Chapter 1

INTRODUCTION

1.1 BACKGROUND

Economic development is no doubt the most important concern and the target of the most of the government policies in an under developed countries, including Nepal, developing countries however need fund to initiate development of the projects of the nation. The role of revenue in the development of the country is not less essential than the role of a oxygen for the existence of the human beings. The nation will able to achieve maximum social welfare if it has adequate financial resources. In this perspective, a government needs to mobilize a lot of internal resources to fulfill its responsibility towards the nation and the people.

Equity growth and stabilization have long been accepted as major objectives of any economy. The undeveloped countries have to hasten their economic growth rate, eradicate absolute poverty, reduce inequalities and create more productive employment opportunities without affecting the ecological and environmental balances.

Being a developing country, the role of government in Nepal is still vital to build up infrastructure to provide a social service and to alleviate forceful poverty. These are challenging tasks, which demand increasing necessities of regular expenditure in general and development expenditure in particular. However, resources mobilization is very low compelling the government to depend on foreign aid. About 70% of Nepal's development budget is financed by external aid. However, external aid is uncertain, inconvenient and not good for healthy development, if there is heavy dependent on it. The experiences of the most developing country show that there are negative effect of increasing in international aid and loan to finance the public development activities. Development plan maker have opine that a country should not hardly depend upon foreign aid, as it would harm the proper utilization of internal resources. More hazardously, it would give the right to the dependency syndrome, which is not healthy signal for any country. Thus, it is better to utilize the internal resources rather than impending the loans and aid.

In the developing countries like Nepal, there is a importance for raising the large volume of resources for financing sustained growth of public investment. It is not impossible in these countries to mobilize resources by curtailing existing consumptions, because it is very low. Public borrowing and inflationary saving also have some limitations. Deficit financing is inflationary and foreign borrowing is not reliable sources. Continuous use of borrowing to raise necessary public fund is not good as it increases inflation.

Of course, the prospect of mobilizing resources through sources other than taxation has not been encouraged. Taxation is the most effective and powerful tool reserve in the hands of the government of any countries. Taxation may be utilized by the government as an effective tool for giving incentives to the proper growth of saving, investment and gross domestic product. There are several direction through which taxation can be looked upon. While some observed taxation as a mere source of investment and growth, the other take is a sources of incentive to the growth of industries and other sector of the economy. In Nepal, however the tax policy is mostly guided by the revenue considerations.

In spite of the fact that the taxation invests a great power in the hand of a government. The later should be imposed arbitrarily. Otherwise there is always possibility of undergoing serious hazards. The government there fore, it is expected to think seriously before imposing tax upon the people. It is so because of tax, if imposed ,does not have only short run but also long run direct and sound impact upon the economy.

Of the two types of taxation, direct and indirect, the later is incidental to a transaction involving the expenditure rather than receipt of money by tax payer while direct tax falls on income. As a part of taxation, indirect tax is an instrument of fiscal policy to achieve broader objectives of stabilization, optional allocation of resources and overall economic growth.

Liberalization of international trade flows has made taxes on international trade less importance by enhancing the use of domestic indirect taxes of revenue generation. The role of indirect is high in developing countries because of poor tax. Administration to collect direct taxes, low per capita income $ 220(WDR) 2002 and evasion possibilities. It implies that there is an economic and administrative limit to the mobilization of resources through direct taxation in the developing countries.

It is possible only through indirect taxes. Indirect tax is major sources of tax revenue in Nepal. It covers 80% of the total revenue. Generally, indirect taxation affects many economic activities such as saving, investments, consumptions, production and distributions of national income. No one can deny the significance of indirect taxes in the developing countries like Nepal. Thus, as a matter of fact, more resources can be raised only through the explanation of the indirect tax.

Indirect tax, which has got the lion shares in total revenue, is composed of three major components: custom duties, value added tax [VAT] and excise duties. All are the indirect taxes developed in the past. Vat is there fore, enacted which is broad based, transparent and economically natural.

VAT is the most important tax innovation of the 2nd half of the 20th century. It is the scientific tax system, which was first introduced in 1945 in France. It has been considered as one of the major instrument of the tax revenue. For this reason, one hundred and twenty six 126 developed and developing countries in the world have adopted it. It appears to have been successful in members in developing countries has been introduced in many developing countries to meet persistent revenue demands. Following the economic liberalization policy, Nepal has also legally and administratively implemented VAT system in November 1997. The government of Nepal has announced VAT as a focal investment for domestic resources mobilization..

To conclude, VAT has been the most essential choice for the most developing countries as an ingredient of their tax reforms because it is the most improved form of sales tax, which leads to revenue enhancement and economic efficiency. It is an important instrument for the mobilization of internal resources. There is tremendous scope for increasing the revenue from VAT. The implementation of VAT will obviously increase its contribution in forthcoming days. The tax reform with adaptation of VAT is therefore essentially connected with many undeveloped countries as one of the major elements for tax revenue to achieve the goal of the countries economic development.

1.2 TAXATION AND ECONOMIC DEVELOPMENT

No problem is of greater worldwide concern today than the development, which implies maximum of people's welfare and efficient allocation of resources. In the last two decades , virtually all developing economies has placed great stress on acceleration of economic development more specifically on raising of per capita real income to the level of the developed countries as quickly as possible.

Developing economies are concern with the utilization of resources so as to accelerate the process of development and increases the living standard of the people. In this context, tax has become a main source of resources mobilization to meet the financial requirement for the economic development. The principle component of fiscal policy to mobilize the public resources has been the government tax policies. Developing countries raises part of the vast financial resources required for their development needs from taxes. Taxes as major fiscal policy instrument and government policies tools have an important role In the increasing the rate of capital formation and their by achieving the high rate of economic growth. Taxation, in a modern world has been taken as the best effective tool for raising the ratio of savings to the national income. Thus income taxation must be viewed as an indicator of economic development.

Taxation is used to combat inflation reduce the gap between the rich and the poor, promote the national economy. The role of taxation in economic development lies in it's function of raising the maximum volume of resources and directing the flow of resources in useful and productive capacity is enhanced. According to Hicks "taxation is the most important source of developing finance for both direct contribution which it can make and for its indirect effects on control an incentive & in narrowing the gap in available income.

1.3 FOCUS OF THE STUDY

Implementation of VAT in Nepal is still in the preliminary stage. The state and the business communities have not developed the consensus for the effective implementation of VAT. The state has not taken the business community into confidence. As a result, the business community has not played a supportive role. The practice of a VAT is not free from misunderstanding between the stock holders. There seems to be a lack of complete knowledge of VAT in the government level as well as in business community level. There are lots of researches on VAT made abroad but very few of these are concern about countries like Nepal, and also most of the effort on VAT was held on the theoretical background. Twelve years have past since VAT had come in operation. Since there exist an acute resource gap. In Nepal the question of resource mobilization is a challenging proposition. In this context, VAT may be an instrument for mobilizing the internal resources more effectively.

In developing countries, budget like Nepal, deficit finance has been shown clearly in every budget preparation in different years. It is due to excessive total expenditure incurred in different sectors of the government. It is necessary to find out the cause of increasing the total expenditure. It also requires identifying such areas of excess expenditure which cause deficit financing. The regular expenditure and developing expenditure are collected from internal resources. It should be sufficient to cover the regular expenditure.

For the study of this data for the ten years have been collected to find out proper ways regarding actual position of tax raising and revenue collection of Nepal. In expenditure side too, data of 10 years are collected to point out the expenses like regular expenditure, and development expenditure which has affected more to bring deficit finance in Nepal. Deficit finance is influenced by foreign loan, domestic loan and cash balance adjustment.

By studying all these aspects, it would be easy to state the actual position of deficit financing and contribution of VAT to improve the deficit financing.

1.4 STATEMENT OF THE PROBLEM

Nepal is facing the problem of rising tendency of government expenditure. To meet the excessive expenditure it requires more revenue. Due to the deficit of internal resources, foreign loan and domestic borrowing will be increased. Foreign loan has a bad effect on national economy. Increase in foreign loan increases the interest of loan too. Such loan will have to be repaid from the amount of regular expenditure. Some foreign donor like: Japan has been providing grant for the repayment of the foreign loan. Foreign loans will be repaid from the debt relief fund, domestic borrowing. Thus the coverage of deficit financing is also not an easy task. As most of the industries are sick in our countries, tourism industry is lacking day be day. The number of tourists arrived from foreign countries are decreasing. The borrowing is also difficult because financial position of the commercial banks of Nepal is not too good.

For the solution to some extent, the raising tax would help to improve the balance of deficit financing. The form of tax was sales tax before the introduction of VAT. The sales tax was nor popular because of mistrust of people towards it. Most of the trade organization and political parties were in against of it. Creating the awareness of traders and businessman towards the new system approach, making improvement in billing system, bringing more efficiency in tax administration it can collect more revenue through VAT. In order to reduce the rising tendency of deficit financing and dependency on foreign loan and borrowing, internal loan, VAT system can be landmark in resource mobilization.

1.5 OBJECTIVES OF THE STUDY

The general objectives of the study are to show the actual rising of VAT to collect the revenue of Nepal and factors affecting the raising of VAT. Following are the specific objectives of the concern study:

1. To maximize historical background of the VAT.
2. To analyze the mobilization of the resources through VAT.

3. To provide suggestion to make VAT effective in mobilization of resources.
4. To discover and identify the performance of VAT.
5. To access the existing issues in implementation of VAT.

1.6 IMPORTANCE OF THE STUDY

VAT is not fragile in itself. It is a powerful tool of government fiscal policy but there are score of problem in encumbering the smooth financing of VAT. The core of the problem lies in the implementation of VAT. VAT should not be labeled as failure in Nepal. The success and the failure of VAT is largely depend upon it's operational efficiency and business communities compliance with it. Business communities used to claim that VAT would create many kind of negative impact on the economy. Now it is necessary to assess all the positive and negative impact of VAT system and put in front of business communities as well as to interested person. Thus the significances of the study are:

1. It is to give information by collecting data of different years (10 years) of all actual raising of VAT to all concern intellectual person, policy making businessman .
2. The study is to show the contribution of the VAT in the collection of revenue with the help of data collected for 10 years and the study is done to show the comparative increasing or decreasing in the raising of tax under sales tax and VAT.
3. The concentration is made to increase the awareness level of general people towards the VAT.
4. The importance of the study is to explain the special provision of VAT to all concerned people, businessman regarding the threshold limit, zero rating, tax exemption, tax refund low rate of tax base.
5. The concentration of this study is to assist in policy making of government through the recommendation of the stated study.
6. Further, importance of this study is to clarify the cause of deficit financing whether form increasing in general expenditure or from the raising development expenditure.

1.7 LIMITATION OF THE STUDY

1. The study has very limited areas of investigation. It is only a part and partial analysis of VAT. Comprehensive study of VAT is not possible in this dissertation due to its certain deadline for completion.

2. The history of VAT is not so long in Nepal. The information and data are collected from the Inland Revenue Department, ministry of finance and other concerned offices. Most of the data are taken from "Economic survey: 2004 – 05."

3. Due to time and resource, limitation mainly secondary data are used in the study. So it is largely dependent on the reliability of the secondary data.

4. Most people, trader, businessperson do not like to show the actual position of paying tax.

5. Though VAT consists of self-policing mechanism there may be found undervaluation while making bill.

6. Most of the traders do not give the bill at the time of purchase of goods from a shop and a people are not interested towards the new approaches of VAT in Nepal.

7. The literature on VAT is inadequate and scattered.

Above all constants have limited the boundary of the study. Despite such limitation, attempt has been made to make it profitable and meaningful.

1.8 ORGANIZATION OF THE STUDY

The study is organized according to methodology and prescribed pattern of the Tribhuvan University. The study comprises 5 chapters. The organization of the study is structured as follows.

Chapter 1: Introduction ---

1.1 background of the study
1.2 statement of the problem
1.3 objectives of the study
1.4 assumption & limitation of the study
1.5 research methodology
1.6 organization of the study

Chapter 2: Literature Review ---

2.1 Conceptual / Theoretical Review
2.2 Review of related studies

Chapter 3: Research methodology ---

3.1 Research design
3.2 Population and sample
3.3 Source of data
3.4 Data collection techniques
3.5 Data Analysis Tools
3.6 Limitations of the Methodology
3.7 Review of Related Studies

Chapter 4: Data Presentation and Analysis ---

4.1 Data Presentation and Analysis
4.2 Major Findings of the Study

Chapter 5: Summary, Conclusion and Recommendation ---

5.1 Summary
5.2 Conclusion
5.3 Recommendation

1.9 PROCEDURE OF PROCESSING AND ANALYSIS OF DATA:

As VAT was introduced very recently in Nepal since 1997, the available data concerning the VAT system in Nepal and its relevancy in the resources mobilization up to study period have been collected, tabulated and analyzed the assistance of descriptive as well as analytical tools. Tools applies in this research are percentage, graph, charts, diagrams, tables, averages, ratios and other tools are as required by this thesis.

CHAPTER – 2

LITERATURE REVIEW

2.1 CONCEPTUAL FRAMEWORK

2.1.1 Meaning of VAT

VAT is a sales tax in advance form, which is, impose on different stages. This tax is imposed of goods and services. VAT is one of the forms of indirect taxes too. There is one saying in encyclopedia of taxation and tax policy that “value added tax is a broad based tax on business design to measure net value generated in a country.” Being a broad based tax, it is impose upon producers, whole seller, retailer and consumer also. It is related with both goods and services. It is levied on industry as well as commerce. Accordingly it measures net value generated in a country, i.e. GDP. Indian tax institute define VAT as “tax imposed on the seller of the goods and services based on value added by their respective units.” VAT is also said to goods and services tax or added value tax. VAT system aims to minimize tax evasion and raise resource mobilization. It is equivalent to multistage sales tax because of imposed value added amount in each stage. In contrast to sales VAT is imposed upon the added value production and distribution. The value is added in the form of profit, rent, salaries etc.

The application of the VAT system in the resource mobilization is essential to strengthen the country’s fiscal system. Many of the developing countries have undertaken the tax reform program to enhance their economy since 5 decades. A distinguished and essential feature of tax reform in almost all developing countries around the world has adopted VAT system. VAT is a recent innovative tax in the field of taxation. VAT is considered as necessary element to form tax. Sales tax levied of goods and services is commonly divided into three groups i.e. turnover tax, single stage tax and VAT.

Turnover tax: turnover tax is levied at all stage of sales of production and distribution process.
Single stage tax: it may be imposed at the manufacturing level or wholesale level or retail level.
VAT: VAT is imposed on the value added at each level of production and distribution.

VAT is a multi stage tax which has grown as a hybrid of turnover tax. Since, the sense that both these tax are imposed at each of production and distribution process VAT differs from the turnover tax as the latter impose don the total value at each stage while the former is imposed only on the value added at that stage.VAT is similar to the retail stage sales tax because the tax base of VAT and of the retail level of sales tax on consumer goods and services are identical. VAT, however, vary from retail tax in the sense that the former is imposed at each stage of production and distribution, and While the latter is imposed only at one stage, which is the final stages. Theoretically, VAT is a broad based as it covers the value added to each commodity by a firm during all stages of production and distribution.There is presumption that VAT is shifted forward to the consumer (khadka *2001:2)* .The firms add value to these purchase materials by processing or handling them with the help of its own factor of production, such as labor, capital, land etc (Shoup, *1969:251*). This raise the value of output over input is the value added by the firm. In other word, value added by a firm is the sum of total of the income paid out by the firms to factor employed. This means that the value added by a firm is equivalent to its payment of wages, salaries, interest plus profit and this value added is the base for VAT.

2.1.2 Features of VAT

Following are the essential feature of VAT system applied in the resource mobilization.

1. It is an indirect tax.
2. It is based on added value.
3. It is a broad based tax.
4. It is based on self assessment system.
5. It avoids cascading and pyramiding.
6. It is of self policing and catching up benefits.

2.1.3 Origin of VAT

In 1919 AD, Wilhelm Von siemens of Germany has introduced a VAT system to replace the multi stage sales tax in order to avoid the undesirable effects, particularly an American professor; Carl S. Shoup suggested the concept of this tax in 1949 to use in Japan. However, the credit of using VAT at first goes to France which has introduced this system in 1954 AD. The introduction year with particular VAT rate has been applied in various countries around the world is shown in the below table.

Table No: 1

	Date VAT Introduced	Standard Rate
Albania	Jul. 1996	20
Algeria	Apr. 1992	17
Argentina	Jan. 1975	21
Armenia	Jan. 1992	20
Australia	Jul. 2000	10
Austria	Jan. 1973	20
Azerbaijan	Jan. 1992	18
Bangladesh	Jul. 1991	15
Barbados	Jan. 1997	15
Belarus	Jan. 1992	18
Belgium	Jan. 1971	21
Benin	May 1991	18
Bolivia	Oct. 1973	14.9
Botswana	Jul. 2002	10
Brazil 2/	Jan. 1967	20.5
Bulgaria	Apr. 1994	20
Burkina Faso	Jan. 1993	18
Cambodia	Jan. 1999	10
Cameroon	Jan. 1999	18.7
Canada	Jan. 1991	7
Cape Verde	Jan. 2004	15
Central African Republic	Jan. 2001	18
Chad	Jan. 2000	18
Chile	Mar. 1975	19
China 3/	Jan. 1994	17
Colombia	Jan. 1975	16
Congo, Republic of	Jun. 1997	18
Costa Rica	Jan. 1975	13
Côte d'Ivoire	Jan. 1960	20
Croatia	Jan. 1998	22
Cyprus	Jul. 1992	15
Czech Republic	Jan. 1993	19
Denmark	Jul. 1967	25
Dominican Republic	Jan. 1983	12
Nepal	Nov. 1997	10
Netherlands	Jan. 1969	19
Netherlands Antilles	Mar. 1999	5
New Zealand	May 1986	12.5
Nicaragua	Jan. 1975	14
Niger	Jan. 1986	19
Nigeria	Jan. 1994	5
Norway	Jan. 1970	24
Pakistan	Nov. 1990	15
Panama	Mar. 1977	5
Papua New Guinea	Jul. 1999	10
Paraguay	Jul. 1993	10
Peru	Jan. 1973	19
Philippines	Jan. 1988	10
Poland	Jul. 1993	22
Portugal	Jan. 1986	19
Romania	Jul. 1993	19
Ecuador	Jul. 1970	12
Egypt	Jul. 1991	10
El Salvador	Sep. 1992	13
Estonia	Jan. 1992	18
Ethiopia	Jan. 2003	15
Fiji	Jul. 1992	12.5
Finland	Jun. 1994	22
France	Jan. 1948	19.6
Gabon	Apr. 1995	18
Gambia	Jan. 2003	10
Georgia	Jan. 1992	20
Germany	Jan. 1968	16
Ghana	Dec. 1998	12.5
Greece		
Guatema		
Guinea		
Haiti		
Hondura		
Hungary		
Iceland		
Indonesi		
Ireland		
Israel		
Italy		
Jamaica		
Japan 4/		
Jordan		
Kazakhst		
Kenya		
Korea		
Kyrgyz R		
Latvia		
Lebanon		
Russia	Jan. 1992	18
Rwanda	Jan. 2001	18
Samoa	Jan.1994	10
Senegal	Mar. 1980	17
Serbia and Montenegro	Serbia: Jan. 2005, 2003	18
	Mont.: 2003	17
Singapore	Apr.1994	5
Slovak Republic	Jan. 1993	19
Slovenia	Jul. 1999	20
South Africa	Sep. 1991	14
Spain	Jan. 1986	16
Sri Lanka	Apr. 1998	15
Sudan	Jun. 2000	10
Suriname	Apr. 1999	10
Sweden	Jan. 1969	25
Switzerland	Jan. 1995	7.6
Taiwan	Apr. 1986	5
Tajikistan	Jan. 1992	20
Tanzania	Jul. 1998	20
Thailand	Jan. 1992	7
Togo	Jul. 1995	18
Trinidad and Tobago	Jan. 1990	15
Tunisia	Jul. 1988	18
Turkey 5/	Jan. 1985	18
Turkmenistan	Jan. 1992	20
Uganda	Jul. 1996	17
Ukraine	Jan. 1992	20
United Kingdom	Apr. 1973	17.5
Uruguay	Jan. 1968	23

	Date VAT Introduced	Standard Rate
Uzbekistan	Jan. 1992	20
Vanuatu	Aug. 1998	12.5
Venezuela	Oct. 1993	16
Venezuela	Oct. 1993	16
Vietnam	Jan. 1999	10
West Bank and Gaza	Jul. 1976	17
Zambia	Jul. 1995	17.5
Zimbabwe	Jan. 2004	15

Sources: **International Bureau of Fiscal Documentation** (IBFD, 2004); and Corporate Taxes 2003–04, Worldwide Summaries (PricewaterhouseCoopers).

Tax laws and tax planning in Nepal Kandel, pushpa raj (2007:296)
India has also used the VAT system from the year 200*. Earlier their was no MODVAT and CENVAT system.

In November 1997, Nepal has introduced the VAT system. However, this concept was introduced early in 1990. Government of Nepal has included this VAT system in 8th plan. Finance act 1992 and 1994 introduced two – tier sales tax to make the base of implementing VAT. VAT tax force was formulated in 1993 in the technical assistance of USAID, which suggested the step to be followed by implementing the VAT in Nepal. The VAT tax force prepared the draft of VAT legislation task force headed by Professor Madan Dahal who suggested the VAT implementation in Nepal in 1995 AD. VAT related act and rules were enacted in 1995 and 1996 respectively.

The implementation of VAT system was delayed due to political instability and strong opposition from the business communities. VAT with single rate of 10% has been fully implemented with the effect from 16 November 1997, (1st mangshir 2054 BS). It has replaced the sales tax, hotel tax, contract tax, entertainment tax and it has been designed to collect the same revenue as the four tax it replaced. VAT is a new tax system for Nepal. VAT has been justified in the light of government fiscal imbalances and for the extra revenue mobilization through an efficient tax system. The government of Nepal has increased the VAT rate to 13% from 10% with the effect from Magh 1 2061 BS.

In an around 130 countries has been popularly applied the VAT system in the world.

2.1.4 Characteristics of VAT

In a nutshell, VAT is an indirect tax that is imposed on different goods and services on the basis of value added amount in different stages of production and distribution. It is not genuinely new form of taxation but merely sales tax administered in different form.

Although it is eventually borne by the final consumers, VAT is collected at each stage of production and distribution.

2.1.5 Types of VAT

There are three different types of VAT; they are consumption types, income types and gross national product (GNP) types. They all are determined on the basis of treatment of capital goods of a firm. Input tax paid for capital goods is allowed or not is the fundamental integration of the study of different types of VAT.

 # Consumption types of VAT:

These types of VAT states all capital goods purchased from other firm, in the year of purchase, are excluded form the tax base, while depreciation is not deducted from the tax base in subsequent year. The base of tax consumption since investment is relived from taxation under this type. Investment is free from the tax burden, export is tax free and import is taxed. It is easier form the point of view of tax administration. Nepal has also adopted the consumption type of VAT system, the most popular type of VAT in the world. Registered person can credit the tax paid in the purchase of goods and services from the tax collected in the sales under the prevailing law of Nepal.

 # Income type of VAT:

This type of VAT does not exclude the capital goods purchased from the other firms form the tax base in the type of purchase. This type however, excludes depreciation from the tax base in the subsequent year. The tax falls on both consumption and net investment. The tax base in this type is not national income. When the capital goods used for the method of production are4 not deductible but
only a potion relevant to a particular is allowed to be deducted and the remaining portion is carried over for the next period. It is turned as income type of VAT.

#Gross national product (GNP) type of VAT:

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

Among all this three types of VAT, the consumption variant has been widely used in European countries and elsewhere in the recent year. The reason for the popularity of this type is that variant does not affect decision regarding investment and growth, since it relieves fro many tax burdens.

2.1.6 VAT as a substitute of sales tax:

VAT is an advance form of sales tax. It is a substitute for sales tax, hotel tax andentertainment tax.It is not an authentically new form of taxation but merely a sales tax administered in different form. The prices to be charged under VAT and sales tax do not differ. Under the VAT system consumer know the amount they are paying in the form of VAT under sales tax system, it was not shown separately in the bill. Though both taxes are collected finally from the consumers, VAT is more transparent than sales tax. VAT is imposed at each stage from production to sales but sales tax is imposed on only certain levels of sales. Following examples will clarify that VAT does not increase the price of goods and services.

Example: an importer imported a certain articles for Rs.10000. then it was passed on to whole seller and retailer before reaching to the final consumer. Importer, whole seller and retailer charged 10% mark up profit on their costs each.

Required:

A. Total sales tax and cost price to consumer.
B. Total VAT and cost price to consumer.

Table No:-2

Channel	Cost price	Profit / markup under sales tax	Selling price	Sales tax @13%	Selling price including sales tax
Importer to whole seller	10000	1000	11000	1430	12430
Whole seller to retailer	12430	1243	13673	0	13673
Retailer to consumer	13673	1367.3	15040.3	0	15040.3

Solution:-

Sales tax

Sales tax rate is assumed 13% [Rs.]

Sales tax collected Rs. 1430
Cost price to consumer Rs. 15040.3

Table No: - 3

channel	Cost price	Value added	Selling price excluded VAT	VAT @ 13%	Selling price including VAT	VAT payable to government
Imported goods	10000	--	--	1300	--	1300
Importer to wholesaler	10000	1000	11000	1430	12430	130
Wholesaler to retailer	11000	1100	12100	1573	13673	143
Retailer to consumer	12100	1210	13310	1730.3	15040.3	157.3

VAT collected Rs. 1730.3
Cost price to consumer Rs. 15040.3

It can be concluded that:
*Sales tax is imposed upon single stage where as VAT is imposed upon multi stage (production to sales).

* VAT is scientific modern, progressive as compare to sales tax.

*sale tax is imposed on total amount of cost of sales and tax amount of earlier stages is included in the cost of sales. On the other hand, VAT is imposed not on total cost of sales but on the value added in each stage.

*unlike in sales tax under the VAT system the consumer knows the amount of tax contributed by them

2.1.7 Methods of Calculating VAT

There are three alternative methods of calculating VAT: **the credit method, the subtraction method, and the addition method.**

Under the ***credit-invoice method,*** a firm would be required to show VAT separately on all sales invoices. Each sale would be marked up by the amount of the VAT. A sales invoice for a seller is a purchase invoice for a buyer. A firm would calculate the VAT to be remitted to the government by a three-step process. First, the firm would aggregate VAT shown on its sales invoices. Second, the firm would aggregate VAT shown on its purchase invoices. Finally, aggregate VAT on purchase invoices would be subtracted from aggregate VAT shown on sales invoices, and the difference remitted to the government. The credit-invoice method is calculated on a transactions basis.

Under the ***subtraction method,*** the firm calculates its value added by subtracting its cost of taxed inputs from its sales. Next, the firm determines its VAT liability by multiplying its value added by the VAT rate. Most flat tax proposals are modified subtraction method VATs.

Under the ***addition method,*** the firm calculates its value added by adding all payments for untaxed inputs (e.g., wages and profits). Next, the firm multiplies its value added by the VAT rate to calculate VAT to be remitted to the government.

<u>**The credit-invoice method**</u> is used by 28 of 29 OECD nations with VATs. Tax economists differ in their classifications of the Japanese VAT. Both the credit invoice and the subtraction methods have been discussed for the United States. The prevailing view of economists is that the credit-invoice method is superior. This method requires registered firms to maintain detailed records that are cross indexed with supporting documentation. A VAT shown on the sales invoice of one firm is the same as the VAT shown on the purchase order of another firm. Hence, the credit invoice method allows tax auditors to cross check the records of firms. Also, each firm has a vested interest in insuring that the VAT shown on its purchase orders is not understated so the firm can receive full credit against VAT liability for previously paid. Thus, the credit-invoice method would seem to be easier to enforce. Also, the credit-invoice method is probably the only feasible method if there are to be multiple tax rates.

Supporters of the subtraction method maintain that it would have low compliance costs because all necessary data could be obtained from records kept by a firm for other purposes. Still, a firm would have to make calculations based on these data. For example, deductible expenses would have to be separated from nondeductible expenses, and some data expressed on an accrual basis would have to be converted to a cash flow basis.

The credit-invoice method would have substantial compliance costs because the amount of VAT would have to be shown on every sales invoice (and, conversely, on every purchase invoice). On the plus side, however, the credit-invoice method would yield an additional data base to firms. Some firms might find these additional data useful in decision making. For example, records of purchase invoices and sales invoices may improve some firms' control over their inventories. Compliance costs of the credit-invoice method might be partially offset by the value of the VAT data base to firms, but this value has never been quantified.

The credit-invoice method would have greater administrative costs than the subtraction method because of its requirements for additional data, computations, and record-keeping. Although there are data on the administrative costs of a VAT calculated by the credit-invoice method, empirical data are not available on the subtraction method; consequently, a quantitative comparison of costs currently is not feasible. The subtraction method would not work administratively if many goods are exempt or if multiple tax rates are levied. Unless specified otherwise, this report will assume that the credit-invoice method is used and that the VAT is the consumption type.

2.1.8 Time Period

Tax incidence usually is measured by using a one-year period. Data on consumption and income are readily available in one-year increments and the concept of a one-year period is easily understood. But many economists believe tax incidence is more accurately determined by measuring consumption and income over a household’s lifetime. Lifetime income and consumption are affected by the life cycle concept and transitional components of income. According to this life cycle concept, a household makes current consumption decisions based on its expected future flow of income, averaging its consumption over its lifetime. For example, a common life cycle is low income in the household’s early years, high income in the household’s middle years, and low income in the household’s retirement years. A young household may save a small percentage of its income in order to acquire consumer durables. In its middle years, this household may save a high percentage of its income while its income is highest. Finally, during its retirement years, this household may save a small percentage of its income in order to maintain its consumption level. Thus, annual consumption tends to be more stable than annual income over the household’s life cycle. Although many economists prefer the concept of lifetime income, federal data are not collected on a lifetime basis. Consequently, economists have developed lifecycle models in an attempt to measure equity, but the distributional results from these models are subject to widespread debate.

2.1.9 VAT Rate

It is very important to adopt an appropriate policy in setting VAT rate(s). There are two basic issues involved: one is the number of VAT rates, and the other is the level of the respective VAT rates. Some countries have applied a single VAT rate, while others have experimented with multiple rates. While a single VAT rate has been criticized on equity grounds, multiple rates have many disadvantages:

- Multiple rates break down the neutrality of the VAT since resources are diverted from highly taxed to more lightly taxed areas.
- Multiple rates complicate the tax system, since goods need to be classified according to rates (which is not easy to do).
- Taxpayers have to keep separate records of the purchases and sales made at different rates, and tax officials should check them.

- Multiple rates induce lobbying for lower rates for certain goods or services. Multiple rates offer a scope for tax evasion since taxpayers can classify higher rated goods as lower rated ones on sales, and vice-versa for claiming tax credits.
- Some vendors may not apply the proper rates, hence discriminating among competing suppliers.

Because of the disadvantages of multiple rates, there is a worldwide tendency to impose a single rate, and the countries that have previously adopted multiple rates have tried to move toward a more uniform rate structure. Nepal adopted a single rate policy from the very beginning of the preparation for VAT. To this end, attempts were also made to move toward a uniform rate of the sales tax: the number of sales tax rates was reduced gradually and was finally unified in 1996/97 (prior to the introduction of VAT). The reason for the adoption of a single positive rate was to make the VAT system simple for both taxpayers (by making bookkeeping, invoicing, and return requirement easier) and tax administrators. Also, a single rate reduces the scope for tax evasion and hence saves the time tax officers would be spending on checking records for this purpose. Moreover, a single VAT rate does not induce producers and consumers to choose lower-rated goods over higher-rated ones and may even bring about a lowering of the overall rate—which would be desirable from both economic and administrative efficiency points of view. A study carried out to find an appropriate rate of VAT13 recommended a 14 percent rate to make the VAT system revenue neutral and hence to ensure its smooth implementation. However, it is better to start with a higher rate and gradually lower it, once its revenue potential is realized. The authors of this study recommended that a 15 percent rate would be a good choice, a rate that would prevent any revenue loss. The authors state that "there always exist a number of revenue risks that accompany the introduction of a new tax system. The tax administration in Nepal is not as experienced or trained, as it would be desirable. Hence, some slippage in tax compliance may arise during the first year of the VAT implementation. Therefore, it would have been prudent to introduce the tax with a higher rate of 15 percent to reduce the risk of revenue shortfall."14 This rate would have actually put an easier burden on the taxpayers than the 15 percent sales tax rate since the taxpayers receive full input tax credit under the VAT. However, in July 1997, through the Finance Act of 1998, the government decided to reduce the sales tax rate from 15 percent to 10 percent. However, the rate of sales tax for the imports by non-registered importers was fixed at 20 percent. These rates remained unchanged under the VAT as well until July 10, 1998, when a single rate of VAT (of 10 percent) was adopted.

2.1.10 Exemptions

Theoretically, VAT can be levied on all goods and services. However, in practice some goods and services are exempt for three main reasons: administrative (some goods and services, like financial institutions, are too hard to tax); political, social, and philanthropic (some relief is given to charities and to medical and educational goods and services; and excess credit (some goods and services are exempt to minimize the excess credit and refund problem). The design of the Nepalese VAT system has taken into account all these reasons (as well as several others) in devising the exemption list. Some of these reasons are summarized below.

(a) Administrative: Unprocessed food is exempt, although food (including green vegetables and fresh fruit) served in restaurants, hotels, cafes, and similar establishments is, by definition, considered processed. Also exempt are fresh vegetables, fresh fruits, and financial and insurance services.

(b) Political, social, philanthropic, and merit goods: Because of their perceived beneficial effects,15 the government wishes to encourage the consumption of merit goods like school books, daily newspapers, and public transportation. Since it is difficult to identify schoolbooks, it was decided to exempt all sorts of books, magazine, and newspapers. Medical and educational services are also exempted.

However, these sectors constitute a large part of the modern formal economy and hence are easier to tax than much of the informal sector; so instead of zero rating them, they are exempted, which permits the collection of some tax on their inputs. The taxation of transportation services was also debated; at first VAT was levied on both the transportation of goods and the long-distance transport of passengers, but in the light of mounting opposition both were later exempted. The tax on electricity was seriously considered, but since the government had increased the electricity rates significantly around the time when the VAT system was being designed, electricity was exempted from VAT, at least in the immediate future.

(c) Excess credits: Exempting certain imports/purchases of inputs and closely monitoring them is preferable to a refund or duty draw-back system, which aids in collusion between taxpayers and tax officials. So some goods are exempted to avoid the problem of excess credit. For example, raw wool is the main input for carpets Nepal's major export. Many small producers are involved at different stages (including import, carding, dying, weaving, washing, and export) in the production of carpets. Furthermore the domestic consumption of carpets and handicrafts is very small. Exemptions, however, are not desirable for several reasons, some of which are outlined below:

- Resources are diverted from taxed to exempted areas, resulting in economic inefficiency.
- The need to classify exempted goods results in administrative complexity and undue pressure from influential groups to exempt their goods.
- The burden on both taxpayers and tax administrators is increased, since the former has to keep separate records of taxed and exempted commodities and the latter has to check them.

- Exemptions create loopholes for tax evasion since taxed goods may be classified as exempted ones.
- Cross-checking of invoices used to claim input tax credit becomes less feasible.
- Exemptions reduce the tax base, and hence result in higher rates levied on taxed goods.
-

Because of these reasons, a policy was originally adopted to keep exemptions to a minimum.
However, over time, due to pressure from various influential groups, the exemption list was expanded.

2.2 Zero Rating versus Exemption

If the objective is to completely relieve certain commodities/transactions/persons from taxation, a zero-rating policy may be adopted. Such a policy, however, is more complicated than an exemption-based one. Under the zero-rating system, vendors have to register, keep records, and file returns, while VAT officials not only have to check these returns and records but also be more careful in order “to prevent fraudulent request for refunds.”16 John Due explains that a zero-rating system “will also require registration even of firms handling only zero-rated sales. It is, therefore, desirable to keep the scope of zero-rating very limited, preferable only to exports. VAT would not apply to the exports concerned but exports would receive input tax credit, meaning that exports would be free from tax. If it is difficult to administer VAT on certain goods, persons, or transactions it is better to provide exemption and collect some revenue from inputs. Exemption is clearly preferable when for various reasons it is desirable to tax the sale of the commodity, but the purchasing firms cannot effectively be taxed on their sales (small firms, for example).” In Nepal, exports are zero-rated in order to maintain the competitiveness of Nepalese products on international markets. The VAT will encourage exporters to come under the official trade regime due to the refund mechanism. Under the sales tax system any sales made in convertible foreign currency, even in the local market, were deemed to be exports and hence were exempted from the VAT. However, the tourist spending in convertible foreign currency on hotel accommodation, restaurant meals, and tours was taxed. Under the VAT, all these sales on consumption in Nepal are taxed. The goods purchased by tourists are, of course, often not consumed in Nepal and are also not zero-rated. To make the tax system simple, the use of the zero-rating policy has been limited. In general, an exemption-based policy is less demanding than a zero-rating one, but sometimes it faces administrative problems because of the need to apportion the input tax credits for both taxpayers and tax collectors. Consequently, attempts were made to keep both exemptions and zero-rating policies at a minimum.

2.2.1 Treatment of Special Sectors, Organizations and Transactions Agriculture

It is difficult to levy VAT on agriculture due to both administrative and political reasons. That is why in many countries agriculture is given special treatment under a VAT system. Some countries directly exempt the agricultural sector or zero-rate agricultural products, while others allow deemed credits when agricultural products are processed. Nepal has exempted the agricultural sector's sales, which is perhaps easiest to implement administratively.

2.2.1.1 Financial and Insurance Services

A VAT on financial and insurance services is justified on both efficiency and equity grounds. As Tait says, "the financial sector in most counties is considered able to bear a tax, and where most services are taxed to exclude financial services seems both unfair and distortionary." However, it is difficult to define value added for these services and hence to tax them. The reason is that "for financial services and insurance (in particular life insurance), it is argued that the price at which those services are sold (i.e., usually in the form of the interest and premiums, respectively) is not necessarily a true reflection of the value of services being provided by the financier or insurer." For example, "interest includes elements which reflect the risk of the loan, the real cost of capital, the inflation rate, and a charge for the service rendered. In principle, only the last should be taxed, but in practice it is impossible to separate out this taxable component of interest from the rest. Because of this problem, no country subjects the full range of financial services to a VAT." An OECD report states that "the insurance premium is made up of a transfer to a fund, which is then invested, on the saver's behalf, and a payment for the services involved in running that fund. It is felt by most countries that it is not possible to arbitrarily differentiate the premium into two payments, the contribution to be untaxed but the payment for the services to be taxed. The difficulty of doing so is compounded with life insurance, where there are in addition all the problems of financial services as well as those relating to insurance. Hence all countries exempt life insurance premiums from VAT." So the price paid for these services 32 cannot be used as the basis for VAT under a tax credit method, which obtains the net tax liability by imposing a tax on the sale price and by subtracting the taxes on inputs. Under these circumstances, the addition method seems to be a better alternative. It results, however, in a number of problems like the requirement of calculating profits, multiple taxation, and the
difficulty of making accurate border tax adjustments. Thus, since it is difficult to bring financial and insurance services under the VAT net, they are generally exempted. As is the case for all less-developed countries, trying to impose a VAT on financial and insurance services in Nepal at this time is highly unpractical. Hence, this sector has been exempted from the VAT, which means that it will pay taxes on its inputs but not on its output.

2.2.1.2 Immovable Property

Rentals, leases, and sales of land and buildings attract special attention under a VAT system for several reasons. VAT is a tax on consumption; since land is not consumed, it should be kept out of the VAT net. Buildings, however, can be treated as consumer-durable (just like automobiles), which are subject to tax. Furthermore, unlike other goods and services, land and buildings are not frequently sold, and their transfer is commonly subject to separate taxes like registration fees, stamp duties, etc. Thus buildings and land rentals, leases, and sales are commonly exempted from VAT, although the construction of buildings is taxed. Sales of buildings almost never occur in rural Nepal—where almost 90 percent of the population lives. Each family has a separate house and, if it is needed, a new house is constructed rather than bought. Moreover, due to social and geographical factors in Nepal, this situation is likely to continue for several years. The selling of buildings is not common in urban areas either because of the very high land transfer tax. So a VAT levied on the sale of buildings does not seem promising in Nepal. Thus the sale, lease, and rental of both land and buildings are exempted under the VAT. Accommodation in hotels and similar sectors are brought under the VAT, however, and so are the materials used for construction and repairs.

2.2.1.3 Government, Government Enterprises, and Local Authorities

In some countries goods and services such as transport, warehousing telecommunications, drinking water, radio, television, etc. are supplied by both the public and the private sectors. In such cases, for neutrality reasons, it is desirable to treat the supplies of governmental (and related) organizations on an equal footing with those of the private sector. Local bodies may provide services like electricity, water, sanitation, drainage, as well as (admission to and use of) public utilities like car parking areas, public halls, swimming pools, stadiums, public transportation, educational facilities, and national parks. Their purchases and supplies are taxable since "the economic value of the particular activity does not depend on whether the supplier happens to be a private firm, a statutory board or a government department. Basing the tax on the nature of the activity rather than the identity of the supplier ensures a level playing field. Purchasers of government supplied goods should be neither advantaged nor disadvantaged by their choice of a government agency as the supplier." If governmental goods and services, which compete with their private sector counterparts, are exempted, they become artificially cheaper, leading to considerable distortions in the competitive process. When they compete with private firms, the government, governmental enterprises, and local bodies in Nepal are treated as suppliers of goods and services in order to avoid distortions. In such cases, they are subject to the same VAT requirements faced by other taxable traders.

2.2.1.4 Charitable and Nonprofit Organizations

Since nonprofit organizations are involved taxable activities, there is no economic basis for excluding them from the tax base. If their supplies are automatically exempt from

VAT, the result may be tax-induced changes in business activities, which would defeat neutrality. So if
their supplies compete with commercial ones, because of both equity and efficiency reasons, it is necessary to tax them. Because of social reasons, a strong lobby formed to promote the exemption of charities from the VAT. Nevertheless, since it is not easy to distinguish between the pure charity work of nonprofit organizations and their business activities, it was decided not to exempt automatically their supplies from the VAT.

2.2.1.5 Small Vendors

Due to their large number, small vendors are difficult to monitor. Hence, their inclusion in the tax net would imply high compliance and administrative costs, without much revenue gain in return. For these reasons, as well as for political ones, small vendors are generally excluded from the VAT net. Small vendors are defined as such on the basis of criteria such as turnover, value added, capital investment, number of employees, and number of business establishments. Of these criteria, turnover is the one most commonly used worldwide. Generally, the procedure is to fix a minimum level of turnover, known as the registration threshold, and grant to the vendors having an annual turnover below this threshold the option to register. Since value added may differ in different lines of business (even in those with similar sales threshold levels), low-income countries may set distinct thresholds for different types of taxpayers. A threshold encourages vendors to artificially suppress their level of turnover just below the threshold, or to split up their businesses in order to remain outside of the VAT net. To discourage business splitting, the threshold may be applied to all the units of a vendor rather than to each unit separately. Alternatively, vendors having more than one firm should be considered large vendors irrespective of their turnover. There is a rich world experience regarding the treatment of small vendors. Some of the special schemes designed include: allowing small vendors not to register, or subjecting them to simplified VAT requirements like simplified invoices; longer accounting, return, and payment periods; cash-basis accounting; lump sum annual taxes; surcharges; lower rate(s) on sales, higher rate(s) on purchases; deemed input tax credit; and separate low-rated turnover taxes. Special treatment, however, eliminates the neutrality of VAT. Small vendors in Nepal are often illiterate, and do not maintain proper records. They are kept out of the tax net through the provision of a registration threshold. To keep the system simple, it was decided to have a single threshold (at Rs 3 million) and, if need be, to fine-tune it later, after some experience with this system had been gained. Also to keep the system simple, Nepal adopted no special scheme for small vendors either. However, in order to encourage small vendors to come under the VAT net, those who registered voluntarily were granted a lengthened return period of four months (as opposed to one month, which was the norm) .

2.2.1.6 Administrative Procedures Registration

Any person or organization involved in taxable activities is required to register. There is no provision for group or divisional registration; for instance, companies within a group are required to register separately for VAT purposes. VAT registered companies are required to levy VAT on inter-company transactions and fulfil all VAT requirements, which leads to an increase in both compliance and administrative costs, as well as to the possibility of tax cascading Under a group registration system, related companies would be allowed to register as a single entity, and intra-group transactions would be disregarded for VAT purposes. This would reduce both the compliance and the administrative costs of VAT (by reducing the number of registrants), would eliminate the incentive to restructure, and would avoid the cascading effects of irrecoverable VAT when one group member sells exempted goods or services to another group member. For all these reasons, group registration should be also considered in the future.

2.2.1.7 Invoices and Bookkeeping

VAT is an invoice-driven tax and hence, for its effective implementation, the recording of the purchases and sales on each invoice is required. But in Nepal, the practice of issuing invoices and/or maintaining purchase and sales records has been very limited, at least for tax purposes. This fact was carefully considered when the invoicing and bookkeeping requirements of the Nepalese VAT system were being designed. For VAT purposes, taxpayers are required to issue invoices of their sales and keep records of both purchases and sales. The original idea was to ask taxpayers to provide specified sale and purchase information and not to issue invoices and maintain records in a specified manner. As such, the description of invoices, and purchases and sales books were included in the VAT regulations simply as an example. However, since according to the Ministry of Law and Justice anything included in the regulations is mandatory, taxpayers are now required to maintain purchase and sales books as specified in the regulations. However, with the prior approval of the VAT Department, taxpayers can issue invoices or maintain records differently. Additionally, for small sales, taxpayers can use an abbreviated invoice on which it is not necessary to provide details about the buyer and to indicate VAT separately. However, due to revenue control reasons, the buyer is not be able to claim input tax credit on the basis of the abbreviated invoice. Hence, registered vendors may demand full invoices instead.

2.2.1.8 Return

Taxpayers are required to submit returns for each accounting period, which can be two weeks, or one, two, three, or six months long, depending upon the revenue requirement, administrative capability, need for refund, and so on. While shorter return periods pressure taxpayers into paying their taxes on time, longer ones reduce both compliance and administrative costs and avoid the problems related to credit sales and taxpayer resistance. However, particularly for small vendors, shorter periods are preferable because the longer the tax period, the higher the chance that the tax money will be used in consumption and hence that taxpayers will become bad taxpayers. Additionally, longer tax periods both increase the amount of tax collected and due (hence the incentive/greed not to pay the tax) and cause cash flow problems for the government. So, in deciding between longer and shorter return periods, the government faces a trade-off between administrative and compliance cost issues on one hand and timely money collections on the other. In the case of exporters, the accounting period needs to be even shorter to avoid a cash flow problem; since taxes are not collected on exports, financing the refunds for the input tax credits claimed is difficult. Because of revenue reasons, and under the influence of the monthly sales tax return system, Nepal adopted a monthly return system. However, to both encourage registration and reduce compliance and administrative costs for the taxpayers that register voluntarily, the return period is a trimester (in this way taxpayers can hold tax money for a maximum period of five months). Generally, registrants are required to file a consolidated VAT return that accounts for all their commercial activities. However, some countries allow corporations and some organizations with distinct (and separate) divisions to apply for the permission to file separate returns for their branches or divisions. Permission to do this is generally granted when the divisions/branches have separate accounting systems and are identifiable by activity or location. Under the Nepalese VAT system, however, there is no such provision; the head office is required to file a single return with the sales and purchases made by all its branches. Under VAT, the case for having an annual return is weak. VAT is a transaction-based tax reported and paid in the reporting period when the transaction occurred. A few countries have, nevertheless, made provisions for an annual return. The reason for this is that if there are mistakes in the monthly returns, tax officials can correct them in the annual one. However, if a mistake in a monthly return is not corrected on time, it is unlikely that it will be corrected in an annual return. Moreover, a system of both annual and monthly returns is time consuming and costly for the administration and businesses alike. In fact, the annual return is usually just a way in which governments make arbitrary assessments in an attempt to raise additional revenue at the end of the fiscal year. Since the idea was to make the tax system simple and to get rid of as many tax formalities as possible, there has been no provision for an annual return in Nepal. Instead, the tax administration is to monitor non-filers and non-timely taxpayers, and to create a computerized assessment for each non-filer during each accounting period when the return is not received.

2.2.1.9 Payment

Taxes can be paid in banks, in tax offices, or both. However, payments made in tax offices run the risk of not being properly recorded, while those made in banks are safer, because the banks have developed systems to maintain proper records. In Nepal, the taxes have to be paid in banks; there are banks in all the places where VAT offices are located and they accept both cash and checks. Another question that arises is whether the payment voucher should accompany the return. If this is the case, then taxpayers are pressured into paying their taxes on time, because otherwise they would suffer double penalties: both for not having submitted the return and for not having paid the tax.

However, this system is not fault-free either. If returns are accepted only if accompanied by the proof of payment, then the taxpayers that (for one reason or another) cannot pay their taxes will be unable to submit their returns either, thus depriving the tax administration of valuable information on their taxable activities. It should be noted here that the return is merely the declaration of a liability and not its actual payment. Hence the two should be treated as separate events so as not to discourage taxpayers from disclosing their liabilities (though, of course, tax officials could encourage the submission of returns accompanied by payments). In this way, if the taxpayers do not pay their taxes, they will be subject to the penalties (including interest) for nonpayment, but not to those for nonfiling. This would even ease the work of tax officials, since they could follow up and take further actions. On the other hand, this might induce taxpayers to submit their returns without paying the taxes due and thus escape the penalty for non-filing and diminish their overall burden for nonpayment. However, the interest and penalties for nonpayment are high in Nepal, and the tax administration is expected to take prompt action in such cases. As a consequence, in Nepal it was decided not to tie the submitting of returns to the actual payment of taxes.

2.2.2 Refund

The credibility and success of the VAT system depend upon the adequate functioning of a refund of excess input credits system. Hence, such a system needs to be carefully designed and properly implemented. In designing the refund system in Nepal, factors like export promotion, administrative feasibility, and revenue were all carefully considered. The resulting conclusions— about when refunds should arise under the Nepalese VAT— are summarized below:

- A person who exports more than 50 percent of his total sales during any month is entitled to claim refunds.
- A person who has an excess of tax credits during a period of six consecutive months is also entitled to claim refunds.
- Accredited diplomats, foreign agencies, and foreign-funded projects are also entitled to refunds of the VAT paid on their purchases.

A tourist refund scheme was also discussed and developed, but ultimately it was not adopted. Tourism is a large part of the economy in terms of generating employment. Trekkers spend on average about $8 per day (probably on lodging and consumables) for a period of, on average, twelve days. A tourist VAT refund system might result in numerous claims, but the total amount may not be large, leading to high administrative costs and exhausting the department’s limited human resources. We should also bear in mind that a 10 percent VAT would not make much of a difference to rich tourists. Handicrafts, one of the major tourist exports, are exempted from VAT and so are their inputs. Since the handicrafts are usually bought from small retailers who are not registered (being below the threshold) the amount of VAT to be refunded may be very small. Handling a tourist refund scheme is difficult in itself, but the cross-border trade with India and the foreign exchange control system further complicate things. Furthermore, tourist refunds could easily lead to a revenue loss and an open loophole for fraud. Consequently, some countries (like Singapore) fix a minimum refund limit, while others (like Cyprus, Fiji, and Thailand) do not have a tourist refund system at all—though the tourism sectors in these countries continuously lobby for one.

2.2.2.1Appeal System

Under a modern tax system like VAT, an efficient appeal system must also be established. Since the Revenue Tribunal in Nepal, which had been set up to handle tax-related cases, had not been functioning efficiently and since it was not easy to streamline it immediately, setting up a revenue consideration board was considered. This board must announce its decision within one year after the date of application (in which case the taxpayers would have to submit the specified), or the decision would be considered to be in favor of the taxpayers. This proposal was ultimately dropped in the parliament; nevertheless, it should probably be included in future amendments to the law in Nepal, and is recommended for implementation in any developing country implementing a VAT.

2.3 VAT Development

The idea of introducing a VAT in Nepal was recommended by the Task Force on Economic Policy Reform appointed by the government in 1991.[26] The Eighth Plan document prepared in 1992 also emphasized adopting a VAT (in the place of several minor commodity taxes) in order to establish a sustainable source of government revenue. VAT has also been recommended in one form or the other in most budget speeches since 1992/93. The entire process began in September 1993 when a VAT task force was called upon to make the necessary preparations for the introduction of VAT. A VAT steering committee was also set up to evaluate and monitor the VAT preparatory activities. The VAT law was drafted in 1994, after having been discussed in depth at several stages with the VAT task force, the Secretary of the Law Reform Commission, and various business groups. The draft was then reviewed by the VAT Steering Committee and sent to various business groups—including the Federation of Nepal Chamber of Commerce and Industry (FNCCI)— for comments. On December 3, 1995, the VAT bill was presented to the parliament. It was referred to the Finance Committee, which discussed it on December 24, 25, and 26, 1995. On December 27, 1995, the Finance Committee sent the VAT bill back to the parliament, together with its report for the amendment of a few provisions. The Lower House of Parliament passed the VAT bill on December 30, 1995, and the Upper House of the Parliament passed it on January 4, 1996. Finally, the VAT bill got the royal seal on March 20, 1996. The VAT regulations were drafted in July 1996. Like the VAT bill, the regulations were discussed at different stages and were finally passed by the Cabinet on January 27, 1997. The operational manual was initially drafted in 1996 and was finalized in the fall of 1997. The Government of Nepal approved it on September 21, 1997. The manual facilitates daily administration and reduces the risk of different interpretations of tax laws by different officials. A number of computer user manuals have been produced as well.

Taxpayers Education Program

Before the tax was introduced, a comprehensive VAT educational program was launched, which intensified in 1996 and 1997. The initial focus of these programs was explaining to the business community the rationale and the working of VAT, and getting input from them for the refinement of the draft VAT law. At later stages, the educational programs were extended to other categories of the population, including consumers and parliamentarians. The main activities carried out in this respect included the following:

Interaction Programs
Seminars and public speeches were organized in different places for various groups. For example, the members of VAT interaction groups came from the FNCCI, and several district chambers of commerce and industry, commodity associations, and professional organizations. Similarly, VAT presentations were made during programs arranged by different bodies and organizations, including training centers, universities, campus organizations, schools, rotary clubs, professional bodies, UN organizations, members of parliaments, diplomats, journalists, and so on.

Brochures, Articles, Posters, and Video Films
Several brochures in both English and Nepali were also prepared and distributed on a large scale. Complementing these brochures, many national newspapers published articles on various aspects of VAT. Different posters, three VAT video films, and many television and radio programs were also prepared. Information was disseminated through the media on a large scale. In 1997 a local advertising company was hired to carry out information campaigns through media as diverse as television, radio, newspapers, posters, brochures, etc. Basic information like the date of the introduction of VAT, the period within which taxpayers must register, the deadline for submitting returns and tax payment, the description of the VAT accounting system, and the penal provisions, were widely advertised through the media.

Visits/Telephone Calls

An extended VAT information service was also provided to both business callers and the general public. Attempts were also made to educate taxpayers through visits made by tax officers.

2.4. Methods of Calculating VAT

There are three methods in which VAT is calculated.

A. Addition Method

B. Subtraction Method
C. Tax credit Method

a. Addition Method: In this method, the tax base is obtained by adding the incomes produced by the firm. In other words, the tax base is computed by adding the payments made by the firms to the factors of production employed in turning out the product, such as wages, interest, rent, royalties and profits. This method is therefore, very close to income type of VAT.

b. Subtraction Method: When cost of production like raw materials, auxiliary raw materials, chemicals, powder etc, are deducted from total sales to find out the added value of production, the method is called subtraction method. This method is appropriate for the consumption variant.

c. Tax Credit Method: This method is also known as the invoice method. Under this method tax is levied on the total value of sales and tax payer are permitted to deduct from their gross tax liability the already paid by their suppliers and passed on them i.e. whatever tax in purchase credited from tax on sales.

There is some apparent resemblance between subtraction and invoice method the only one difference is that the later requires invoice while the former does not. Both methods do provide the same through out the production and distribution process. Since value added (VA) is sale value minus cost of purchased inputs (CPI) a given tax rate, , say (t) would give same result in either system as shown below :

Subtraction method : T=t.(SV-CPI) or T= t .SV- t. CPI
Tax credit method : T=t. SV-CPI

A simple example of the calculation of VAT liability under different methods is given in the following table.

Table No: - 4
Three different methods of calculating the VAT Liability

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Addition method:

S .N	particulars	Level of transaction			total
		manufacturer	wholesaler	Retailer	
a	Wages	1500	200	300	2000
b	Rent	500	400	100	1000
c	Interest	200	100	200	500
d	Freight	300	100	100	500

e	Local taxes ,fee & charters etc.	200	100	200	500
f	Profit	800	600	600	2000
G	Value added (a+b+c+d+e+f)	3500	1500	1500	6500
h	VAT liability@13%of value added	455	195	195	845

Table No.5

Subtraction Method:

a	Sales	10000	12560	15000	15000
B	Purchase	8000	10000	12560	8000
C	Value added	2000	2560	2440	7000
d	VAT Liability @ 13 % of value added	260	333	317	910

Table No:-6

<u>Tax credit method:</u>

a	Sales	1500	18000	20000	20000
B	Tax collected on sales (output tax)	1500	1800	2000	2000
c	Purchase price	10000	15000	18000	10000
D	Tax on purchase (input tax)	1000	1500	1800	1000
e	Net VAT liability (b-d)	500	300	200	1000

2.5 Origin principle and Destination Principle

There are two principles in the case of international trade under the VAT system. . One is taxing all domestically product goods and services including exported goods and exempting imported goods and second is taxing all imported goods and exempting all exported goods.

2.5.1 Origin principle

By the term itself it is clear that under this principle goods and services produced in country are taxed at the place where, they are produced or rendered, irrespective of whether they are consumed or not. It implies that all exports are taxable and imports are non-taxable.

2.5.2 Destination Principle

The most popular form of principle adopted by a large number of countries is destinations principle. Under this principle, goods or services are taxed not at the place where they are produced or rendered but the place where they are consumed. Alternatively, all imports are taxed while all kinds of exports are tax exempt.

Under the destination principle, VAT system is very easy and simple because the VAT is fully imposed upon the value for the custom purpose in imports . Similarly, export is fully freed from VAT. The main benefit of this is nondiscrimination between imports and internal production. On the other hand, origin principle gives preferences to imported goods and services over domestic production. Countries with international boundaries prefer not to have this principle while taxing. But in European community (EC), where there is common border this principle of taxation is gaining importance.

2.6 VAT and Some Key Issues

2.6.1 VAT and Small Traders

The issue of the small traders is one of most prominent issues of the applicability of a VAT in Nepal. Small traders dominate the trading activity of the country, which includes most of the retailers, butcher, fruit and vegetable sellers, grocers, hairdresser, street hawkers, etc. they are scattered throughout the country including rural and remotes areas, it has made it difficult to bring them into tax net and govern administratively.

The trading activities of our country are dominated by small traders. So, the treatment of them should be taken seriously. The inclusion of small traders under the circle of VAT provides some advantages, which are as follows:

a) It helps widening the tax base and increasing revenue yield.
b) Tax evasion is difficult because of cross-checking.
c) It helps to achieve the theoretical as well as practical advantages of the tax.
d) It helps to derive large amount of revenue at low rate.

In spite of advantages, the inclusion of all small traders into coverage of VAT arouses many problems for both tax administration and small traders. The problems of tax administration are how to handle the small traders as tax payers with minimum cost and adequate efficiency. The problem of small traders as tax payers is how to comply with the VAT with no additional burden and bad effects on them. So the effectiveness or success of VAT depends on how far the small taxpayers are handled with relative case.

The root cause of the problem of small traders is that of recording basic perquisite for a VAT. Small traders make transaction with no systematic written or arranged records. G oods and services are freely sold and purchased with no invoice issued and entry in set of books. The small traders keeping no records are the outcome of many factors; first, small traders have the traditional type of business with no practice of records keeping system. Third, their scale of operation is usually so small that there is no need of record keeping. Fourth, an important factor that small traders are self employed in making purchase and sales and there is no need for issuing invoices and keeping records of their purchase and sales.

Problems arise equally in the administrative front also. Inclusion of small traders into tax bracket of VAT would result in an –at-once and considerable increase in the number of tax payers. The number of tax payers may alone be a headache for the administration. Further more registration, accepting returns and their verification, tax payer's services, control of evasion, inspection, auditing etc. pose many problems for efficient administration of the entire tax system. Even if the administration is an efficient administration is an efficient one, the control of such a large number of tax payers, which are fairly dispersed throughout the country in small markets, town even in villages; seasonal markets, weekly markets village shops and markets in remote areas are a formidable tax for the administration. So, small traders having a turnover up to the level of threshold may be exempted from VAT.

2.6.2 VAT and price

Perhaps, the most important issue of implementing VAT in Nepal, like any other country is its impact on prices. What would be the effect of VAT on prices? Will there be a sharp increase? Will it invite inflation? Such question often raised from every corner remains generally unanswered. Many uncertainties and ambiguities exit in this regard, and any statement or forecast made about it may not match with the reality.

Each country has different condition and effect of VAT on prices must be seen in the context of each country. An attempt has been made to asses the effect of a VAT on prices in Nepal. Various possible cases of the increase and decrease in prices are examined first and conclusion is made thereafter. Let us first consider the various cases facilitating price increase.

a. Revenue Effect:

The generation of revenue through VAT has a certain and direct impact on prices. If the VAT rate is designed in such a way that the revenue yield is substantially larger than before VAT it would cause a big increase in the prices taxed goods. If the VAT rate is designed that raises equal amounts of revenue as the taxes it replaces, there would be no general upward shift of the prices of taxed goods. Alternatively, an equal yield of VAT would change only the relative prices of some goods would increase while prices of other goods would decrease.

VAT in Nepal not additional tax. It replaces the existing sales tax, hotel tax and entertainment tax and contract tax. There seem to be no plan for generating a substantially larger amount of revenue through VAT it would be an equal yield or slightly larger yield reform. It is also worthwhile to note that some goods, which were exempted before but included into the coverage of VAT, would have their prices increased at least by the rate of VAT.

b. Compliance cost:

One possibility of price increase after the adaptation of VAT is the tax compliance cost of newly registered business. The registered business incur some amount of cost in with VAT like issuing invoice , keeping records, filing return, going to the tax office etc. they may regard the compliance cost as their input cost and add in to the prices of their sales by increasing their existing margins.

Nevertheless, the possibility of price increase due to the VAT compliance cost is rather weak, perhaps not possible. Because of competitive market condition there may be no unanimity among the businessman as to shift the tax compliance cost to the price of the sales. Even if there may be any unanimity among the trader, such as among wholesaler, to shift the VAT compliance cost to the price of goods, the increase in price due to the shifting would be a negligible.

c. Announcement effect:

Introduction of VAT alone may be a cause of price increase since the announcement of a new tax would have a “psychological” effect on general traders and customers. Introduction of VAT creates a sort of uncertainty about its effect on compliance cost, price etc. Traders may use it as an opportunity to increase the price and widen the margins of their sales. It may be well being seen in Nepal that changes in government, elections etc .can become excuses for the prices hike. VAT may be a great excuse for a price hike.

Nepalese market is underdeveloped and prices are largely determined by supply conditions but not by demand and supply. It may be a good “opportunity” and excuse for the back marketers to increase the price, the public may more readily accept the increase, and it will be blamed to VAT. It is also possible that the announcement of VAT would be used to increase the price of non-taxed essential goods like foodstuffs. Such a tendency exists and very less seen in Nepal.

There are some other causes, which help to a decline in the prices after the adopting of VAT. These are:

a) The cascading and pyramiding effect of the tax does not occur under VAT. The manufacturer would be able to credit the tax on their inputs to the tax on their sales. It reduces the tax burden in their sales, and they would be able to sale their products with relatively lower price than before. This pyramiding effect of the sales tax would not occur under VAT, which reduces the price of goods and services

b) After adaptation of VAT, the trade margin on various goods would be more or less. If any seller is selling at higher price, his record s of invoice shows that he is earning a large amount of profit leaking to a considerable increase in his income tax liability. A high price charged creates a doubt on them. So no trader would like to take a risk of raising income tax liability. Rather, it is very much possible that the VAT would bring a tendency of lowering price.

c) VAT does not cover most of the essential goods and services whose demand is inelastic. Instead, VAT covers common or luxury type of goods and services whose demand is elastic. It has important implication that of the price of the goods, which are taxed, increases s the sales of these goods and services would be lowered because of the decrease in demand compelling traders to reduce the price

d) Price under the VAT would tend to be somewhat rigid because of the profit margins of different traders that would be known to the tax authorities and the trader margin would be more or less fixed. There would not be any frequent fluctuation in the price as at present.

d. VAT and Economic Growth:

VAT will broaden the base of tax both legally and administratively. Broadening the tax base will be possible to reduce the rate of other taxes, income tax and import duties, thereby making the tax system economically more efficient. VAT will improve the efficiency and competitiveness of domestic products in the international market by relieving exports from internal commodity taxes. Furthermore, as VAT will be levied only on value added, inputs will relieved from taxation, meaning that double taxation will be eliminated under VAT. VAT will improve the competitiveness of the domestic product in other ways as well. It is also noteworthy that existing sales tax system discriminates against domestic products. The effect of some of the current sales tax administration policies is to administer more control over domestic goods than over imports. The VAT makes the control equal for domestically produced and imported goods.

e. VAT and Regressivity:

Every indirect tax has regression according to its nature when it's applied with unitary rate. Definitely, VAT is an indirect tax whose burden falls upon only the final customer. However, VAT is known as the reformed form of the sales tax but in many respects it is defined as a regressive one in which large proportion of tax burden falls in poor than rich. Regressively of tax is the according to the burden in nature. Every tax is regressive, if the poor pay a more proportionate share of income to tax than a rich one.

Among the three types of VAT, consumption type is most appropriate and practical, and it is used worldwide. Proportionate share of consumption expenditure rises when income falls. In this sense, the rate of differentiation should become the sophisticated tool reducing for the regressive nature of VAT. By this technique, providing exemption of zero-rating on food stuff and other necessities under merit "goods and services" and higher rate to luxury goods and services such as hotels, restaurant, telephones, financial services etc. which are basically demand by the richest ones of the population.

While comparing the other alternatives of VAT, it is considered as the instruments of reducing absurdities than other kind of indirect taxes on the ground of generating revenue by broad coverage, neutrality and resources allocation, buoyancy, cross audit check, regulation of demand etc. It should be taken also as a superior alternative to make progressive ways by reducing the disparities of income distribution by adopting rate, differentiation and exemption techniques. In terms of alternatives, VAT would be better off to maintain its progressiveness to replace the cascade type and discriminatory tax.

All the instruments of reducing regresses of VAT, such as experiment, zero rating and rate differentiation are inefficient tools in practice. In conclusions regressively of VAT may not be eliminated but it can be lowered, if proper use of exemptions as well as dual rate structure is applied.

f. Tax and forms of VAT:

Sales tax has been as the most established tax and regarded as consumption related tax. Sales tax has greater revenue potentiality (power) due to its broad base coverage and the most of the underdeveloped countries have survived by the sales tax and other kinds of its developed forms. Sales tax is directly imposed upon production and distribution process and collected by the seller. In Nepal sales tax was levied on telephone and related services in 1996/1997, non life insurance premium in 1992/1993, advertisements given in newspaper, TV, radio, cinema halls, color labs, auto services and courier services in 1996/1997.VAT is a member of sales tax here having been compared VAT with other forms of sales tax i.e. multi stage sales tax (MST), wholesale stage sale tax (WST), and retail stage sale tax (RST).

i. VAT Vs MST and WST

The VAT can have a broader base than the MST and the WST. This is because VAT is broadly applied, in comparison to the limited scope of MST/WST that imposes tax on the import value / manufacturer's sales price and wholesale margin of a limited number of venders, to the wholesale and retail levels. Further, VAT brings more goods and services under its net than MST &WST or alternatively a lower rate can be applied to achieve the same amount of revenue. Experience of other counties also has proved this fact.

VAT is more neutral than the MST and WST. VAT puts an equal burden on both imported and domestics products since the burden of this tax depends upon the final price. VAT improves the efficiency and competitiveness of domestic products in the international market by relieving exports from tax burden.

The WST is inefficient as well As this, tax is levied on the dealers margin of only few goods, other items subject to tax only the manufacturer's price are artificially cheaper one to the point at which the is levied.

As VAT would be levied only on value added, inputs would be relived from taxing further, since VAT relieves investment from any tax burned, it is neutral regarding the investment decisions. Since, the tax liability on a given commodity depends on the total value added regardless of the number stages through which it passes. The tax does not encourage manufactures transfer some of their functions to the wholesale dealers or create artificial sales deport to escape taxation, as does MST.

However, VAT, as MST and WST, is vertically inequitable. The inclusion on new items, including necessaries, makes VAT more inequitable than MST and WST. The imposition of VAT on goods and services are largely consumed by the higher groups, which had got higher opposite effect. Further, a special tax (excise) on luxury and socially less desirable items helps mitigate the regressivity of VAT of to some extent.

On the ground of revenue potentiality, VAT provides more revenue than WST. But as compared to MST, wholesaling enterprise lies somehow greater than MST compared to VAT, for the administrative formalities like calculating tax base, cross checking and auditing, refund procedure etc. are less under the WST system. Furthermore, WST is easy to handle since it needs only to watch in sales point of wholesales. On the basis of these reason, WST is argued to be superior theoretically.

Despite these merits of WST, the contradictory and evil effects of WST and MST scan not are ignored in practice, which puts the demerits of VAT in shadow.

The government has been collecting sales tax at the manufacturing points since 1974/75. This tax was collected as MST. Sales tax was extended into the wholesale level for a few domestic products in 1992/93. In 1993/93, the scope of the wholesale level sale level tax was further extended to wholesalers of some more domestic products and to sole distributors or agents of foreign firm or companies and their wholesales. This tax was called WST. Nepal government decided to replace MST & WST by introducing VAT since 1997 hoping that VAT has the capacity of collecting more revenue without cascading and pyramiding (cascading denotes tax on tax in chain of production and distribution and pyramiding implies incidence of tax rate in excess of actual rate at the last level of consumption) effects.

ii. VAT Vs RST

VAT & RST are acceptable on theoretical grounds. Both are identical in the sense of tax base. Both differ in the tax collecting techniques in which VAT is collected at each stage of business process while RST is imposed only at the final stage. Either system provides the same amount of revenue because totals value added of final goods and services are same and both are principally the destination based on consumption types.

From the administrative point of view, RST seems to be simple as compared to VAT because their records and audit are sufficient on keeping the single stage. And the number of taxpayers remains more under VAT than RST. RST is based on the suspension principle in which tax retailers are required to register for sales tax purchase. This means that the RST is only levied on the sales, which is registered to be sold to customer. Such provision is required in order to facilitate cross-checking. Even under the VAT, producer, wholesaler and retailer are required to register both sales and purchase, issues bills, collect tax on their value added, deposit it to the treasury and submit returns but records of purchases may not be important under the RST. In this sense, RST is simpler than VAT. Further, tax credit and tax refund system are absent under RST, which makes the tax administration much easier.

VAT and RST, both are vertically neutral with respect to production and distribution. As total tax on a given common commodity depends on final price under both RST and VAT, imports and domestic products are treated equally under both systems. On the other hand, VAT and RST both are able to avoid the problems of cascading effects since there is no possibility for tax imposes on tax. Both taxes avoid the problem of pyramiding since there is no need of apply the mark-up on the tax amount levied at earlier stages.

Despite these few similarities, there are many disparities between RST and VAT. RST is defined on the basis of commodities and generally it ignores the service sectors while VAT can be levied on goods as well as service sector easily. At the distribution process, if wholesalers encourage to their goods directly to final consumer resulting an absolute degree of tax avoidance and tax revenue will be nil. Further more, it invites the economic distortion and price discrimination because of the tax applicable commodity could not be neutral among the methods of production and distribution as well as consumer choices. RST doesn't provide precise amount of tax refund because there is difficulty in identifying producer's goods and consumer goods, which are taxed in practice. This discourages capital intensive production and hence economic growth. On the other hand, VAT is collected step-wise. This method may create tax administration more feasible and fair, which helps to reduce the tax evasion, but under RST it is much more difficult.

As a conclusion, it can be said that VAT is more performed in developing countries too but an efficient tax administration is needed.

2.7 Freeing from VAT:

Under, VAT regime there is some provision keeping some special goods and services or transaction beyond the tax base. Such provision makes the tax administration simple and promotes equity among taxpayers. There are three provision of freeing

From they are Exemption, Zero rating and threshold.

a) exemption and zero rating

Exemption and zero rating are two popular methods escaping from VAT. Exemption and zero rating are not the same method they are different each other. The transaction of tax-examples goods and services remains outside the preview of VAT. The exempted taxpayers do not have to fulfill any formalities. The exempted tax payers do not have to collect tax on sales and they cannot claim for a refund of tax paid purchase and imports. Thus, the exempted taxpayers are treated as final consumer. If on the transaction of certain goods and services zero rated tax is levied then such goods and services or transaction are kept which in the preview of VAT. The dealing in such transaction has to be registered under VAT and fulfill all other formalities that applicable to other registrants. Such registrants have to collect VAT at the rate of zero percent on their sales and deduct the tax incurred on their purchase. This means that the rated good s and services do not bear the burden of VAT but should follow all formalities of VAT. On the tax exempted goods and services the tax can not be collected and non-cash, the input tax be claimed but on the zero-rated goods and services and the input tax can be claimed. This means that in the zero-rated goods and services there is no burden of VAT, where as in the tax exempted goods and services although VAT is not levied on the sales the VAT burden paid on inputs remains. If it is administratively difficult to apply VAT on certain goods and services exemption is given where zero rating is applied on certain goods if they are necessary to free from tax burden.

b) Threshold Business Person

Small business person having annual turnover up to certain amount are not required to register under VAT. The amount fixed for this purpose is known as threshold. To keep small business person outside the tax preview a threshold has been specified under the VAT system. The wholesaler, retailer dealers or producer who sell taxable goods and services below the threshold level do not have to register under VAT and neither do they have to collect VAT on their sales. Thus, threshold is a kind of exemption, which is based on the amount of the transaction but on the kind of goods and services. Therefore, threshold must be set based on the nature concerned and the status of the education and record keeping at various level of volume among business firms.

2.8 Taxable Person (VAT Act 2052: Sec., 2L)

a. Person with in the scope of the law (sec.,2l)

A person within the scope of VAT is usually described as a taxable person. A VAT law should include all legal persons created under the law of state that engage in economic activities of any kind, as well as all physical persons. A VAT law may regard an association or partnership, although the association does not, for general legal purpose, have separate personality. Government bodies at the national, regional and local levels are to be included as taxable persons.

b. VAT Register (sec.,10)

To administer the VAT, it is standard practice to establish a formal state register of those who are registered persons. There must then be a requirement that any person who is, or should be, a taxable person take the necessary action to seek to be registered for the VAT.

C. VAT Number (sec., 10-4)

State sometimes decide to adopt and an existing register, such as the register for the companies or a general register of taxpayer, to act as the VAT register. That is for a state to decide, but the register must be capable of generating a unique VAT number for each taxable person, as well as providing the authorities with an up to date list of those, and only those, who are taxable persons.

d. Voluntary registration (sec.10-2)

Voluntary registration state often allows those who are not required to be registered to register voluntarily. This may be appropriate for many organization that intended to have a large turnover, but have not yet reached it; incur large expenditure is one year, expecting the income in the next year ; or are carrying out business activities at the level that does not reach the registration limit, but that do not wish this information to be known customer. Voluntary registration also allows those operating just below the threshold level to avoid any competitive disadvantages compared with other operators who are required to register.

e. Effect of Registration (sec., 10-3)

A person who is required to register for the VAT is a “taxable person” who subject to the duty to impose and collect VAT on all supplies whether or not the person registered.

e. Cancellation of registration (sec., 11)

There are main three conditions for the cancellation of VAT registration. The first is where a person has been registered for VAT properly, but where the registration is no longer appropriate. This will occur where a person was required to register because activities exceed the threshold but where, subsequently, the person’s level of business activities has decline to below the threshold. The second case is where the person has ceased to carry out business activities. The final case is where the person has been registered by mistake or by misrepresentation on the part of the person.

f. continuing a registration despite a charge in the taxable person

Situation will arise where a person cease carrying on a business unavoidably. For example, the death, incapacity or insolvency of an individual or the winding up of a company may mean that the person registered as running a business is no longer running it. The business will usually continue at least for a time to be run by some other person.

2.9 Procedures and Administration

i. Need for specific VAT Rules

Legislative approaches to deal with administrative and procedural provision of laws vary markedly from state to state. In general, there are distinct advantages to combining, as for as possible, the procedure and administration of VAT with that of other taxes.

ii. Combining VAT and Customs Administration of imports (VAT Rules -053,ch. 9)

The case for combining the collection of VAT imports of goods with the collection of customs duties is particularly strong. This approach ensures that powerful provision exist to handle VAT on imports with a minimum of legal difficulty, administrative provision and taxpayer's confusion.

iii. Handling VAT on internal supplies (VAT Rules-053,ch-11,56)

There is also strong argument for combining the administration of VAT on internal supplies with the administration of the direct taxes. In particular, many income taxpayers with business income will also be taxable person's for VAT purpose.

iv. Regulation, instruction and guidance

The VAT is an invasive tax potentially applies to every aspect of the economy.

v. VAT Invoices (VAT Regulation 05, Rule-17,3)

A VAT invoice is an invoice, chit, till roll, print, or other document that is issued by as taxable person who makes a taxable supply and that record the supply and the amount of VAT payable on it. In the invoice- based VAT system the issue of invoices in the part of the procedure for imposing and enforcing the VAT. The requirement that a special invoice be is sued is feature unique to VAT.

vi. VAT Returns (sec., 18)

There should be standard form of return, so that the taxable persons know precisely what is required of them and can comply more easily with the formalities of making return, and so that tax administration can process return efficiently.

vii. Payment of VAT (sec.,19)

All taxable people must pay to the tax authorities at specified time the net amount of VAT due for the VAT period on self-assessment basis.

viii. Assessing VAT (sec., 20)

Where a taxable person has not made a return for a period for which a return should have been made, the tax authorities should be given reserve power to impose an obligation on the taxable person to pay VAT to the authorities.

ix. VAT Period (sec.,10)

The standard period is calendar month; often, taxable with small levels of taxable turnover is allowed to use longer periods of three month or a year.

x. **Repayment of excess VAT credit (VAT Act 052, sec-17,Regulation Rule-39 to 44)**

Where the input tax credit for any VAT period exceeds the output tax collected, there is excess of VAT credit or deductible input tax. As a direct result, the taxable person will pay no VAT to the authorities for that period. In such cases the tax authorities use that excess to offset to future obligation.

2.10 REVIEW OF RELATED WORKS/ STUDIES

2.10.1 REVIUW OF BOOKS

Tax law design and drafting: it is an international monetary fund publication. It deals with the drafting and designing of different tax laws. The value added tax is also discussed in chapter six. This particular chapter, VAT been dealt by David Williams. The article confers standard practices on value added tax in the international context. It begins with the general introduction of VAT. The present status of VAT, its terminologies, economic, implication, territorial scope, charges to VAT, and its principle of VAT non discrimination are covered in the introduction section. Then it proceed into the definition of taxable person under the value added tax along with the provisions regarding the registration, VAT number, cancellation of registration and voluntary registration. Third section deals with definition on the supplies goods and services and the condition for the business transaction to come under the scope of VAT. The fifth section comments about the exemption of VAT and its implications on the economy. The next part ponders over the valuation goods and services. The payment of VAT is discussed in the seventh section where the process and the rates of VAT in different part of the world are also recovered. Finally, the article concludes with the administrative management of VAT.

VAT IN NEPAL (KHADKA: 2001): Dr. Rup Bahddur khadka, an expert in VAT in Nepal, writes this book. It is a collection of his published papers. The first paper gives general introduction to VAT. The second paper which was written at a time, when the draft VAT law was under development outlines the purposed structure and operation of VAT and the administrative structure to run run this tax. The third paper provides an overview of the VAT system in force, while the fourth paper describes mainly the reasons to introduce VAT in Nepal. The basically paper basically points out the preparation made for the political, economic and administrative complications appeared in the course of VAT implementation. The six chapters present the existing status of VAT implementation and the major implements that needed to be removed for the smooth running of VAT. The last analysis the Indian document indirect tax system and present s views of various committees and individual on VAT in India.

VAT and its Relevancy to Nepal (khadka: 1997): this is collection of different articles published and written by Dr. Rup Bahadur Khadka. The articles specially deal with the general introduction of VAT on the eve of the introduction of VAT in Nepal. He has compared the VAT with sales tax in use before the introduction of VAT. Nepal had the experience of the implementing import/ manufacturing level sales tax. The MST had a narrower base and suffered from the cascading effects. It also discriminates against the domestic products in relation to imports because the profit margin of the importer. The wholesale level sales tax was operating in Nepal before VAT. The WST also suffer from the similar shortcomings. The wholesalers used to create take distribution channels to evade tax. The RST- Retail level sales tax –is neutral with respect to methods of production and distribution and does not suffer from the problem of cascading effect. But, the wholesale tax is at stake if retailer does not file his return because RST places a heavy burden only at the retail level. (Khadka: 1997).

Nepalma Mulya Abhibhridhi kar: SidhantaRa Byabahar (khadka: 051/540BS):
This book is the collection of different articles published in various newspaper and written by Dr. RUP BAHADUR KHADKA during 2051- 2054. The main objective of this book is is to bring public awareness regarding the implementation of VAT. It cites the examples of India, China and Bangladesh where VAT are also covered in the book. The success story of Singapore and the failure story of Ghana and their implementation to Nepal are delineated in the story. (KHADKA: 051/054)

VAT four years of Implementation (IRD/DANIDA Report, 2001):
This is a compilation of articles contributed by various experts on VAT in Nepal on the occasions o f four years completion of implementation of VAT in Nepal. This is the publication of Inland Revenue Department and VAT project in Nepal by Dr. Rup Bahadur khadka. It of comprised of twelve main articles along with some comments provided by various personals.

Mr. Shakti Prasad pandit, Under Secretary at the MOF, writes the first articles “VAT Accounts and Audit”. He emphasize on for visit to a tax payers premises, if any irregularity resulting in tax evasion is found while conducting a tax audit, then the tax officers assesses the tax amount that has been evaded. Mr. Lal Mani Joshi, Deputy Director General of IRD, writes the second articles,” Tax Credit and Tax Refund Process under the VAT system.” The tax refund process to rather lengthy in his opinion. He disclosed that there has been an increase in the amount refunded in each year. The third article of VAT “Assessment, penalties and the Appeal Procdure”is written by Mr. Ratna Rajya Bajracharya, a senior practicing Charter Accountant. He opines that the requirement of the VAT registration for marginal entrepreneurs is not very much conductive for the cottage and small industries as well as marginal entrepreneurs. The fourth articles,” value added tax : A retrospection “ written by Mr.Nabraj Bhandari, Director of IRD, describes the amounting enthusiasm and the zeal of the staff to the support of the MOF, the VAT Department and the DANIDA VAT project.

The fifth articles," implementation of VAT in Nepal: in Evaluation," is written by Dr. Govinda Bahadur Thapa, the director of foreign currency exchange department of NRB. The article points towards the weakness inherent in the value added tax system in Nepal. He is critical to the timing of the introduction of VAT in Nepal. He strongly denounces the existence of an unstable government at the time of introduction, which forced the government to accept many compromises in this regard. He makes critique on the lack of serious consideration to the impact of impact of smuggling from the administration and proper accounting systems are also impeding the functioning of VAT in Nepal.

The sixth articles," Value Added Tax in the university Curriculum," is written by Dr.Puhpa Kandel, Lecturer at Saraswati Multiple Campus, TU. He opines that a coordinated working atmosphere with government and Universities, blowing their own trumpets, is not going to benefits the nation in any way.

The seventh articles," Value Added Tax: The road ahead," written by Madu Kumar Marasini, Director at the IRD, advocates for increasing in the cities where most of the taxpayers reside. He has also advice for sudden inspection of goods and services on the road to check evasion.

The next articles,"Value Added Tax and the practice of issuing and Receiving Invoices in the context of market economy," is written by Vidhyadhar Mallik, Director of IRD. He believes the market runs in fair manner, the market principle will bring "welfare to much happiness to many." He clearly point out the weakness on the part of the government, the business community and the general public. This tax system deserves concerned efforts of all stakeholders. The business may use cash machines and inexpensive billing software. They can develop the habit of quoting the price inclusive of VAT and remained customer to take invoice by displaying notices. He urges for black listing and transparency on the part of the business community. Customer can inform the tax authorities about the fraudulent transaction. The tax administration should increase surveillance and customer education level. The ninth article entitled, "Value added Tax in Nepal: Analysis and suggestion", is written by Dr. Rup Jyoti, a leading industrialist in Nepal. He suggests the practice of under- invoicing should be discouraged and the same time the custom duty must be gradually decreased.

The next article, "Value Added Tax, The Concept International Experience and its application in Nepal", is by the editor himself. In this article, Sr. khadka's attempts are again to give the knowledge about VAT to the general public. He has also included the current developments and the status of VAT in the Nepalese as well as international context. He believes that, despite different hurdles, VAT implementation is becoming more effective. Lene Bendix, "in four years of Value Added Tax in Nepal" has simply assessed the implementation of VAT in Nepal and has lots of hope in VAT. The final article entitled, Value Added Tax: Its past, present and future", is written by Mr. Narayan Prasad Silwal, former director general of the VAT Department and the current joint secretary in the MOF. He points to the lack of ownership after the formation of the Inland Revenue Development. (IRD/DANIDA Report, 2001)

2.10.2 Review of journals and Articles

The international Monetary Fund Staff Papers, July, 1973, contains an articles entitled, "The Value Added Tax in developing countries", George E. Lent, Milka Casangera, and Michele Guerard. It analyses the position of VAT in seven developing countries; Brazil, Ecuador, Ivory Coast, the Malagasy Republic, Morocco, Senegal and Uruguay. As per the study, a substantial part of the revenue in developing countries is derived from imports. A VAT with multiple rates and many exemptions presents greater difficulties of administration and compliance than does a single rate tax with few exemptions. A VAT not only impose greater discipline by reason of its so-called self checking feature but also is self –correcting in "catching up" with tax that may have been escaped at a previous stage. In this respect, it has some advantage in reducing the risk of revenue leakage.

The same journalinMarch-1973 has an article entitled, "The Brazilian state Value Added Tax", by Michele Guerard (1973). The state tax reform was prepared in 1965, along with a general reform of the entire Brazilian tax system. Brazillian introduced VAT, in the name of imposto sobre artculacao demercadori as with effect from January 1, 1967. IT remained basically a sales tax, and it was still intended that it be fully shifted forward to the purchaser at each successive transaction. The tax en each stage was levied at a uniform rate on all commodities, with few exemptions. The Brazilian experience shows that the VAT technique can be adopted with no great difficulty to conditions in some developing countries.

Another article entitled, ***"The Equity Impact of Value Added Tax in Bangladesh"*** by Shahabuddin M. Hossain is in June1995 of the same journal. The government of Bangladesh introduced a VAT at the time manufacturing/import stage on July 1, 1991. the findings of the study suggests that among the different possible VAT scheme with some exemption and additional exercise is likely to be more acceptable to the general public and policy makers than a uniform VAT which is in contradiction with the Brazilian experience.
A article entitled "Tax System and its Reform in Nepal", written by Dr. Govinda Bahadur thapa , was published in the 'Business Age' in Dec. 2003 views VAT as an important element of tax return program, Mr. Yadav Prasad Dhungana has scrutinized the legal aspect of VAT in "Value Added Tax and its legal scrutiny" published in the same magazine in Dec-2003. He concludes that as other areas of economy that are heavily influenced by political instability, corruption, bad governance, frequent change in

government and Maoist revolution; VAT also has witnessed weak implementation owing to these hurdles.

An article, ***"Mulya Abhibridhi Kar Maujdat Ghosanale Ubjeko Prashnaharu"***, published in the Rajaswa in Baishakh and written by Mr. Ram Prasad Mainali prescribes remedial actions for the smooth operation of the VAT. His emphasis was upon the proper billing system, political commitment, motivated staff, public awareness, technological improvement, effective audit, online data system and reduced threshold.

2.10.3 Review of Related Research Works

Choi (1983): in this research paper, he examines and evaluates the VAT in Korean Economy. VAT was introduced in Korea in 1977. The main objective of introduction of VAT in Korea is simplification of tax restructure and its administration promotion of exports, capital, capital formation, maintaining neutrality in indirect tax system. VAT has neither so negative nor so positive effect on the economy of Korea. VAT did not have major impact on prices level. It has positive impact on investment and exports. The study found that the VAT in Korea and more or less regressive with respect to income. In Korea the VAT broadened tax base reduce evasion, increased revenue and solved many problems associated with previous taxes.

The Korean experience of VAT during seven years had proved that VAT is not as simple as in practice as it is in the theory. It creates a host of problems that give rise to voluminous paper work more or less arbitrary distortions in trade and consumption and inequalities in the distribution of tax system. (Choi: 1983)

Due and Meyer (1988): they have examined the VAT in Dominican Republic (A Caribbean Country with 6 million population and $1370 per capita GNP in 1983). The VAT in Dominican Republic came in effect from Nov. 1983. However, the general reaction towards the tax was hostile from the business sector. Labor unions as well as political parties opposed the tax. Much of complain rose from increased record keeping requirements because the commercial sector of economy was dominated by small and medium size business houses. The other main objection was for the belief that VAT was responsible for increased inflation (with VAT the rate of inflation rose from (7% to 38%), but the inflation was also due to other reasons. There was a general agreement that the enforcement of the tax had not been adequate mainly because of the lack of personnel. Evasion was wide spread, many firms failed to register. The overall evaluation of the tax in the country therefore remained 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 the advantage of a complete value added tax. The experience of the county with the tax provided a warning to other developing countries not to attempt to use a value added tax extending beyond the important b manufacturing sectors without careful consideration of the ability of the wholesale and retail sectors to operate the tax ,and general attitude of these sectors towards the tax. (Due & Meyer: 1988

Khadka (1989): "VAT is the most recent innovation in the field of taxation. It is levied on the value added of goods and services. This 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, the various types and methods of computation of VAT, reason for the growing popularity of VAT etc. Apart from this, 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 best known person as an observer of VAT abroad. He proposed VAT for Nepal for the first time with micro studies of Nepalese economy and tax system. In his proposed structure, the coverage of VAT 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 complications and inefficiencies in this collection.

Lastly, he developed a VAT proposal for Nepal showing some successful VAT implemented in Asian countries like China, Indonesia, Korea, New Zealand, Philippines and Taiwan. (Khadka)

Tait (1991): in this chapter, he mainly raises the policy level issues about VAT. The main conclusions of the study are as follows.

- VAT provides a new tax base and improves tax system in terms of neutrality and efficiency.
- VAT contributes from 12% to 30% of revenue in most of the countries representing about 5% to10% of gross national product.

-VAT is more complicated than other sales taxes from administrative point of view.
-collecting VAT and paying refund make it complicated than other sales tax.

The study compares VAT and retail level sales taxes in several respects and concludes:

** Neither retail sales tax nor the VAT can tax the unofficial and back transaction and both are open to evasion by under recording sales. However, under valuation is more difficult in VAT.

** a comprehensive VAT covering all stages of production to retail level and the service is preferable.

** Single rated VAT with only few exemptions and without zero rates makes it more regressive.

** If VAT is replaced to get equal tax yield relative price may be increased and it will have deflationary effect rather than inflationary, if net revenue is raised. (Tait: 1991)

An **IMF** occasional paper **(1991)** reviews VAT and brought out the beauty of VAT briefly and examined the reason why the VAT is chosen as the main sales tax. The study concentrated on the policy concerns on the basic illustration of some theoretical as well s empirical proof.

The study clearly has depicted three main groups of reasons to adopt VAT: Revenue, Neutrality and Efficiency.

Revenue:- VAT would generate more revenue with less cost than taxes it has replaced. “Traditional income and sales taxes have been meeting public resistance and the VAT provides a new buoyant revenue base, typically yielding more than initial estimates as the cost Indonesia, Korea, Newzeland Portugal and Tunisia show.” Because of broad coverage this tax offers much greater revenue potentiality as compared to other types of taxes. According to the study, the VAT contributes from 12% to 30% in most of the countries.

Neutrality: - “the VAT in non-distortion provided there are few exemptions and little zero rating. VAT on investment should be fully credited and its frequency is an improvement over the taxes replaced often taxed capital goods”.

VAT is neutral with respect to the choice methods of production and distribution. Since the tax is levied only on the value added at each stage in the system, tax liability remains the same regardless of the system of production and distribution. Total tax on given commodity depends on the rate of the tax and of stages through which it has passed. So the tax is considered vertically neutral except for negligible elements of discrimination. It also doesn’t discriminate the production whether it is capital intensive or labor.

Efficiency: - a significant characteristic of an ideal tax system is efficiency. An efficient tax system is one that does not cause any distortion in the production and consumption. In other word, such a tax system does not bring any unintended and considerable effect in the methods of production distribution or in consumption. Rather it avoids probable distortion of the optimum allocation of resources.

In this connection Editor Alan A. Tait writes, “The VAT has often replaced inefficient, destortionary and badly administered taxes.”
The introduction of VAT provides an opportunity to sweep away the cobwebs and revamp a substantial part of the administration.

A high level task forced led by Dahal (HMG 1995) to review Nepal's tax system has made some recommendation for VAT in Nepal. In its report, the tax force recommends VAT in the place of existing sales tax and small services based taxes as along term tax reform measure. The report has emphasized on the introduction of VAT in Nepal to

a. broaden tax base and increase the tax revenue.
b. make the tax system efficient.
c. prevent the tax evasion.
d. make the tax system transparent and elastic and
e. encourage the exports.

The report has also emphasized that there are some other factor to be considered seriously before implementing the VAT. They are

a.) price level b) Nature of tax payer c) Small tax payer etc.

The report has recommended some necessary precautions to be undertaken before implementing a VAT such as drafting a law, developing an efficient and capable administration etc. A functional organizational pattern is recommended. The other recommendations of task force are development of an effective tax refund system, measures to increase self compliance, tax payer's services, computerization of the administration, research and development, a different type of personal system, extensive tax payer's education program etc.

Mr. Balananda Poudel submitted the research paper named "A study on Nepalese Tax Structure" in July 1995 for the degree of Master of public Administration. In his own words the major findings of the study is "Revenue collection system has been made to improve to generate more revenue. But still the situation is far from satisfactory. The share of revenue to GNP is lower in Nepal than other country. We should concentrate ourselves in the tax revenue because it generates more than 80% of total revenue and it is more elastic to the total revenue. The sales tax is one of the important taxes at present and will continue to be so in days to come over and invoicing is common in foreign trade. Attempt should be made to change the tax form retailer. When the infrastructure is ready for tax through retailer the sales tax system should be switched to the value added tax system. It will indeed help in generating more revenue."

Mr. Ram Mani Duwadi has done research in 1995. On "An Evaluation of the Sales Tax in Nepal" to submit the dissertation for the Master Degree of public Administration. This study has focused its effort to explain the evolution of sales tax, its kinds, structural and functional characteristics of the Nepalese Sales Tax system with its contribution to revenue. In his own word, the this study is " the indirect taxes has larger share on total revenue than the direct taxes and the share of indirect taxes and direct taxes on total revenue is 63.4% and 15.3% respectively. Sales tax occupies

1.9% of GDP, 20.2% of revenue, and 26.2%of tax revenue and 31.8% of indirect tax revenue. The growth of sales tax collection from goods in the study period is24.3% and the growth rate of the sales tax collection from services in the study period is 144.1%". He has made recommendation as

** Long term policy with clear vision.
** updating tax payer's profiles.
** Starting of VAT instead of sales tax.
** Simplification of tax refund system.
** Transparency and uniformity in the tax rules, regulations and Circulars.
** Unification of various similar natures of indirect taxes.
** Computerized information system connected to inter office and interdepartmental.
** Comprehensive education program for the tax payer.
** Establishment of Research and Development Wing with in the Revenue Board.

Khadka (1996) :- in his chapter, " 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 proposed structure, the coverage of VAT should be made as broad as possible covering all business transaction. Exemption should be granted unless there is specific reason to do so, such as administration and equity. Zero rating should be limited to exports, and tax should be single to avoid complication and inefficiencies in collection.

The proposed operation of VAT requires that the taxpayers above a threshold limit should be registered, the vendor should issued an invoice for each sale, keep a clear account of his purchase and sales (separate account for zero rated, exempted and positive rated goods) a VAT liability should be calculated of its taxable sales, tax credit method should be used as a method of computation of the tax. The tax return period should be one of month. The present sales tax and excise department should be restructured drastically to administer a VAT. Officer level post should be provided including the operation fromevery field should be set up. A detail preparation should be considered as a prerequisite for the introduction of VAT. A comprehensive VAT education program should be launched to educate the taxpayers.

In a dissertation submitted to Tribhuwan University for degree in Economics, Baburam Subede (1997) concludes that, "VAT is applicable to Nepal". Since the existing tax system's not efficient in raising adequate revenue and it is also distortationary inequitable and gives incentives for tax evasion k, the finding emphasizes the need for reform of entire tax system. To reform the tax system, it is desirable and necessary to move towards VAT and improves the implementation. A VA Tin Nepal expands the coverage of tax, removes the distortationary effects of the existing taxes, and will have a minor effect on prices. Empirically, VAT is also found to be their best alternative for reducing the inefficiencies and introducing neutrality, fairness, productivity and transparency in the tax system.

According to the study, most important problem for implementing a VAT is administrative inefficiency. The present sales tax administrations not capable for handling VAT. Other problems associated with the implementation of VAT are: lack of account keeping system, lack of knowledge about VAT, lack of co-ordination between the government and private sector, illiteracy, low public awareness etc. the existing tax evading practices also pose a serious problem. The full advantage of VAT can not be achieved without extending it to the retail level.

The study suggests that a moderate a single rated VAT is desirable. If the VAT is implemented well, it will generate 1.5 to 2.5 folds more revenue than existing sales tax. However, a VAT in Nepal may not be "a hen with golden eggs", nor it is "penance" for curing all ills. It requires active efforts and commitment from all sides.

A study made by **Nepal Chamber of Commerce (1997**) to analyze the possible effects of VAT on Nepalese economy has made some observations. The observations are: A) Adverse effects on price level, B) increase in the price of the imported goods would the import business and re-export of imported goods leading to a decline in the revenue from imported taxes. A) The account keeping requirements of the VAT would increase the tax compliance cost and cost of doing business, it would adversely affect the small traders. D) Adverse effect on domestic production due to the abolition of protection policy under VAT would occur. E) VAT would be unjustifiable on social ground, it would it aggregate the income distribution, F) Negative effects in revenue collection would raise and G) Chances of failure of VAT in Nepal in great because the present administration is incapable for implemented in haste. A partial VAT on some commodities should be implemented on experimental basis to know its pros and cons and after that a full VAT may be considered.

Nepal Chamber of Commerce organized a nationwide discussion program on VAT. According to the report of discussion program (Nepal Chamber of Commerce 1997) the various views expressed about VAT in Nepal may be summarized as follows.

**Government machinery is not capable for implementing VAT.
**The business community has no confidence on the administration because it has failed to implement many other taxes effectively and fulfill its own commitment.
**VAT will hamper genuine trade as a consequence, illegal trade will prosper. Rise in the prices of the domestic product will make them less competitive. Import and re-export of imported goods will get negative impact leading to decline in government revenue.

**VAT will inhabit the growth of newly developing and industrial activities in the country.
**The modern account keeping system required for is difficult to keep. This will raise the cost of running business.
**There will be a sharp price hike if a VAT is introduced. Consumers will badly affect due to price hike. Nepalese market in boarder areas will dry up due to VAT. It was included that it was not possible to implement a VAT and if implemented it will have adverse effects on the country.

Subedi (1998) concludes that value added tax theoretically is the best form of the sales tax, especially because it is neutral regarding the method of production and generation of more revenue. The self enforcing feature of VAT manufacturing level sales tax a s well as other taxes seem to be inefficient and productive that has created cascading and pyramiding effects. So the rationalization of such taxes in Nepal is a need of time. The VAT can be viewed as an important form of domestic resource mobilization in Nepal. As a bulk of tax performance to generate more revenue, increase neutrality, maintain efficiency, fairness and make self policy and as simple and equitable tax system VAT is applicable in Nepal. However, it is a challenge for Nepal. It needs more administrative efforts. Moreover, 'cross audit' feature of VAT would be also being questionable unless the parallel business through open boarder is controlled in Nepal. It is hard to bring those illiterates a small retailers scattered from Terai to Himalaya together make them to put proper records. Thus, administrative capability is the prerequisite for the success of VAT in Nepal.

The proposed operation of VAT requires that it should be implemented after preparing required level of infrastructure, a consumption type of VAT, fully excluding producer's goods from tax base and taxing many goods and services close to the consumers, apply tax credit method, apply destination principle, extent VAAT through retail level, apply a single rate (preferable of 13 %), decision for establishing District VAT Office should be promptly made preferably covering 30 districts at initial level and other should be covered (in second phase, number of tax officials should be predetermined). Before implementing VAT, registration campaign should be launched to the related tax officers and tax officers and tax payers training should be made in related topic etc. VAT is based on market economy, price control and discretion of the tax officials should be fully avoided and recommended to make transparent accounting system.

Koichi (1999): the VAT is a useful tax that is considered to have little discretionary effect on resource allocation and to encourage capital accumulation. Nevertheless VAT is not completely neutral to resource allocation and generally is regressive to income distribution. If one tries to make it less regressive by excluding food and necessities from taxation then one will hurt the neutrality even more. Many Asian government implemented tax reforms base on the introduction of VAT. Generally, the revenue enhancing objective of tax reforms seen to have been fulfilled. VAT has been the most popular way of raising government revenue. The VAT has regressive characteristics but its possible harms should be compared with the damage from inflation that might occur without the implementation of revenue raising devices including the imposition of the VAT of increasing the rate of VAT (Koichi 1999).

Khanal (2000) : He undertakes the research to assess the feasibility of VAT as an alternative to sales tax in Nepal and to consider the possible effects of VAT on the socio- economy of Nepal. The study finds that VAT was appeared in Nepal as an alternative of sales tax. There were many problems associated with sales tax. One of the major problems of sales tax was its narrower tax base. Adoption of full fledged VAT replacing the sales tax is its large broad tax base. The increase tax base would make the system more productive and elastic. Adaptation of VAT would be helpful in removing the production distortions and other undue pressure on economic activities caused by the inherent defects of sales tax. The VAT would also remove the unfairness of the sales tax system and would increase the competitiveness of Nepalese products. The VAT would not be more regressive than the sales tax system. As VAT seen more attractive for revenue point of view. A number of problems arise regarding the administration of VAT in Nepal. As a modern tax VAT demands highly capable administration which is seriously lacking in Nepal.

2.10.4 Research Gap

There is only few research works conducted in this topic. But such VAT related research work has not provided appropriate solution about effective implementation of VAT system in Nepal. Ruined practicing scenario was the main problem of VAT system. Researchers have provided general recommendation only. In this research, researcher has tried to fulfill such research gap. For better implementation of VAT it needs to be specific recommendation. Researcher wants to eliminate research gap exist in the past and explore for in depth information, which can be helpful better implementation of VAT phenomenon.

Table7

Resource Gap in Nepal

Fiscal year	**Total Exp (A)**	**Total Rev. (B)**	**Resources Gap(A-B)**	**Foreign Grant (C)**	**Res.Gap A-B+C**	**Foreign Loan (D)**	**Res.Gap A-B+C+D**
1990/91	23549.8	10729.9	12819.9	2164.8	10645.1	6256.7	4398.4
1991/92	26418.2	13512.7	12905.5	1643.8	11261.7	6816.9	4444.8
1992/93	30897.7	15148.4	15749.3	3793.3	11956.0	6920.9	5053.1

1993/94	33567.4	19580.8	14016.6	2393.6	11623	9163.6	2459.4
1994/95	39060	24575.2	14484.8	3937.1	10547.7	7312.3	3235.4
1995/96	46542.4	27893.1	18649.3	4825.1	13824.2	9463.9	4360.3
1996/97	50723.7	30373.5	20350.2	5988.3	14361.9	9043.9	5318.3
1997/98	56118.3	32937.7	23180.4	5402.6	17777.8	11054.5	6723.3
1998/99	59579.0	37251	22328	4336.6	17991.4	11852.4	6139.0
1999/000	66272.5	42893.8	23378.7	5711.7	17667	11812.2	5854.8
2000/001	79835.1	48893.9	30941.2	6753.4	24787.8	12044	12143.8
2001/02	80072.2	50445.5	29626.7	6686.1	27440.7	7698.7	15241.9
2002/03	84572.3	56229.8	28342.5	8372.3	19970.2	8950	11020.2
2003/04	819442.6	62331.0	27111.6	11283.4	15828.2	7629	8199.2
2004/05	102660.5	70122.7	32437.8	14391.2	18046.6	9266.1	8780.5
2005/06	110899.2	72282.1	38607.1	13827.5	24779.6	8214.3	16565.3
2006/07	131851	86135.5	45715.5	15946.0	29769.5	10331	19438.5
2007/08	154860.3	91258.6	63601.7	16710.2	80311.9	11510.2	45281.3
2008/09	178986.2	96231.5	82754.7	17801.6	100556.3	11989.1	52959

Sources: Budget Speech, MOF, GON

2.10.5Terminal VAT Registration

In the following table it had been express terminally about the VAT registration in the fiscal year2065/66

Table No.8

Monthly, Fourth Terminal and Second Terminal of VAT Registration Sheet2065/66

Office code	Office Name	Monthly		Fourth Terminal		Second Terminal		Total
		No.	Total %	No.	Total %	No.	Total %	
11	Bhadrapur	1580	74.1	551	25.9	0	0.0	2131
12	Biratnagar	2666	63.6	1182	36.4	2	0.1	3250
13	Dharan	1089	58.7	765	41.3	0	0.0	1854

14	Janakpur	829	44.6	1028	55.4	0	0.0	1857
15	Lahan	603	34.9	1126	65.1	0	0.0	1729
16	Simra	644	54	549	46.0	0	0.0	1193
17	Birgunj	2100	62	1286	38.0	0	0.0	3386
18	Hetauda	763	56.9	578	43.9	0	0.0	1341
19	Bharatpur	1145	61.3	635	34.0	88	4.7	1868
20	Dhangadi	557	29.6	1326	70.4	0	0.0	1883
21	Mahendra Nagar	216	19.7	883	80.3	0	0.0	1094
22	Pokhara	2311	64.8	1253	35.2	0	0.0	3569
23	Lalitpur	2215	53.1	1955	46.9	0	0.0	4170
24	Bhairwaha	2158	65.00	1144	34.4	20	0.6	3322
25	Kathmandu-3	5509	53.3	4799	46.5	19	0.2	10327
26	Nepalgunj	1263	44.00	1602	55.8	8	0.3	2873
27	Kathmandu-1	6402	53.7	5511	46.2	4	0.0	11917
28	Kathmandu-2	5196	78.2	1446	21.8	2	0.0	6645
29	Bhaktapur	1115	39.7	1692	60.2	2	0.1	2809
30	Krishna Nagar	373	51.5	351	48.5	0	0.0	724
51	Dang	533	39.00	835	61	0	0.0	1368
52	Central Tax Officece	339	98.8	0	0.0	4	1.2	343
	Total	39006	56.00	30498	43.8	149	0.2	69653

Sources :- www.ird.com.np

2.10.6 Comparative study tax Office

In the same way table 9 express the comparative statement of office of tax of Nepal.

Table No. 9

Comparative statement of tax office (3 Years) 2065/66

Office code	Office Name	2063/64	2064/65	Registration in 2064/65	Growth Rate	Registration in 2065/66	2065/66	Growth Rate
11	Bhadrapur	12857	14074	1217	109	17404	3330	124

12	Biratnagar	11782	13023	1241	111	15002	1979	115
13	Dharan	9524	10682	1158	112	13488	2806	126
14	Janakpur	11809	12687	878	107	13353	666	105
15	Lahan	10037	11063	1036	110	13265	2192	120
16	Simra	7801	8405	604	108	9617	1212	114
17	Birgunj	8466	9253	787	109	10852	1599	117
18	Hetauda	3877	4329	452	112	5104	775	118
19	Bharatpur	103041	11461	1157	111	14320	2859	125
20	Dhangadi	8012	9524	1512	119	11284	27600	129
21	Mahendra Nagar	5638	6307	669	112	7695	1388	122
22	Pokhara	18146	20163	2017	111	26253	6090	130
23	Lalitpur	12428	14230	1802	114	17421	3191	122
24	Bhairwaha	15053	16521	1468	110	21036	4515	127
25	Kathmandu-3	29109	33670	4501	116	42556	8886	126
26	Nepalgunj	13597	15797	2200	116	20300	4503	129
27	Kathmandu-1	31591	36334	4743	115	44266	7932	122
28	Kathmandu-2	15443	16921	1478	110	19546	2625	116
29	Bhaktapur	8791	10253	1462	117	13236	2983	129
30	Krishna Nagar	4801	5276	471	110	6494	1218	123
51	Dang	6756	7582	826	112	10012	2436	132
52	Central Tax Offiece	384	393	9	102	398	5	101
	Total	256210	287958	31748	112	353902	65944	123

Sources :-www.ird.com.np

:-Annual Report of IRD 2066/67

CHAPTER - 3

RESEARCH METHODOLOGY

Research methodology is a research method used to meet the specified objectives. It is a systematic way to find out the probable solution. It refers to the various sequential steps (along with rational of each steps) to be adopted by a researcher in studying the problem with certain objectives in view. Thus the research method designed to achieve the objectives of this thesis contains research design, population and sample, data collection procedure, tools for analysis and methods of analysis and presentations.

3.1 Research Design

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

3.2 Population and Sample

The population for this study was comprised of the entire person belonging to or associated with Value Added Tax in Nepal. They were Tax administrators, Experts Business persons and Customers. In order to fulfill the objectives of the study, samples from the population in the Katmandu Valley were carefully selected by consultation with lecturers and best judgment of the researcher. The respondent's could be divided into three groups. The following Table shows the groups of respondent's and the size of samples.

Group of Respondents and Sample size

Sn	Group of Respondents	Sample Size	Percentage %
1	Tax Administrators/ Experts	10	22
2	Business Person	20	45
3	Customer	15	33
	Total	45	

3.3 Nature and Sources of Data

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

A. Primary Sources

The primary data were collected through following techniques:

a. Interview

b. Questionnaire

c. Telephone queries

d. Discussion with resource persons

e. Field Survey

B. Secondary Sources

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

a. Published and unpublished reports, articles and dissertations on the concerned subject.

b. Published documents of National Planning Commission

c. Publication and annual report of Inland Revenue Department (IRD)

d. Different publication of Central Bureau of Statistics.

e. Publications of Nepal Rastra Bank

f. Various books written by tax officers and scholars

g. Publications, Budget Speeches and Economic Survey of various fiscal year of Ministry of Finance, the Government of Nepal.

h. Newspapers, such as, Gorkhapatra, The Rising Nepal, Kantipur Daily, and so on

i. Publications of various VAT Department.

j. Websites

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

3.4 Procedure of Presentation and Analysis of Data

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

a. Simple Average,

b. Simple Percentage,

c. Graphs, Charts and Diagrams,

d. Trend analysis

e. Correlation

f. Hypothesis testing (Student’s t-test)

CHAPTER - 4

DATA PRESENTATION AND ANALYSIS

4.1 Structure of Nepalese Tax System

The term Value Added Tax (VAT) has been spreading in most of countries in the world. In the beginning, the concept of Value Added Tax was originated by DR. Wilthelm Von Siemens in Germany in 19191 AD. From the view point of the collection of VAT it can be classified in two ways such as a) Preliminary practice b) actual practice. In preliminary practices Value Added Tax was not introduced actually. The infrastructure, writing recommendations and exercise were done on order to adopt Vat in the countries. .But in Actual practice it was introduced by many countries by replacing their previous other tax related budget heading. Not only to collect the large amount of tax but also to maintain the economic stability and social justice through improvement the distribution of wealth area the primary objectives of taxation. In this way tax structure stands as a mirror of the fiscal policy instruments. The taxable capacity of government as well as ability of people to ay tax is the major factor of designing the tax structure. For the underdeveloped countries like Nepal the role of taxation in the process of economic development is considerably significant. In this respect, the tax structure has vital role in development. Tax system was informal during early Shah Period; it was bounded by traditional land tax and other fines etc. In Rana period, taxes were levied on agricultural income from forest and mines, business etc. However the specific tax system and trend of revenue collection was commenced with the budget speech of 1951 but, which are limited to traditional sectors. Income tax was introduced from fiscal year 1959/60 and sales tax, contract tax, house and rent tax in 1965/66. Tax reform programs and implementation of new tax system were continuous in Nepalese tax structure. In this way the government introduced VAT from 1997.

4.2 Need for reforms on present tax system in Nepal

The tax reform exercise has been the most important and technically the most exciting Component of the reform programmer in the fiscal sector Arguments put forward in favor of reforms in Nepalese tax system are:-

- To enhance more revenue needs.
- To enable tax administration.
- To fulfill the increasing resource gap.
- To face the problem of continuing and raising difficulties.

Tax reform is inevitable for liberal and competitive economy.

To increase productive efficiency.

There is a global trend of tax reforms. In this way there were as many as twenty five-tax Reform programmers between 1984-1990 in major Asian developing countries also and this trend continued in Latin America, Europe and Asia from 1990-1995 (Fiscal issue No. 4 IRET Washington DC 1984, page 173).

4.3 VAT Administration

Tax administration plays a critical role in the effective implementation of any tax system. Success and effectiveness of VAT in Nepal hinges on the administrative capability. In other words, the tax system in developing countries like Nepal must be designed in such a way that it can be administered effectively with existing administrative capability. In this regard, Shoup suggests that in a developing country, still at an early stage of development where most business activity is fragmented among small firms a turnover may be preferred on administrative grounds. If only retail trade is fragmented, the value added technique may be applied in less than comprehensive manner to affect only imports, manufactures, extra active industries and perhaps wholesalers.(Shoup, 1998;149). Poor administration can hinder the utility of VAT in Nepal. VAT is a modern and new tax system which can not be implemented without efficient and modernized administrative setup. Nepalese industrialist and businessmen did not have any faith and positive remarks on the VAT administration and its refund system as past records of deficiency of tax administration. The3 past records may be a mirror which reflects the things that are going to happen in future. Even in the past, government came up with so many stereo typed promises to facilitate the business communities but alls were eventually proved abortive. So this time, they hardly, have any confidence on the government policy and commitments. If administrative capability is not so strong to administer tax, the theoretical merits of the VAT only remain on paper. So it is most important to judge the capability of present VAT administration. To judge the capability of present VT administration question was asked and the results so obtained has been presented in the table as follows.

Table 10

Efficiency of Nepalese VAT administration

Respondents	Tax Official		Tax Persons		Consumers		Total	
Alternative	No.	%	No.	%	No.	%	No.	%
Efficient	14	70	1	5	0	0	8	17.70
Inefficient	2	10	10	50	8	53.33	19	42.22
Needs Impro.	4	20	9	45	7	46.67	18	40.00
Total	20	100	20	100	15	100	45	100

According to table no.10, 40.22% view that present administration absolutely unable to handle VAT. However, 40% are optimistic. Their view is that if certain improvements can be made within the tax administration there will certainly be possibilities of positive result. According to them:

i. Past records reveal that the revenue administration has mostly failed to fulfill the administrative requirement for various taxes while expected outcome has65become only theoretical. This indicates that the same will be the case in the future because past is the mirror on which the future is reflected.

ii. Many government policies in Nepal are implemented without proper consideration and preparation. Most deplorably, the government of Nepal is used to performing the task in hurry or on the spur of the moment without giving it a detailed thought. This has often resulted in the failure of the policies it has formulated. Regarding VAT, the case is more or less similar in that the government is still unable to shatter its status quo.

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

4.3.1 VAT as the best way to increase public revenue

The implementation of VAT in Nepal was necessitated by the strong aspiration to increase the revenue. VAT is by far the most transparent, fair and broad based tax system. So there can be no possibilities of tax evasion. Different people have different view when asked what the best way it is to increase public revenue through VAT

Table 11

Best way to increase public revenue through VAT

Respondent	Tax Officials		Business Persons		Consumers		Total	
Alternatives	No.	%	No.	%	No.	%	No.	%
Increasing tax	2	10					1	2.22
Widening its Coverage	14	70	15	75	9	60	30	66.77
Discouraging tax evasion	4	20	4	20	6	40	13	28.89
Others			1	5			1	2.22
Total	20	100	20	100	15	100	55	100

Table 11 shows, that the best way to increase public revenue through VAT is to widen its coverage. Here, 66.77% of the total respondents are found to think along that line. About 28.89% went for the option of discouraging the tax evasion. The public awareness program also has a great bearing on the phenomenal increase of public revenue.

4.3.2 Habit of taking bills on purchases

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

Table No. 12

Habit of taking Bills on Purchase

Respondents	Tax Officials		Business Person		Consumers		Total	
Alternatives	No.	%	No.	%	No.	%	No.	%
Yes on every Purchase	10	50	10	25	1	6.66	21	24.44
Yes, on most of the Purchase	10	50	26	65	2	13.33	38	44.44
Yes, But not Regular			4	10	10	66.67	16	26.67
No, I never get any bill					2	13.33	2	4.5
Total	**20**	**100**	**20**	**100**	**15**	**100**	**75**	**100**

Table 12 shows that 50% of tax officials, 65% of business and 13.33% of consumers have the habit of taking bills on most of their purchases. In total 24.44% of people take bills on every of their purchases. About 26.67% of people have the habit of taking bills but are not so serious about it so they are not regular about picking up bills on their purchases. 4.45% of people complain that they are not given any bill when they buy goods or services. It is a liability of every salesman to produce the bill whereas demand for bills is the lawful right of every customer.

4.3.3 Percentage of Customers demanding bills

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

Table 13

Percentage of Customers demanding bills

Respondents	Tax Officials		Business Persons		Consumers		Total	
Percentage	No.	%	No.	%	No.	%	No.	%
Less than 20	9	90	12	60	10	66.67	31	68.89
20-40	1	10	3	15	4	26.67	8	17.78
40-60			1	5	1	6.66	2	4.44
60-80			2	10			2	4.45
80 above			2	10			2	4.44
Total	10	100	20	100	15	100	45	100

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

4.3.4 VAT Education

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

Table 14

Effective Media for VAT Education

Respondents	**Tax Officials**		**Business Persons**		**Consumers**		**Total**	
Alternatives choices	No.	%	No.	%	No.	%	No.	%
Radio/TV	2	20	12	60	5	33.33	19	24.44
Newspaper	5	50	3	15	7	46.67	15	48.89
Booklets/Pamphlets			2	10	1	6.67	3	17.78
Wall Painting/Banner	2	20	1	5	1	6.66	4	6.67
Seminar	1	10	2	10	1	6.66	4	2.22
Total	**10**	**100**	**20**	**100**	**15**	**100**	**45**	**100**

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

4.3.5 Weaknesses in VAT Administration

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

Table 15

Weaknesses in VAT administration

Respondents	Tax Official		Business Persons		Consumers		Total	
Alternatives	No.	%	No.	%	No.	%	No.	%
Lack of Expertise	8	40	2	10	5	33.33	15	24.44
Lack of Trained	4	20	14	70	6	40	26	48.89

Manpower								
Corruption & Bribing			4	20	4	26.67	8	17.78
Lack of Physical infrastructure	6	30					6	6.66
Lack of sufficient field Offices	2	10					2	2.22
Total	20	100	20	100	15	100	65	100

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

4.3.6 Behavior of VAT Administrator towards Taxpayers.

The following survey shows what the respondents which are only Business persons feel about the administrators' behavior towards them.

Table 16

Behavior of VAT Administrator towards Taxpayer

Respondents	Business Persons	
Alternatives Choices	No.	%
Very Helpful	12	60
Helpful	3	15

Very Troublesome & slow in their work	2	10
Disrespectful, Treating Badly	1	5
Total	20	100

The table 16 shows that about 30% of businessmen have the view that the VAT administrators are helpful. About 70% view that tax official's work in steady and troublesome manner, not finishing the work in time and causing unnecessary trouble to them. Some even believe that VAT administrators are incapable, disrespectful and dishonest i.e. finishing work only after they are sufficiently described.

4.3.7 Problems in VAT Collection

The reason behind the introduction of VAT is mainly to increase public revenue. VAT is collected from tax payers. Modern and scientific as the VAT is, it is expected that tax collection will pick up significantly through VAT, but the result has not been satisfactory yet. The crucial question is: What are the problems behind it? There maybe various problems causing a setback to the collection of VAT. Four alternatives were given to the respondent so that they can rank them at will. Total marks given by tax officials, businessmen and consumers can be seen from Table 17.

Table 17

Problems in VAT collection

Respondents	Tax Officials		Business Persons		Consumers		Total	
Alternatives	No.	%	No.	%	No.	%	No.	%
Registration	2	20	6	30	4	26.66	12	26.66
Account Keeping	3	30	6	30	5	33.33	14	31.11
Biling	4	40	3	15	5	33.33	12	26.66
Tax Refunding	1	10	5	25	1	6.66	7	15.55

Total	10	100	20	100	15	100	45	100

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

4.3.8 Problems in Account Keeping

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

Table 18

Problems in Account keeping

Respondents	Tax Official		Business Persons		Consumers		Total	
Alternatives	No.	%	No.	%	No.	%	No.	%
Illiteracy	2	20	2	10	3	20	7	15.56
Not used to A/c Keeping	3	30	14	70	4	26.66	21	46.67
Rules & Regulation still confusing			2	10	2	13.33	4	8.89
Tax evasion is difficult under VAT	5	50	2	10	6	40	13	28.89
Total	10	100	20	100	15	100	45	100

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

4.3.9 Problems in the implementation of VAT

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

Table 19

Problems in Implementation of VAT

Respondents	Tax Official		Business Persons		Consumers		Total	
Alternatives	No.	%	No.	%	No.	%	No.	%
Adm. Incapability	1	10	5	25	3	20	9	20
Under invoicing	2	20	1	5	4	26.67	7	15.56
Frequent change in Acts	1	10	4	20	1	6.66	6	13.33
Lack of Public awareness	2	20	3	15	4	26.66	9	20
Lack of long term policy & Strategy	2	20	3	15	1	6.67	6	13.33
Tax Payers unknown to VAT	2	20	4	20	2	13.33	8	17.78
Total	10	100	20	100	15	100	45	100

Table 19 reveals that about 20% point to the lack of public awareness for the problem in the effective VAT implementation. Due to the lack of public awareness, customers hardly demand any bills on their purchase. Total 20% consider administrative incapability as a hindrance to VAT implementation. Tax payers are oblivious to the term VAT itself.

4.4 VAT as a Substitute of Sales Tax

VAT is an improved form of sales tax. It is a substitute for sales tax, hotel tax, contract tax and entertainment tax. It is not a genuinely new form of taxation but merely a sales tax administered in different and more developed form. The prices to be charged under VAT and sales tax do not differ. Under the VAT system, consumers know the amount they are paying in form of VAT but under sales tax system, it was not shown separately in the bill. Though both taxes are collected finally from the consumers, VAT is more transparent than sales tax. VAT is levied at each stage from production to sales but sales tax is levied on only certain level of sales. Following example will clarify that VAT does not increase the prices of goods on services.

Example: An importer imported a certain article for Rs. 1,000. Then it was passed on to wholesaler and retailer before reaching to the final consumer. Importer, wholesaler and retailer charged 10% profit/mark up on their costs each. Not following tables are used to find out the cost price to consumer in both tax systems.

Table 20

Calculation of Sales Tax and the Cost Price to the consumer

Channel	Cost price	Profit mark up under sales	Selling Price	Sales Tax	S.P incurring sales Tax
Importer to wholesaler	1000	100	1100	143	1243
Wholesaler to Retailer	1243	124.3	1367.305	0	1367
Retailer to consumer	1367	136.7	1503.7	0	1503.7

Sales tax collected Rs.143

Cost Price to the consumer Rs. 1503.7

Table 21

Computation of VAT and the cost price to consumer

Channel	Cost Price	Value Added	S.P exc. VAT	VAT @13%	S.P incl. VAT	VAT Payable
Imported	1000		1000	130		130

Goods						
Importer to Wholesaler	1000	100	1100	143	1243	13
Wholesaler to Retailer	1100	150	1250	162.5	1412.5	19.5
Retailer to Consumer	1250	200	1450	188.5	1638.5	26

Since, Cost price to the consumer Rs.1638.5

VAT payable Rs. 188.5

From all above, it is known that:

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

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

4.5 Revenue Structure of Nepal

. Revenue collected from tax and non tax revenue is said to be total revenue of government. The tax revenue, which is compulsory sacrifice of the peoples, can divide into two components i.e. direct tax and indirect tax. Those revenues collected as income tax, land tax, property tax, etc are direct tax and those revenues collected as sales tax, value added tax (VAT), customs and contract tax etc are an indirect tax. Another side, the government has received other kinds of revenues, e.g. postal service charge, fees fines and forfeiture etc are non-tax revenues. Non-tax revenue are not imposed specially views f revenue collection. In Nepalese economy amount of tax revenue is generally higher than that of non-tax revenue. In Nepal, the contribution of tax revenue used to be almost 80% and non-tax revenue almost 20%. The structure can see in the Table no. 8.

Table –22

Revenue Trend in Nepal

Rs. In million

Year	Total Revenue	Tax Revenue	Tax Revenue@%of TR	Non Tax Revenue NXTR	Non Tax Revenue as% of TR
2000/01	48893.6	38865.1	79.49	10028.5	20.51
2001/02	50445.5	39330.6	77.97	11114.9	22.03
2002/03	56229.8	42586.9	75.74	13642.9	24.26
2003/04	56229.8	48173	85.67	8056.8	14.33
2004/05	62331	54104.7	86.80	8226.3	13.20
2005/06	70122.7	57430.47	81.90	12692.23	18.10
2006/07	72282.1	71126.73	98.40	1155.37	1.60
2007/08	87712.1	85155.5	97.09	2556.6	2.91
2008/09	107622.5	117051.9	108.76	-9429.4	(8.76)
2009/10	143474.5	93080.5	0.65	50394	35.00

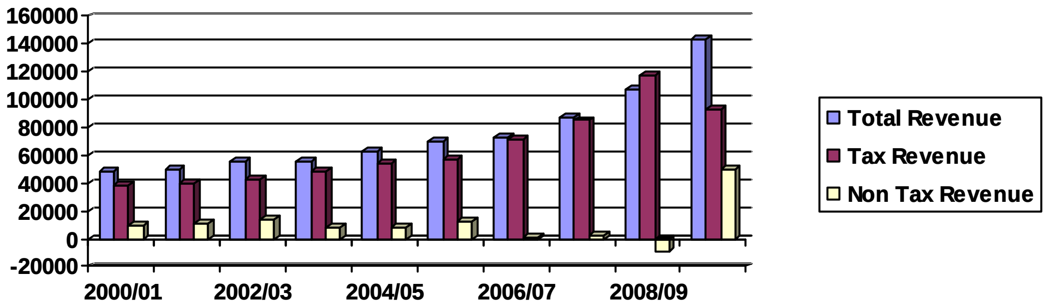
Source: Finance Comptroller General Office,

Economic Survey 2009/2010, Ministry of Finance

***Note:** VAT Implementation Year

Above table exhibit structures of total revenue of the government before and after implementation of VAT. The contribution of tax revenue on total revenue in the year 2000/01 is 77.29%. There is slightly increased in the year 2001/02. In the next year 2002/03 there is decrement of 75.74%, in the same following year 2003/04 the tax revenue revenue increase the 85.67%. Likewise in the 2004/05 there is increment and in the year 2005/06 the percentage falls to 81.90% . After the above year the tax revenue is in the increase order till 2009/10 year.

VAT Implementation Year



Fiscal Year.

Chart no: - 1

4.5.1 Structure of tax Revenue

Tax is the compulsory levy made to government treasury by public. Tax is levied either directly on income of indirectly on consumption of goods and services. Indirect tax is collected mainly from customs and the consumption of goods and services. Supremacy of tax user of indirect tax is one of the important features of the developing economies. The propensity to consumption is higher in developing countries due to their marginal income. The insignificant level of saving, marginal results in to the poor level of the collection of direct tax. The heavy reliance of indirect taxation in Nepal is justified on the administrative ground .Nepal is not in a condition to generate adequate revenue from direct taxation. Agriculture is the main occupation of the Nepalese people.

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

Table No.23

Structure of Total Tax Revenue **Rs. in million**

Year	Total Tax Revenue	Direct Tax Rs	Ratio %	Indirect Tax Rs	Ratio%
2000/01	38865.1	10159.4	26.14	28705.7	73.86
2001/02	39330.6	10597.5	26.94	28733.1	73.06
2002/03	42586.9	10105.7	23.73	32481.2	76.27
2003/04	48173	11912.6	24.73	36260.4	75.27
2004/05	54104.7	13071.8	24.16	41032.9	75.84
2005/06	57430.47	13968.1	24.32	43462.37	75.68
2006/07	71126.73	18980.29	26.69	52146.44	73.31
2007/08	85129.57	2308.77	2.71	82820.8	97.29
2008/09	68080.2	3432.07	5.04	64648.13	94.96
2009/10	93080.5	2261.49	2.43	90819.01	97.57

Source: Finance Comptroller Department2009/10,

Economic Survey 2009/2010, MOF

***Note:** VAT Implementation Year

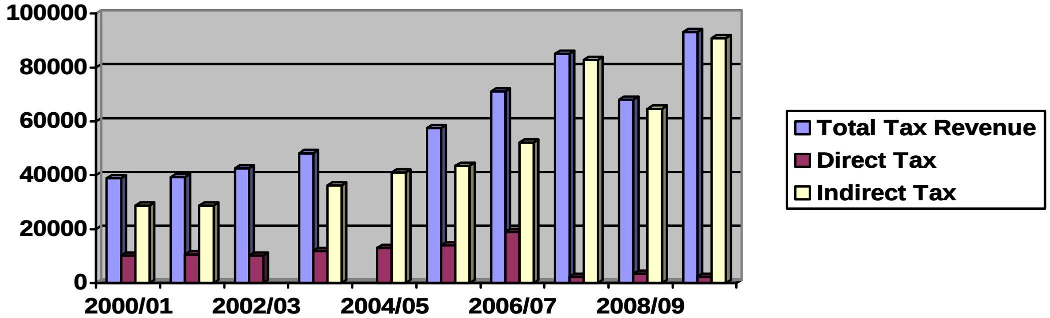


Chart No.2

In the above data the total tax revenue of 2000/01 is Rs.38865.1 in which direct tax is Rs.10159.4 and indirect tax is 28705.7 and the percentage of these are 26.14% and 73.86% respectively. And in the year 2001/02 the total tax revenue is Rs.39330.6 out which Rs.10597.5 is tax revenue and Rs.28733.12 is indirect tax revenue and the percentage of it is 26.94% and 73.06% respectively. Similarly in the forth coming year the total tax revenue is found to be in increase order. The highest percentage of direct tax revenue is found to be 26.69% in the year and 2006/07 and the highest indirect tax revenue is found in the last fiscal year i.e 2009/2010. in brief it said to be flexible in nature. .

4.6 VAT Registration

Registration is a preliminary step in the whole process of VAT system. The threshold limit of VAT registration used to be Rs. 2 million previously. But now, it has changed only. All tax payers whose taxable transaction stand above Rs. 1 million are compulsorily required to register for VAT. But those firms whose turnover is apparently below the prescribed threshold limit also can go for registration if they so desire. The firms having more than Rs. 2 million who were not previously registered under sales tax required to register for VAT within 90 days from 16 November, 1997,or the date of issue of VAT Act. It was however not necessary to register if they only dealt with tax exempt goods and services. Similarly, the Nepalese VAT Act does not allow branch or division registration system.

Table 24

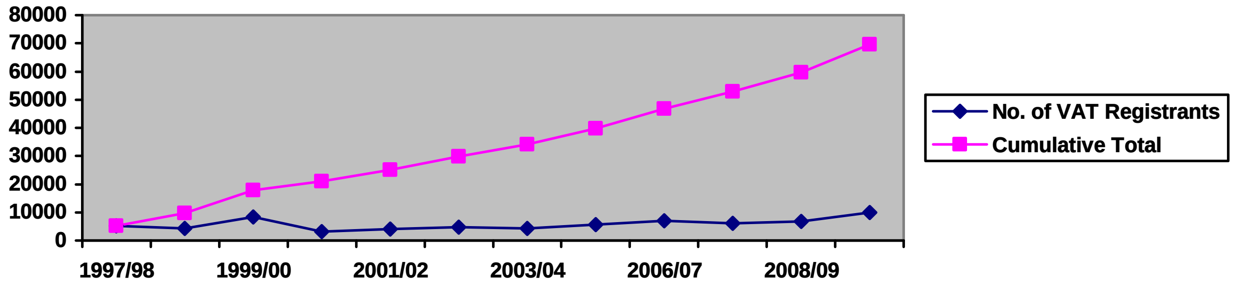
Year-wise number of VAT Registrants

Fiscal Year	No. of VAT Registrants	Cumulative Total (CT)	Rate %
1997/98	5237	5237	-
1998/99	4405	9642	84.11
1999/2000	8305	17947	86.13
2000/01	3146	21093	17.53
2001/02	4056	25149	19.23
2002/03	4723	29872	18.78
2003/04	4302	34174	14.40
2004/05	5602	39776	16.39
2005/06	7055	46831	17.74
2006/07	6134	52965	13.10
2007/08	6742	59707	12.72
2008/09	9946	69653	16.65
2009/10	10600	80253	

Source: Annual Report 2009/2010,

Inland Revenue Department :www.ird.gov.np

Trend of VAT Registration



Fiscal year

Chart No: 3

The number of sales tax registrant was 2045 at the time of the introduction of VAT in1997. Among them those with an annual transaction above the VAT registration threshold were converted into VAT registrants from 16 Nov. 1994 while between those having transaction below the threshold level some registered voluntarily and other remained under the VAT net. Other potential taxpayers that were outside, the sales tax net registered for VAT over the year. The member of VAT registrants increased gradually. In one side, some taxpayers registered under the revenue department and in the other side, some registrant tax payers cancelled their registration under VAT department. This is proved by the above table and chart, which shows in the year1997/98, 5237 taxpayers registered for VAT.

In the year 1998/99 new tax payers registered were 4405 and the total tax payers increased to 9642 by 84.11%. The growth rate of VAT registration remained at a high level in the fiscal year 1999/2000 at about 86.13%. Both voluntarily and compulsorily, the business communities came under VAT flag because there is a legal provision in the VAT law that the government bodies are required to buy only from the VAT registrants in case of their purchases exceeding certain amount. This seems to have compelled them to register for VAT. However, the figure above shows the trend is in the steady line with sporadic rise, but that is negligible. The percentage is on the decrease finally ending up at 13.10% in the fiscal year 2006/2007. This show the businessmen are getting disinterested in registration for VAT. The year 2009/10 shows a little increase in the VAT registrant's i.e 16.65% in the comparison of the last fiscal year 2008/09.The table below shows the tax payers' trend of canceling registration from VAT.

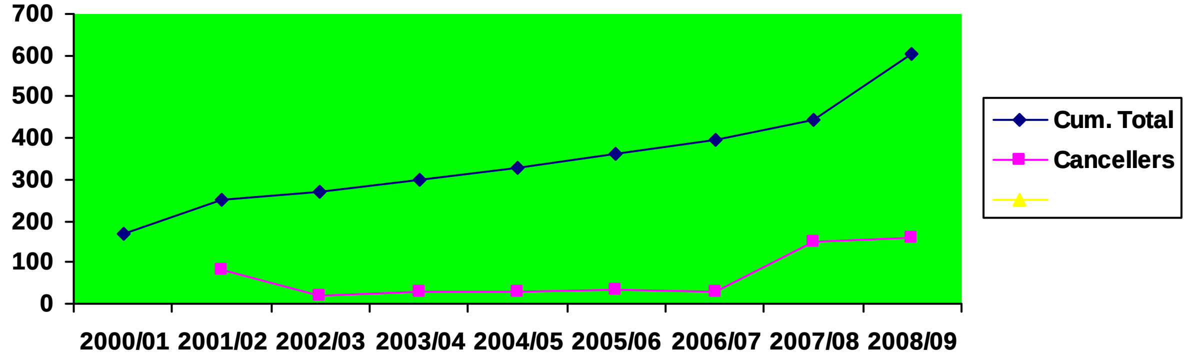
Table 25

Year-wise number of VAT Cancellation (2000/01-2009/10)

Fiscal Year..	No. of Cancellation	Cumulative Total	Rate (%)
2000/01	170	170	-
2001/02	80	250	0.47
2002/03	18	268	0.07
2003/04	30	298	0.11
2004/05	30	328	0.10
2005/06	36	364	0.11
2006/07	31	395	0.09
2007/08	150	445	0.37
2008/09	158	603	0.35
2009/10	168	771	0.28

Source: Annual Report 2009/2010, Inland Revenue Department

Trend of registration cancellation



F

iscal year

Chart No: -4

The above table and chart depict the data from the fiscal year 2057/58 to 2063/64, according to which the taxpayers who cancelled their registration in the fiscal year2000/2001 was by far the most huge number of those of the subsequent years, i.e. 170.This was followed by only 80 which shows about half the decrease of the preceding year. The percentage 0.47 shows the significant decrease. In the fiscal year2059/60, the cancellation decreased even significantly, thereby hinting at the taxpayers' more inclination towards VAT. The trend stood almost constant from the fiscal years. But in the last two years 2064/65 and 2065/66 has been increased which is not a good indication from the nation side. In the above of the recent two years it is obviously effective for the nation. Still awareness program must be held to transit the taxpayers about the benefits of the VAT.

4.7 Non-Filers

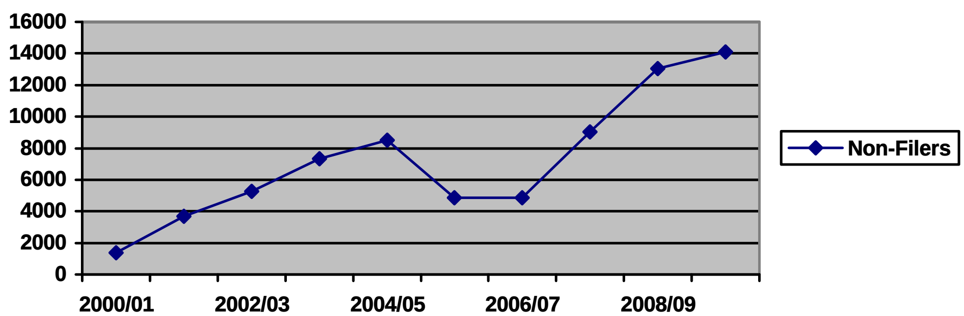
There is a legal provision in the VAT law that all the registrants are required to submit their tax return after 25 days of completion of the tax period. It does not matter whether any transaction takes place within that period or not. It is necessary to submit the tax return within the specified time. Registrants who fail to submit their tax return is known as non-filers. The table and chart below illustrate the no. of non-filers in each fiscal year from 2000/2001 to 2008/2009

Table 26

Year-wise number of Non filers (2000/01-2009/10)

Fiscal Year	Total Registrants	Non-Filers	%
2000/01	21093	1383	6.56
2001/02	25149	3676	14.62
2002/03	29872	5255	17.59
2003/04	34174	7322	21.42
2004/05	39776	8492	21.34
2005/06	46831	4879	10.41
2006/07	52965	4879	9.21
2007/08	59707	9050	15.15
2008/09	69653	13040	18.72
2009/10	76598	15240	19.89

Source: Annual Report 2009/2010, Inland Revenue Department



Fiscal Year

Chart No: - 5

Table 22 and figure 5 shows that the status of Non-filers in increasing trend from the fiscal years 2000/2001 to 2005/2006. In the fiscal year 2000/2001, only 4percent failed to submit the tax return. But this trend was on the increase in each subsequent year until the fiscal year 2005/2006. In 2006/2007, the trend once again declined showing a significant check on taxpayers' habit of not submitting the tax return. On the other hand, it foretells a good sign for the future trend as well because it is said that the morning shows the day. But in the year 2008/09 and 2009/10 the table shows the exceeding ratio of non filers which is not a good indication for the economy.

4.8 Revenue Collection from VAT

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

Table 27

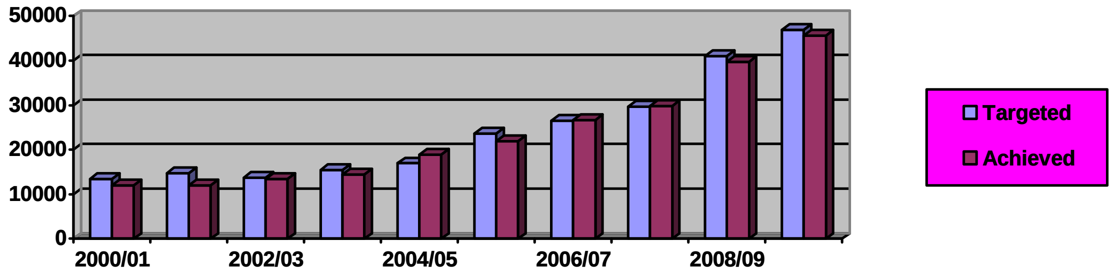
Revenue collection from VAT

Rs.In million.

Fiscal Year	**Targeted**	**Achieved**	**% Change**
2000/01	13500	12050	-10.74
2001/02	14750	11947.95	-19.00
2002/03	13730.05	13449.12	-2.00
2003/04	15503.50	14448.89	-7.00
2004/05	16950	18894.63	11.00
2005/06	23650	21946.01	-7.00
2006/07	26463.	26704.18	1.00
2007/08	29651.9	29815.7	+ 0.55
2008/09	41000	39700.9	-3.17
2009/10	46955	45665	-2.74

Sources: - Inland Revenue Department. (Annual Report 2009/10)

Revenue collection from VAT



F

iscal Year

Chart No: - 6

VAT was introduced in order to meet the revenue gap that government had been facing for a long time. In the fiscal year 2000/01 total Rs.12050 million was collected where as expected or targeted was Rs. 13500 million in the same year which is less by 11%than targeted. Similarly, in the fiscal year 2001/02achieved VAT was Rs. 11947.95 million whereas targeted was Rs. 14750.00 million which is 19% less than targeted. However, by small margin of 2% only differ between targeted and achieved in the fiscal year 2002/03. In the fiscal year 2004/05, the revenue actually collected even exceeded the targeted one. In figure, the targeted revenue for that period was Rs. 16950 million where as the collected revenue amounted to Rs.18894.63, i.e. 11% more than the targeted one. But the boom period in revenue collection was to soon be followed by the depression when the 11% increase went far down to -7 in the fiscal year 2005/06 with the targeted revenue Rs. 23650 million and the actual collection only amounting to Rs. 21996 million. This trend seems to be improved again in the following fiscal year 2006/07 when the actual revenue marginally exceeded the targeted one by 1 percent. In the same way year2007/08 shows the little increment in the collection of revenue where as in the year 2008/09 and 2009/10 the revenue collection decreased by3.17% and 2.74% respectively. The change in the revenue collection was triggered partially by the major change in the Nepalese political scenario that took place in the aftermath of the people's movement part 2 on April 2005. Now as can be seen in the figure above, after for the last few years, comparatively the trend of revenue collection is good one although it is still in a fluctuating nature.

4.9 Composition: following are the composition of VAT

4.9.1Composition of VAT Revenue

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

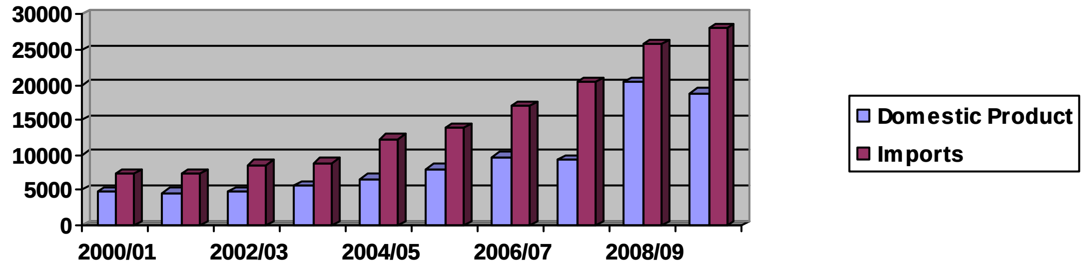
Table 28

Composition of VAT Revenue (Rs. in million)

Fiscal Year	Total VAT Revenue	Domestic Product		Imports	
		Amount	%	Amount	%
2000/01	12050	4744.72	39.38	7303.04	60.61
2001/02	11947.95	4608.37	68.57	7339.58	61.43
2002/03	13449.12	4819.61	35.84	8629.51	64.16
2003/04	14448.89	5604.12	38.79	8874.77	61.42
2004/05	18894.63	6624.33	35.06	12270.29	64.94
2005/06	21946.01	8057.43	36.71	13888.58	63.29
2006/07	26704.18	9689.98	36.29	17014.20	63.71
2007/08	29703.21	9264.71	31.19	20438.5	68.81
2008/09	39700.9	13918.49	35.06	25782.43	64.94
2009/10	46910	18788	40.05	28122	59.94

Sources: - Annual Report 2009/10;

Composition of VAT Revenue



Fiscal Year

Chart No: - 7

In fiscal year 2000/01, share of domestic and imported VAT revenue in total revenue was 39.38% and 60.61% respectively while in the fiscal year 2002/03 is 35.83% to 64.16%. In the fiscal year 2006/07, domestic products contributed 36.29% whereas imported goods contributed 63.71% in the total VAT revenue. In Nepalese VAT structure, collection from imports share about two-third and collection from domestic source occupies one-third only. In the fiscal year 2009/10 the total VAT revenue is 46910 where as domestic product is 18788(40.05%) and imports is 28122(59.94%)

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

Gross Domestic Product is the total final output of goods and services produced by the country's territory by residents and non-residents, regardless of its collection between domestic and foreign claims. The VAT/GDP ratio measures the consistency of the growth of VAT revenue with the corresponding growth in gross National Product. This is an indicator of the utilization of taxable capacity. Normally, the growth of VAT revenue mobilization in line with the growth in GDP is desirable for the rapid economic development of a country. The collection of

VAT revenue is more reliable than the Direct tax revenue, Non tax revenue which facilitates the process of economic planning and development in the country. VAT has been introduced in Nepal to increase the contribution towards revenue generation. The contribution of VAT revenue in GDP is shown below.

Table 29

VAT Revenue as percentage of GDP

Rs. in million

Fiscal Years	**GDP**	**VAT Revenue**	**% of VAT on GDP**
2001/002	404482.00	11947.95	2.78
2002/003	468920.00	13449.12	2.92
2003/004	472424.00	14448.89	2.89
2004/005	504101.00	18894.63	3.44
2005/006	582950.00	21946.01	3.64
2006/007	670588.70	26704.18	3.98
2007/008	820814.00	29815.70	3.63
2008/009	960012.00	39700.90	4.13
2009/2010	1119210.00	47988.55	4.28

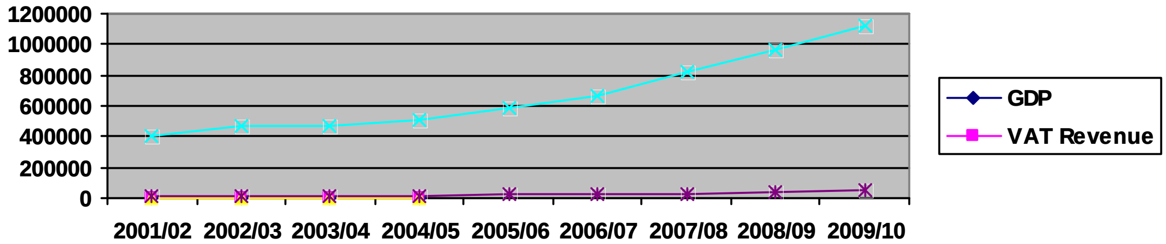
Source: Economic Surveys 2009/2010 MOF.

Macroeconomic Indicators of Nepal 2009/10,

Economic Reports 2009/10 NRB, Katmandu, Nepal

*Gross Domestic Product at current price

Share of VAT Revenue



Fiscal Year

Chart: - 8

Above table reveals, that share of VAT revenue in GDP is 3.01% in an average through the analysis period. The contribution made through VAT in GDP is very low. In fiscal year 2001/2002, total amount Rs. 11947.95 million was collected as VAT which was only2.78% of GDP. However, though insignificantly, the percentage shows the increasing trend, but very low percentage of GDP throughout all the years of analysis. The highest percentage i.e.4.28% was recorded in the fiscal year 2009/2010 with VAT revenue amounting to Rs 1119210million. So, it can be said that the trend does show an increasing trend although in a snail pace which can be better seen in the graph. So in conclusion, the contribution made through VAT in GDP is very low.

4.9.3 Share of VAT Revenue in Total Revenue

Total Revenue includes Tax revenue and non-tax revenue. The contribution of VAT revenue to the total revenue has been shown in the Table 26.

Table 30

VAT Revenue as percentage of Total Revenue (Rs. in million)

Fiscal Years	Total Revenue	VAT Revenue	% of VAT on total Revenue
2000/01	48893.9	12050	24.65
2001/02	50445.6	11947.95	23.68
2002/03	56229.7	13449.12	23.92

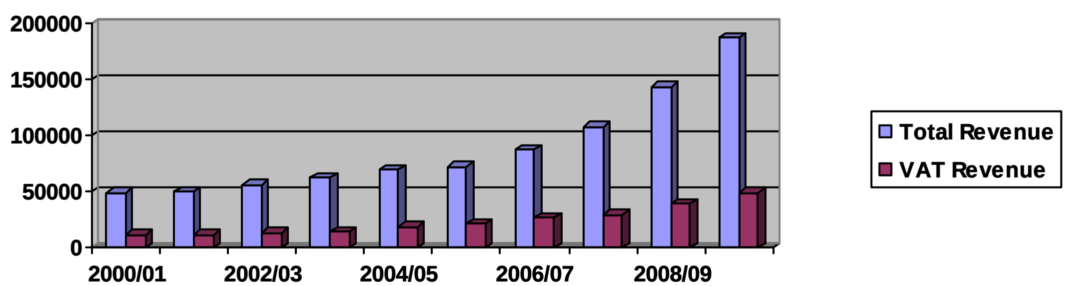
2003/04	62331	14448.89	23.18
2004/05	70122.7	18894.63	26.95
2005/06	72282.18	21946.01	30.36
2006/07	87712.08	26704.18	31.00
2007/08	107622.48	29815.70	27.7
2008/09	143474.48	39700.9	27.67
2009/10	186974	49267.65	26.35

Source: Table 1.1, Economic Survey 2009/10, MOF.

Budget Speech 2009/10, MOF.

Above table, reveals that an average contribution of VAT to the total revenue is 27.47In the fiscal year 2000/2001, its contribution was 24.65, it kept increasing in the Year to 2006/07 by 31.00%, and the highest ratio is found in the study and in the next 3 fiscal years2007/08, 2008/09 and 2009/10 it is found to be decline in the ratio by 27.7%,27.67and 26.35% respectively. The same figure can be better viewed in the following chart.

Share of VAT Revenue in Total Revenue



Fisc

al year

Chart No: - 9

4.9.4 Share of VAT Revenue in Total Tax Revenue

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

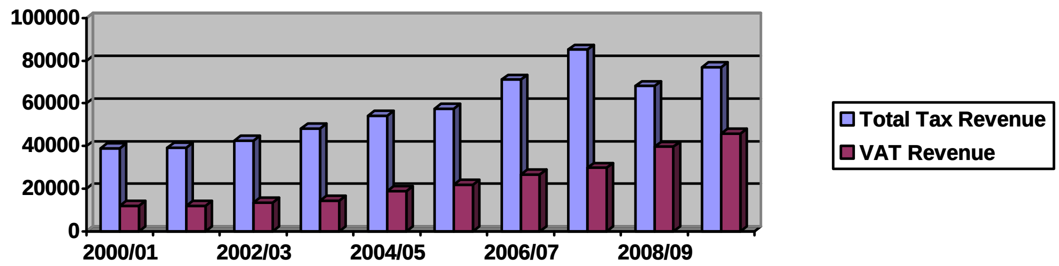
Table 31

VAT Revenue as % of Total Tax Revenue Rs. in Million

Fiscal Year	Total Tax Revenue	VAT Revenue	% of VAT on Total Revenue
2000/01	38865.10	12050	31.00
2001/02	39330.6	11947.95	30.38
2002/03	42586.90	13449.12	31.58
2003/04	48173.00	14448.89	29.99
2004/05	54104.70	18894.63	34.92
2005/06	57430.40	21946.01	38.21
2006/07	71126.73	26704.18	37.54
2007/08	85129.57	29815.70	35.02
2008/09	68080.2	39700.9	58.31
2009/10	76987.3	45876.73	59.59

Source: Annual Report 2009/2010, Inland Revenue Department

VAT Revenue as % of Total Tax Revenue



Fiscal Year

Chart No: -10

The above table shows that there is high share of VAT in total revenue in Nepal. In the fiscal year 2000/01, the percentage of VAT in total tax revenue is 31% similarly in the fiscal year 2009/10 it was increased to 59.59% less by 1.28 % from the previous fiscal year. The average contribution of VAT to the total revenue is 42.56%, which is a fraction above the half of the total tax revenue. This proves that Nepalese tax revenue without the inclusion of VAT is unthinkable.

4.10 Analysis of the Data with Various Statistical Tools

4.10.1Time Series Analysis

A time series is an arrangement of statistical data in a chronological order, *i.e.*, in accordance with its time of occurrence. It reflects the dynamic pace of movements of a phenomenon over a period of time. Most of the series relating to Economics, Business and Commerce, *e.g.*, the series relating to prices, production, and consumption of various commodities; agricultural and industrial production, national income and foreign exchange reserves; investments, sales and profits of business houses; bank deposits and bank clearings, prices and dividends of shares in a stock exchange market etc., are all times series spread over a long period of time. Accordingly, time series have an important and significant place in Business and Economics, and most of the statistical techniques for the analysis of time series data have been developed by economists. However, these techniques can also be applied for the study of behaviors of any phenomenon collected chronologically over a period of time in any discipline relating to natural and social sciences, though not directly related to economics or business. (Gupta, 1996: 754)

One of the most commonly used method is the *Least Square Method* which is employed here to measure the trend for further prediction of the GDP and VAT revenue for the next five years from the fiscal years 2007-2008 to 2012-2113 to estimate whether there may be increase in the VAT/GDP ratio from the current average of 3.22%, given the same trend. Future amount of GDP and VAT are predicted on the basis of the data of the last fiscal years. The parameter of time series analysis for the further prediction of GDP and VAT revenue, a and b, where a is the Y interception or the computed trend figure of variable when X = 0 and b represent the slop of the trend line or the amount of change in Y variable that is associated with a changeable of one unit in x variable. The x variable in time series represents time and Y represents GDP and VAT revenue. For **predicting the amount of GDP**, the parameter of the analysis, computed in the appendix 1 are as follows:

a = 271883.77;

b = 75256.16

Thus the trend line of dependent variable GDP and independent variable time (i.e. year)is: GDP (Y_c) = 271883.77+ 75256.16 X

Similarly**, for predicting the VAT revenue**, the parameters of the analysis, computed in the Appendix-2 are as follows:

a = 5189.10

b = 3760.95

Where the trend line of dependent variable VAT revenue and independent variable time

(I.e. year) is:

VAT Revenue (Y_c) = 5189.10 + 3760.95 X

Predicted amount of GDP and VAT revenue, computed in the for the period 2009-2010 to 2013-2014 is presented in the table …………………….

Table 32

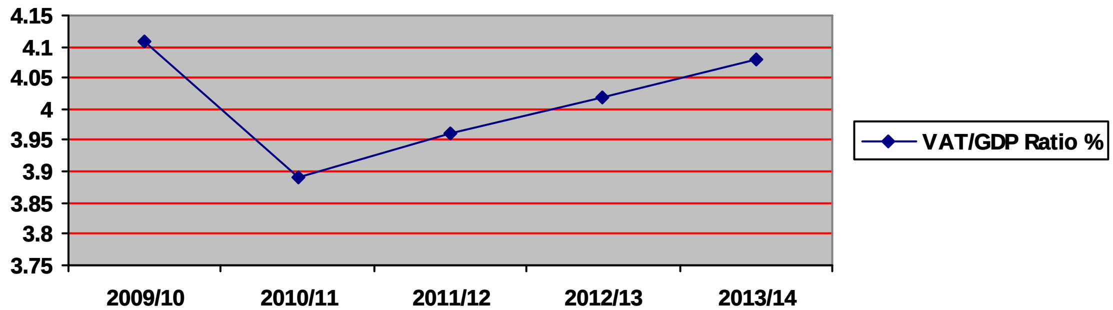
Predicted value of GDP and VAT Revenue

In million

Fiscal Year	2009/10	2010/11	2011/12	2012/13	2013/14
GDP	949189.21	1099701.53	1174957.69	1250213.85	1325470.01
VAT	39037.65	42798.6	46559.55	50320.5	54081.45
VAT/GDP (%)	4.11%	3.89%	3.96%	4.02%	4.08%

The table shows that given the same trend, the ratio of VAT on GDP will grow in a nominal rate in the coming future. These ratios are presented in the figure 12 as well.

Predicted Value of GDP and VAT Revenue



Fiscal year

Chart No:- -11

In the figure 12, X-axis denotes years and y-axis denotes ratio of VAT on GDP. The figure depicts that the percentage of VAT of VAT on GDP will increase over 4% over the next five years. The remarkable point is that, if VAT revenue and amount of GDP follow the same trend lines in the coming years, the target of government to increase the percentage of VAT on GDP at or beyond 4% will be achieved. But this is only nominal growth. For the phenomenal increase like up to 5 or 6% at least, there must be several things that need to be taken into considerations by the government like the good administration, VAT education etc which were already described above.

4.10.2 Correlation Analysis

Correlation is defined as the association of two or more random variables or is the degree of relationship between variables, which seeks to determine how well a linear or other equation describes or explains the relationship between variables. The significance of correlation coefficient can be tested through t-test with certain level of significance at certain number of degree of freedom. One very convenient and useful way of interpreting the value of coefficient of correlation between two variables is to use square of coefficient of correlation, which is called coefficient of determination.

4.10.2.1 Gross Domestic Product with Value Added Tax Revenue

The relationship of VAT revenue and GDP is examined with the help of seven year data from the fiscal year 2001/2002 to 2009/2010. Further, the relation of VAT with GDP, coefficient of determination and value, of t-test, computed in the Appendices- 3 are presented below:

Statistical Tools for Analysis	
Correlation Coefficient (r)	0.99
Coefficients of Determination (r^2)	0.98
Value of t-test	9.157
Table Value of $t_{0.05,5}$	2.145

The association of VAT revenue with GDP is very high or in other words, the VAT revenue is perfectly correlated with GDP (i.e. r = 0.989). The significance of correlation efficient is high which is over 5 times greater than the value of $t_{0.05,5}$ (i.e. 9.157 > 2.145).The coefficient of determination (r^2) is 0.98 which means 98% of total variation in VAT revenue is explained by gross domestic product.

4.10.2.2 Total Revenue with Value Added Tax Revenue

The effect of VAT revenue to total revenue is identified with the help of six years VAT revenue from the fiscal year 2000-2001 to 2009-2010. The association of VAT and sales tax revenue with total revenue, coefficient of determination and value of t-test, computed

Appendix 4, and average ratio of VAT and sales tax with total revenue over the reviewed period are presented below:

Statistical Tools of Analysis	
Correlation of Coefficient (r)	0.98
Coefficient of determination (r^2)	.96
Value of t- test	1.23
Tabulated value $t_{0.05}$	2.12

The relationship of total revenue with VAT revenue is very high. Or, there is almost linear relationship between total revenue and VAT revenue, where the calculated value of r is 0.978. The significance of correlation coefficient is also very high and the calculated value of t is lesser is than the tabulated value of $t_{0.005,5}$ (i.e.,1.23< 2.12). For testing the significance of correlation coefficient, 5% level of significance has been fixed. The coefficient of determination (r2) is 0.956 which means 95.6% of total variation in total revenue is explained by VAT revenue.

4.10.2.3 Total Tax Revenue with Value Added Tax Revenue

The effect of VAT on the total tax revenue is found out with the help of six years data from 2000-2001 to 2009-2010 on which the study has been confined. The correlation of total tax revenue with VAT and sales tax revenue, coefficient of determination and value of t-test, computed in the appendix-5 and average ratio of VAT in total tax revenue are presented below:

Statistical Tool for Analysis	
Correlation coefficient (r)	0.85
Coefficient of determination (r^2)	0.72
Value of t- test.	5.66

Average % in total tax revenue	37.42 %

The relationship of total tax revenue and VAT revenue is positive and very high or to put it another way, these are perfectly correlated where value or r is 0.991. The significance of correlation coefficient is also high which is more than 6 times greater than table value of $t_{0.05,5}$ (i.e., 17.48>2.571). For testing the significance of correlation coefficient 5% level of significance has been fixed and degree of freedom was 5. The coefficient of determination (r^2) is 0.984 which means 98.4% of total variation in total tax revenue is explained by the VAT revenue. The average percentage of VAT in total tax over the reviewed period is 49.78. This means 49.78% in total tax revenue is contributed by VAT revenue.90

4.10.2.4 Total Indirect Tax Revenue with Value Added Tax Revenue

The contribution of VAT in Total indirect tax revenue and association of total indirect tax with VAT is found out by analyzing the six years data from the fiscal year 2000-2001 to 2009-2010 on which the study has been confined. The relationship of Indirect Tax with VAT, coefficient of determination and value of t-test, computed in the appendix-6 and average of percentage of VAT on indirect tax over the studied period are summarized below:

Statistical Tools for Analysis	
Correlation Coefficient (r)	0.86
Coefficient of determination (r^2)	0.74
Value of t-test.	2.56
Average % in total indirect tax revenue	46.05 %

The association of total indirect tax and VAT is 0.986, which is very high. It can be said that it is perfectly correlated with each other. This result shows that the total indirect taxis largely affected by VAT. The significance of correlation coefficient between VAT and indirect tax revenue is also higher which is more than 5 times greater than table value of $t_{0.05,5}$ (i.e., 13.04>2.571). For the purpose of testing the significance of the relation, 5%

coefficient of determination (r^2) is 0.971, which means 97.1% of total variation in indirect tax revenue is explained by the VAT revenue. The contribution of VAT in indirect revenue in an average over the reviewed period has been 44.65%.The result shows that the correlation coefficient, coefficient of determination and contribution of VAT are all higher and increased proportionately over the succeeding fiscal years although with slight hiccups in the beginning of course.

4.10.3 Hypothesis testing (Student's t-distribution)

Hypothesis testing begins with an assumption, called a hypothesis that we make about a population parameter. Then we collect sample data, produce sample statistics, and use this information to decide how likely it is that our hypothesized population parameter is correct. Let us suppose that we assume a certain value for a population mean. To test the validity of our assumption, we gather sample data and determine the difference between the hypothesized value and the actual value of the sample mean. Then we judge whether the difference is significant. The smaller the difference, the greater the likelihood that our hypothesized value for mean is correct. The larger the difference, the smaller the likelihood. (Levin & Rubin, 1996: 366).

4.10.3.1 Test of VAT/GDP and VAT/TR (Total Revenue) ratio

The Hypothesis testing tool is used here to test whether there is significant difference between the mean ratios of VAT/GDP and VAT/TR. For that the following hypothesis is established. **(Appendix-5)**

Null hypothesis (H_0): $\mu_1 = \mu_2$

- i.e., there is no significant difference between mean ratios of VAT/GDP and VAT/TR.

Alternative hypothesis (H_1): $\mu_1 \neq \mu_2$ (two tailed test)

i.e., there is no significant difference between mean ratios of VAT/GDP and VAT/TR.

For the purpose of testing the hypothesis, μ_1 denotes the mean of VAT/GDP ratio andμ_2 denotes the mean of VAT/TR ratio for the period of 2000-2001 to 2009-2010. Likewise, X_1 denotes VAT/GDP ratio and X_2 denotes VAT/TR ratio whereas n_1 and $n_2$denote no. of years. For the purpose of getting conclusion, (generally used) 5% level of significance is fixed ($t_{0.05}$) and degree of freedom (n_1+n_2-2) is 16. The test is two tail test (viz., *two* *tailed*) because the study is directed to examine whether or not there is a significant difference between those two mean ratios μ_1 and μ_2. Thus table value of t for 5% level of significance at 16 degree of freedom ( ) is 2.12 (i.e., $t_{0.05,\ 12}$ = 1.782).Computed value of t in **Appendix VIII** is 8.38, which is greater than table value (i.e., 8.38 > 2.12). Alternative hypothesis is accepted and it can be concluded that there is significant difference between mean ratios of VAT & GDP and VAT & TR. In other words, VAT contributes lesser portion to GDP than the Total revenue.

4.11 Major Findings of the study

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

1. The VAT system that has been implemented in Nepal has completed 12 years of its operation and enters into 15 year. But the data presented in this research is only of the 12th year i.e., 1997-98 to 2009-10 due to several constraints. Due to various complexities and problems this tax system has not been able to achieve the expected level of success.

2. Theoretically VAT is superior to Sales tax in many of its form. As it was abolished ready, there is no possibility to compare it with VAT now. So, only theoretical superiority is established.

3. A large amount of government revenue comes from taxation. More than 75% of government revenue comes from taxation whereas the contribution of non-tax revenue is less than 25% in Nepalese tax structure. The contribution of tax revenue was expected to increase after the implementation of VAT. However, implementation of VAT did not increase the contribution of tax revenue on total revenue significantly.

4. Though VAT has been implemented in Nepal in order to generate more revenue, but the efficiency of the Nepalese VAT administration is not satisfactory and not up to the expectation of the general people.

5. More revenue can be generated through VAT by widening its coverage. The small traders which fall on the threshold limit could not have been brought into VAT net yet. They should be registered. The revenue can increase by discouraging tax evasion. There is wide range of practice of evading tax.

6. Only few numbers of consumers have habit of taking bills on their purchases. Customers have no habit to take bill on their purchase. This implies that there is very low public awareness and consciousness level towards VAT. On the other hand, businessmen do not want to issue bills. The businessmen have the intension of 'malpractice' on VAT. So they don't provide bills to customers. This indicates the very need of supervision and rational auditing. The percentage of customers demanding bills on their purchase is very low. This might be the cause of ignorance and no habit of taking bills. Taxpayers are not satisfied with the VAT administration. Only few administrators show helpful behavior towards them. Most of the VAT administrators complete their works very slowly and in steady manner. This type of behavior has created great tension and frustration among taxpayers. Professionalism has not been developed yet in VAT in Nepal. Lack of trained manpower and expertise affects the fluency of VAT administration. Physical infrastructure is also lacking. Unless and until administration is made transparent, capable and trained, the government's intention to collect comparatively more revenue through VAT is just a day dream. There is little knowledge about VAT to taxpayers and low public consciousness level in Nepal. To educate taxpayers and all the concerned bodies, educational programme has to be launched in an effective way. But whatever programme has been under way is not sufficient to create its impact on people. Most of the respondents suggest that Radio/TV might be best media to educate taxpayers and consumers. Newspaper might be another good alternative. The expected amount of VAT collection is not possible due to lack of maintenance of proper accounts which is very serious problems. Billing is also a very serious problem regarding VAT collection. Customers do not have the habit of keeping bills on their every purchase and business does not feel liable to provide bills on their every sale to customers. The only motive not to provide bills is for tax evasion. It has been noticed that traditional Nepalese businessmen do not have the habit of maintaining their account. Tax evasion is very difficult if account is properly maintained. Some are illiterate and some desire to evade tax. Administrative in capability, under invoicing/unbilling and lack of public awareness towards VAT are main problem in the process of VAT implementation in Nepal.

7. Number of taxpayer's registrants under VAT has been increasing year after year. The ratio of registrants just kept fluctuating, it decrease to the 13.10% in the fiscal year 2006/2007 but in the year 2009/10 there is little enhance to 16.65%. This is certainly not a good sign which will have along term bearing on revenue collection. Number of taxpayers canceling their registration under VAT is also generally in the increasing trend, in the fiscal year 2007/08 the cancellation is 37% whereas in the fiscal year there is little decreasement i.e. to the 35%. It is quite ineffective sign in the aspect of nation economy development.

8. The status of Non-filers is not also satisfactory. In the fiscal year 2005/2006, it had increased up to 21.63%, although it had decreased to 14.58% in the fiscal year 2006/2007. But the trend seems to be fluctuating. There is never a constant proportionate increase.

9. Up to the fiscal years 2005/2006, the government failed to meet the targeted revenue. It was only in the fiscal year 2006/2007 that it had just touched the target in the fairly low margin. In the fiscal year2007/08 VAT revenue has been increased by 0.55% but in the next fiscal year 2009/10 target revenue has been decreased by 3.17%. Even after the implementation of VAT 12 years ago, the government had collected the VAT more than target

10. In Nepal, collection of VAT has been classified as domestic and imports sources, out of which collection from domestic has significant share i.e. Rs18788 million is collected in the fiscal year 2009/10 where as imports share Rs.28122 million in the same fiscal year of the total revenue Rs.46910 million where the ratio of domestic is 40.05% and the ratio of imports is 59.94%. This surely indicates that there is a heavy dependence on imports rather than domestic products.

11. The contribution of VAT to GDP reached 4.11 % in the fiscal year 2009/2010. So the VAT/GDP ratio is very low as indicated by the statistical tools like hypothesis testing also.

12. The contribution of VAT in total revenue is not up to the satisfactory level either. In an average, it could contribute just about 27.47 % to the total revenue which is way above the VAT/GDP ratio as indicated by hypothesis testing.

13. Hopefully, an average share of VAT revenue in total tax revenue is pretty good, i.e just about 42.56% which simply indicates that VAT though implementation wise, faring very poorly, is still emerging as the important source of revenue generation.

14. So far as the price to the consumer is concerned, as with the sales tax, the consumer pays the same amount to the retailer. There is no difference in consumer price which paid for the product or service.

15. The Time Series shows that given the same trend, the VAT/GDP ratio is expected to rise to 4%. But this is just the estimated figure for the next 5 years. The last trend shows that the actual VAT revenue has kept falling short of its target.

16. The correlation coefficient of VAT with GDP is 0.989 and coefficient of determination is 0.977. These results show that flexibility of VAT is greater than the sales

tax whose correlation coefficient and coefficient determination are 0.983 and 0.966 respectively. Likewise, the association of total revenue with VAT revenue and coefficient of determination are 0.978 and 0.956 respectively and the relationship of tax revenue with VAT revenue is 0.991 and coefficient of determination is 0.984 with its average percentage in total tax revenue being 42.56. The correlation coefficient of indirect tax with VAT and coefficient determination is 0.86 and 0.74 respectively. The contribution of VAT in indirect tax revenue is 44.65. So these result show that VAT revenue is growing quite proportionately or head to head with GDP, Total revenue, Total tax revenue and Total Indirect Tax Revenue.

17. Most significantly, the hypothesis that the VAT/GDP ratio is different from the VAT/Total Revenue also proved correct when it was tested using the student's t test. All these result show that there is only nominal share of VAT revenue in GDP as contrasted with its big share with Total Revenue and Total Tax revenue.

CHAPTER - V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

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

5.1 Summary

This research work entitled, "Tax Reform in Nepal: A Study of Nepalese Value Added Tax System", has been carried out to ponder into the theoretical knowledge of VAT and to examine the administration system of VAT especially in the Kathmandu valley, to assess the post-implementation period of VAT as compared to the period before the implementation in connection with generating revenue, to examine whether VAT is superior to Sales tax. To achieve those objectives, correlation analysis, time series analysis, t-test analysis empirical analysis have been done with the help of 7 years data(i.e. from the fiscal year 2000/2001 to 2006/2007) and questionnaire developed by the researcher. The study has been divided into five broad chapters. The contents of those chapters' are as follows:

Chapter I: Introduction

Chapter II: Review of Literature

Chapter III: Research Methodology

Chapter IV: Presentation and Analysis of Data

Chapter V: Summary, Conclusion and Recommendations

The first chapter begins with the brief background of the study, i.e., the introduction to Taxation itself, its types and all relevant information about Taxation which is essential for having some understanding about VAT, the main topic. The chapter also goes on to discuss the main focus of the study, research questions, objective of the study, significance, limitations and organization of the study. Therefore this chapter presents the outline of the study highlighting its main aims and the reasons for carrying out the research. In the second chapter, theoretical framework of VAT has been discussed. This chapter includes introduction to VAT, types of VAT, methods of computation of VAT, Origins. Destination principle as dual principles of VAT, historical development of VAT around the globe and in Nepal, Coverage of VAT in Nepal and Tax administration also. Likewise in the resume of earlier studies, related materials like books, dissertations and journals have been reviewed. The third chapter briefly explained the research design, nature and sources of data and the statistical procedure and tools which have been used to conduct the research. The fourth chapter is the main body of the research work which has two main sections viz. presentation and analysis of data, and major findings of the study. This chapter begins with the need for reforms on the present tax system in Nepal, the reform in Tax being the VAT. Its importance was also studied . It also tries to show the superiority of VAT to different forms of Sales tax. The study then moves on to examine the trend preceding and following the implementation of VAT in Nepal. The sample survey of concerned people consisting of tax officials, Businessmen and consumers was conducted to throw light on the administration system of Nepal. About 9 questions were asked them about the various issues relating to administration of VAT in Nepal. The study also discusses the trend of registration, cancellation of registration, Non-filers. Tax return, revenue collection from VAT, composition of VAT revenue, share of VAT revenue to GDP, to Total Revenues and to Total Tax revenue. The chapter then studies the future trend of GDP/VAT ratio. This was done with the statistical tool of Time Series. This will set a benchmark for the future action plan to ensure the growth of the ratio. For studying these various issues, data from the 7 fiscal years, i.e. from 2000/2001to 2006/2007 has been used. To analyze the relationship of VAT with GDP, Total Revenue, Total Tax Revenue, and Total Indirect Tax Revenue, different statistical tools like correlation coefficient, coefficient of determination, and student's t-test method for hypothesis testing were also used. After all these studies were made, the study came up with major find ins which were also included in this chapter. The fifth and final chapter contains the summary of the four earlier chapters. This chapter also has conclusion of the research and attempted to offer various suggestions and recommendations for the enhancement and betterment of VAT in Nepal.

5.2 Conclusion

The ultimate goal of the underdeveloped countries like Nepal is to achieve the economic development and ensure the rapid rate of economic growth. It calls for a huge amount of investment in economic overheads and other development activities for which taxation is undoubtedly a primary source of Inland Revenue for the government. Taxation may be considered as a basic tool in the path of economic development for the underdeveloped countries. Recently, developing as well as developed countries in the world have increasingly focused their attention towards reforming the tax system by standardizing and improving the poorly designed tax structure in order to mobilize high volume of resources for the development purposes and make the economy healthy, efficient and self sufficient to a larger extent. In this regard, VAT has become a point of attraction for about 130 countries in the world including Nepal. Existed sales tax along with contract tax, entertainment tax and hotel tax were replaced by VAT since 1997 in Nepal. VAT was initially expected to have a high revenue yield due to its broader coverage and sis. Elimination economic distortions caused by tax system, elimination of cascading and pyramiding effects, creation of the competitive business environment, strengthening foreign trade etc, as it were, are other features of VAT theoretically, expected to be fulfilled in the real practice. It was not easy for the Nepalese government to implement VAT easily as there were any objections and complaints from the business community. But after some dialogue and negotiations, the government was able to implement it to the satisfaction of all.. One of the key issues is administrative capability and situation which definitely are of great importance for the effective implementation of VAT in Nepal. Actually VAT was introduced in Nepal in an ambitious hope to increase the revenue and particularly stop the leakage made through other forms of taxes. But history has shown that the government has already tried many reforms in the field of taxation but no alternative have effectively materialized because it lacked proper planning and in other words leading to administrative failure. Indeed, this is true in the case of VAT also, Nepalese businessmen are generally found to avoid the frequent contacts with the tax officials because they are widely known for unofficial benefits. Even in the administrative area, there is a widespread corruption. From the survey, it is clear that it is difficult for the customers to get the job done by officials without sufficiently bribing them. There is 100 also a red tapism everywhere. So, for the government, administrative capability and transparency are the serious concerns. In order to make VAT applicable, following things should be considered:

i. Administrative power and credibility

ii. Tax payer identification

iii. Registration and educational program

iv. Incentives for small traders

v. Co-ordination with private sector

vi. Feasibility of refund system

vii. Electronic media

Currently, DANIDA and GTZ have jointly established a VAT project in order to assist the implementation of VAT in Nepal. While the number of registrants are increasing but the tax collection has not been satisfactory when compared to the number of registrants. Public awareness is very low. The salesmen are not used to issuing bills and the consumers to ceiving them. Undervaluation and smuggling of goods are mostly found. The problem seems to be aggravated by the government's increasing the VAT rate to13% which immensely discourages the customer in demanding bills on their purchases. Truly, recent increment in VAT rate has a fairly negative influence on general people. Their viewpoint is to broaden the tax base instead of increasing the tax rate. Tax rate has been increased time and again for nothing, but this does not get reflected in real revenue mobilizations. Rates should be continued for a long time for transparency and must be incorporated in VAT Act itself. So, the government has to pay serious heed in increasing the tax base instead of increasing the tax rates. International experience tells us that the gradual lowering of duties or tax rate is an effective tool in achieving the desired goals rather than increasing it. Periodical policy has also been obstacles for its speedy enforcement, and a major hurdle that has hurt revenue generation. Excise duty is an important source for VAT, but it has not been effectively administered. Custom officials are more worried on customs duty than VAT collection. Widespread leakages are normal practices due to lack of professionalism, integrity, technically competent, and international orientation. Tax auditors have been auditing without basic knowledge and academic background. As it's weakly enforced, many sectors are out of tax net. Taxpayers complain that the procedures are complicated and time consuming during the decision-making process.101Thebills from eighty percent of taxpayers, who pay only twenty percent of revenue. The system is not new; many countries have already tried with the lottery system, and failed gaining from it. It means, we have no valid mechanism to bring potential payers into net, and no valid mechanism has been developed on bringing them into the tax net. The April 2005 movement (also known as the *second janandolan*) is a harbinger of new hope in Nepal. It was intended to overthrow the old feudal regime replacing it with the new sovereign and people-ruled system. Nepalese people are beginning to dream of a different New Nepal following the constituent assembly. Under such situation, the old status quo in the administrative field also must change. Surely, this is real challenge to the administrators and the policy makers of Nepal. In other words, this is not happening at the moment. If that status quo could not be broken, no matter whatever big changes take place, they would have no influence at all. This is a real paradox. However, if the nation is to march fast enough to keep pace with the momentum of development and political change; it must come out with a new inventory of concepts and strategies as opposed to the old stereo typed ones. It is a well known fact that the industrialization of Japan, Hong Kong and South Korea was possible because of their tax policies. So under the changed system in the country, a tax system definitely could play a crucial role in course of nation-building. Sweeping and radical reforms on VAT system with a comprehensive incentive package based on VAT concept would help the economy boom. A bold vision, evolutionary leadership, efficient bureaucrats, honest taxpayers plus collectors and graft-free society are the invisible infrastructures required. So all must think from a long-term perspective rather than weighing up immediate pros and cons. The Inland Revenue Department must come up with a forward-moving process, concrete action plan and policies to cope with the global challenges in order to accelerate the reform process.

5.3 Recommendations

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

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

2. Unproductive, corrupted, inefficient staff lacking practical and specialized training is a serious problem. So, providing training to such staff is highly essential.

3. The tax administration should be very watchful to prevent any kind of formal practice, fraud and tax evasion. Utmost care should be taken to prevent any kind of bribing and corruption. Tax officials should effectively be monitored.

4. Taxpayers, customers are clearly ignoring the VAT system and taking it for granted. They have lack of proper knowledge about computation of tax liability, taking invoice or bill on their purchases. So, emphasis should be given in educating the tax payers. The issuance of proper bill for every taxable sells must be made mandatory

.5. The success of VAT system is not only the success of the IRD, but also the success of nation as a whole. The role of general media, radio, TV, newspaper plays an important one. Emphasis should be given on mass media. Awareness towards VAT system should be created among general public, non government a land government organization.

6. Computer system and networking program through online service must be developed and linked so as to make the work simple and easy. Computer links between tax officer and custom offices should be maintained.

7. Government has been providing tax refund facility to business organization and foreign diplomacy and foreign aided project. Tax refund is one of the sources of tax leakage. Therefore, tax authority should manage tax refund facility properly.

8. Research and investigation should be conducted on various issues, such as the effect of VAT on price, economic growth, investment and measures for solving VAT problems should be recommended by the expert group. VAT law needs to be reviewed on the basis of experience gained so far.

9. The accounting system should be transparent. Taxpayers should be encouraged to register their business voluntarily. Instead of forcefully coercing tax payers, providing various facilities to them can increase VAT compliance. The tax administration can select genuine business persons and reward them.

10. Border should be effectively controlled to prevent the illegal trade. Warehouse and highways checking should be done effectively to prevent any kind of illegal trade.

11. VAT collection on import is remarkably higher than domestic production. Government should take effective steps to encourage domestic production.

12. Lots of efforts should be made to reestablish a functionally well-organized organization where the tasks are carried out in a modern, effective, efficient, transparent and service-minded manner.

13. Most of the national economic activities are dependent upon agriculture and large portion of GDP coming from agricultural sector remains out of the tax net. Thus VAT should also be levied on agriculture sector with sufficient exception for generating more tax revenue. This will increase VAT/GDP ratio.

14. Most of the taxpayers are not satisfied with VAT administrators. They always have complaints against the administrators who do their jobs rather slowly, harassing the customers unnecessarily. The work that is to be finished today is postponed for the next day. This is their habit. Therefore, it is suggested that tax administrators should be consumer-focused and result oriented.

15. Lastly, the periodic information about VAT is now available on the website as well. For the researcher this is a great privilege. But the websites are not up dated and doesn't have the older reports. So, the website must be updated from time to time and must be kept up-to-date. And all backup copies of the old (old fiscal years') annual reports and Economic surveys must also be available on the website. This facilitates the researchers greatly and other concerned bodies, even the consumers, because for minor information, they would not have to frequent the Inland Revenue Department and Ministry of Finance.