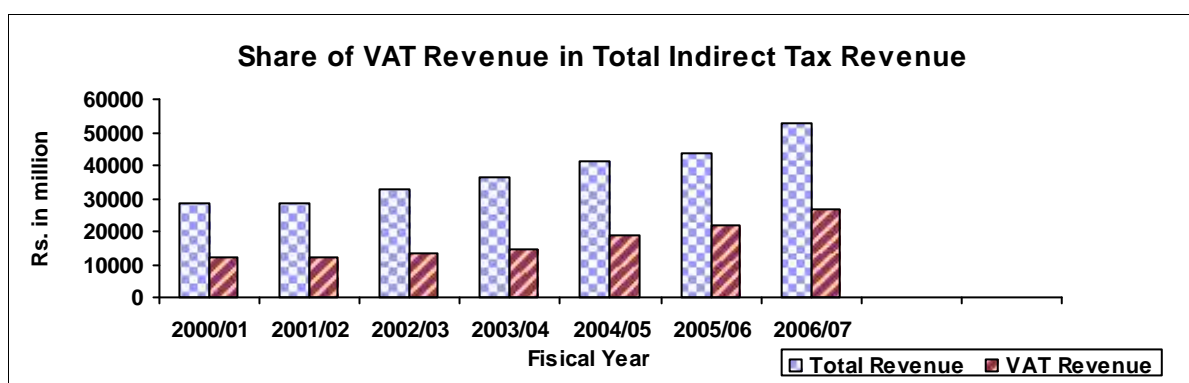
**(Rs. in millions)**

<b>Fiscal year</b>	<b>Total Indirect tax revenue</b>	<b>VAT Revenue</b>	<b>Percentage of VAT Revenue</b>
<b>2000/01</b>	28373.30	12047.76	<b>42.46</b>
<b>2001/02</b>	28413.70	11947.95	<b>42.05</b>
<b>2002/03</b>	32470.60	13449.12	<b>41.42</b>
<b>2003/04</b>	36260.40	14478.90	<b>39.93</b>
<b>2004/05</b>	41042.10	18894.60	<b>46.04</b>
<b>2005/06</b>	43798.50	21946.00	<b>50.11</b>
<b>2006/07</b>	52654.68	26704.18	<b>50.72</b>

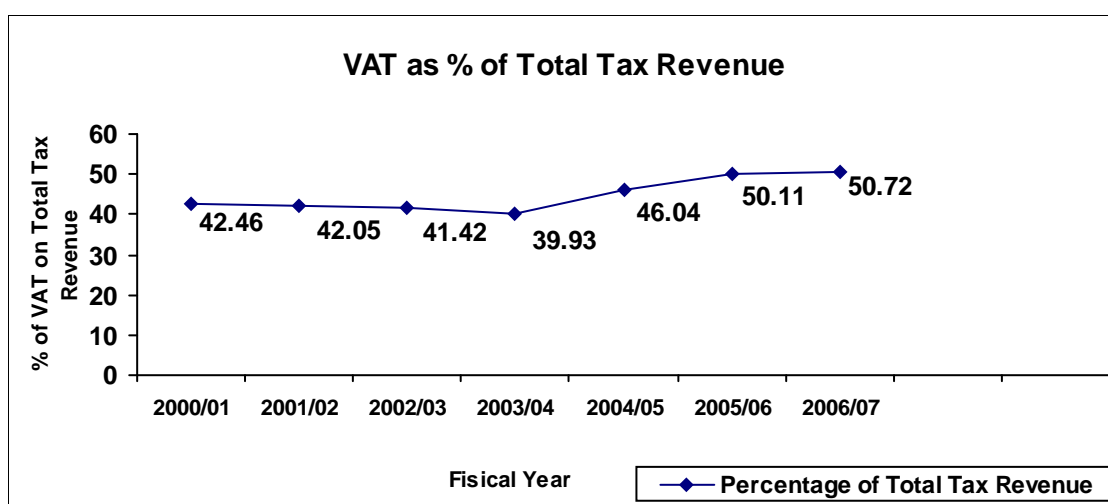
*(Source: Annual Report 2006/07, Inland Revenue Department, Kathmandu)*

As indicated in the above table, the contribution of VAT revenue in total indirect tax revenue is in increasing trend. The share of VAT revenue as percentage of total indirect tax revenue increased from 42.46% in fiscal year 2000/01 to 50.72% in fiscal year 2006/07. And the share of VAT revenue as percentage of total indirect tax revenue decreased from 42.05% in F/Y 2001/02 to 39.93% in F/Y 2003/04. During the above seven year period, the percentage contribution of VAT revenue is in increasing trend except in the F/Y 2001/02 and 2003/04 with no higher reduction.

**Figure: 4 - 5**



**Graph: 4 - 4**



#### **4.8 Revenue Collection from Value Added Tax**

Value added tax is the based from of Sales Tax, its includes Sales Tax, entertainment tax, hotel tax, air flight tax and contract tax which is neutral regarding method of production and helpful in generation of more revenue collection. Because of its broad coverage, neutrality, transparency and fairness, VAT will generate more revenue with less distortion. The revenue collection from VAT in different fiscal years is presented in table below:

**Table: 4 - 7****Trend of Revenue Collection from VAT****(Rs. in millions)**

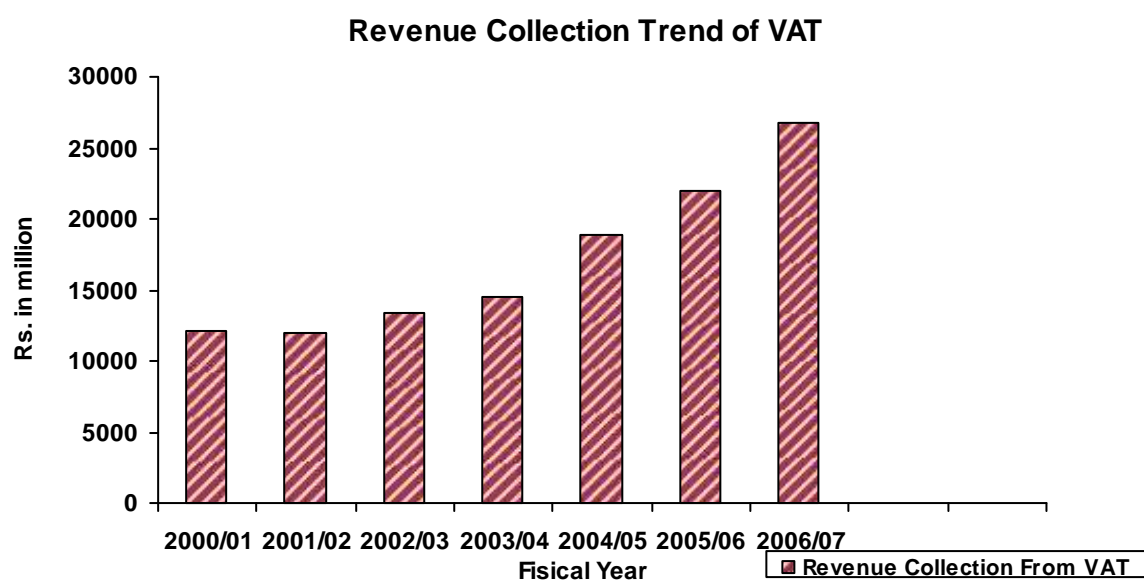
<b>Fiscal year</b>	<b>Revenue Collection from VAT</b>	<b>Trend Percentage</b>
<b>2000/01</b>	12047.80	-
<b>2001/02</b>	11947.95	<b>- 0.99</b>
<b>2002/03</b>	13449.12	<b>12.56</b>
<b>2003/04</b>	14478.90	<b>7.66</b>
<b>2004/05</b>	18894.60	<b>30.50</b>
<b>2005/06</b>	21946.00	<b>16.15</b>
<b>2006/07</b>	26704.18	<b>21.68</b>

*(Source: Annual Report 2006/07, Inland Revenue Department, Kathmandu)*

VAT generated about Rs. 12047.80 millions revenue in fiscal year 2000/01, in fiscal year 2001/02; it reached up to 11947.95 million as decreased by 0.99% to previous year 2000/01. Similarly, revenue collection from VAT in fiscal year 2001/02, 2002/03, 2003/04, 2004/05, 2005/06 and 2006/07 is Rs. 13449.12, Rs.14478.90, Rs.18894.60, Rs.21946.90 and Rs.26704.18 millions respectively. The trend of VAT collection increased up to fiscal years 2002/03 at 12.56% and in fiscal year 2001/02, it is decreased as – 0.99%, to previous years. Then it is increased in the fiscal year 2003/04 by 7.66%. Though, VAT collection has reached Rs. 26704.18 millions in fiscal year 2006/07 from Rs. 12047.80 million in fiscal year 2000/01. Despite the various difficulties in the implementation of VAT, the collection trend of revenue through VAT is not so bad. It is expected that VAT will generate more and more revenue in the days to come when it is implemented effectively and efficiently. Since VAT is as broad based tax, it will provide a stable base of revenue to the government. The amount collection from VAT revenue is increasing trend except in F/Y 2001/02 but the percentage of VAT collection is decreasing trend due to smuggling and under valuation of goods, lack of proper billings, lack of proper accounts and weak tax administration. But in F/Y 2005/06 VAT revenue increased by

30.50% to previous year which shows the good prospects of VAT in Nepal in future.

**Figure: 4 - 6**





#### 4.9 Composition of VAT Revenue:

The revenue collection from VAT can be divided into two major components as domestic and imports. The current trends shows that about one third of total VAT revenues comes from domestic products and two third from imports. The following table represents the composition trend of VAT revenue.

**Table: 4 - 8**  
**Composition of VAT Revenue**

(Rs. in millions)

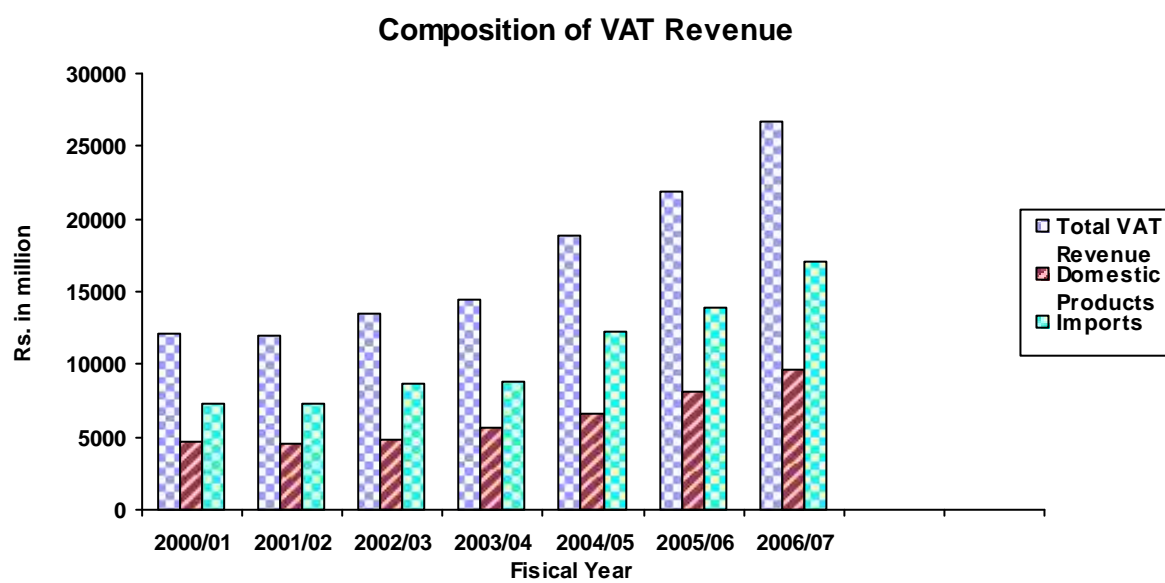
Fiscal Year	Total VAT Revenue (TVR)	Domestic Products		Imports	
		Amount	Percent	Amount	Percent
2000/01	12047.80	4744.75	39.38	7303.05	60.62
2001/02	11947.95	4608.37	38.57	7339.58	61.43
2002/03	13449.12	4819.61	35.84	8629.51	64.16
2003/04	14478.90	5604.10	38.71	8874.80	61.29
2004/05	18894.60	6624.30	35.06	12270.30	64.94
2005/06	21946.00	8057.43	36.71	13888.57	63.29
2006/07	26704.18	9689.98	36.29	17014.20	63.71

*(Source: Annual Report 2006/07, Inland Revenue Department, Kathmandu)*

In the fiscal year 2000/01, the share of domestic product and imports in total VAT revenue was 39.38% and 60.62% respectively, where as in the fiscal year 2001/02 their share was 38.57% and 61.43%. Likewise, in F/Y 2002/03, the share of domestic products and imports was 35.84% and 64.16%. For the F/Y 2003/04, 2004/05, 2005/06 there share was 38.71% and 61.29%, 35.06% and 64.94%, 36.71% and 63.29% and lastly F/Y 2006/07 were 36.29% and 63.71%.

For the above figure, the trend shows, the share of imports in total VAT revenue has been declining continuously but the share of domestic products has been increasing which seems that both the domestic products and imports VAT are likely to have the equal share in the total VAT revenue in near future. Internal disturbances, change in the composition of consumption capacity and change in import structure are the main causes of decline.

**Figure: 4 - 7**



#### **4.10 Consistency between planned and Actual Revenue Collection from value added tax (VAT)**

The consistency and variability between planned revenue collection and actual revenue collection from VAT is presented in the table below:

**Table: 4 - 9**

##### **Planned and Actual Revenue Collection from VAT in Diff. years**

**(In Rs. millions)**

<b>Fiscal year</b>	<b>Target Revenue collection from VAT</b>	<b>Actual Revenue Collection from VAT</b>	<b>Revenue Collection Percentage</b>
2000/01	13500.00	12047.80	89.24
2001/02	14750.00	11947.95	81.00
2002/03	13730.05	13449.12	97.95
2003/04	15503.50	14478.90	93.39
2004/05	16950.00	18894.60	111.47
2005/06	23650.00	21946.00	92.79
2006/07	26463.00	26704.18	100.91

*(Source: Annual Report 2006/07, Inland Revenue Department, Kathmandu)*

From the above table it is clear that the consistency between planned and actual revenue collection is not so satisfactory. In average 95.92% of plan revenue collection is achieved in last seven year i.e. F/Y 2000/01 to 2006/07. In the comparison of target or planned revenue collection, the percentage of actual revenue collection is decreasing trend. Reasons for this decline are smuggling and under valuation of goods, lack of proper billing, lack of proper account and weak administration. Though in F/Y 2004/05, the Actual collection is higher then that of planned, it shows the good sign of VAT implementation as Sales Tax.

For analyzing the consistency and variability of planned revenue collection and actual revenue collection in detail we can use different statistical tools. The detail calculation of these statistical tools can be presented as follows:

**Table: 4 - 10**

**Computation of Correlation & Regression**

<b>Fiscal Year</b>	<b>Planned Rev. collection from (VAT) X</b>	<b>Actual Rev. Collection from (VAT) Y</b>	<b>(X- qX)</b>	<b>(Y - qY)</b>	<b>(X-X )<sup>2</sup></b>	<b>(Y-qY)<sup>2</sup></b>	<b>(X-X) x (Y-qY)</b>
2000/01	13500	12047.80	-4292.36	-5019.14	18424391.16	25191723.32	21543958.89
2001/02	14750	11947.95	-3042.36	-5118.99	9255980.45	26204014.74	15573819.32
2002/03	13730.05	13449.12	-4062.31	-3617.82	16502397.36	13088590.54	14696704.46
2003/04	15503.50	14478.90	-2288.86	-2588.04	5238899.72	6697928.86	5923662.52
2004/05	16950	18894.60	-842.36	1827.66	709577.59	3340356.74	-1539559.12
2005/06	23650	21946.00	5857.64	4879.06	34311896.16	23805268.30	28579781.21
2006/07	26463	26704.18	8670.64	9637.24	75179923.69	92876477.42	83561034.49
<b>N = 7</b>	<b>∑X= 124546.55</b>	<b>∑Y= 119468.55</b>			<b>∑(x-qx)<sup>2</sup>= 159623066.12</b>	<b>∑(Y-qY)<sup>2</sup>= 191204359.93</b>	<b>∑(X-qX)*(Y-qY)= 168339401.76</b>

$$\bar{X} = \frac{\sum X}{N} = \frac{124546.55}{7} = 17792.36$$

$$\bar{Y} = \frac{\sum Y}{N} = \frac{119468.55}{7} = 17066.94$$

$$S.D.X = \sqrt{\frac{\sum (x - \bar{x})^2}{x}} = \sqrt{\frac{159623066.12}{7}} = \sqrt{22803295.16} = 4775.28$$

$$S.D.Y = \sqrt{\frac{\sum (Y - \bar{Y})^2}{Y}} = \sqrt{\frac{191204359.93}{7}} = \sqrt{27314908.56} = 5226.37$$

$$CV_X = \frac{S.D.of X}{\bar{X}} = \frac{4775.28}{17792.36} = 0.268 \%$$

$$CV_Y = \frac{S.D.of Y}{\bar{Y}} = \frac{5226.37}{17066.94} = 0.306 \%$$

Co-efficient of Correlation (b)

$$\begin{aligned} r_{xy} &= \frac{\sum (x - \bar{x})(y - \bar{y})}{\sqrt{\sum (x - \bar{x})^2 \sum (y - \bar{y})^2}} = \frac{168339401.76}{\sqrt{159623066.12 \times 191204359.93}} \\ &= \frac{168339401.76}{12634.20 \times 13827.66} = \frac{168339401.76}{174701503.68} = 0.963 \end{aligned}$$

Probable of error (r)

$$PE \text{ of } r = 0.6745 \times \frac{1-r^2}{\sqrt{n}}$$

$$= 0.6745 \times \frac{1-(0.963)^2}{\sqrt{7}}$$

$$= 0.6745 \times \frac{1-0.9274}{2.6945}$$

$$= 0.6745 \times \frac{0.0726}{2.645}$$

$$= 0.0185$$

$$\text{Significant of } r = 6 \times PE(r) = 0.0185 \times 6$$

$$= 0.1111$$

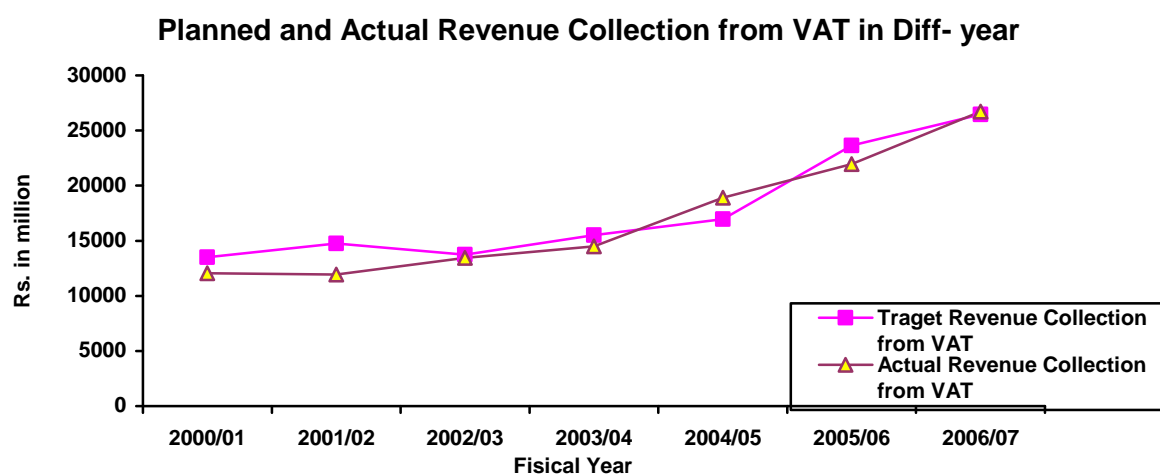
### Summarizing the Result Table from Correction & Regression

**Table: 4 - 11**

<b>Parameters</b>	<b>Planned Revenue Collection in million (x)</b>	<b>Actual Revenue Collection in million (y)</b>
<b>Mean</b>	17792.36	17066.94
<b>S.D.</b>	4775.28	5226.37
<b>C.V.</b>	0.268	0.306
<b>Rxy</b>	0.963	
<b>PE of r</b>	0.0185	
<b>Significant of P.E. of r</b>	0.1111	

Since  $r$  is much greater than  $6 \times \text{P.E.}(r)$ , so the value of  $r$  is highly significant. But C.V. of actual revenue collection 0.306% is greater than that of planned revenue collection's (i.e., 0.268%). It shows that the consistency between planned and actual revenue collection is not so satisfactory. We can present the figures of budgeted and actual revenue collection from VAT in graphical presentation.

**Graph: 4 – 5**



The graphical presentation shows that the gap between budgeted and actual revenue collection is in fluctuating trend.

The value of  $r$  shows that there is positive correlation between planned and actual revenue collection since that value of ' $r_{xy}$ ' or co-efficient of correlation (b) is 0.963, it can be said that there is perfect correlation between target revenue collection and actual achievement. The actual revenue collection is changed in the same direction of the change in budgeted revenue collection.

The significant of probable of error ( $r$ ) ( $0.963 > 0.0185$ ). The value of ' $r$ ' is definitely significant. So it can be said that actual revenue collection will go on same direction that of budgeted revenue collection.

A regression line also be fitted to show the degree of relationship between budgeted and actual revenue collection and to forecast the possible actual revenue collection with given budget figure. For the purpose actual revenue collection achievement has been assumed to be dependent upon budgets.

So, the regression line of  $y$  on  $x$  / or achievement ' $y$ ' budget ' $x$ ' is as follows :

We have the following values as calculated above:

	Budgeted 'X'	Actual 'Y'
<b>Mean</b>	17792.36	17066.94
<b>S.D.</b>	4775.28	5226.37
<b>Rxy</b>	0.963	

Then,

$$Y - 17066.94 = 0.963 (5226.37/4775.28) (X - 17792.36)$$

$$Y - 17066.94 = 1.0539 X - 18752.58$$

$$Y - 1.0539 X = - 18752.58 + 17066.94$$

$$Y = 1.0539 X - 1685.65$$

By the regression equation, it is clear that the actual revenue collection is in increasing trend and the actual revenue will be increased by Rs. 1.0539, per rupees increase in budgeted revenue collection.

By the help of regression equation, we can ascertain the expected revenue achievement with given value of target revenue say  $x_1$  if we use this equation to ascertain the expected revenue achievement for the year 2007/08, the following result will be obtained.

Here = budgeted revenue collection for 2007/08 = Rs. 32,000 then expected sales achievement,

$$Y = 1.0539 \times 32000 - 1685.65$$

$$Y = 33724.80 - 1685.65$$

$$Y = 32039.80$$

In the relationship between budgeted and actual revenue collection remain same as previous year then the actual revenue collection for the year 2007/08 will be Rs. 32039.80 as stated by the above regression equation.

Another statistical tool called least square method can also be used to analyze the trend of actual revenue collection to estimate the possible future revenue



collection for a given time period. A straight line trend shows the relationship between time (year) and actual revenue collection of the relevant year. In this method it is assumed that the revenue collection is consistently changed (increase or decrease) with the change in time and such change can be expressed by the component of time series. To fit the straight line trend, the time factor is considered as independent factor and revenue collection is considered dependence factor up in time. The straight line trend of actual revenue collection 'y' up on time is expressed by: -

$$Y_e = a + bx$$

Where, x is the time when we fit the straight-line trend. Then we can estimate the possible actual revenue collection. Calculating the values required to fit straight line trend.

**Table: 4 - 12**

**Calculation of trend line of best fit**

<b>Fiscal year</b>	<b>Act. Rev. coll (y)</b>	<b>X</b>	<b>x<sup>2</sup></b>	<b>Xy</b>
2000/01	12047.80	-3	9	-36143.40
2001/02	11947.95	-2	4	-23895.90
20002/03	13449.12	-1	1	-13449.12
2003/04	14478.90	0	0	0
2004/05	18894.60	1	1	18894.60
2005/06	21946.00	2	4	43892.00
2006/07	26704.18	3	9	80112.54
<b>N = 7</b>	<b>dy = 119468.55</b>	<b>dx 0</b>	<b>dx<sup>2</sup> =28</b>	<b>dx y = 69410.72</b>

Fiscal year 2003/04 is assumed as base year therefore the value of x in 2003/04 is zero and negative for the year before 2003/04 and positive for the year after 2003/04.

Putting the value in straight line equation

$$Y_e = a + bx$$

$$\text{Where } a = \Sigma y / N = 119468.55 / 7 = 17066.94$$

$$b = \Sigma X Y / \Sigma X^2 = 69410.72 / 28 = 2478.95$$

$$Y = 17066.94 + 2478.95 X$$

This trend line shows the positive revenue collection figure for future. The revenue collection increased by Rs.2478.95 every year if the revenue collection trend of past years continues for future.

By using this trend equation, we can estimate the actual revenue collection for the year 2007/08.

The value of x for the year 2007/08 = 4 (∵ 2003/04 base year)

Then,

Revenue collection for 2007/08 (Y) =

$$Y = 17066.94 + 2478.95 \times 4$$

$$= 17066.94 + 9915.80$$

$$= 26982.74$$

In the trend does not change the possible revenue collection for year 2006/07 will be Rs. 26982.74 millions.

#### **4.11 Empirical Findings:**

There have been various empirical studies conducted before and after the implementation of VAT system in Nepal. It is viewed that this system has not been implemented effectively as expected. There was a strong opposition from the business community during the earlier period of VAT implementation. In that time, there was a negotiation between private sector and government on the different aspects and provisions of VAT. After that, VAT was extended through the retail level and thus implemented in its full-fledged form. In the beginning period of VAT implementation, there was lack of skilled and trained manpower's and officers; administrative structure was not set up properly. But currently different informative programs, seminars and meeting were held to make the Businessmen, Consumers and people known to the VAT.

Currently business community is also in favors of VAT and further demanding to identify all the Traders having taxable capacity and include in to the tax net. In such situation an empirical study is done to know the views of person of different field on different aspects of VAT.

For the purpose of survey, different questionnaire were prepared to know the opinion of the various persons of different field including Tax Experts, Tax Officers, Businessmen/Traders, Consumers about all sides of VAT such as issues, policies, its effects and other relevance.

##### **4.11.1 Views on the Billing System**

Billing system is one of the most important aspects of the VAT system. All the Businessmen have to receive the bills of actual transaction price while importing and buying of goods services. The price of the goods and services with and without VAT has to be mentioned explicit in the bill. While selling goods, purchaser has to compulsory been given the same type of bill. The Businessmen have to pay the amount of difference between tax collected in sale and tax paid on purchase to the VAT office. He has to pay the income tax

as well on the profit of his transaction. Thus, the billing system plays crucial role in the field of VAT system. But in Nepal, the billing system has been one of the major problems. So, the question is designed to show the comments on billing system of VAT. The outcome of the field survey in this aspect is given below:

**Table: 4 - 13**

**Views on the Billing System**

<b>Respondents</b>	<b>Possible</b>		<b>impossible</b>		<b>I Don't Know</b>		<b>Total</b>
	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No.</b>	<b>%</b>	
<b>Tax Experts</b>	5	100	-	-	-	-	<b>5</b>
<b>Tax Officers</b>	15	100	-	-	-	-	<b>15</b>
<b>Businessmen / Traders</b>	18	60	10	33.33	2	6.67	<b>30</b>
<b>Consumers</b>	34	68	4	8	12	24	<b>50</b>
<b>Total</b>	<b>72</b>		<b>14</b>		<b>14</b>		<b>100</b>

*Source: Field Survey, 2009*

From the above study, it is found that all the experts and officers advocate for the possibility of billing system in VAT system. 60 percent of Businessmen/ Traders claimed that billing system is possible, at the same time 33.33percent argue that it is impossible where as 6.67 percent are unknown about it still, similarly,68 percent consumer say that there is possibility of billing system, 8 percent say impossible and 24 percent say I don't know.

#### 4.11.2 View on Rate of VAT

VAT rate is very significant and sensitive for revenue mobilization. the success of VAT system stands upon the degree of VAT rate. Earlier the tax rate of Sales Tax, which is replaced by VAT, was 15%. Likewise other taxes i.e. contract tax, entertainment tax, hotel tax air flight tax were not below than 15% on average. But VAT rate is now subject to 13%. Due to broader base and coverage, VAT was expected to have a greater revenue yield on present rate structure. However this expectation is not achieved in practice basically due to its weak implementation aspect. In such situation, field survey was conducted to identify the rate structure of VAT. The following table shows the views on this matter

**Table: 4 - 14**

#### **Views on Rate of VAT**

<b>Respondents</b>	<b>Low Rate</b>		<b>High Rate</b>		<b>Normal/ok</b>		<b>I Don't Know</b>		<b>Total</b>
	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No.</b>	<b>%</b>	<b>No</b>	<b>%</b>	
<b>Tax Experts</b>			1	20	4	80			<b>5</b>
<b>Tax Officers</b>	3	20			12	80			<b>15</b>
<b>Businessmen / Traders</b>			15	50	9	30	6	20	<b>30</b>
<b>Consumers</b>	-	-	18	36	12	24	20	40	<b>50</b>
<b>Total</b>	<b>3</b>		<b>34</b>		<b>37</b>		<b>26</b>		<b>100</b>

*Source: Field Survey, 2009*

Survey result shows that most of the respondents agree with the existing rate of 13% i.e. normal. However, 50% business claim that rate of VAT is high. Likewise 36% Consumers say that it seems high rate and 24% say it is ok. 40% Customers have no idea at all. Three VAT officer reports that there is still general increment needed in rate of VAT to generate high revenue. The study

shows that the rate structure in the context of present situation is normal. Unless and until tax system is not an instrument to raise the revenue from taxation. Once the implementation is effective, it will be better to change the rate structure to some extent according to the requirement.

#### **4.11.3 Views on Rising Price Due to VAT System**

In the beginning period of VAT implementation there was a strong opposition from the business community. The basic argument behind it was due to rise in the price from VAT. After the implementation of VAT, there was a voice from different people on price rising on commodities. Consumers also complain that businessman charge more prices without following the act of VAT. Here, an endeavor has been made to get the information from the respondents to find out whether there will be raised in price due to VAT system.

The following table presents the views of respondents on this aspect:

**Table: 4 - 15**

#### **Views on Price Rise Due to VAT System**

<b>Respondents</b>	<b>Yes</b>		<b>No</b>		<b>I don't know</b>		<b>Total</b>
	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	
<b>Tax Experts</b>	1	20	4	80			<b>5</b>
<b>Tax Officers</b>	3	20	12	80			<b>15</b>
<b>Bus. Men/ Traders</b>	18	60	9	30	3	10	<b>30</b>
<b>Consumers</b>	35	70	5	10	10	20	<b>50</b>
<b>Total</b>	<b>57</b>		<b>30</b>		<b>13</b>		<b>100</b>

*Source: Field Survey, 2009*

In the outcome, 57% respondents reached at the conclusion that there is a rise in price due to VAT system. 30 % claims for not rise in price and 13 % has no

idea at all. The study shows 20% Tax Experts, 20% Tax Officers, 60% Businessmen and 70% Consumers claims that there is a raise in price because of VAT system where as 80% of Tax Experts, 80% Tax Officer, 30% Businessman and 10% Consumers say that there is no raise in price due to VAT. According to the study, 10% Businessmen/Traders and 20% Consumers have no idea about this system. When they were asked for the reason of the raise in the price, respondents have different view: due to compliance cost, higher profit, non-awareness of Consumer.

#### 4.11.4 View on Superiority of VAT over Sale Tax

VAT, a latest development of Sales Tax system is new innovation in the field of taxation. VAT is being preferred by many countries of the world, is superior over Sales Tax system without comparison with Sales Tax we cannot say' VAT is superior to other Sales Tax system. "With base to effective revenue mobilization, the tackle to all tax evasion, wide tax base, transparent; VAT consider as superior as Sales Tax. The survey result on this aspect is summarized in the table below:

**Table: 4 - 16**

#### **Views on Superiority of VAT over Sales Tax**

<b>Respondents</b>	<b>Yes it is</b>		<b>No it is not</b>		<b>I don't know</b>		<b>Total</b>
	No	%	No.	%	No.	%	
<b>Tax Experts</b>	5	100					<b>5</b>
<b>Tax Officers</b>	12	80	3	20	-	-	<b>15</b>
<b>Business/Traders</b>	20	66.67	8	26.67	2	6.67	<b>30</b>
<b>Consumers</b>	10	20	8	16	32	64	<b>50</b>
<b>Total</b>	47		19		34		<b>100</b>

*Source: Field Survey, 2009*

According the field survey, 47% of respondents provided their view regarding superiority of VAT over Sales Tax, 19% of respondents opposite of its system and 80% respondent had not idea about it. In the outcome, 100% each Tax Experts and 80% Tax Officers argue about the superiority of VAT over Sales Tax. Similarly, 66.67% Businessman/Traders, 20% Consumers also provided their view on superiority of VAT. But 26.67 Businessmen still said that it is not superior than Sales Tax and 6.67% businessman Traders and 64% consumer and unknown about it. The outcome proof that VAT is superior to other Sales Tax system on the aspect of revenue mobilization, coverage broaden tax base, transparent. But its superiority depends upon the strength of VAT administration. So the VAT administration is strong, then the success of VAT system will prove its superiority.



#### 4.11.5 View on Sufficiency of Legal Provisions and Rules of VAT

Before the implementation VAT, the government has prepared VAT act 2052 B.S. and VAT regulation 2053 B.S. but the legal provision and rules, in general different to understand by all. The documents of this enactment carry all the matters such as VAT administration and its operation. The Tax Officers and its authorities (duty and responsibility), taxpayers and its responsibility, the procedure of VAT collection, identification of new tax payers, monitoring, cross checking, penalties and punishment. The field survey has been conducted to find out whether the present act and regulation are sufficient or not reference to current VAT system. The outcome / attitude of the respondents on this aspect is present in the table below:

**Table: 4 - 17**

#### **View on Sufficiency of Legal Provisions and Rules of VAT**

<b>Respondents</b>	<b>Yes</b>		<b>No</b>		<b>Moderate</b>		<b>I Don't Know</b>		<b>Total</b>
	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No.</b>	<b>%</b>	<b>No</b>	<b>%</b>	
<b>Tax Experts</b>	4	80	-	-	1	20	-	-	<b>5</b>
<b>Tax Officers</b>	10	66.67	2	13.33	3	20	-	-	<b>15</b>
<b>Businessmen / Traders</b>	5	16.67	12	40	10	33.33	3	10	<b>30</b>
<b>Consumers</b>	8	16	6	12	4	8	32	64	<b>50</b>
<b>Total</b>	<b>27</b>		<b>20</b>		<b>18</b>		<b>35</b>		<b>100</b>

**Source: Field Survey, 2009**

The field survey shows that 80% Tax Experts, 66.67%. Tax Officers, 16.67% Businessmen and 16% Consumers were in favors of present legal provisions

and rules of VAT while 13.33%. Tax Officers, 40% Businessmen and 12% Consumers said the present act and regulations are not sufficient. It is clear from the table that out of the total respondents 27% claimed for its sufficiency or rules and legal provision of VAT, 20% were opposite of this view, 18% had moderate view and remains 35% were unknown about this question it can be said that the present rules and legal provision are enough to implement VAT system effectively and properly.

#### **4.11.6 Views on Problems of VAT System in Business Sector**

Businessmen/Traders are the main taxpayer group in VAT system. The taxpayers have to prepare sales and purchase account of all transaction. They have compulsorily given and receive bills while selling and purchasing goods. Though this makes the tax system transparent, the Businessmen have to employ assistants and fulfill various formalities. The field survey shows that, the major problems which Businessmen are facing are registration, account keeping system, cost of record keeping of VAT, billings and soon. The outcome of survey on this aspect is presented in the table below:

**Table: 4 – 18****Views on Problems of VAT System in Business Sector**

<b>Respondents</b>	<b>Registration</b>		<b>Account Keeping</b>		<b>Billing System</b>		<b>Miscellaneous</b>		<b>I don't know</b>		<b>Total</b>
	<b>Nos.</b>	<b>%</b>	<b>Nos.</b>	<b>%</b>	<b>Nos.</b>	<b>%</b>	<b>Nos.</b>	<b>%</b>	<b>Nos.</b>	<b>%</b>	
<b>Tax Experts</b>	1	20	4	80	-	-	-	-		-	<b>5</b>
<b>Tax Officers</b>	8	53.33	5	33.33	2	13.34	-	-	-	-	<b>15</b>
<b>Businessmen / Traders</b>	12	40	10	33.33	7	23.33	-	-	1	3.34	<b>30</b>
<b>Consumers</b>	3	6	14	28	8	16	10	20	15	30	<b>50</b>
<b>Total</b>	<b>24</b>		<b>33</b>		<b>17</b>		<b>10</b>		<b>16</b>		<b>100</b>

*Source: Field Survey, 2009.*

According to the field survey, 20% Tax Experts 53.33% Tax Officers, 40% each Businessmen and 6% Consumers considered that there is problem exist in business sector on registration process. The view of the other 80% Tax Experts, 33.33% Tax Officers, 33.33% Businessmen and 28% Consumers was that there is problem due to amount keeping system. Likewise 13.34% Tax Officers 23.33% businessman and 16% Consumers supported that business sector is suffered from problem of billing system. Among the total respondent's view 24% argued on problem of registration, 33% viewed problem on account keeping. 17% opinion on billing system, 10% said miscellaneous and 16% were unknown.

#### **4.11.7 Views on Major Weakness of VAT Administration**

VAT system has been implemented instead of ineffectiveness of provisions Sales Tax system because the revenue creation of it was not so much significant to the economy with respect to VAT. For the effective and

successful implementation of VAT, we have to identify the current weakness of administration. It is reported that there have been various weaknesses behind the non-functioning of VAT system in an expected way VAT administrative reform is weak, inadequate and incomplete which cause problem and challenges in the path of operation of VAT administration. It is found that major weakness of VAT administration in Nepal are lack of expertise, lack of trained man power, weak financial resources, lack of physical resources, lack of physical infrastructure and miscellaneous. The field survey was conducted in this aspect to know the major weakness in VAT administration. The outcome on this view is shown in the following table:

**Table: 4 – 19**

**View on Major Weakness of VAT Administration**

Respondents	Lack of Experts		Lack of trained manpower		Lack of physical infrastructure		Weak economy		Miscellaneous		All		Total
	Nos.	%	Nos.	%	Nos.	%	Nos.	%	Nos.	%	Nos.	%	
<b>Tax Expert</b>	1	20	2	40	-	-	1	20	-	-	1	20	<b>5</b>
<b>Tax Officers</b>	2	13.33	2	13.33	-	-	4	26.67	3	20	4	26.67	<b>15</b>
<b>B.men/ Traders</b>	5	16.67	12	40	2	6.67	3	10	1	3.33	7	23.33	<b>30</b>
<b>Consumers</b>	4	8	20	40	3	6	4	8	6	12	13	26	<b>50</b>
<b>Total</b>	<b>12</b>		<b>36</b>		<b>5</b>		<b>12</b>		<b>10</b>		<b>25</b>		<b>100</b>

*Source: Field Survey, 2009*

From the above field survey, 20% Tax Experts, 132.33% Tax Officers, 136.7% Businessmen, and 8% Consumers viewed that major weaknesses of VAT administration is due to lack of experts, while 40% each Businessmen and Consumers reported due to lack of experts, while 40% each Businessmen and Consumers reported due to lack of trained man power. Similarly 20% Tax Experts, 26.67% Tax Officers, 10% Businessmen, and 8% consumer, viewed miscellaneous reasons cause weakness of VAT administration, where as 20% Tax Experts, 26.67 Tax Officers, 23.33% Businessmen, 26% Consumers viewed weakness of VAT due to all reasons mentioned above.

#### **4.11.8 Views on Current Challenging Problems of VAT**

It is not a matter how much easy to introduce VAT system but how much effectively and properly to run it because VAT is complicated and advance than other taxes. The taxpayers as well as the tax collectors must be more conscious for the successful implementation of VAT. In the context of Nepalese economy, there are many problems associated with the implementation of VAT. It is found that the further success of VAT basically depends on its effective implementation aspect. The field survey has been conducted to identify the most challenging problem among smuggling and under valuation, lack of proper billings, lack of proper accounting and weak tax administration. The outcomes of different respondents on this aspect are following as presented below:

**Table: 4 – 20**  
**View on Current Challenging Problems of VAT**

Respondents	Smugglings under valuation		Lack of proper billing		Lack of proper accounts		Weak tax Administration economy		All		I don't know		Total
	Nos.	%	Nos.	%	Nos.	%	Nos.	%	Nos.	%	Nos.	%	
<b>Tax Experts</b>	3	60	1	20	-	-	1	20	-	-	-	-	5
<b>Tax Officers</b>	6	40	3	20	1	60.67	5	33.33	-	-	-	-	15
<b>B.men/Traders</b>	8	26.67	12	40	3	10	5	16.67	-	-	2	6.66	30
<b>Consumers</b>	5	10	11	22	5	10	10	20	1	2	18	36	50
<b>Total</b>	<b>22</b>		<b>27</b>		<b>9</b>		<b>21</b>		<b>1</b>		<b>20</b>		<b>100</b>

*Source: Field survey, 2009*

From the field survey, it is found that 60% Tax Experts, 40% Tax Officers, 26.67% Businessmen and 10% Consumers engage that smuggling and undervaluation is the most challenging problem associated with VAT. Similarly, 20% each Tax Experts and Tax Officers, 40% Businessmen and 22% Consumers argue that lack of proper billing is the causes of VAT implementation. While 20% Tax Experts, 33.33% Tax Officers, 16.67% Businessmen and 20% Consumers identify administration as the most challenging problem. Thus out of the total respondents, 22% viewed smuggling and under valuation is main challenging problem 27% identify that lack of proper billing system is current existing problem; whereas 9% argued on lack

of proper accounts, 21% following by weak tax administration and 20% had no idea on this view.

#### 4.11.9 Views on Responsible Group of Tax Evasion

Any tax system may not provide the expected revenue yield when there exist tax evading loopholes. Evasion of tax not only loses the revenue but also creates economic distortions, market imperfection etc. However, tax-evading practice is a general phenomenon in any country and it cannot be solved perfectly but it must be minimized as far as possible. Generally business enterprises may not take responsibility for tax evasion but it is not true in all the cases and time. There is other group such as Consumers, tax administration who may be supporting, helping or encouraging business enterprises for tax evasion, for their direct or indirect benefit and thus may be more responsible for tax evasion. The opinion survey was conducted to provide the views on most responsible group for tax evasion among business enterprises, Consumers, administration or all and the outcomes finding is presented in table below:

**Table: 4 - 21**  
**Views on Responsible Group of Tax Evasion**

Respondents	Registration		Account Keeping		Billing System		Miscellaneous		I don't know		Total
	Nos.	%	Nos	%	Nos.	%	Nos.	%	Nos	%	
<b>Tax Experts</b>	5	100	-	-	-	-	-	-	-	-	<b>5</b>
<b>Tax Officers</b>	8	53.33	1	6.67	1	6.67	5	33.33	-	-	<b>15</b>
<b>Businessmen / Traders</b>	8	26.67	12	40	-	-	7	22.33	3	10	<b>30</b>
<b>Consumers</b>	3	6	12	24	6	12	15	30	14	28	<b>50</b>
<b>Total</b>	<b>24</b>		<b>25</b>		<b>7</b>		<b>27</b>		<b>17</b>		<b>100</b>

*Source: Field Survey, 2009*

From the above outcomes, 100% Tax Experts, 53.33% Tax Officers, 26.67% Businessmen and 6% Consumers supported that the most responsible group for tax evasion is business enterprises. Similarly, 6.67% tax effacers, 40% Businessmen/Traders and 24% Consumers viewed due to tax administration. Likewise 33.33% Tax Officers, 23.33%. Businessmen/Traders and 30% consumer agreed due to the entire responsible group. Out of total respondents, 33% opinioned due to business enterprises, followed by 25% tax administration, 7% Consumers, 27% by all groups and remaining 17% had no idea on this view.

#### **4.11.10 Views on Reasons for Need of VAT in Nepal**

Having great pressure for development, all developing countries like Nepal, Bhutan and Bangladesh etc. need higher revenue collection from internal resources. For that the effective implementation of VAT has great significance for these developing countries. Almost developing countries depend upon the external resource such as foreign aid, foreign loan and financial assistance. So these countries tried to seek to stand on the internal revenue through VAT system. On the context of Nepal, the period of Sales Tax seems to be very unfruitful on the revenue mobilization, tax loopholes i.e. smuggling, under valuation etc. So there was no way alternative except accepting tax reform. So increasing the popularity and the success of VAT in the international arena. Nepal preferred VAT to the tax reform in order to eliminate all kinds of defects and problems. The following table idealized about the opinion of respondents why VAT is needed in Nepal.



**Table: 4 - 22****Views on Reasons for Need of VAT in Nepal**

Respo ndents	Effective revenue		transparency		Avoid tax leakage		Broaden tax base		All		I don't know		Total
	Nos.	%	Nos.	%	Nos.	%	Nos.	%	Nos.	%	Nos .	%	
<b>Tax Expert s</b>	3	60	-	-	-	-	1	20	1	20	-	-	<b>5</b>
<b>Tax Officer s</b>	9	60	-	-	2	13.33	2	13.33	2	13.34	-	-	<b>15</b>
<b>B.men/ Trader s</b>	12	40	3	10	5	16.67	2	6.67	6	20	2	6.66	<b>30</b>
<b>Consu mers</b>	15	30	5	10	4	8	5	10	6	12	15	30	<b>50</b>
<b>Total</b>	<b>39</b>		<b>8</b>		<b>11</b>		<b>10</b>		<b>15</b>		<b>17</b>		<b>100</b>

***Source: Field Survey, 2009***

According to the survey 60% each Tax Experts and Tax Officers, 40% Businessmen/Traders and 30% Consumers agreed that VAT is needed in Nepal due to the reason of effective revenue generation. Similarly 20% Tax Experts, 13.33% tax effacers, 16.67% Businessmen and 8% Consumers reported VAT is needed due to broaden tax base. Likewise 20% tax expert's 13.34% Tax Officers, 20% Businessmen and 12%consumer's views there is need of VAT due to all mentioned reasons where as 6.66% Businessmen and 30% consumer has no idea on this view. Out of total respondents, 39% supported for effective revenue, followed by 8% transparency, 11% avoiding tax leakages, 10% broaden tax base, 15% due to all reasons, and 17% had no idea on need of VAT in Nepal.

#### 4.11.11 Views on Improvement of Revenue Mobilization through VAT in Nepal

The tax is main source of revenue of government, for developing countries; the major part of the total tax income is contributed by indirect tax. In the context of Nepal, the major part of indirect tax is contributed by VAT/sale tax. Mainly, the government has moved toward VAT system. In order to increase revenue by broadening tax base and make tax system transparent. To find out whether the previous Sales Tax or VAT system will help & improve the government revenue the respondent's views were presented in the table below:

**Table: 4 - 23**

#### **Views on Improvement of Revenue Mobilization through VAT**

Respondents	Yes		No		I don't know		Total
	No	%	No	%	No	%	
<b>Tax Experts</b>	5	100	-	-	-	-	<b>5</b>
<b>Tax Officers</b>	15	100	-	-	-	-	<b>15</b>
<b>Bus. Men/ Traders</b>	24	80	4	13.33	2	6.67	<b>30</b>
<b>Consumers</b>	15	30	3	6	32	64	<b>50</b>
<b>Total</b>	<b>59</b>		<b>7</b>		<b>34</b>		<b>100</b>

*Source: Field Survey, 2009.*

From the above table, 100% Tax Experts and Tax Officers, 80% Businessmen and 30% Consumers in view that there will be improvement of revenue mobilization thought VAT, while 13.33% Businessmen, 6% Consumers said there will not be improvement in revenue generation. Similarly 6.67% Businessmen and 64% consumer had no idea about its effect in revenue mobilization. Out of total respondents, 59% viewed that there will be

improvement in revenue, 7% said that there will not be any increase in revenue and remaining 34% in total had no idea on this view.

#### **4.11.12 Views on Whether the VAT be Effective in Future:**

According to the international experience, VAT is effective to the revenue mobilization and strong tax administration. However, it cannot be said properly that it is advantageous and effective in future until effective implementation. In Nepalese context, the smuggling trade level is at peak point, tax leakage is at higher magnitude, and the revenue collection is at the lower level, the effectiveness and administration is weak. So, without proper implementation, there is big doubt whether VAT will be effective in future or not. The views of various respondents on this aspect are presented in the table below:

**Table: 4 - 24**

#### **Views on Weather the VAT be Effective in Future**

<b>Respondents</b>	<b>Yes, it will be</b>		<b>No, it will not</b>		<b>I don't know</b>		<b>Total</b>
	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	
<b>Tax Experts</b>	5	100	-	-	-	-	5
<b>Tax Officers</b>	15	100	-	-	-	-	30
<b>Bus. Men/ Traders</b>	22	73.33	2	6.67	6	20	30
<b>Consumers</b>	16	32	4	8	30	60	50
<b>Total</b>	<b>58</b>		<b>6</b>		<b>36</b>		<b>100</b>

**Source: Field Survey, 2009**

According to the field survey 58% of total respondents were totally optimistic that VAT will be effective in future but 6% of total respondents were pessimistic that VAT will be ineffective in future. Remaining 42% respondents including Businessmen and Consumers had no idea about this aspect. From the survey, it is found that 100% each Tax Experts and Tax Officers supported that

VAT will be effective in future, followed by 73.33% Businessmen and 32% Consumers.

#### **4.11.13 Views on Effect of VAT on Revenue Mobilization**

Presenting resource gap is one of the major characteristics for the Nepalese economy. Due to lack of sufficient revenue sources, government is not capable to operate the development activities in the country. Beside this the large amount of foreign debt is forcing the economy towards the debt trap situation. In such circumstances, VAT was expected to have the greater revenue yield due to its broader base and other features such as catch up effect, self enforcing nature, transparency etc., but it has a low revenue yield due to weak implementation until the beginning year of implementation however improving in successive years. The opinion survey on this aspect is presented in the table below:

**Table: 4 - 25****Views on Effect of VAT on Revenue Mobilization**

<b>Respondents</b>	<b>Positive</b>		<b>Negative</b>		<b>No effect</b>		<b>I Don't Know</b>		<b>Total</b>
	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No.</b>	<b>%</b>	<b>No</b>	<b>%</b>	
<b>Tax Experts</b>	5	100	-	-	-	-	-	-	<b>5</b>
<b>Tax Officers</b>	15	100	-	-	-	-	-	-	<b>15</b>
<b>Businessmen / Traders</b>	25	83.33	-	-	2	6.67	3	10	<b>30</b>
<b>Consumers</b>	16	32	4	8	4	8	26	52	<b>50</b>
<b>Total</b>	<b>61</b>		<b>4</b>		<b>6</b>		<b>29</b>		<b>100</b>

*Source: Field Survey, 2009*

According to the field survey, 100% each tax expert and Tax Officers, 83.33% businessman and 32% Consumers said that VAT would have positive effect on revenue mobilization compared to the other replaced taxes. An aggregate, 61%, 2%, 6%, and 29% of the respondent provided their opinion on positive, negative, no effect and I don't know option respectively.

#### **4.11.14 Views on Making VAT Effectively Successful**

VAT has already been in Nepalese environment however it has not yet secured the expected results, and many problems still exist in the real field. It is necessary to identify the existing problems and solve them successively to make the VAT more successful in future. So that it still help to increase revenue pattern properly. Hence, there are so many options to make VAT more successful. These are strengthening and improve the VAT administration, improve VAT laws and regulation, trained and educated officers, public awareness. Programs about VAT etc. the opinion survey on this context of different respondents is summarized in the table below:

**Table: 4 - 26****Views on Making VAT Effectively Successful**

<b>Respondent s</b>	<b>Strengthe n improve VAT administra tion</b>		<b>Trained educated officers</b>		<b>Improve VAT laws and regulation</b>		<b>conduct public awareness programs</b>		<b>I don't know</b>		<b>Total</b>
	<b>Nos .</b>	<b>%</b>	<b>No s.</b>	<b>%</b>	<b>Nos.</b>	<b>%</b>	<b>Nos .</b>	<b>%</b>	<b>Nos .</b>	<b>%</b>	
<b>Tax Experts</b>	1	20	1	20	3	60	-	-	-	-	<b>5</b>
<b>Tax Officers</b>	6	40	2	13.33	5	33.33	2	13.33	-	-	<b>15</b>
<b>Businessme n / Traders</b>	6	20	8	26.67	10	33.33	4	13.33	2	6.67	<b>30</b>
<b>Consumers</b>	12	24	6	12	5	10	10	20	17	34	<b>50</b>
<b>Total</b>	<b>25</b>		<b>17</b>		<b>23</b>		<b>16</b>		<b>19</b>		<b>100</b>

***Source: Field Survey, 2009***

According to above field survey out of total respondents 25% viewed that to make VAT effectively successful, there will be need of strength and improvement in VAT administration. Similarly 17% supported contained and educated officers. Likewise 23% expressed their view to improve VAT laws and regulations where as 16% opinioned to regulate public awareness programs and 19% had no idea on this view. Among total Tax Experts, 20% each viewed to strengthen and improve VAT administration and trained and educated officered, and remaining 60% reported to improve VAT laws and regulations for making VAT effectively successful. Out of total Tax Officers 40% agreed to strengthen and improve VAT administration 13.33% supported to need of trained and educated officers, 33.33% opinioned on improve VAT lows and regulations and remaining 13.33% viewed on conduct public awareness programs to make VAT effectively successful.

#### **4.12. Major Findings of the Study:**

On the basis of previous chapter and data presentation and analysis, some important findings can be drawn. The major findings are given bellow:-

1. VAT has been most essential choice as ingredient of tax reforms for developing countries like Nepal, which leads to revenue enhancement and sustainable economic development. There is tremendous scope for increase in the revenue from VAT and its sound implementation in coming days.
2. Overview the current revenue structure of Nepal, the share of tax revenue has been greater than the share of non-tax revenue. About three quarters of total revenue comes through tax revenue and one third from non-tax revenue, which shows the dominant role of tax revenue to total revenue. Due to this reason, government heavily depends upon tax revenue and the foreign grants and aids, which leads country's situation towards fiscal crises and resources gap.
3. In Nepal, indirect tax plays pioneering role for internal resource mobilization, which is now the principal source of revenue collection. Almost, 72.90% of revenue collected through indirect taxation, which shows dominant role of indirect tax over direct tax. So, to direct the country's economy in the channel of development, it is necessary to increase the share of direct tax over indirect taxation.
4. In recent decades, developing as well developed countries in the world have increasingly focused their attention towards reforming the tax system by realizing the poor designed tax structure in order to mobilize higher volume of resources for the development purposes and make the economy health, efficient and self-dependent to a greater extent. In this sense, VAT became a power point of attraction of many countries and gaining popularity day by day.

5. The government expenditure is increasing consciously but revenue resources are very limited which leads the country to fiscal crises. The major cause of persisting fiscal deficit in Nepal is due to the poorly designed and defective tax system, which causes inadequate mobilization of resources.
6. The contribution of VAT revenue to total revenue is in increasing trend, which is beneficial for sound economic development despite the various difficulties in the implementation of VAT; the collection trend of revenue through VAT is very satisfactory. It is expected that VAT will generate more and more revenue in the coming days. VAT generated about Rs. 7122.60 Million revenue in F/Y 1997/98. It reached up to Rs. 26704.18 millions in F/Y 2006/07, which is about 374.92 %, increase in comparison to F/Y 1997/98.
7. The share of VAT in the GDP in Nepal is very low in comparison to other developing countries. The contribution of VAT revenue as a percentage of GDP remained 3.06, 2.95, 2.87, 3.06, 3.75, 3.76 and 3.98 from F/Y 2000/01 to 2006/07 respectively, however showing a improving trend. Likewise, the registration trend into VAT is also increasing day by day. The number of registrant increased from 5237 in FY 1997/98 to 52965 in F/Y 2006/07 by almost ten fold.
8. The consistency between planned and actual revenue collection of VAT is not so satisfactory. In average 95.92% of plan revenue collection is achieved in last five years i.e. F/Y 2000/01 to 2006/07. In the comparison of target or planned revenue collection, the collection of actual revenue is less than that of planned revenue. Reasons for this decline are smuggling and under valuation of goods, lack of proper billing, lack of proper account, and weak tax administration. Though in F/Y 2004/05, the actual collection is higher than that of planned, it shows the good prospects of VAT in coming days.



- 9 Many countries of the world due to superiority over Sales Tax prefer VAT. With the base of effective revenue mobilization, wide tax base, transparent and easily tackle over tax evasion, VAT is considered as superior to Sales Tax; 72% of total respondents are favor of VAT system.
10. 37% of total respondents argued that current rate structure of VAT is sufficient to have greater revenue yield where as they claimed that it has to be improved. 34% opined for higher rate, 26% were unknown and 3% opined that existing rate was high.
11. Due to broader tax base, catch-up effect, self-enforcing nature, transparency etc. features of VAT; VAT is expected to have the greater revenue yield. Out of the total respondents, 79% viewed about the positive effect of VAT on revenue mobilization.
12. Most of the taxpayers are unknown about the record keeping and process of VAT system. About 24% respondents provided their views on registration difficulty, 45% on collection process and 13% opinioned on problem of tax refund system.
13. The major problems that exist in business sector are registration procedure, account keeping system, proper billing systems and cost of record keeping. 24% of respondent provided their view on difficulties in registration, 33% opined on account keeping system and 17% argued on billing system and 10% are says to miscellaneous problem.
14. Billing system is one of the major aspects of effective implementation of VAT but Businessmen hardly issue bill to Consumers. Consumers are not much interested in taking bills due to misconception of increase in the price of goods. Such practice has discouraged the Consumers to demand VAT bill and is the root cause of the failure of the billing system.

15. The proper issuance of bills has remained a major bottleneck. The potential revenue is severely lacking due to non-operation of billing system in most of the registered firm. Most of the businessman holding VAT certificate issue VAT Bills just for formalities and issue illegal bills for every transaction. Besides that, most of the business firms do not issue bills; however, they issue parallel bills, loose bills. On the other hand, they make parallel account one for the tax purpose and other for business purpose.
16. VAT administration is still weak, traditional, corrupted, inadequate and incomplete which cause problems and challenges in the path of successful implementation of VAT. Out of the major weakness of VAT administration, 12% viewed lack of experts, 36% in favor of lack of trained man power 5% opinioned due to insufficient physical infrastructure and 12% complained about its weak land poor economic situation. Remaining 10% views are miscellaneous problem.
17. For making VAT effectively successful in future, it is necessary to overcome the current challenging problems like smuggling, under valuation, lack of proper billings, lack of proper accounts and weak tax administration.
18. Successful operation of VAT is extremely challenging for a burgeoning economy like Nepal where, there is long open border, a large segment of the economy is yet to be magnetized, business system is still running in traditional way, geographical structure is rugged, non-adherence of standard norms and codes is wide spread, public consciousness level is very low, existing practice consciousness level is very low, existing practice of smuggling and under valuation in the custom is supporting for the under invoicing in the successive stage of production and distribution. Further all the rules and regulation are not seen in real practice, bribing and corruption is wide spread in the tax administration and all other sectors of the economy. These are the facts that exist in

Nepalese environment which encourages Businessmen for the tax evading practices and make them less responsible in this system.

19. VAT can be entrenched as an integral part of the Nepalese tax structure in the long run if its implementation could be successful. VAT has brought prospects in future but prospect of VAT entirely depend upon its implementation aspect. Mainly, the successful implementation depends upon the strong, fair and capable administration, strong political commitment, co-ordination between the customs office and Inland Revenue Department, co-operation/co-ordination between private sector and the government bodies, systemization of rules and regulation according to time.
20. According to the field survey; 58 % of total respondents are totally optimistic that VAT will be effective in future, 100 % each Tax Experts and Tax Officers, 83.33 % Businessmen/Traders, and 32 % Consumers agree with that VAT would have positive effect on revenue mobilization, compared to the other replaced taxes.
21. The tax is main source of revenue of government for developing countries like Nepal. The major parts of the total tax income is contributed by Indirect Tax, 60% each Tax Experts and Tax Officers, 40% Businessmen/Traders and 30% consumer agree that VAT is needed in Nepal due to reason of effective revenue generation. As this, 100% Tax Experts and Tax Officers, 80% Businessmen/Traders, 30% Consumers view that there shall be improvement of revenue mobilization through VAT.

## **CHAPTER - FIVE**

### **SUMMARY CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Summary:**

Value Added Tax (VAT) is a form of indirect taxation, which is gaining wide popularity at present. VAT, as the name suggest, is the tax levied in the net value addition made in the goods and services. Unlike sales tax, VAT is imposed on each stage like import, production, wholesale distribution and retail distribution. Thus, the VAT liability at each stage is based on the difference between the value of the outputs and the value of the inputs (hence "added value"). Nepal has adopted VAT by replacing sales tax, hotel tax, contract tax and entertainment tax and air flight tax since Mangsir 01, 2054 in order to avoid the cascading effect on the price of goods and services because of multi-point levy of sales and other taxes. This definitely shall help to encourage investment in the country. Nepal follows the destination principle of VAT.

VAT is the one of the forms of sales taxes. Actually, it is the replacement of sales tax, entertainment tax, hotel tax, air flight tax and contract tax. Nepal introduced a consumption type, tax credit method VAT based on the destination principle with single positive rate of 13%. Nepal introduced VAT system for several reasons. It was necessary to introduce such a tax to develop stable source of revenue, to broaden the tax base to promote economic growth, to generate revenue required for improving its deteriorating macro economic performance, to establish an account based modern transparent tax system to make the tax system more scientific, to gain the confidence of donors, to make the Nepalese tax system effective.

In fact, the implementation of VAT was not easy in the initial days. It was a matter of great debate. Even after the passage of the law, there were a lot of constraints and difficulties in introducing and implementing VAT in Nepal. A large number of traders and business community were against VAT. The first

two years of VAT implementation were very turbulent. The FNCCI, NCC and their affiliated agencies were in the front line of opposition. Despite all this, VAT was introduced and survived because of the efforts of a small group of extremely dedicated, motivated and hard working people who never gave up their hopes of making VAT successful one day. VAT is currently well receipted by the consumers as well as business and industrial communities of Nepal, for this account-based tax that leads to transparency and accountability both on the part of tax payers and tax collectors. Despite the strong opposition to VAT from the business community, the number of VAT registrants has been increasing gradually, reaching about 52965 in the fiscal year 2006/07 in the span of last 10 years.

VAT, a premier indirect tax to Nepal's tax structure, is composed of two components: Domestic and imports. Almost two thirds of VAT revenue is generated from imports. However both the domestic and imports VAT are likely to have the equal share in the total VAT in the near future. Domestic VAT revenue further consists of production, distribution and service sectors.

The present VAT administration may be simplified in two functional needs. Department and VAT offices (the Income Tax, Vat and Excise has now been merged as Inland Revenue Department/Office). The VAT department and field offices under this department are responsible for administering VAT. The organizational structure of the VAT administration is based on functional line. Large taxpayer, tax refund, taxpayer services, tax audit and investigations, internal monitoring, collection and registration are important sections of VAT administration. There are 22 Inland Revenue Offices under the VAT department and divided into four categories, depending upon their workload.

VAT is still facing number of challenges & problems. The lack of proper billing is being most of the challenging problems to implement VAT effectively and successfully. However, the problem is equally associated with others such as smuggling and under valuation, weak performance of tax

administration, low level of public consciousness, rampant corruption, political instability, geographical barriers, open border and unauthorized trade, narrow tax base, lack of co-ordination between custom office and VAT related offices etc. so improvements in such various areas are needed.

Because of Rs. 2 Million Threshold of Mandatory Registration under VAT, businessmen spilt up their businesses in name of their family members/ staffs etc. and remain out of scope of VAT. This is a major problem in effective VAT Implementation.

In the empirical study, the analysis has been done about VAT on the basis of information collected from tax experts, tax officers, businessmen\traders and consumers. The total that is basically used is the questionnaire. The questions were asked to 100 different respondents related to this field. Out of total respondents 5 are tax experts, 15 are tax officers 30 are businessmen and 50 area consumers.

## **5.2 Conclusion:**

Value added tax plays greater significant role in revenue mobilization/generation in Nepal. The reason behind this is that VAT system is transparent, with broaden tax base that discourage tax evasion. So it is needless to say that VAT is the most important sources of the government revenue. VAT is the most scientific, innovative and powerful tax instrument with built-in quality of universal application for both developed and developing economics. The biggest virtue of VAT is revenue which is buoyant and highly instrumental for resource mobilization especially in an economy with acute shortage of resource. VAT would make it possible to broaden the tax base, eliminate tax cascading, create an investment friendly tax system, has a simple and modern tax system that finally increase revenue. This is a matter of great pride that the Nepal has entered in to a major global tax system with the introduction of VAT. As we are about to get the membership of WTO, we

shall need to decrease our custom duties drastically. Custom duties are being curtailed in worldwide span in order to accept liberalization policy. Excise duty in Nepal is severely limited due to the contraction of industrial activities throughout the nation in recent years. Under such condition, we can not collect more revenue from income tax, customs duty and excise duty. Consumption based tax is only an alternative to collect more revenue, which directly helps to increase domestic resources for development works. One of the base of Nepalese tax system is VAT. It is based on consumption related indirect taxes which do not maintain equity norms but they can be considered as one of the reliable sources of revenue generation. Furthermore, this will help reduce the burden of our foreign debt, and will provide a great relief to our future generation. There is no doubt on the fact that VAT, in long run, will help to make Nepalese economy stronger. In this sense, the successful implementation of VAT system has a greater significance as well as importance in Nepal.

The issue, however, today is not whether VAT or NO VAT but how to make the implementation of VAT more effectiveness and efficient. It is not matter that VAT should be removed but the implementation aspect of VAT must be managed and enhanced, VAT regime is extremely challenging in a burgeoning economy like Nepal where, with long open border, a large segment of the economy is yet to be magnetized. Resistance from the business community, ignorance of general people and the lack of full support and commitments from the politicians and government officials forced the authority responsible for implanting VAT to make compromises on various aspects of VAT which has weakened the process of its implantation right from the beginning. The attitude of businessmen and the tax administration also appear hostile to the effective implementation of VAT in Nepal. The culture of doing business without maintaining proper books of accounts or maintaining multiple sets of books of accounts have made implementation of VAT difficult. The problem is further intensified due to lack of culture of issuing and receiving bills at the point of sale and purchase, negative behavior of tax officials and lack of sense of accountability in the government and political parties. It is a big challenge to

resolve these problems. Apparently, VAT can not deliver the intended results unless these problems are addressed seriously.

Theoretically, the Nepalese VAT system has no weak provision; it is one of the best models in the world. In practice, however, the system is not effective even today. Most of the problems concerning the operation of VAT in Nepal have been identified. The government needs to take necessary steps to sort out emerging problems in implementation of VAT. The government needs full co-operation from the tax administration, tax payers and businessmen as well as consumers in its efforts to generate more revenue. VAT must be made successful and this should be morality of tax officials and business people. Responsibility and accountability in every section of the economy is the basic requirements as well as honesty and confidence between the business people and tax administration. There is need for will power and action. The government must be curative. Unnecessary hindrance to economic activities must be avoided. In the absence of growth in economic activities revenue generation can not be increased. Thus, it is the time for action and improvements for effective and successful operation of VAT in Nepal for further perspective as well as present needs of economic development.

### **5.3 Recommendations:**

On the basis of major findings, summary and conclusions, following recommendations have been made to make vat effective and more effective, which could be fruitful to concerned authorities while reforming Nepal VAT System.

1. Extra effort should be made to encourage consumers to demand invoices at the time of purchase. Information on VAT should be disseminated to consumers. Awareness should be raised among the consumers on which goods are taxable, which are tax-exempted and why it is necessary to ask for invoices on purchases, for this billing



advertisement comparing has to be launched. The consumers have to be convinced that by not taking an invoice, they are not free from VAT but there will only be increase in there possibilities of the businessmen collecting the tax but not submitting to the treasury.

2. The implementation of VAT cannot be considered successful unless under-invoicing on imports is discouraged. In fact, it is the under invoicing that takes place on import that leads to under invoicing at the later stage of distribution. Under-invoicing can be discouraged by decreasing the rate of custom duties, strict monitoring of the business activities in the border area. Booking channel like letter of credit should be made compulsory for the imports from India and China. The open border problem which encourages illegal business should be eliminated by streamlining the custom administration.
3. An efficient, strong and fair administration is the most crucial for the proper implementation of VAT. But VAT administration is still weak, traditional corrupted in nature. In spite of these, there is lack of expertise, well-trained and skilled officers in the VAT administration. So, informative programmed such as seminars, training, discussions, should be organized to make the tax officers skilled and capable in their field of jobs and services minded attitude needs to be developed in the mind of tax officers. To motivate the tax administration, training programs on various aspects of VAT like tax audit, legal matter, and computer should be conducted.
4. Many businessmen having taxable capacity 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 should be encouraged. The level of voluntary compliance could be raised through a set of promontory and regulatory measures including positive and service minded attitude of the tax personnel, realization of tax structure, simplification of tax procedures and forums, strengthening

tax administration conducting audit and investigation in an effective manner and penalizing those who do break the rules, the procedures regarding registration, collection, interest, penalty, audit, and appeal should be simplified and improved.

5. There should be a close co-operation between the private sector and government sector for the successful implementation of VAT. But in practice, there is a crisis of confidence between the private and government sector. There were made many agreements between VAT payer and VAT collector. Persons of each sector blaming to another. Due to the lack of understanding between them, there is loss of revenue; the tax authorities in many cases arbitrarily fix taxable amount, which is beyond the current feature of VAT system. Hence it is necessary to co-operate the private sector with government sector. A proper co-operation between both sectors should be established confidently.
6. The tax administration should be very watchful to prevent any kind of mal-practice, fraud and tax evasion. Up most care should be taken to prevent any kind of bribing and corruption. Tax official should effectively be monitored.
7. VAT refund mechanism should be simplified so that the refund can be made without delay and the taxpayers have confidence in the system.
8. The VAT Act and Rules should be amended as per the need of the present day requirements of business organizations.
9. Border should be effectively controlled to prevent the illegal trade in border side.
10. Lack of proper billing system is the most challenging problem in Nepalese context so computerized billing /automatic billing system should be developed in the VAT system. The use of cash machines should be encouraged in the shops to solve the problem to great extent.

11. Basically custom duty and Excise duty is paid for import and export. The more we decrease rate the more we promote export and import of the goods.
12. Open borders should be strictly monitored and L/C has to be managed for the import of goods because of this, trend of avoiding VAT by under-voicing the goods will decrease and VAT collection will be more.
13. For domestic product related to production, distribution and service, if current VAT rate is decreased then the effective mobilization of internal source shall be possible and the possibility of maximization of internal goods and services.
14. If we decrease consumable goods in VAT rate then the customers do not feel any kind of VAT burden and they regard government as a good provision.
15. The people and organization which are going to pay VAT or tax should put in order form. For example A++ A+ A B C D.... respectively. And government should make the provision for these elements like prize, award etc. and by applying this method they will be more number of people in paying VAT or tax. And the most probability in increasing the internal revenue.
16. In the present Nepalese environment, there exists instability of political situation, so government should create an environment of strong political comment for effective and successful implementation of VAT system.
17. Implication of Proper Valuation Mechanism at Custom Point for import of goods. In case of under-valuation of Imported Goods, Custom Office should purchase those goods on declared value and sell it again.
18. Zero Rate of Vat to be implemented for all items, which are not under VAT Purview, which shall make the transaction-volume of business transparent.

19. VAT Threshold (Rs. 2 Million Transaction in consecutive 12 Months) for Mandatory Registration to be declined gradually.
20. Last but not the least, the government should show the commitment to implement VAT effectively. No matter which political party is ruling the roost, it should be honest and serious about VAT implementation.

## BIBLIOGRAPHY

Agrawal, Govind Ram (1980), *Resource Mobilization in Nepal*, Kathmandu CEDA

Ahmed and Cudlow (1989), *Tax Reform Packages on VAT for Pakistan*, Institute of Policy Studies working paper (vol.20)

Basnet, Dependra (2002), *An Analysis of VAT in Nepal*, Unpublished M.B.S. Dissertation, Central Department of Management T.U.

Bista, Raghubir (1999), *Applicability and Feasibility of VAT in Nepal*.

Budget Speeches, *Various Issues*, MOF, HMG/N

Clue and Friendlander (1981), *Government Finance Economics of the Public Sector*, 7<sup>th</sup> Edition.

Cnossen, Sijbren (1992), *Key Question in Considering Value Added Tax in Eastern European Country*, Staff Paper (Vol.29. No. 2) IMF, Washington D.C.

David N. Hyman (1972), *Economic of Government Activity*, Halt Rirehart and Winston Inc.

Dhakal, Arjun (2000), *Vat and Its Revenue Potential in Nepal*, unpublished dissertation submitted to the Central Department of Economic, T.U.

Due John F.(1976), *Value Added Taxation in Developing Economics*, Praeger Publisher, New York.

Due John & Fand Meyer Carrie (1998), *Dominican Republic Value Added Tax*, Bulleton for the International Bureau of Fiscal Documentation (vol.42 no...1) Amsterdam: IBFD

Economic Report, IURB, 1999-2001

Economic Surveys various issues, MOF, HMG/n, 2004/05, 2006/07

Ghimire, Lalmani (1998), *VAT: Key issues in Nepal*, Unpublished M.B.A dissertation T.U.

**Khadka, Rup. B. (2000), *Nepal Overview of VAT System*, Asia Pacific Tax Bullentin (No. 5, Vol. 6)**

**Khadka, Rup. B. (2001), *Value Added Tax : Four Years of Implementation*, (Ed.) (English), Inland Revenue Department and Value Added Tax Project Kathmandu.**

**Lent, George E. (1973), *Value Added Tax in Developing Countries*, IMF, Fiscal Affairs Development, Washington DC.**

**Margarent Nicholson (1989), *Accounting Skills*, Macmillant Ltd. London**

**Sharma, Chintamani (1998), *VAT in Nepal: An Administrative and Policy Issues*, Unpublished MBA Dissertation, Central Department of Management T.U.**

**Sharma, Krishna Prasad (1988), *Issues and Option in the Applicability of Value Added Tax in Nepal*, Unpublished M.A. Dissertation, Central Department of Economics, T.U.**

**Sharma, M.L. (1994), *C.A. Foundation Course of Economics*, Chand and Company Ltd.**

**Silwal, Narayan Prasad (1999), *Resource Mobilization and VAT*, Rajaswa, year 19, 001.29, no. E, HMG/N.**

**Silwal, Narayan Prasad (2000), *Value Added Tax: Its Problems and Prospects in Nepal*, Rajaswa, Nepalese Journal of Public Finance and Development, (year 8, vol. 2), (in Nepali).**

**Silwal, Narayan Prasad (2002), *Value Added Tax, Nepalese Experience*, Kathmandu.**

Subedi, Babu Ram (1997), *Applicability of VAT in Nepal*, Unpublished M.A. Dissertaion, Central Department of Economics, T.U. Kathmandu.

Taif, Alain A (1991), *Value Added Tax: Administrative and Policy Issues*, IMF.

Taif, Alan A (1988), *Value Added Tax: International Practice and Problems*, IMF, Washington DC.

**Tax Reform in Nepal, 1997: 66**

Thapa, Gobind B. (1994), *Value Added Tax in Nepalese Context*, Mirmire, Banker' S club, Nepal Rastra Bank, Kathmandu.

Value Added Tax Department (1998b), *Value Added Tax and Business Community (Nepali)*, VAT Department, Lalitpur.

Various      Related      Websites.      [www.mof.gov.np](http://www.mof.gov.np),

[www.ird.gov.np](http://www.ird.gov.np)

VAT Project (1996), *Common Questions and Answer on Value Added Tax*, VAT Project, Kathmandu.

VAT Task Force (1996), *Value Added Tax: Queries and Solutions*, (Nepali), VAT Department, Kathmandu.

## **Appendix – I**

### **A Study on Value Added Tax in Nepal: Problems, Prospects & Suggestions**

Dear Sir,

I would like to introduce myself as the Student of Thakur Ram Multiple Campus, Birgunj Department of Management, MBS. This year, engaged in a research work. In order to fulfill the partial requirement, I have prepared a dissertation on "Value Added Tax in Nepal: Problems, Prospects & Suggestions"

I humbly request for your valuable comments, view, suggestions and information on this issue which would be very useful for my study. That's why I request you to fill up the following questionnaire. I would very much appreciate if you could provide your time for filling this questionnaire.

I assure that the information, you provide me will be useful in research work. I hope for your kind co-operation and support with many thanks as soon as possible.

#### **Questionnaire**

Name of respondents:

Office / Organization / Business

#### **Occupation:**

Experience (in VAT or related field): ..... Years

Age:

Sex:

Educations: