

Chapter - 1

Introduction

1.1 Background

Tax is the largest source of public revenue of today's government. It is the internal source of national income. Tax is the legal duty of every citizen of a country to pay honestly. In the present day, government has to spend a lot of money to fulfil its responsibility towards its people. The responsibility may be either for security, health, education, or other developmental activities. To meet the growing public expenditure the government has to manage its funds from internal as well as external sources. External sources of funds are foreign grant and loans. Such external sources are uncertain, inconvenient, and not good for healthy development if there is heavy dependent on them. It would be better to mobilize internal resources rather than expecting with beggar eyes to the donors. The experiences of developing countries shows that there are negative results of increasing international aid and loan to finance the public development activities. As a result, their economic condition has gone down day by day.

The tax reform exercise has been the most important and technically the most exciting component of reform program in the economic sector. In the present context of raising needs of development expenditures and deficiency of government revenue, there is a need of entire reforms. The government of a country requires sufficient revenues to carry out development plans, to handle day to day administration, to maintain peace and security, to maintain law and order and other public welfare

activities. The government collects revenues from various sources such as tax, revenues from public enterprises, special assessment, fees, fines, grants and assessments etc. Among them tax is the main source of government revenue.

The term tax is defined as a liability to pay an amount to the government. It is a compulsory contribution to the national revenue from the tax payers according to law. It is used for common interest of the people. However the tax payer does not get direct personal benefits. The tax can be classified in two types, they are:

1. Direct tax
2. Indirect Tax

A direct tax is a tax paid by a person on whom it is legally imposed. In direct tax, the person paying and bearing tax is same. The person cannot shift his tax to others. For e.g. income tax, property tax and gift or prize tax are indirect taxes that are paid by the person on whom they are levied. On the other hand indirect taxes are those which are imposed on one person but partly or wholly paid by another. In indirect tax the person paying and bearing tax is different. In other words, those types of taxes are ultimately paid by consumers, not by a businessman or a firm. They are only mediators. For e.g. excise duty, custom duty, value added tax (VAT) are indirect taxes. Among the indirect tax, VAT is the most recently introduced in the field of taxation.

Since there is a global trend of tax reforms, Nepal cannot remain an exception to such reforms. Although tax system has to be structured or reformed depending on a country's own economic and social characteristics, it however overlook the global changes in such reforms.

Thus, no nation can route back to the global trend, it ultimately has to be followed.

Developing countries attempt to mobilize internal sources. So the government should be trying to reform tax policy and strategy. Nepal also has changed its policy and strategy to achieve more internal resources replacing sales tax by VAT. It is the tax imposed on value added by business firms on goods and services at the successive stages of production and distribution. Value is added in such production and distribution in successive stages. Value addition on a commodity or services is simple the excess of sale value over business purchases by a business entity. During the successive stage of production and distribution processes, business enterprises add value to their purchase by processing and handling them by their own machinery, building or other capital goods. VAT is considered as one form of sales tax, it is the multiple stage tax that has grown as a heterogeneous of turn over tax and retail level sales tax. Thus, VAT is the multi stage sales tax which is levied on the value added by business enterprises at different stage of productions.

In Nepal, value added tax act was enacted in 1995 and started to implement only on 16th November 1997. This tax was levied in place of the manufacturing level sales tax, hotel tax, contract tax and entertainment tax. However, it could not be implemented fully until the fiscal year (F/Y) 1998/99 due to the political instability and strong opposition from the business community. VAT replaces the old sales tax, the contract tax, the hotel tax and entertainment tax. It has been designed to collect the same revenue as the four taxes are replaced. Since the collection of both custom duties and income tax depends to a great extent

upon the effectiveness of VAT, it is expected to help to enhance revenue collection. The VAT is broad-based tax as it covers the value added to each commodity by a firm during all stages of production and distribution. It is a modern tax system to improve the collection of taxes, to increase efficiency and to lessen tax evasion.

Value added tax is a tax imposed on the value of each economic activity from production to consumption. It means VAT is charged on value addition done to prepare the final product. Ultimate resting-place of this tax is final consumption so that consumers are the sole taxpayers of the VAT; business people only collect the VAT as a mediator so they don't bear its burden. In conclusion, VAT should be the most essential choice for the developing countries as an ingredient of their tax reforms because it is the most improved form of sales tax, revenue enhancement and economic efficiency. It is an important instrument for the mobilization of internal resources. There is tremendous scope for increase in its contribution on coming days. VAT is an improved form of sales tax. It is not a genuinely new form of taxation but merely a sales tax administered in different form. Under VAT system, consumer knows the amount they are paying in form of VAT. VAT is more transparent and account based tax system. Thus, tax reform and adoption of VAT is integral part of whole tax system in present situation.

1.2 Statement of The Problem

Government has to spend a lot of money to fulfil its responsibility towards its people. The responsibility may be either for security or special service, economic development or other development activities. So government expenditure is rising. To meet the growing public expenditure, the government has to manage its funds from internal as well

as external sources. The external sources are uncertain, inconvenient and not good for healthy economic development if there is heavy dependent on them. The government collects its revenues through different sources. Out of which, taxes contribute a significant amount in the public revenues. The government mobilizes its revenues through budget in development activities for the public welfare and interests. Nepal is an undeveloped and one of the poorest countries in the world. It has low per capita income and more than one third people of the nation are living under the poverty line. The economic development and prosperity is very low. Foreign dependency and internal leakages has made the government to think for another option which is expected to increase the revenue. Moreover, fiscal deficit has been increasing due to the continuously growing expenditure and the low revenue performance in Nepal. In addition, the country has also been facing the increasing burden of foreign loan. Nepal is facing the serious problem of resource gap and high dependency on foreign loan. Reducing expenditures on development work, infrastructure and social services will not be just for a country crawling towards development. So, higher resource mobilization through taxes remains to be the best option.

VAT is a new experiment in Nepalese tax system. So many problems and difficulties have to be faced in primary phase of implementation. There is no conducive environment for executing the concept of VAT. The tendency of unnecessarily troubling taxpayers must be stopped to ensure a friendly atmosphere at various tax collecting offices. The major problem associated with VAT is lack of knowledge. In Nepal most of the tax payers are unknown about VAT. The billing system is also confusing for the tax payer. The billing system is lacking. Most of the businessmen do not issue VAT bill to their customers. Even if they do, they charge

extra amount in the name of VAT to the customers. The general concept is that, VAT increases the prices of commodities and services.

In Nepal, resources mobilization is still poor that does not cover the growing expenditure. Because of deficit financing and external loan, the economy has to face the resource gap, debt trap problem. It is widening continuously with the increment of total expenditure in respect to total revenue collection.

Since 1965, Nepal has been attempting the deficit financing although its nature is inflationary. Each budget contributes enlarging its size in the budget. So, we can conclude that its increasing trend is still continuous. Government expenditure is increasing day by day but there is no increase in government revenues accordingly. Such unbalanced growth in revenue and expenditure has resulted in massive revenue expenditure gaps or budgetary deficit in the country. The major cause of persisting fiscal deficit in Nepalese economy is inadequate resources mobilization. It is the result of poorly designed tax structure. The design of tax in Nepal is poor and defective. The revenue instruments are always having very weak performance. Contribution of tax to the national revenue is low due to the above reasons. In other sense weak performance of tax is the root cause of low tax GDP ration.

To avoid deficit budget, effective implementation of VAT would be an important tool. In Nepalese tax structure, sales tax has suffered from very low tax base, cascading effect and distortion effect. But, VAT is considered as the best form of sales tax having many merits like as; self policing, catching up effect, broad base, mass participation, transparent, account based, neutral etc. Least developed countries are facing numerous

problems in the process of economic development. Nepal is an example to this condition. More than one third of total population is below the poverty line. The majorities of people have out off reach to get basic needs. Government needs huge amount of capital to meet growing public expenditure. The government expenditure rate is exceeding over the growth rate of revenue almost every year from the beginning of the planned development in Nepal. Thus, the study focuses on how to overcome resource gap problem and effective implementation of VAT in order to increase its contribution to the national revenue.

1.3 Objectives of the Study

The overall objective of this study is to examine effective implementation of VAT and to analyze the practical aspects of the implementation of VAT in the Nepalese context. The specific objectives of this study are:

- a) To study and analyze the present provision and status of value added tax system in Nepal.
- b) To compare VAT with other major sources of revenue.
- c) To examine the problems and prospects of VAT.
- d) To evaluate the contribution of VAT on revenue mobilization and suggest concerned department on the basis of study findings.

1.4 Significance of the Study

VAT is the effective tool of tax system. Therefore most of the economists of the world have begun to levy VAT. Nepal as a developing country and has not been independent from external sources for revenue generation, therefore, effective mobilization of internal sources is necessary and VAT can be an effective and successful tools to internal resource mobilization. The scope of the study is to explore the practical scenario of VAT. In addition, it also finds out the contribution of VAT to gross domestic

product. So the research is significant in the sense that its thorough study may facilitate the government in policy making and solving the implementation problems of VAT related issues. It may be helpful for the businessmen and the consumers as well who are still lost amid the confusion about the proper implication of VAT. They will also keep themselves informed about the current condition of VAT implementation in Nepal.

Nepal has adopted VAT since 16 November 1997 with the objectives of expanding the tax net, export promotion; reduce economic inefficiency, to accelerate the development by reducing cascading effect and evolving a clean and transparent tax system in place of sales taxation.

Despite more than 12 years of VAT implementation, many Nepalese are unknown about various aspects of it. This study basically concentrates on administrative structure of VAT, the importance of VAT to improve internal resource mobilization, existing issues of VAT in Nepal and provides effective suggestion in making VAT effectiveness.

In this regard, this study carries a great significance to mobilize additional resources through improved and successful implementation of VAT and hence make the country self-dependent to some extent instead of the rapidly persisting resource gap.

1.5 Limitations of the study

Some limitations that occurred in the study are as follows;

-) This study covers the period from F/Y 1997/98 to 2008/09.
-) This study is mainly based on published secondary data and information. No attempt has been made to examine the reliability of the data i.e. if provided secondary data is wrong when the conclusion may be wrong.
-) The study is based on analytical and descriptive types of research.
-) Due to small size, it may not fully represent Nepal as a whole. Survey will be conducted within Kathmandu valley only.

1.6 Chapter Scheme

This study is divided into following five chapters;

First Chapter: Introduction

The first chapter describes the theoretical knowledge in VAT and VAT in Nepal with statement of problems together with the objective of the study. It will also describe the suitable methodology, limitation, importance of study etc.

Second Chapter: Review of Literature

Second chapter will include literature review, which will help to become clear about what others scholars have already done and what remains to be done in this subject. This chapter covers concept of VAT, provision of VAT, an overview of VAT system, methods of calculating VAT etc. In addition, it will also support of refute the research questions/hypothesis, which will be formulated with theoretical and analytical framework of the study.

Third Chapter: Research Methodology

This chapter consists of Research design, sources of data, data collections techniques and analysis of data.

Fourth Chapter: Presentation and Analysis of Data

This chapter will deal with the presentation and analysis of data. Presentation will be either in tabulation or in graphic or both. Analysis will be done in accordance with suitable tools.

Fifth Chapter: Summary, Conclusion and Recommendation

This chapter covers summary of this study, conclusion of research findings and recommendation for effective implementation of VAT.

CHAPTER - II

REVIEW OF LITERATURE

This chapter is devoted to the review of relevant literature on the topic of study undertaken. This chapter deals with the conceptual framework, which introduces concept of VAT, briefly the provision of VAT, provides an overview of VAT system in Nepal, describes the methods of calculating VAT, and reviews earlier studies, In addition, it also helps to justify the research gap.

2.1 Conceptual Framework

2.1.1 Introduction to Value Added Tax (VAT)

Value added tax is the most recent innovation in the field of taxation. Actually, VAT is considered one of the most important tax reforms of the second half of the twentieth century. It is a scientific tax system, which was first introduced in 1954 in France. VAT is a family member of indirect tax. Indirect tax is primarily so called because the real burden of tax under this type can be shifted forward to the consumers or in other words, it is not borne directly by the person who pays it. As long as the burden of the tax can be shifted forward, it is indirect. To obtain the exact definition of VAT, the following section gives its practical and precise meaning as implicit in the definition of various experts and institutions.

2.1.2 Meaning of VAT

Different experts and institution have attempted to give the meaning of VAT according to their own interpretations. Here, some of their definitions may be studied. In the words of Bhattarai and Koirala (2007), VAT is a general consumption tax assessed on the value added to goods

and services. It is a general tax that applies, in principle, to all commercial activities involving the production and distribution of goods and the provision of services. It is a consumption tax because it is borne ultimately by the final consumer. It is not a charge on companies. It is charged as a percentage of prices, which means that the actual tax burden is visible at each stage in the production and distribution chain. It is an indirect tax, in that the tax is collected from someone other than the person who actually bears the cost of the tax (namely the seller rather than the consumer). As VAT is intended as a tax on consumption, exports (which are, by definition, consumed abroad) are usually not subject to VAT or VAT is refunded. (Bhattarai and Koirala, 2007: 321). According to economy watch website, value added tax, popularly known as VAT, is a special type of indirect tax in which a sum of money is levied at a particular stage in the sale of a product or service. (www.economywatch.com/business-and-economy/vat.html). According to Wikipedia Website, value added tax (VAT), or goods and services tax (GST), is tax on exchanges. It is levied on the added value that results from each exchange. It differs from a sales tax because a sales tax is levied on the total value of exchange. For this reason, a VAT is neutral with respect to the number of passages that there are between the producer and the final consumer. A VAT is an indirect tax, in that the tax is collected from someone who does not bear the entire cost of the tax. To avoid double taxation on final consumption, exports are usually not subject to VAT and VAT charged under such circumstances is usually refundable. According to Khadka, (1977:59), value added tax is not an additional tax, but has replaced tax such as sales tax, hotel tax, contract tax and entertainment tax that used to be levied on the sale of goods and services. From the above definitions, it is obvious that VAT is an indirect tax which is the newest and significant experiment done on the modern

tax system. Like its predecessor, i.e. sales tax, VAT is also levied on the sale of goods and services (GST). VAT is a broad based tax as it also covers the value added to each commodity by a firm during all stages of production and distribution. It is modern tax system to improve the collection of taxes, to increase efficiency and to lessen tax evasion. VAT is a modern and scientific tax system. It is not similar to customs, excise duty or sales tax that has borne the traditions or historical heritage. It is not a tax that has been improved and amended and accordingly inserted and deleted. It is a tax of the 21st century since it is highly developed and skill. Moreover, it confirms with the present context of liberalization, privatization and globalization. It is easily adaptable with the open economy system and matches with private sector and the market economy of the present day. It is a tax that is transparent and has an in-build system of self-control. In summary, the value added tax system is designed to address various problems associated with the conventional sales tax. It is a tax that has developed as an alternative for the traditional sales tax. That's why it is also called improvised version of sales tax. (IRD and VAT Project, 2001:95). As clarified by Adhikari (2003:6), it is also improved and reformed sales tax. In sales tax, there is no provision for input tax credit, which means that the end consumer may pay tax on an input that has already been taxed previously. This is known as cascading and leads to increase consumer tax and price levels, which increase the rate of evasion and can be detrimental to economic growth. In contrast, the VAT that has been levied in the previous level can be deducted while paying taxes on the later levels. It has a special system where a person trying to deceive tax will be caught on either one of the subsequent levels. Therefore, the trend of tax evasion is highly discouraged.

2.1.3 Types of VAT

There are three possible types of variants of VAT: the product type (P-VAT), the income type (I-VAT) and the consumption type (C-VAT). The meaning of these three variants of VAT can be best understood by comparison of income and expenditure aggregates in the national income accounts. Expenditures on the gross domestic product (GDP) consist of final private consumption expenditure ©, gross investment expenditure (I), final government non-wages expenditure on goods and services (Gc) government expenses on-wages and salaries (Gw), and the trade balance (the values of exported (x) less imported (m) goods and non factor service) Howell, (1995:85).

$$\mathbf{GDP = C + I + Gc + Gw + (x-m)}$$

While gross domestic income (GDI) is the sum of factor income payments (wages, interests, profits etc) - commonly referred to as the value added (v) of production and depreciation (D).

$$\mathbf{GDI = v + D}$$

Above equation can be stated in terms of either factor cost (i.e., exclusive of indirect taxes net of subsidies) or market price (i.e., inclusive of indirect taxes net of subsidies)

A. Product Type VAT (P-VAT)

Broadly speaking a P-VAT taxes all expenditure (except government wage expenditure, which is infeasible to tax under any variants of VAT) on GDP if implemented on the origin principle, and on GDP adjusted for the trade balance if implemented on destination principle. This variant does not allow the deduction of depreciation from the tax base in subsequent years either. Assuming for the time being that the origin principle is employed, so that exports, being of domestic origin, are taxed but imports, whose value originated from abroad, are not. Then the base

of a P-VAT is simply the sum of all expenditures on GDP (hence its name as a product type VAT) net of government wage expenditure. This base can be expressed as follows: (Howell, 1995:86).

$$\text{Base of P-VAT} = \text{GDP} - \text{Gw} = \text{c} + \text{I} + \text{Gc} + (\text{x-m}).$$

B. Income Type VAT (I-VAT)

Gross investment expenditure, which is part of the base of a P-VAT, reflects an economy's actual aggregate on capital goods (i.e. gross capital formation) in a given period. Part of this expenditure, however, is used to compensate for capital goods that have been consumed or depreciated. While depreciation as such is merely a book-keeping entry and does not represent an actual economic transaction, it affects the computation of profitability, and thus the value added, of business. An I-VAT excludes depreciation from its base. It therefore taxes the net, rather than the gross, investment expenditure (Howell 1995:86).

$$\text{Base of I -VAT} = \text{GDP} - \text{Gw} - \text{D} = \text{C} + (\text{I} - \text{D}) + \text{Gc} + (\text{x} - \text{m})$$

C. Consumption Type VAT (C -VAT)

If, in addition to depreciation, expenditures on capital goods, which contribute to a net augmentation of the capital stock, are also not taxed, the entire gross investment expenditure would in effect be excluded from the tax base. The resultant base would be the base of C-VAT:

$$\text{Base of C-VAT} = \text{GDP} - \text{Gw} - \text{I} = \text{C} + \text{Gc} + (\text{x} - \text{m})$$

In this way, the variants of VAT differ in its treatment of capital goods. Among these three types of VAT, the consumption variant is the most superior form of VAT and is universally practiced. The reasons for the popularity of this type are as follows:

-) This variant doesn't affect decision regarding investment and growth since it relieves investment from any tax burden.

-) Likewise, the consumption variant is attractive from point of view of tax administration as there is no need to distinguish between the purchase of intermediate goods and capital goods under this variant which is necessary under the other two variants. Unlike the consumption variant, the other two variants stimulate firms to classify their purchases of capital goods as intermediate goods leading to complication for the administration.
-) Furthermore, the consumption variant is more attractive than the income variants from the consideration of foreign trade, because the consumption variants are compatible with the destination principle of taxation, which has been used by many countries. Under the destination principle, the tax base is consumption and hence export is relieved completely from VAT.

2.1.4 Methods of Computation of VAT

There are three basic methods by which VAT can be calculated. They are:

- A. Tax Credit Method
- B. Subtraction Method and
- C. Addition Method

The first two methods are frequently used while the third method is rarely used.

A. Tax Credit Method

This method is also called the Invoice Method. Under this method, tax is levied on the total value of sales and it required that the amount of VAT charged by explicitly stated on the invoice associated with any taxable transaction. The amount of tax merchant submits of tax authorities is simply the difference between the tax collected on his sales and the tax he paid on his purchase (Khadka, 1997:6). Since the value added (VA) is

sale value (SV) minus cost of purchased inputs (CPI), a given tax rate, say (t), the tax revenue (T) will be;

$$\mathbf{T = t.SV - t.CPI}$$

Since business is required to state the tax on invoices under the tax credit method. This implies that the amount of tax that levied on export can be refunded to exporters. Similarly, this method is effective under the destination principle where exports are zero-rated and the tax credit chain is not broken. It also provides the facility of cross checking.

This method is particularly useful if it is desired to reduce the rate of value added tax at certain stage in the prices of production and distribution. Since the mechanism puts an equal burden of taxation on both imports and domestic products, it is further preferred. The tax credit method, thus, is desirable for several reasons and has been adopted by many countries in the world.

Nepal has adopted the tax credit method. Among three methods, the tax credit method is much better than other. It has following major benefits over the other two types of VAT computation.

- a) In the tax credit method, tax liability is attached to transaction that makes it legally and technically superior.
- b) Tax collection is easy.
- c) Cross checking is possible.
- d) It provides the benefits catch up effect that makes under evaluation and tax evasion impossible.
- e) There will be no loss of revenue due to the exemptions granted to the small traders.
- f) It never demands for the calculation of value added total tax.
- g) Liability entirely depends on the rate of the last stage, so rate differentiation is possible for the same revenue yields.

Table 2.1 Calculation of VAT under credit method (VAT rate 13%)

(In Rs.)

		Stages of Production and Distribution			
S.n	Particulars	Farmer	Manufacturer	Wholesaler	Retailer
	Types of Production	Sugarcane	Sugar	Sugar	Sugar
a	Purchase	0	200	400	450
b	VAT paid on purchase	0	26	52	58.5
c	Sales value	200	400	450	510
d	Gross VAT liability on sales @ 13% on (c)	26	52	58.5	66.3
e	Net VAT Liability (d-b) or VAT Paid in each stage	$(26-0)=26$	$(52-26)=26$	$(58.5-52)=6.5$	$(66.3-58.5)=7.8$
	Actual Sales Price	226	452	508.5	576.3

Note: Figure is estimated only and both the sales and purchase value exclude tax liability.

B. Subtraction Method

Under this method, each merchant's tax liability is computed by applying the applicable VAT rate to the difference between his total sales (inclusive of the VAT element in his sales price) and his total purchases (inclusive of the VAT element in his purchase price). Hence, unlike the credit method, the amount of VAT connected with a taxable transaction is not required to be explicitly stated on the associated invoice. (Howell, 1995:94). This method is appropriate for the consumption variant of VAT.

The tax revenue under this method can be calculated by using this formula.

$$T = t (SV-CPI)$$

Table 2.2 Calculation of VAT under subtraction method

Phase Of Production and Distribution	Net Purchase Price (CPI)	Net Sales (SV)	Value Added (SV-CPI)	VAT @13%
Raw Material Producer	-	3000.00	3000.00	390.00
Producer	3000.00	4500.00	1500.00	195.00
Wholesaler	4500.00	5800.00	1300.00	169.00
Retailer	5800.00	6500.00	700.00	91.00
Total	13300.00	19800.00	6500.00	845.00

C. Addition Method

Under this method, the tax base is obtained by adding the incomes produced by the firm or by adding the payment made by the firm to the factors of production employed in turning out the product, such as wages, interest, rent, royalties and profits. This method is appropriate for the income type of VAT.

2.1.5 Principles of VAT

VAT can be implemented under either the origin or the destination principle.

A. Original Principle

Under this method, the tax base is obtained by adding the incomes produced by the firm. This implies that all exports are taxable and all imports are non-taxable. Where there is a border and cross-country trade,

this principle gets important to imported goods or services over domestic production. Countries with international boundaries do not prefer to have this principle. But in European community (EC) where there is a common border this principle of taxation is essential. The main reason behind not following this principle is, revenue loss. It also discourages the export either directly or indirectly.

B. Destination Principle:

The most popular form of principle adopted by a large number of countries is destination principle. Under this principle, goods or services are taxed on at the place where they are produced but the place where they are consumed. This means all imports are taxed while all kinds of goods and services are free to taxation. The main advantage of this principle is non-discrimination between import and internal production. This principle is favourable for promoting export. Many countries follow this principle because they are eager to boost export. Nepal's VAT system is also characterized by the Destination Principle.

2.1.6 History and Development of VAT:

Tax is collected by government to meet the need of budget. Among the various types of tax, the sales tax is one of the major source. VAT is the most scientific system of sales tax. In the early days, the tax from the consumption and production is collected as sales tax. But now, it is almost completely replaced by the VAT. The concept of VAT was introduced in 1919 by Wilhelm Von Sieman in Germany. The concept was brought to replace the "Usnatzsterller" (multi stage sales tax) due to its undesirable effects, particularly escaping and vertical integration of the latter tax (MST) for the first time (Due and Friedlander, 1977: 416). Until early 1950s the development of VAT remained limited only in the theory.

France was the first implementer of VAT in 1954 covering only in the industrial sector. The VAT was limited to only up to whole level. But these countries limited the VAT only on import and manufacturing stage. In late 60s, VAT started to become popular. Countries like Denmark and Brazil adopted the system of tax in 1967, France, the first implementer of VAT, extended it to the retail level for the first time. And Germany also adopted VAT in the same year. In 1969, the countries like Netherland and Sweden also adopted VAT in their countries. In 1970, 1971 and 1973, Luxembourg, Belgium and Ireland introduced the VAT respectively.

In Asia, Vietnam was the first country to introduce this most scientific tax system. The country adopted VAT in 1973. The trend being VAT popular was increasing all over the world. In 1977, 1984, 1985, 1986, South Korea, China, Indonesia and Taiwan introduced VAT respectively. Similarly, VAT was introduced by Philippine in 1988. Japan in 1989, Thailand in 1992 and Singapore in 1994.

In SAARC region, Pakistan was the first adopter of VAT. It implemented VAT in 1990. India introduced VAT first as modified value added tax (MOD VAT) in 1996. But actually in India, VAT replaced sales tax on 4 January 2005. Although some states did not opt for VAT (for political reasons), majority of the states embraced VAT such as states like, Andhra Pradesh and Maharashtra taking the lead. (The VAT Project Office, 2005).

The Empowered Committee, constituted by Government of India, provided the basic framework for uniform VAT laws in the states but due to the federal nature of Indian constitution, States do have a liberty to set their own valuations for the VAT levied in their own territory.

India introduced the full VAT in some prescribed regions of the country on April 1, 2005. Around 130 countries have introduced VAT system across the world. The list below shows the chronology in which VAT was implemented in different countries.

Table 2.3 Implementation of VAT in different countries in the chronological order:

Year	Countries that have started adopting VAT
1954	France
1960	Ivory Coast
1961 to 1970	Brazil, Denmark, Germany, Uruguay, Netherlands, Sweden, Ecuador, Luxembourg, Norway
1971 to 1980	Belgium, Ireland, Austria, Bolivia, Italy, United Kingdom, Vietnam, Argentina, Chile, Colombia, Costa Rica, Nicaragua, Honduras, Israel, Peru, Mexico
1981 to 1990	Haiti, Dominican Republic, Guatemala, People's Republic of China, Indonesia, Turkey, Morocco, New Zealand, Nigeria, Portugal, Spain, Taiwan, Grenada, Greece, Hungary, The Philippines, Tunisia, Japan, Malawi, Iceland, Kenya, Pakistan, Trinidad and Tobago
1991 to 2000	Bangladesh, Benin, Canada, Jamaica, Mali, South Africa, Armenia, Algeria, Azerbaijan, Cyprus, El Salvador, Estonia, Fiji, Kazakhstan, Tajikistan, Byelorussia, Kyrgyzstan, Russia, Thailand, Turkmenistan, Ukraine, Uzbekistan, Moldova, Burkina Faso, Czech Republic, Paraguay, Poland, Romania, Georgia, Slovak Republic, Venezuela, Bulgaria, Finland, Lithuania, Singapore, Tanzania, Western Samoa, Madagascar, Nigeria, Gabon, Ghana, Switzerland, Zambia, Malta, Latvia, Liechtenstein, Mauritania, Togo, Albania, Belize, Guinea,

	Uganda, Barbados, Congo, Nepal, Croatia, Mongolia, Sri Lanka, Tanzania, Vanuatu, Surinam, French Polynesia, Cambodia, Cameroon, Mozambique, Netherlands, Papua New Guinea, Slovenia, New Jersey, Australia, Chad, Macedonia, Namibia, Sudan
2001 till Today	Botswana, Rwanda, Lebanon, India*

Source: The VAT Project Office (Revenue Administration Support), IRD, IRD/DANIDA, 2001: 3-4)

** India has implemented Modified VAT since 1986. This system is not exactly a VAT system. The system was introduced to refund excise duty paid on inputs.*

2.1.7 Value Added Tax and Other Sales Taxes:

VAT is modern and scientific tax than other forms of sales tax. VAT is compared with other form of tax as follows:

1.2.7.1 Value Added Tax and Turnover Tax:

Turnover tax is a form of sales tax, which applies to the selling price of each point of sales. In this sense, a turnover tax is the multiple stage cascade tax. This means the effective tax rate applies to all stages of productions and distribution. This tax offers mainly two advantages: (a) A low tax necessity for given sum of revenue (ii) There is no complication of concession for various types of firms. Under this system, the evasion may arise because there is possibility of vertical integration. Such integration distorts the economy. This effect of tax is reducing economic efficiency which is the worst level of the tax.

A turnover tax further discriminates against the domestic product and imported goods. Imported goods need to pass less stages of transaction if

the goods are finished product. On the contrary, domestic products need to pass more stage and transaction. Turnover tax applies to the total volume of transaction of the product at each stage of production and distribution. It creates a strong incentive for reducing the economic activities at earlier stages like performing many activities of producing and distribution under a single roof. There will not be any incentives for integration in VAT system, since the total amount of tax on the product will be the production and distribution system and the taxable price is always equal to the final price of the product. Thus from the view point of neutrality, VAT is so far superior to the turnover tax.

The turnover tax is comparatively easy to administer as it applies only on gross so that there is no need of tax credit. The double-checking and several provisions associate with the VAT create complicity however makes the tax system transparent, efficient and equitable.

Comparative easiness and simplicity also can be found in turnover tax in the viewpoint of tax compliance. But due to the self-enforcing feature of VAT, it is more attractive to check the tax evasion. An uneven burden is also created on various commodities by turnover tax and further the burden varies with the typical number of transaction through which a commodity passes on its way to the final consumer.

2.1.7.2 VAT and Manufacturer's Sales Tax (MST):

Manufactures Sales Tax (MST) basically covers domestic manufacturing as well as imports. This is a single stage levy. In practice, manufacturers and importers are required to register for sales tax purpose. Generally this type of tax is applied on sales in case of domestic product and on the import value in the case of imported goods. These types of tax is favoured

in many developing countries in the sense that it more or less avoids the cascade evil and covers more organized entrepreneurs so as to make administration easy.

In contrast, VAT avoids cascading and pyramiding effects. It does not have a negative impose or negative impact on economic growth. The tax burden also falls stepwise under a VAT system, rather than at once in an import level of sales tax. The stepwise burden would not distort economic sectors. So, they will not encourage evading tax. But if, burden is laid down at once, a very high load will depress the entrepreneurs so as in creating the tax evasion. From the above discussion we can conclude that MST is non-neutral, limited in base and encouraging various difficulties with the culmination of tax evasion. VAT proves advantageous over MST, that it has broad coverage equipped with catch up effects, eliminating cascading and pyramiding and desirable in developing countries because it is designed according to consumer expenditure. The main disadvantage, coherent to VAT, in comparison to MST, is the large number of taxpayer with poor record keeping. But it can be covered by means of improvement in administration.

2.1.7.3 VAT and Wholesale Level Sales Tax (WST):

Simply speaking, the wholesale level sales tax (WST) means the taxation on sales to retailers by wholesaler. In underdeveloped country, wholesalers are more organized than the producers and retailers. Thus it is easy to implement in practice and more meritorious than MST in the sense that it covers value added by wholesalers. Wholesaling goods are carried directly from producers or importers. But in many countries, there is no provision of separate registers. Making the provision of separate registered as domestic enterprises and imports can enlarge the volume of

taxable base. This makes WST more suitable too. As a theme, WST can be levied in two ways i.e. On wholesale enterprise and accompanies with manufacturing or retail system. On the ground of revenue potentiality, VAT provides more revenue than WST but as compared with MST, wholesale enterprises lie some how greater than MST compared to VAT. For the administrative formalities like calculating tax base, cross checking and auditing, refund procedures etc. are less under the WST system. Further more, WST is easy to handle since it needs only to watch on sales point of wholesalers. On the basis of this reasoning WST is argued to be superior. The inclusion of new items i.e. basic necessities would make VAT more vertically inequitable than MST and WST as it will be levied at uniform rate however, the imposition of VAT on services, which the highest income group largely consumes, would have opposite effect. Despite these few merits of WST, we cannot ignore the contradictory and bad effects of WST in practice, which put the demerits of VAT, in shadow. If manufacturers or importers encourage direct sell to retailers or consumers then the revenue will be nil. The problems would be more serious when the two kinds of goods having same qualities and price whereas distribution process is different. Suppose one commodity (say A) supplied from producer to wholesaler and wholesaler to retailer successively but the other commodity (say B) is supplied directly from producer to retailer or to consumer, then definitely the price of “B” becomes far below than “A” due to the WST. In this case, the commodity “A” cannot compete with “B” in the market. Such a vast alternation compels the producer of commodity “A” to close down his production. Thus WST is not neutral among the production and distribution process as well as consumer choices. But in contrast, it is notable that VAT does not create such discrimination because VAT is levied in every stage of business process.

Thus, WST encourages manufacturers or importers to sell directly to the retailers so that product remains beyond the tax net. This results a loss in the revenue, on the other hand, it discriminates against those products by means of competitive advantage, which bear the tax burden favouring those firms and product, which do not bear the tax burden. In contrast, VAT does not create such discriminations since it is levied at every stage of production and distribution and tax evasion is also more difficult. Thus VAT is neutral among the process of production and distribution.

2.1.7.4 VAT and Retailer's Sales Tax (RST):

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

From the administrative point of view, RST seems to be simple as compared with VAT because their records and audit are sufficient on keeping the single stage. And the number of taxpayer remains more under VAT than RST. RST based on the suspension principal in which retailers are required to register for the sales tax purchase. Thus it is meant that the RST is levied only on the sales, which is registered to sale the consumer.

VAT and RST are vertically neutral with respect to production and distribution as total tax on a given commodity depends on the final price under both systems. On the other hand VAT and RST both are able to avoid the problem of cascading effects. Both taxes avoid the problems of

pyramiding since there seems no need to apply the make-up on the tax amount levied at earlier stage. So, consumer price increase only by the amount of tax.

RST is more susceptible to tax evasion than VAT. RST places a heavy burden only at the retail stage. Under this tax system, the whole tax is imposed at single stage (i.e. retail level). If a retailer does not file his return under the VAT, tax collection is dispersed over the whole production and distribution process. Thus the tax burden is distributed among a large number of taxpayer who feels it less burden as compared to RST. VAT provides a self-policy mechanism, which is not available under RST. VAT also provides a more complete audit trail than RST. As a conclusion, we can say that VAT is more preferred in developing countries but it requires efficient tax administration.

2.1.8 Reasons for the Increasing Popularity of VAT:

VAT is definitely a new and modern tax as compared with other traditional tax systems. Actually, VAT is thought of being the most important tax reform in the 21st century. Of all the indirect taxes that evolved in the past, VAT is the far better tax system. In contrast, other tax system had never rises into prominence in such as short span of period.

Ever since its introduction in France around 1954, VAT has gradually and promisingly won the heart of people and it is currently implemented in about one hundred and thirty countries.

Several other countries, which so far have not adopted VAT, are trying to make necessary changes in their fiscal policies and laws to assimilate and accommodate this scientific tax system into their economic set up.

Although VAT is a new system as compared to other traditional tax system, its popularity is growing fast. It is a precondition that any European countries must have already adopted VAT to become a member of EEC. This precondition plays a vital role in the popularization of VAT. In addition to them, there are some factors that are attributed to the growing popularity.

1. VAT is neutral with respect to the choice of method of production and distribution. Since the tax is levied only on the value, it is efficient too. An efficient tax system is one that does not cause any distortions in production and consumption. In other words, such a tax system does not bring any unintended and undesirable effects in the methods of production and distribution or in consumption.

Added at each stage in the system, tax liability remains the same regardless of the system of production and distribution. Total tax paid on a given commodity depends on the rate of tax and on the total value added (i.e. the final price) of the VAT does not interfere with the optimal allocation of means of production, it is considered neutral. All other forms of sales tax are distorted since they bring unnecessary and intended changes in the method of production and distribution. VAT is, thus, superior to other forms of sales tax on the ground of efficiency since this tax is neutral with respect of method of production and distribution.

Likewise, VAT is neutral with respect to consumer's choice too. VAT does not affect the relative price. Consequently, there is no need for the consumer to shift from one community to the other as responsive to tax.

Thus VAT does not affect the preference of the consumer. It also avoids probable distortions of the optimum allocation of resources. All other forms of sales taxes are not neutral in respect to consumer's choice.

2. Another feature of an ideal tax system is equity. VAT is more equitable in the sense that it falls equally on all goods that gather a different proportion of value added at various stages.

VAT is also attractive from the point of view of foreign trade considerations. Exports are commonly relieved from taxation in order to maintain the competitive exports and increase global competitiveness. Therefore, the tax levied on exports is refunded to exporters. It is possible to refund the exact amount of tax levied on exports under VAT. It is difficult to refund the exact amount of tax levied on exports under other form of sales tax system except the retail tax.

Another reason for the growing popularity of VAT is that this tax avoids the problem of cascading or pyramiding. Under VAT system especially when the invoice method is adopted, the exact amount of the tax can be shifted forward to the consumer.

3. One of the desirable features of a good tax system is the revenue productivity. VAT is popular from the revenue point of view. VAT is well known in the world for its effective revenue generation. It is important instrument for the mobilization of resources. There is tremendous scope for increasing the revenue from VAT. It offers

greater revenue potentiality as compared to other forms of sales taxes. VAT is an improved version of sales tax, which has the virtue of mobilizing substantial amount of revenue. Hence, VAT has become an important source of revenue on many developing as well as developed countries. It yields more than 20 percent of tax revenue.

4. Furthermore, VAT is favorable from the administrative point of view also. VAT is favored on the ground that, as the base of this tax is broad; a relatively low rate can produce the required revenue. Low rate reduce the possibility of tax evasion. Since the tax burden is distributed among a large number of taxpayers under the VAT system, it does not put a heavy burden on a taxpayer and hence avoids the chance of considerable tax evasion. The built-in control nature of VAT makes tax evasion more difficult. VAT is thus, better in this respect than other forms of sales taxes.

In summary, VAT is a modern and transparent tax system. It is less distorted and more revenue productive. Therefore, this tax has become a popular topic for tax reform and has been spreading all over the world since the late 1960s. The attractiveness for VAT across the nation has proved that it is preferred not merely for raising revenue but also its avoiding multiple distortions as created by other forms of sales tax. In the process of economic liberalization and globalization, VAT makes the tax system flexible and the bracket widen. All this indicates that the VAT is the tax system of the present days.

2.2 VAT in Nepal:

2.2.1 History and Development of VAT in Nepal:

In the 1980s, various countries, to maintain a sound macroeconomic policy, adopted various taxes for reform programs. The program was in swing in 1990s. As the adoption of reform program was at the heart of worldwide policies. Nepal was no exception. The Nepalese government revealed its intention for the adoption of various reform programs to promote market oriented economy in the Eighth Plan (1990~1995) document. In a process to reform tax policy, it has mentioned that some time in the mid-plan period a VAT will be introduced in the country. Before that VAT was completely unknown word to the general people of Nepal. After a restoration of democracy in 1992/93, a two-tier sales tax system was in function at that period. Under this system dealers and distributors of nine-selected items were required to register for sales tax purpose and collect tax on their sales. It was extended to five more items in 1993/94. Only the amount of tax paid to manufacturers was allowed to credit. Further, sole distribution or agents of the foreign firm or companies and their wholesalers were also required to register for the purpose of collection of sales tax.

As a part of its liberal economic policy, the Government of Nepal asked donors to study the VAT system. Finally a VAT task force was created in the sales tax and excise department in 1993. United States Agency for International Development (USAID) and Harvard Institute for International Development (HIID) started the study in order to make the necessary preparation for the introduction of VAT. The task force was fully devoted to accomplishing preparatory work. It prepared the draft for VAT legislation, organization, staffing and exemptions. Due to political

instability and frequent changes in the priority for the implementation of VAT, the task force could not continue its job. At the time of creation of task force, the Nepali Congress was in absolute majority in parliament.

A mid-term poll changed the political scenario. The United Marxism-Leninism (UML) party created a minority government whereas the Nepali Congress became the opposition party. The government led by UML could not reveal its positive attitude towards the implementation of VAT. In the contrary, the two-tier sales tax was declared to be removed in its 1994/95 budget. This negative step hurt the donor agencies and consequently the USAID suspended its support and Harvard Institute for International Development's experts returned. The VAT task force was dismantled.

Soon after the verdict of the Supreme Court to re-install the dissolved parliament, a coalition government led by Nepali Congress, formed and it showed as earlier, a firm commitment to introduce VAT in its F/Y 1996/97 budget. The USAID resumed its support but fund allocated for the study of VAT had already been transferred to other projects. Again, scarcity of fund is realized by the government and search of the donor who can provide the necessary fund and technical assistance for the implementation of VAT. After all, the DANIDA supported the VAT project. It is continuously supporting till now.

As a part of preparatory work, the VAT act was passed in 1996 by the parliament. The government in 1997 approved VAT Regulations. In the same year, the department of sales tax and excise were renamed as the department of Value Added Tax (VAT). After a year, the Ministry of Finance approved nine volumes of manuals. Further more, VAT task

force organized a various discussion and interaction program related to VAT in different parts of the country. Various introductory brochures were published and distributed to the potential taxpayers, businessmen and the administrative staffs.

The VAT was initially scheduled to be effective from July 1997. The government was planned to register the potential taxpayers in VAT from this period. In support of VAT, the government decided to rationalize the tax structure by educating the rate of income tax, sales tax and custom duties in advance. The VAT was to replace the hotel tax, the entertainment tax and the contract tax. For this purpose the VAT task force was preparing its work in accordance with the schedule. Meanwhile the private sector of business field opposed the government policy on adoption of VAT. Nepal Chamber of Commerce held a nation wide discussion program among traders, businessmen, industrialists and their representative association in March 1997 to collect the attitude towards the introduction of VAT in Nepal. Most of business community showed their dislike to the VAT which was scheduled to be operated from two months later.

Business persons protested the decision of adopting of VAT with the slogan "NO VAT" issue of VAT resulting in a conflict between the government and the private sector. Confrontation continued for a long time. Accepting the increasing pressure of business sector, finally the government decided to postpone the date of application for four months. The government also announced the date for the VAT to be effective from November 16, 1997.

Whatever reasons were laid for the postponement of the effective date of VAT, the preparatory team got a very valuable time for the preparation of VAT. The government and its associated body tried to convince the business community in favour of VAT. It was really a hard work to implement VAT without the full cooperation of business community. The VAT project, ministry of finance as well as department of VAT devoted the extended period of making friendly relations by providing more training, information meetings, campaign meetings, talk program and interaction program between different groups of people.

In the mean time the business group was also divided into two groups. Industrialist was in favour of VAT whereas the trading group was against it. Despite heavy protest by the trading group, the government implemented the VAT from the scheduled date of November 16, 1997.

Even after the adoption of VAT the days were not as easy as expected. Trading businessmen were completely against the VAT whereas industrialists were in favour of it with heavy concession on various taxes. The government announced all the concessions without prior plan in budget speech four months before the date of VAT implementation, which could not motivate the businessmen. On the other hand the businessmen enjoyed the privilege provided by the government for the successful enforcement of VAT, and continued to protest against VAT.

Political situation was also volatile. The government was in a pressure to quit. As usual, the businessmen were against VAT. Industrialists were in favour of further concession in tax regime that was against the principle of VAT. VAT administrators were not fully aware of its system. Due to various reasons VAT could not function as expected. The business

community demanded the continuation of all exemptions and incentives granted under the sale tax system.

Businessmen were also very angry at the function of octroi, a local tax. FNCCI, an apex body of private sector decided on February 4, 1998 that they would not sit for negotiations with government regarding the implementation of VAT unless the government scrapped out octroi.

On March 1998, the government and the private sector reached an agreement regarding the modalities of the implementation of VAT. Exemptions of industrial machinery and tractor, soft behave towards the retailer, acceptance of the bill value in import point, set up a committee in order to review the VAT law and establishment of permanent revenue board where the main agreement. Since most of the agreed points were not activated the businessmen again began to oppose VAT. A series of discussion took place before the presentation for the FY 1998/99 budget. The demands of businessmen were increasing considering the volatile situation of the political parties. The government requested for the agreement but the businessmen rejected the proposal and didn't sign in the agreement. Even though the government addressed few issues that were asked by the businessmen, the Finance Bill, 1998 incorporated the changes the threshold was increased from Rs. 1 million to Rs. 2 million, cottage industry got relief from the registration in VAT, a special arrangement to be provided to settle the old stock of businessmen, the rate of interest was reduced to 15 percent from 18 percent, the rates of penalty of the late filing of return fixed at 0.1 percent per day instead of 100 percent, tax offices were empowered to issue a tax assessment if tax prayer cannot justify the reason for under invoicing, firms, companies' and industries are required to issue serially numbered invoice with their

names and addresses, the VAT administration may inspect, with prior approval of the DG of the VAT department, the books of accounts of unregistered vendors in connection with VAT, and may penalize if the books of accounts are not maintained properly, a list of exempted items increased.

Despite above mentioned provision, the government also announced the several measures in the field of income tax, customs duty and revenue investigation with a view to rationalize the tax in accordance with VAT principle. Provision of some curative measures provided for the simplification of tax collection irritated businessmen more than were attracted towards it. They continue to oppose the VAT system vigorously. Finally both parties agreed not to implement the provisions provided by the finance act until they reached an agreement. Ultimately, both parties agreed on 39 points on September 1998. Most of the agreement was in connection with the further exemptions and concessions in various fields VAT as well as to the taxes. Few of them were in adverse direction of VAT principle.

VAT administration had allocated a TPIN (Tax Payers identification number) consisting of nine digits to registered tax payers with a view to process data in computer. It was developed as per international standard. Last ninth digit was for checking the accuracy of the number, which is called check number. All the records of tax payers are stored in the computer in database format. As the computer processed all the data of tax payer, it has become an integral part of VAT administration. Before that all the records were kept manually.

In accordance with the purpose of integrating VAT and tax department into one department from coming year a provision was made in Finance Act 1999 that “a PAN (Permanent Account Number) was allocated to the registrant of income tax from the next fiscal year”. For this purpose a tax payer service centre was established under the department of Tax. PAN was also similar to TPIN. Those tax payers who have already received the TPIN were converted to PAN with same number. The service of this centre was only confirmed to nine offices of Kathmandu Valley.

Issuance of PAN was accessed to all tax prayers of the country from December 16, 1999 after the establishment of Inland Revenue Department (IRD). For the simplification of management of date, a database computer system has been developed since the inception of VAT in Nepal.

With a view to provide all the services from the same window and to make effective mobilization of internal resource, the government decided to integrate the department of VAT and department of tax. The department of VAT merged into department of tax on April, 2000. Through the budget speech for F/Y 2001/02, the government announced to establish "Inland Revenue Department" from July 2000.

Before the merger, there were 17 offices under the VAT department and 41 offices under tax department. All over the county, all those offices were merged together and established 21 offices on the basis of including geographical region, number of tax payers, tax payer services and potentially of tax collection. Out of them, four offices were into "A" class, two into "B" class, five into "C" class, five into "D" class and five into "E" class. Officials and staffs were reorganized according to its work load.

The newly established department will administer the following taxes from the same window.

1. Income tax (individual and corporate income tax, Remuneration income tax, interest tax, house rent tax.)
2. Value added tax.
3. Non-tax (dividend, principal and interest payment, royalty, charges and fees)
4. Other related charges and fees related to excisable goods.

VAT has been justified in the light of government fiscal imbalances and need for extra revenue mobilization through an efficient tax system. The government of Nepal has increased VAT rate to 13% effective from Magh 1, 2061.

2.2.2 Basic Features of Nepalese VAT System

The type of VAT adopted by Nepal is conventional similar to that implemented over 130 countries around the world, it has injected some special features into the VAT system to make it uniquely Nepalese like the adoption of consumption type of VAT because VAT is finally borne by the consumer, the computation of VAT through tax credit method, the principle of destination, the level of threshold is Rupees 2 million, the facility of tax refund, the application of VAT to all business turns over the retail stages, the rate of VAT is single and positive @ 13%, the provision of exemption and zero rate for the goods and services, the allowance to tax credit for taxable supplies including the zero rate supply, small entrepreneurs are exempted to register in VAT office and self assessment system.

2.2.3 Coverage of VAT in Nepal

VAT is a tax on goods and services consumed in Nepal. The tax is based on the principle that each producer or distributor adds value, in some way, to the materials they have purchased and it is this added value that is taxed at each stage of the production and distribution. The coverage of VAT in Nepal is based upon transfer, sales, supply, import and export of goods and services except some special provisions. It is levied on the value added at each stage of the production or distribution. Every person, firm or company involved in some economic transactions is liable to pay and collect tax. The actual coverage is structured by the standard and zero rates as well as tax exempted provisions. In other words, tax coverage is guided by tax invoice system. VAT is administrated by invoice method.

2.2.3.1 Standard Rated Areas

Nepal has adopted “Inclusive Basket System” which means board-based tax coverage. Under this system all transactions regarding transfer, sales, supply, imports and exports of goods and services, where value added exists are taxable, except some special provisions. The value added tax act 1995 has made provision for exempted goods and services under special law. Unless this provision, all the value added economic transactions are taxable and tax is collected at the rate of 13%. This is called standard rated area.

2.2.3.2 Zero Rated Areas

Under the VAT system, goods and services are, or may be, taxed at zero-rate. The objective of this zero rate is to relieve some goods and services from taxation working under regular VAT system and net for the purpose of promoting and encouraging export and maintaining diplomatic behaviours. Under this, purchaser is allowed to credit the tax paid on

inputs or purchase in concern. However, one has to maintain all the records regarding VAT. The VAT is meant to apply only to the consumption of goods and services in Nepal. Supplies made in Nepal that are exported are taxable at zero-rate. Exporters are allowed to claim input tax credits for VAT paid or payable on purchases of goods and services relating to their commercial activities. Exports taxed at zero percent include exports of both goods and services.

Goods or services payable at zero rate:

1. Export of goods
 - a) Goods exported outside the Nepal; or
 - b) Goods shipped for use as stores on a flight to an eventual destination outside Nepal; or
 - c) Goods loaded for use as stores on aircraft to a destination outside Nepal or as merchandise for sale by retail or supplied to persons in the course of such a flight.
2. Export of services
 - a) Supply of services by a person resident in Nepal to a person outside Nepal and having no business establishment, agent, or legal representative acting on his behalf in Nepal
 - b) Where goods are supplied on a here or loan basis by a registered person resident in Nepal to a person resident outside Nepal
3. Imports of goods and services by accredited diplomats
4. Medical industries can get zero rate facility, if they intended.
5. Local purchase from those which were provided exemption from sales tax as per the agreement made previously.

2.2.3.3 Exempted Goods and Services

Under VAT system all goods and services are divided into basic categories: taxable and tax –exempt .Goods and services are either taxed at the rate of 13 percent or they are taxed at zero percent .Those taxed at the standard tax include all goods and services except those that are specified as taxed at zero percent or tax exempted. According to VAT act 1996, the purchaser will not pay VAT on tax exempt goods and services and the supplier is not allowed input tax credits on purchases related to the following goods and services:

-) Goods of Basic Necessity
-) Basic agricultural products
-) Livestock and their production
-) Agriculture related products and equipment
-) Medicines, medical treatment and other health services
-) Education
-) Books, newspapers, printed material, and, printing and publishing
-) Culture, arts and craftsmanship related services
-) Passenger transport and goods transportation services
-) Commercial or professional services
-) Miscellaneous goods and services
-) Building and land
-) Betting, casino, and lotteries

2.2.4 Tax Administration

In general the prime goals of VAT administration are to promote voluntary compliance and the VAT revenue by efficient and economic way. Identification of tax payers, tax registration, processing of returns,

tax audit, assessments, collection, credit, refund and control of stop filers are main functional areas of tax administration.

In the Nepalese periphery, Ministry of finance is the main responsible body for collecting financial resources and managing the public expenditure. Department of customs, revenue administration training centre, department of revenue investigation and inland revenue department are the wings of Ministry of Finance. Previously the VAT was administered by the department of value added tax. By 2001/2002, the government merged the department of taxation and the department of value added tax and named it “Inland Revenue Department (IRD)”. IRD is currently responsible for the administration of the taxes like income taxes, corporate taxes, value added tax, excises and certain fee, liquor control duty, smoking liquor duty, special fee etc. Likewise the department is also responsible for monitoring the non-tax revenue of the government. This department is located in the Kathmandu valley. Under IRD there are 21 inland revenue offices through the country. These offices and departments jointly administer the VAT as well as income taxes. The government of Nepal has the authority to appoint tax officers in required numbers. Similarly, the jurisdiction of a tax teacher should also be prescribed by the government.

All the tax officials are the civil servants under the revenue service. Thus, IRD is the authority to mobilize inland revenues including VAT.

The IRD has functional organization structure. From operational point of view it has been divided into two wings. One is policy related and other is operational wing. The operational wing contains six functional works and these are taxpayer service, tax audit, investigation, collection, tax refund

and others. Similarly, policy related wing contains the sections related to personnel administration. The government of Nepal may delegate tax administration related to other government officer. Similarly the VAT act has provided the authority to the government to define the jurisdiction of tax officers. Thus the department carries out the functions such as tax administration, making tax policy, tax treaty and international taxation, review and appeal related tax matters, advance ruling, tax enforcement and investigation, tax audit, tax refund, excise and liquor administration, tax payer services. (Adhikari, 2003:30-31).

2.2.4.1 Registration

For the implementation of VAT it is essential that producers and suppliers liable to taxation register themselves in time. According to VAT act and VAT related other laws of Nepal, the persons (the suppliers or distributors or producers dealing with taxable goods and services) are required to register in the concerned inland revenue office obtain the TIPN. In other words, the person who gets involved in commercial activities having the turnover that exceeds the given threshold is required to register for the VAT purpose.

A person means an individual, firm, company, association, cooperative, institution, joint business, partnership, trust, government body or religious organization. Similarly those persons who fall below the defined threshold don't necessarily have to register. But if they want, they can register and take the TPIN. A non-registrant is not entitled to collect VAT and utilize the facility of tax credit and refund. The TPIN refers to the taxpayer identification number that is to be allocated to each registrant during the registration process. For the registration, first of all the tax payer should get the prescribed form (in Nepal) from any inland revenue

office. The TPIN or PAN is very important regarding the inland revenue administration. The taxpayer should include his TPIN in the documents related to VAT office, income tax, customs, imports and exports, and banks. Registration is required for any business with annual taxable sale of more than Rs. 2 million.

Regarding the calculation of turnover zero-rated sales if from it is impossible to identify the purchase, sales stock, the tax officer may treat all these transaction as turnover and may assess the tax. This mean if the zero rated sales exceed the threshold, taxpayer is liable to register. VAT registrants are required to pay VAT on or before the 25th day following the end of each month. Every tax payer that is involved in taxable sales exceeding the prescribed threshold is liable to register for VAT before starting their business or 30 days after starting their business. They must provide their customers with a tax invoice and should maintain records and keep their VAT records for a period of 6 years. It is required to give notice and advice to the concerned inland revenue office if any change to the business such as new address, telephone number or a reorganization of the partnership. They post their certificate of registration at their principal place and copy of it all branches where the customers may easily notice and observe it. They should allow tax officers to enter the business to examine the business records and the stock in hand. (Adhikari, 2003: 31-32).

2.2.4.2 Deregistration

A VAT registration may be cancelled by anyone whose total taxable sales for consecutive calendar quarters is not more than Rs 2,000,000 and who has been registered for a full fiscal year or by person who no longer have

commercial activities. Regarding the cancellation of registration, the VAT act has mentioned the following conditions:

-) If the organization is closed or transferred or collapsed in case of corporate body.
-) If the business is running under proprietorship with the owner dead.
-) If the partnership is dissolved.
-) If the distributor or producers stops selling or producing taxable goods and services.
-) If the business was registered by mistake.

Regarding the cancellation, the tax officer collects the tax on the capital and other goods that the tax credit facility has been taken by taxpayer previously. The categories falling under this ground neither are required to collect VAT nor allowed to claim a refund of the VAT that they have in producing their goods and services for sale. (Adhikari, 2003:34).

2.2.4.3 Accounting

The effectiveness of VAT depends on the VAT accounting system. It should neither contain unnecessary details nor is inadequate so that it cannot provide appropriate and useful information. The VAT accounting should be information based as well as less costly. The accounting in VAT consists of the process of maintaining purchase, sales, book, VAT account and stock. The purchase and sales books are the main part of VAT accounting. The purchase book contains the information such as TPIN, the supplier's name with TPIN, the customers name with TPIN. Similarly in the sales books date, invoice number, name and number of the supplier, purchase price and taxable price of the import, taxable value and the amounts of VAT should be recorded. The purchase book is a certified register. The registrants should maintain or record all the

purchases during the period, all the goods and services either taxable or non-taxable appearing in separate columns. Likewise, the sales book is another main part of accounting. It should be posted on the basis of sales invoices chronologically showing the amount of standard and zero-rated sales amount and the tax amount. At the end of tax period it should be totalled while mentioning the amounts in the VAT account. The VAT account is monthly summary showing the sources of the figures used in the VAT return. In order to complete the VAT return, a taxpayer should need to ensure that the mount of VAT paid on purchase, the amount of VAT collected on sales, the time of goods and services supplied and proof that goods were exported. (Adhikari, 2003:35).

2.2.4.4 VAT Invoices:

Every registrant is required to issue a tax invoice to the recipient in supplying any goods and services. The specimen of an invoice has been prescribed in schedule 5 and 6 of VAT regulation 1997. It is necessary to mention seller's PAN, buyers PAN whether it is registered in VAT or not, address of sellers and buyers, date of transaction, date of invoice issue, description and price of goods and VAT amount of the tax invoice issue. The invoice must be issued in sequential order for the starting of every fiscal year. A minimum of three copies of each invoice must be raised. First copy must be provided to purchase mentioning tax invoice.

Only retailers are facilitating to issue abbreviated invoice with prior approval of tax officer. It is not necessary to mention details in abbreviated invoice as shown in tax invoice. It can't be issued for transaction exceeding Rs. Five thousand including VAT. It also must be issued in sequential order. It shall be the duty of a registered person to provide a tax invoice who asks for. A recipient who receives and

abbreviated tax invoice shall not be allowed to edit the input tax. In an abbreviated tax invoice, tax is calculated by multiplying the sales value by tax and dividing by adding 100 to rate of tax. (www.ird.gov.np)

2.2.4.5 Abbreviated Invoice

Tax officers may grant permission for a VAT registrant to issue an abbreviated invoice for retail sales below the value of Rs. Five thousand. The chief difference between the two tax invoices is that an abbreviated invoice does not require the name and address of the purchaser. The registrants have the right to request a detailed tax invoice as they will not be able to claim input tax credits with abbreviated invoices. IRD may order taxpayer to issue invoices by using cash machine or computer. The procedure in such case shall be as prescribed by the DG of IRD. IRD will have anytime access to the database of the taxpayer. (www.ird.gov.np)

2.2.4.6 Return Filing

VAT is based on self-assessment system. Tax payer himself calculates all taxes. Every registered taxpayer is required to submit the return to a tax officer within twenty five days after the close of tax period. Such return has to be submitted whether or not a taxable transaction was carried out in that tax period. Failure to submit return in specified time is penalized; nil return or credit return Rs. one thousand flatly. Debit return 0.05 percent per day of the due amount or Rs. One thousand whichever is higher. (www.ird.gov.np)

2.2.4.7 VAT Collection

The producers and suppliers are the agents for tax collection on behalf of the department of VAT administration. Usually they collect VAT on sales and deposit and the collected amount after crediting the tax (if any

amount remains) is prescribed in public treasury account. Tax should be collected in selling price that comprises the costs related to transportation and distribution expenses as well as profit. Excise duty, custom and other tax except income taxes are also included under the selling price. But the trade discount and trade commission are not included. A person who is not registrant is not entitled to collect tax. The collection of VAT is not the responsibility, only of the business community, but also of the revenue offices. In Nepalese context if the tax payer fails to deposit collected tax by regular system, the tax officer may implement various methods and measures to collect the tax arrears. These methods they may employ are as follows;

-) Deducting the tax from the refundable tax amount.
-) Possessing the taxpayer's fixed and current account.
-) Auctioning the property owned by the tax payer.
-) Deducting from the bank account.
-) Deducting from the amount payable to tax payers by government offices or government owned enterprises.
-) Deducting from the amount payable by the third person with the prior approval of the tax payer.
-) Blocking the tax payers' export import business. (Adhikari, 2003:40-41)

2.2.4.8 Input Tax Credit

Registered businessmen are obliged to collect and remit VAT on their taxable transactions. These registrants are entitled to recover the tax paid on their purchases. This recovery or refund is known as input tax credit.

The input tax credit (ITC) is the total of the tax paid or payable on taxable goods and services purchased in Nepal, and the tax paid on taxable goods imported into Nepal.

Where the VAT is paid or payable by a registrant on a purchase or on imports, the registrant is allowed to claim input tax credit for those purchases made by the registrant in his commercial activities.

However, even though the purchase of goods or services may relate in part to a commercial activity, in certain circumstances the purchase may not generate input tax credit entitlement when he sells goods or services which are tax exempt.

Most registrants are entitled to claim input tax credits for the tax paid on acquisitions of capital goods for use primarily in commercial activities. Unlike the income tax deduction rules, the input tax credit for any VAT paid on capital goods is not amortized over the life of the asset. It can be claimed in full in period in which it is acquired. If the capital goods are later put to a non-commercial use, special change -of-rules will apply. Taxpayers whose export is more than 50% of total sales or those who are continuously on six months credit may claim for refund. Refund shall be made within thirty days from the receipt of refund claim.

Tax may not be deducted in respect to the goods and services like beverages, alcohol or alcohol mixed beverages such as liquors and beers, petrol and entertainment expenses.

Some goods are used for the both purposes of the business and personal use. Tax paid to the following goods may be deducted on the following proportions:

-) On all aircraft, 40 percent of purchase value.
-) On automobiles (any motor vehicle with three or more wheels used on a road for carriage of passenger, 40 percent of purchases)
-) On computer, 60 percent of purchases value. (www.ird.gov.np)

2.2.4.9 Assessment

VAT is self assessed tax. Tax payers assess their liability themselves. They are self allowed to get credit tax paid on purchase. Self-assessment system is developed in the assumption does not satisfy. Taxpayer may assess wrongly or may fail to pay correct tax. To correct this situation there is a provision of management tax assessment, which is done by the tax officials. Following criteria has been fixed for management tax assessment.

-) If tax is not fixed.
-) If tax return is filed lately.
-) If tax return contains incomplete information or
-) If tax official has reason to believe the tax is not genuine.

2.2.4.10 Refund

Excess of input tax over output tax in any tax period can be adjusted in the following tax period by carrying forward to next period or can claim for refund to the tax office. Two major criteria have been fixed in VAT law for the claim of refund by tax payers. It is allowed to claim either by regular export basis or by regular six months credit basis. Exporter having more than fifty percent export to total sales is treated as regular exporters.

There is also a separate provision of refund for the diplomat and foreign aided projects. They are allowed to claim refund immediately.

2.2.4.11 Management Information System (MIS)

The tax system should be backed by good and effective information technology which must be tax payers friendly and conducive to the tax administration as well. A scientific information system provides highly sophisticated and standardized services to the tax payers, providing them with needed and adequate information at the right time and also the management and the decision makers. To meet this very purpose, a separate department called "Information Technology section (IT Section)", is installed. MIS does the following functions:

-) Processing of tax application form and related information
-) Updating the tax payers' individual accounts
-) Entering, processing and preservation of the central data.
-) Preparing of master record in database format regarding tax collection, refund, tax credit, registration, de-registration and the business closure.
-) Managing of integrated information between department and field offices.
-) Managing and preservation of data and information for a long period.

The IRD posts the data in tax payers' account and send the result to the related revenue offices. The information of tax payer is kept confidential according to VAT act. DANIDA VAT project has contributed a lot to systemize the MIS in Nepal (Adhikari, 2003:54).

2.2.4.12 Appeal

A tax payer may file an appeal to the revenue tribunal within thirty five days against tax assessment or penalty charged by a tax officer of an order by the director general relating to the suspension of this place of transaction. A provision of appeal to director general has also been included in first amendment in VAT act as a choice to tax payer.

Before filing the appeal the tax payer must deposit the disputed amount of the assessed tax due, the rest of the amount of the tax due plus the whole amount of the file shall have to be deposited or a bank guarantee of the same has to be provided. (www.ird.gov.np)

2.2.4.13 Offences and Penalties

In the VAT act, there is a special provision for the offences and penalties too. the registrant is liable to fine or penalties if he fails to use the registration number or does not clearly display his registration certificate, fail to file a return, does not issue invoices, fails to keep an up-to-date account of transaction, obstruct the visit by tax officer, prepare false accounts and invoices or attempts to evade tax. According to VAT act, action is taken in case of non-registrants (those failing under taxable criteria), non filers or stop filers, who has tax due/arrears, who has no VAT accounts and records as prescribed by the law.

The act also has the provision of punishment to tax officers. If the tax officer is found to have made the assessment quite negligently or maliciously, the Director General has full authority to take action against such a culprit.

2.2.4.14 Administrative Review

A tax payer who is not satisfied with the tax assessment of a tax officer may submit an application to the DG or IRD for administrative review within thirty days from the time of receiving such decision.

2.2.4.15 Rewards

According to VAT act, if a person provides information with solid evidences showing that a tax payer has evaded or attempted to evade all or some portions of tax, he will be rewarded with the amount of equal to twenty percent of the amount of tax collected on that basis of such information. The DG himself is responsible for rewarding the informants.

2.2.4.16 Proxy Criteria

Tax payers whose annual turnover is more than Rs. two million are required to register in VAT compulsorily. Taxpayers who fall below this limit will be required to register in VAT within thirty days of their annual transaction reaching or crossing Rs. two million. However, if the tax payer falls under any one of the following proxy criteria; he is required to register in VAT compulsorily.

- a) If the stock of the tax payer exceeds the specified amount when the tax officer inspects the stock or if the monthly sale exceeds Rs.2 lakh or more during a month.
- b) If the annual expenses of the tax payer on the telephone and rent exceeds Rs. 1 lakh; or
- c) If the premises of the tax payer lies within the specified area of the market or the street as specified by the department (IRD).
(www.ird.gov.np)

2.3 Review of Earlier Studies

Since the period of introduction of VAT in Nepal, many individuals as well as some institutions have made effort on study of VAT for finding the ways for the improvement. Many books, research reports and articles have been written and published in this respect. The researcher had consulted books, theses and some articles with VAT during the thesis writing. Some of them are presented in brief below.

2.3.1 Review of Books

The value added tax does not have a long journey history even in the global context; admittedly, there are not as much literatures available on this topic as other forms of tax system. So in other words, very few studies have been done on this particular topic with special reference to Nepal. An attempt, thereby, has been made to review the theory of tax reforms as well as the recent literature on VAT.

Pandit (2053), *Kardata ko Guide* gives the glimpses of different forms of taxes and their provision. He tries to make aware about the general terminology of VAT and its application in Nepal. He clearly defines the every term of VAT that is associated with VAT system and the procedure that business community has to follow if fails under the threshold.

Adhikari (2003), *Value Added Tax in Nepal: Theory and Practice* comprises of three chapters. The first chapter deals with the theoretical concept of VAT which includes historical background, objectives, merit and demerit of VAT. The second chapter comprises practice of Nepalese VAT which deals with introduction of VAT system in Nepal, different terminologies associated with VAT, tax administration system and legal provision made for the VAT implementation in Nepal. The third chapter

consists of different model questions of TU on VAT, specimen of VAT related forms and accounts and value added tax rule 1997 and value added tax act 1996.

Silwal, (2005) Value Added Tax; A Nepalese Experience discloses the empirical finding of VAT after its implication. He was actively associated in VAT administration from the very beginning. He regarded sales tax system as narrow tax base and low rate, low elasticity and buoyancy, parochial administration and abundance of tax but lot of evasion.

Taxpayers were initially scheduled to register in VAT from the July 17, 1997 and VAT was scheduled to effect from the beginning of F/Y 1996/97. At the time of its announcement he realizes that the preparatory work was not completed. In his own words, the computer system was not ready, staffing was not complete, manuals were not approved and the business community strongly resisted the introduction.

He further added "taking into account all these factors, it was quite reasonable to postpone the scheduled date from April 16 to November 16 1997 because the VAT being a modern a voluntary tax had to rely on the computerized information system as well as the cooperation of the business community". Tax base, rate structure, exemption and threshold issues were major factors affecting VAT design in Nepal. According to his study staff recruitment, issue of retention and issue of attitudes of staffs are crucial problems in administration front.

Kandel, (2004) published a text books entitled "Tax laws and Tax Planning in Nepal". The book was designed to fulfil the needs of MBS and BBS levels under TU. This book was very useful to the students and teachers to know the legal provisions of VAT. The book has attached

unofficial translations of the tax laws - both- acts and rules- related to value added tax and income tax. This book was more informative rather than analytical.

Amatya, Pokhrel, Dahal(2004), published a book entitled "Taxation in Nepal (Income Tax, Property Tax and Value Added Tax)". This book has exclusively been designed for the subject "Taxation in Nepal" as per the syllabus prescribed by the Faculty of Management, Tribhuvan University for 3rd year of Bachelors of Business Studies (BBS). Unlike other books available on this subject, this book makes an in-depth approach to the study of value added tax in Nepal in order to meet the specific requirements of those students who are studying taxation as a concentrative/elective subject at BBS 3rd year. This book was very useful to know the legal provisions of value added tax act 2052. Theoretical aspects as well as numerical problems of value added tax are shrewdly presented in this book.

Same like another book entitled "Tax laws and Planning in Nepal" has been written by K.C. (2006) which helps the MBS students to study about taxation in Nepal. This book helps students theoretically as well as numerically.

The book named "Tax Laws and Tax Planning" written by Bhattarai and Koirala (2006) describes VAT system in depth. This book includes the separate chapter on value added tax. It describes VAT practices in Nepal with several theoretical aspects and numerical examples. This book was specially designed for the students of MBS 2nd year under Tribhuvan University.

2.3.2 Review of Journals and Articles

According to Jyoti (2002), VAT was introduced in Nepal in response to realization that a fundamental change was necessary in the country's revenue policy. The business community was strongly against the VAT in the beginning but the gradually withdrew the opposition as they went on being clearer about positive aspects of the VAT and also its simplicity. Government went through many negotiations with business communities before implementing VAT in Nepal. Taxpayers were opposing VAT not because of any defect in VAT as a system. Rather they were afraid of frequent contacts with revenue officials who were historically notorious for a behaviour that exploited the taxpayers. The success of the VAT is dependant on some prerequisites, such as acceptance of the correct invoice, self-assessment of taxes, and refund of the tax amount in speedy and simple manner when the conditions for a tax refund are met.

According to him, VAT system will not be failed because of any defect in it but because of inadequate and incorrect step taken to ensure billing and or billing at the correct prices, failure to enforce VAT threshold on an effective way.

Dhungana (2003): has scrutinized the legal aspects of VAT in “Value Added Tax and Its Legal Scrutiny”. 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 witnessed weak implementation owing to these hurdles.

2.3.3 Review of Previous Studies

There are quite a few dissertations relating to value added tax in Nepal undertaken by various individuals and some institutions. Some of them are reviewed below.

Chaudhari (2001), in this dissertation, VAT in Nepal: An analysis of its problems and prospects, having the objective to review historical background of VAT, to examine the structure of VAT in Nepal, to observe the contribution of VAT to resource mobilization and to analyze the existing problems of VAT in Nepal, through the primary and secondary data and information, has concluded that the main problems for business houses are account keeping and billing and the weakness of VAT administration are lack of motivation and service minded attitude among tax officials lack of honesty in VAT officers.

Though from the theoretical point of view it is sure that VAT system is the best and advanced fiscal tool, its effect in the context of Nepal is not as expected because of the lack of string and honest tax administer, lack of motivation and service minded attitude among the tax officials, lack of the cooperation of business community, lack of strong coordination between tax collectors and tax payers, lack of strong political commitment and weak public consciousness. He has further recommended some suggestions for better solution of these problems. Tax related information should be published regularly. Interview program with professors, researchers, tax experts, and economists should be conducted and published through advertising media. Often escape away from actual custom duty, as under valuation of the goods has been a tradition. Thus to overcome these problems, the government either has to collect the custom duty of the actual price of the goods or it has to fix the actual price of the goods in the market. Enforcement should be effective

through more audits, investigations and collection visits and integrated approach to total tax system should be introduced for successful implementation of VAT.

Neupane (2006) in his dissertation entitled “Resource Mobilization through Value Added Tax in Nepal” has the basic objective to examine historical background of value added tax and to analyze mobilization of revenue through VAT. Mr. Neupane also provided the bird view of the practising scenario of VAT in the foreign countries. He conducted a research applying secondary data to analyze simple ratio and also use of observation method. He concluded that VAT administration has to bring its program package very strictly and immediately to register the traders, who are supposed to get registered in the VAT in order to control the leakage of revenue and to control tax evasion, so that the number of tax payers would increase and hence the revenue collection would also increase exponentially. He complains that in Nepal, after the implementation of VAT, the government has hardly paid any attention to the consumers. He gave several reasons behind this. According to him, after the implementation of VAT, attempt was made to inform the public about some non-VAT including commodities through the public means of communications like radio, television and newspapers, but it could not prove effective.

As a result, the consumers are on the other hand, as he argues, the businessmen opposing the VAT had raised the prices of daily consumption goods like rice, vegetable etc, which had added future burden to the consumers. The government, he observed, could neither reduce the price nor punish those businessmen against such act. Instead, the government compromised with those businessmen. These are some of the grievances articulated by Neupane on the conclusion of the thesis, but

he also gives some recommendations. His constructive recommendations were:

1. The boundary of VAT should be increased instead of increasing rate of VAT in order to increase the tax amount under VAT.
2. The concentration must be given to bring the use of billing in all trading concern,
3. The most important one, the consumer should be comprehensively educated about the nature and beneficial aspects of VAT.

Basnet (2002), in his dissertation, “VAT: present status and future prospects in Nepal”, by using the analytical and explanatory research design and having the objective to assess the present status and future prospect of VAT and its effects on various aspects of economy, has concluded that the implementation of VAT in Nepal would have very poor results than expected due to poor planning and poor implementation. But VAT implementation has been becoming more and more effective and VAT net has been spreading and revenue collection is on the constant rise establishing it firmly in Nepal. It is expected that positive impact can be seen in tax collection as code of conduct announced recently includes all the required ingredients, such as, utilization of tax revenue, respecting the tax payers, simplification in the service and improvement in the behaviour of tax administrators. Moreover, he recommended that tax related newspapers, pamphlet, radio and television etc. Interview programs with professors, researchers, tax experts, and economists should be conducted and published through advertising media. Similarly, school and campus level curriculum should include tax education and social obligation of paying tax. Border should be effectively controlled to prevent the illegal trade. There should be a broader tax adjustment checking and highway checking should be practical effectively to prevent

any kind of illegal trade, The accounting should be transparent and VAT officers should control auditing as far as possible.

Gautam, (2002) submitted the thesis on "Value added tax: Problem and Prospective".

The main objectives of his study are:

-) To examine the possible effects of VAT in the economy.
-) To observe the potential revenue of VAT in Nepal.
-) To analyze the existing challenges on VAT.
-) To examine the Nepalese tax structure.

Major findings of Gautam are as follows:

-) There is a trend of persisting resource gap along with the huge amount of saving & investment and revenue & expenditure structure of Nepal.
-) An efficient, strong & fair administration is the most crucial for proper implementation of VAT collectors.
-) There is a crisis of confidence between the private sector and the government bodies i.e. VAT payers and self VAT collectors.
-) VAT being a self-assessed, involve based and account based tax, the role of business community along with the general consumer is more important for its successful operation.

Gautam's recommendations are as follows:

-) An efficient, strong and fair administration is the most crucial for proper implementation of VAT payers and self VAT collectors.
-) As VAT is a self-assessed, involve based and account based tax, the role of business community along with the general consumer should play more important for its successful operation.

Bhatta (2005) submitted the thesis on “Value Added Tax System in Nepal”

The major objectives of the study are:

-) To review background, trend of VAT collection and its contribution in government revenue.
-) To analyse the problem faced by the government to collect VAT.
-) To study the effects made by government to collect VAT.
-) To evaluate the performance of VAT.
-) To find out the status and prospects of VAT in Nepal.

Major findings of Bhatta are as follows:

-) Administrative capability is great important for the effective implementation of VAT in Nepal.
-) There is a problem in billing system.
-) The VAT revenue collection is not satisfactory.
-) Various publicity programmers should be initiated.

Bhatta’s recommendations are as following:

-) Billing system should be properly managed to get good result from VAT.
-) Administration should play its role properly to collect Tax.
-) Various publicity programmers should be initiated to make satisfactory collection of VAT.

Nepal (2008) submitted the thesis on “Revenue generated from VAT in Nepal” –

The major objectives of the study are:

-) To analyse the status of VAT registration.
-) To analyse the composition of VAT revenue.
-) To analyse the applicability of VAT.
-) To examine the helpfulness of VAT on economic growth.

Major findings of Nepal are as follows:

-) VAT revenue from imports dominates VAT revenue from domestic VAT revenue.
-) Among the source of revenue VAT has dominant in all other sources of revenue collections i.e. income tax, excise duty and others.
-) People show positive response towards applicability of VAT.
-) VAT increases inflation.
-) VAT helps in economic growth.
-) VAT discourages illegal trade.

Nepal’s recommendations are as follows:

-) Collection of VAT should be done more effectively.
-) VAT collection should be increased to minimize illegal trade.

Ghimire (2008) submitted the thesis on “Contribution of VAT to National Income”

The major objectives of the study are:

-) To assess the contribution of VAT in IRD of Kathmandu to national revenue, total tax revenue, indirect tax revenue and total VAT revenue.
-) To study about effectiveness and problems of implementation of VAT.
-) To provide suggestions for effective implementation of VAT in Kathmandu.

Major findings of Ghimire are as follows:

-) The trend of VAT registrants in IRD of Kathmandu is in increasing trend which shows that people are being quite aware regarding VAT system and its advantage.
-) Revenue is in increasing trend so it is expected to generate more VAT revenue in future and in the long run VAT will be an integral part of Nepalese tax structure but the revenue resources have not increased to meet in increasing government's expenditure as expected.
-) Difficulties in business registration procedure, account keeping system and cost of record keeping are the major problems in business sectors.
-)

Ghimire's recommendations are as follows:

-) Procedure, account keeping system and cost of record in business sectors should be made more scientifically.
-) VAT collection is one main way to minimize the resource gap.

Shrestha (2008) submitted the thesis on “A Study on VAT: Implementation, problems and its effectiveness in the Nepalese Economy”

The major objectives of the study are:

-) To examine the implementation of VAT in general.
-) To analyse the problems faced by the government to collect VAT.
-) To conduct an empirical investigation regarding to effectiveness and problems of VAT in Nepal.
-) To provide suggestion on the basis of the study to the concerned authorities.

Major findings of Shrestha are as follows:

-) Despite the best effort, large numbers of potential tax payers are outside the boundaries of VAT net due to which honest taxpayers have to face unfair competition.
-) There is no proper system of valuation of goods in custom and control mechanism is also not good, beside this open boarder is one of the main problems for successful implementation of VAT.
-) Business persons are not happy with the present VAT rate although the present VAT act is very good for implementation.
-) There is lack of education among customers and business sector.
-) Fine and penalty system is very strong rather than facilitative one.

Shrestha's recommendations are as follows:

-) Education about tax among customers and business sector should be increased.
-) Government should facilitate the tax payers.

Acharya (2010) “Effectiveness of Value Added Tax in Revenue Collection in Nepal”

The major objectives of the study are:

-) To study the historical background of the VAT.
-) To examine the contribution of VAT in revenue collection in Nepal.
-) To analyze effectiveness and problems of VAT in Nepal.

Major findings of Acharya are as follows:

-) Trend of revenue collection ratio through VAT depending in import business.
-) Open boarder is main problem for collectiveness of VAT revenue collection.
-) For improvement and more effectiveness of VAT, there should be developed skill manpower, make coordination with private sector, manage of reward and punishment systems prove in administration so on.

Acharya's recommendations are as follows:

-) Government should manage reward and punishment systems properly.
-) Skilled manpower should be appointed to tax offices.

2.4 Research GAP

In this way, various books, dissertations, reports, articles and other reference materials have been reviewed while preparing this dissertation. But there are not sufficient studies/reports conducted in such particular topic that VAT as a tool of revenue mobilization in Nepal. A few works have been done earlier but they are not able to explain explicitly the real picture of revenue collection from VAT, its trend and its relation with total revenue, total tax revenue and total indirect tax revenue. No one have evaluate the contribution of VAT on revenue mobilization and suggested to the concerned departments on the basis of study findings. They have not examined the prospects of VAT in Nepal, so this study is unique and original.

CHAPTER – III

RESEARCH METHODOLOGY

The chapter describes the research methodology used for achieving the basic objective of the study. Thus, it presents research design, population and sample, data collection, tools for analysis, and method of presentation and analysis.

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 problems 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 comprise 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 fulfil the objectives of the study, 45 samples from the population in the Kathmandu Valley were carefully selected by consultation with lecturers and best judgments of the researchers. The respondents could be divided

into three groups. The following table shows the groups of respondents and the size of samples:

Table 3.3 Group of Respondents and Sample size:

S. NO.	GROUP OF RESPONDENTS	SAMPLE SIZE	PERCENTAGE
1	Tax Administrators / Experts	10	22
2	Business Persons	20	45
3	Customers	15	33
	TOTAL	45	100

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 data is different, collection procedure also tend to vary. A set of questionnaires was designed and distributed to the selected respondents and data were also collected from respondents through field visit by the researchers. 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 Survey
- (c) Telephone Queries

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 reports 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, the Kantipur Daily and so on.
- (i) Publications of various VAT Departments.
- (j) Websites.

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

3.4 Techniques of Presentation and Analysis of Data:

In the process of presentation and analysis of data, various statistical tools are 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 are used:

- (a) Simple Average,
- (b) Simple Percentage,
- (c) Graphs, Charts and Diagrams,
- (d) Trend Analysis

CHAPTER - IV

PRESENTATION AND ANALYSIS OF DATA

This chapter deals with the presentation and analysis of data. The data collected for the purpose of attaining the objectives of the study are presented in tabulation and graphic forms. Similarly, the presented data are analyzed using different suitable tools. This chapter has thus been divided into two main parts. The first part deals with presentation and analysis of secondary data and the second part consists of the presentation and analysis of the primary data. This chapter also contains the summary of findings of the study.

4.1 Presentation and Analysis of Secondary Data

This section presents and analyzes the data collected from the secondary sources as mentioned in chapter three.

4.1.1 Revenue Structure of Nepal

The total revenue of government of Nepal is collected from tax and non-tax sectors. 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 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. 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 be seen in the following table.

Table 4.1 Revenue Trend in Nepal (Rs in million)

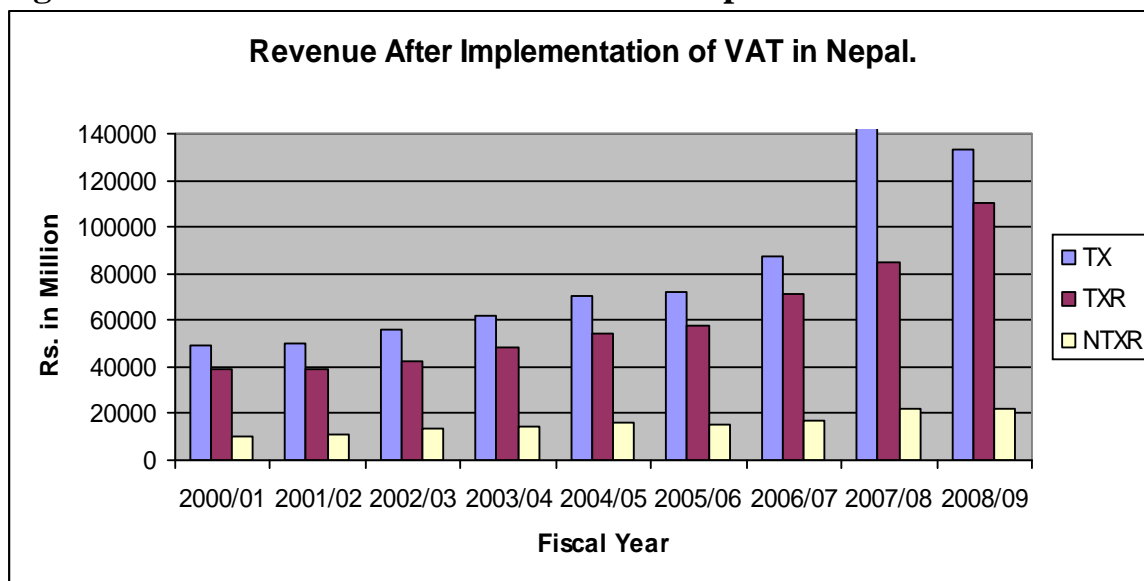
Fiscal Year (FY)	Total Revenue (TR)	Tax Revenue (TXR)	Tax Revenue as % of TR	Non-Tax Revenue (NTXR)	Non tax revenue as % of TR
2000/01	48893.60	38865.10	79.49	10,028.80	20.51
2001/02	50,445.50	39,330.60	77.97	11,115.00	22.03
2002/03	56,229.80	42,586.90	75.74	13,642.70	24.26
2003/04	62331.00	48,179.00	77.29	14,158.00	22.71
2004/05	70,122.70	54,104.70	77.16	16,018.00	22.84
2005/06	72,282.10	57,430.40	79.45	14,851.70	20.55
2006/07	87,712.08	71,126.73	81.09	16,585.35	18.91
2007/08	1,07,622.48	85,155.46	79.12	22,467.02	20.88
2008/09	1,32,953.40	1,10,621.86	83.20	22,331.54	16.79

Source: IRD, Annual report 2008-2009

The above table demonstrates the structures of total revenue of the government after implementation of VAT. The contribution of tax revenue on total revenue in the year 2000-01 is 79.49%. This is slightly increased up to the year 2005-06. In the year 2006-07 it reached to 81.09%. On the other hand, the contribution of non-tax revenue on total revenue is 20.51% in 2000-01 which kept increasing until it reached to 22.84% in the year 2004-05. It proves that tax revenue was in decreasing order and non-tax revenue is in increasing order. But overall judging the figures presented in the table, no significant changes have occurred so far. This only proves the lack of contribution of VAT to raise the tax revenue

of the government of Nepal proportionately which can be presented in the following graph also.

Figure 4.1 Revenue Trend in Nepal



4.1.2 Structure of Tax Revenue

Tax is the compulsory levy made to government treasury by public. Tax is levied either directly on income or indirectly on consumptions of goods and services. Indirect tax is collected mainly from customs and the consumption of goods and services. Nepal is not in a condition to generate adequate revenue from direct taxation. Agriculture is the main occupation of the Nepalese people.

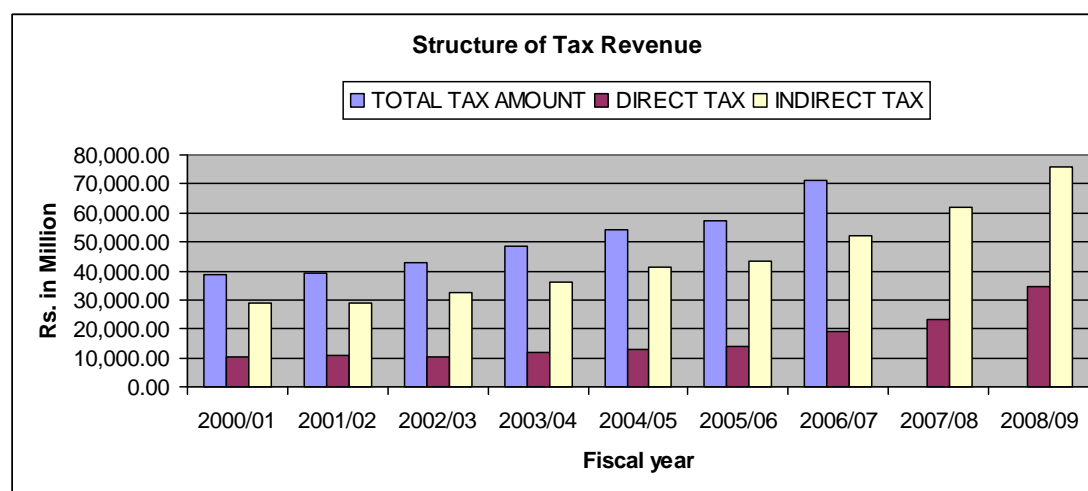
The industrial development is very primitive in Nepal. It contributes only about 10% in the GDP. The per capita income of Nepalese people is extremely low. In Nepalese economy, the contribution of direct tax is very low, it is almost 20% of total tax revenue and contribution of indirect tax is remarkably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

Table 4.2 Structure of Total tax revenue (Rs in million)

Fiscal Year (FS)	Total Tax Revenue (TR)	Direct tax		Indirect Tax	
		Amount	% of Total revenue	Amount	% of total revenue.
2000/01	38,865.10	10,159.40	26.14	28,705.70	73.86
2001/02	39,330.60	10,597.50	26.94	28,733.10	73.06
2002/03	42,586.90	10,105.70	26.73	32,481.20	76.27
2003/04	48,713.00	11,912.60	24.73	36,260.40	75.27
2004/05	54,104.70	13,071.80	24.16	41,032.90	75.84
2005/06	57,430.40	13,968.10	24.32	43,462.30	75.68
2006/07	71,126.73	18,980.29	26.69	52,146.44	73.31
2007/08	8,55,155.46	23,087.76	27.00	62,067.70	73.00
2008/09	1,10,621.86	34,724.20	31.38	75,897.66	68.62

Source: IRD, Annual Report 2008/2009
MOF, Economic Survey 2008/2009

Figure 4.2 Structure of Tax Revenue



According to above data, the contribution of the direct tax is very low. Contribution of direct tax revenue in the year 2000/01 is 26.14%. On the other hand contribution of indirect tax revenue is also in decreasing order. Although, value added tax belongs to the indirect tax category,

introduction of this tax does not increase the share of indirect tax on total revenue. The tax experts always say that implementation of VAT helps to collect more revenue. It also helps to collect more income tax and other direct taxes due to its transparency characteristics. This claim of tax experts might come true in the case of successful implementation. But hopefully, in spite of the decreasing trend of the direct taxes, from the fiscal year 2006/07, it suddenly had started picking up once again but in an insignificant percentage of only 26.69% with reverse impact on the indirect tax revenue standing at 73.31%, about 2% falling below the previous figure. In the fiscal year 2008/09, the contribution of direct tax and indirect tax is 31.38% and 68.62% respectively.

4.1.3 Registration

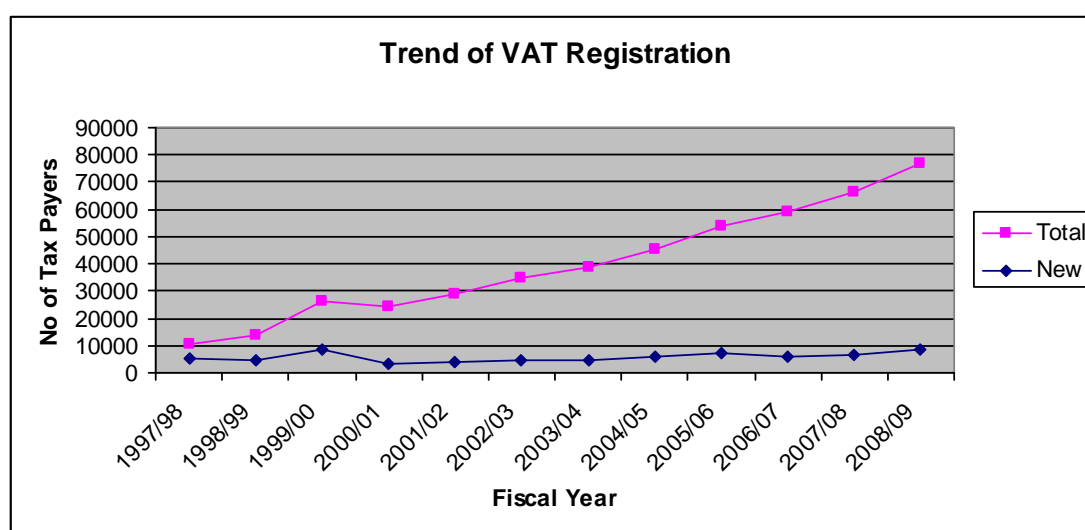
Registration is a preliminary step in the whole process of VAT system. The threshold limitation of VAT registration is Rs. two million. All tax payers whose taxable transactions stand above Rs. two million are compulsorily required to register for VAT. But those firms whose turnover is apparently below the prescribed threshold limit also can go for registration if they so desire. The firms having more than Rs. two million, who were not previously registered under sales tax is required to register for VAT within ninety days. 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 4.3 Year-Wise Number of VAT Registrants

Fiscal Year	Total registrants	Cum-total	percentage
1997/98	5,237	5,237	-
1998/99	4,405	9,642	84.11
1999/00	8,305	17,947	86.13
2000/01	3,146	21,093	17.53
2001/02	4,056	25,149	19.23
2002/03	4,723	29,872	18.78
2003/04	4,302	34,174	14.40
2004/05	5,602	39,776	16.39
2005/06	7,055	46,831	17.74
2006/07	6,134	52,965	13.10
2007/08	6,742	59,707	12.73
2008/09	8,434	68,141	14.12

Source: IRD Annual report of 2008/09.

Figure 4.3 Year-Wise Numbers of VAT Registrants



The above table and chart shows that in the year 1997/98, 5237 tax payers registered for VAT. In the year 1998/99, new taxpayer registered was 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 1999/00, 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 14.12% in the fiscal year 2008/09. This shows that the businessmen are disinterested in registration for VAT.

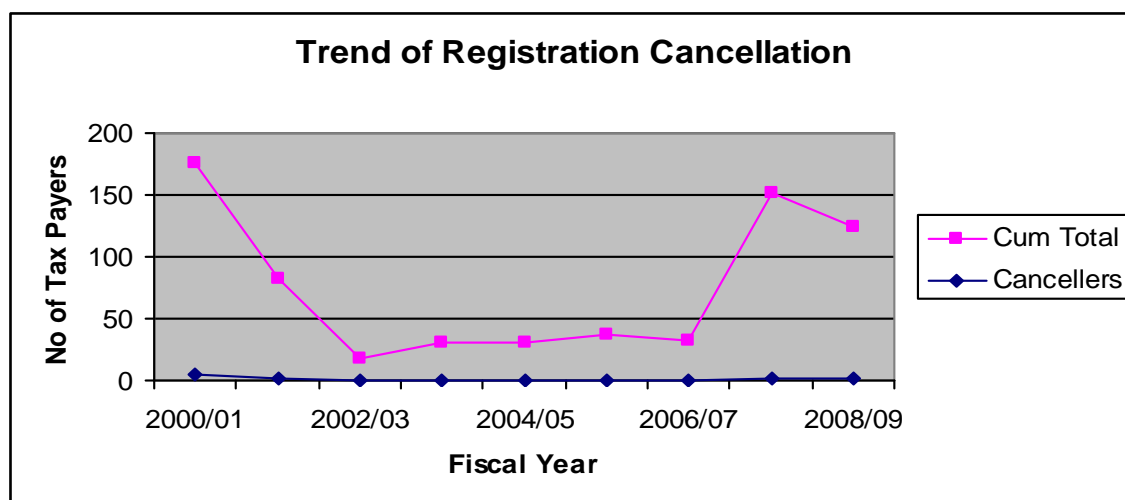
The table below shows the tax payers trend of cancelling registration from VAT.

Table 4.4 Year Wise Number of VAT Cancellation

Fiscal year	No of Reg. cancellers	% of Reg. cancellers
2000/01	170	5.40
2001/02	80	1.97
2002/03	18	0.38
2003/04	30	0.69
2004/05	30	0.53
2005/06	36	0.51
2006/07	31	0.50
2007/08	150	2.22
2008/09	123	1.45

Source: IRD Annual report of 2008/09.

Figure 4.4 Year-Wise Number of VAT Cancellation



The above table and chart depict the data from the fiscal year 2000/2001 to 2008/09 according to which the tax payers who cancelled their registration in the fiscal year 2000/01 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 percentage 1.97 shows the significant decrease. In the fiscal year 2002/2003, the cancellation decreased even significantly, thereby hinting at the tax payers' more inclination towards VAT. The trend stood almost constant from the fiscal years 2002/2003 to 2006/2007. But in the fiscal year 2007/08, the number of cancellers significantly increased reaching the number 150. It indicated that more awareness programs must be held to transmit the tax payers about the benefits of VAT.

4.1.4 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 number of non-filer.

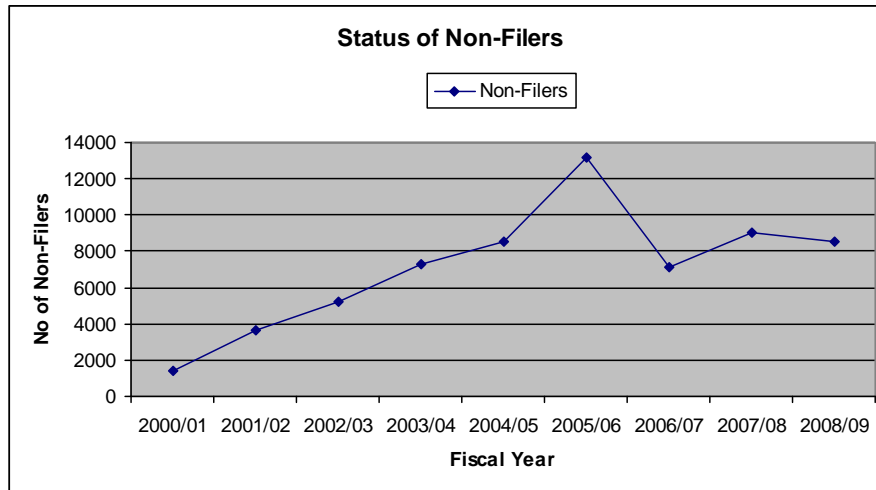
Table 4.5 Year-Wise Number of Non-filers

Fiscal Year	Total registrants	Non-Filers	percentage
2000/01	21,093	1383	6.55
2001/02	25,149	3676	14.61
2002/03	29,872	5255	17.59
2003/04	34,174	7322	21.42
2004/05	39,776	8492	21.34
2005/06	46,831	13198	28.18

2006/07	52,965	7098	13.40
2007/08	59,707	9059	15.15
2008/09	68,141	8496	12.46

Source: IRD Annual report of 2008/09.

Figure 4.5 Year-Wise Number of Non Filers



The Table 4.5 and Figure 4.5 above show that the status of non-filers was in increasing trend from the fiscal years 2000/01 to 2005/06. In the fiscal year 2000/01, only 6.55 percent failed to submit the tax return. But this trend was on the increase in each subsequent year until the fiscal year 2005/06. But in 2006/2007, the trend once again declined showing a significant change on taxpayers' habit of not submitting the tax return. But in the fiscal year 2007/08, the trend once again increases by 2% from the preceding year showing the necessity of more intensive supervision on VAT return filing and in 2008/09 it is little bit decreased.

4.1.5 Tax Returns

Tax returns means a return furnished by a tax payer in regard to the tax payable for transactions carried out during the tax period. A study on the status of tax return facilitates the forecasting of the amount of potential tax collection. In general, the tax return includes debit, credit and nil tax return. Debit return implies the return which the tax payer furnishes

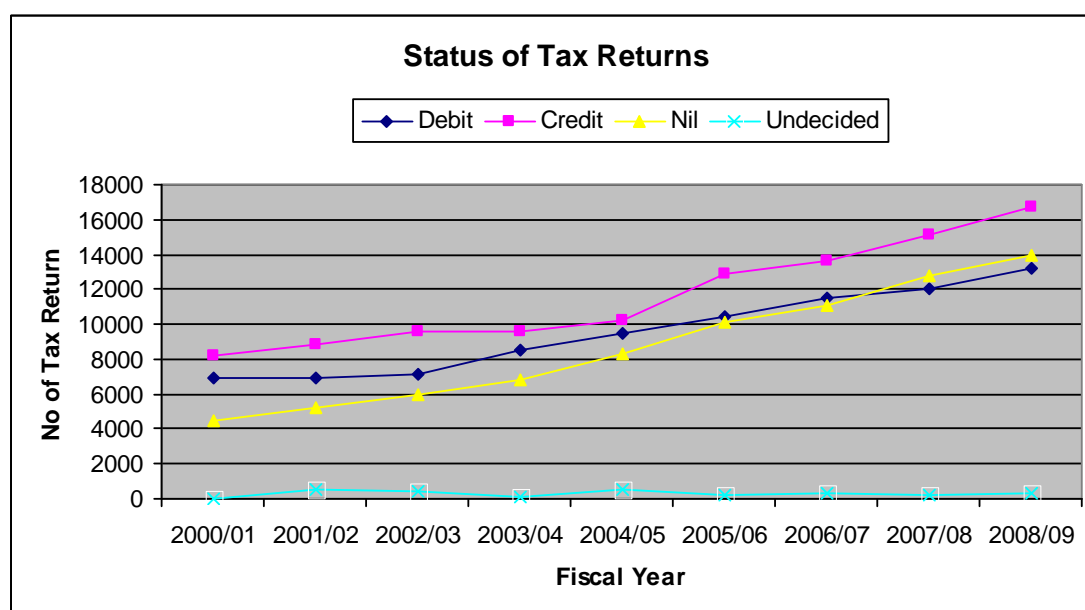
declaring to pay tax. Debit return shows the output tax exceeding input tax credit. Credit return is just opposite of debit return. If input tax is greater than output tax, the possibility of credit return is realized. so, debit return is favourable for the government. If there is no transaction during the particular tax period, then it is nil or zero return. The status of tax return is depicted in table 4.6 and Figure 4.6.

Table 4.6 Status of Tax Returns

Fiscal Year	Debit		Credit		Nil		Undecided		Total
	No	%	No	%	No	%	No	%	
2000/01	6,975	35.39	8,250	41.86	4,471	22.68	14	0.07	19,710
2001/02	6,936	32.30	8,844	41.19	5,207	24.25	486	2.26	21,473
2002/03	7,178	32.06	9,553	41.36	5,972	25.85	396	1.72	23,099
2003/04	8,483	33.87	9,625	38.42	6,783	27.08	158	0.63	25,059
2004/05	9,478	32.20	10,260	36.00	8,271	29.00	516	1.80	28,525
2005/06	10,449	31.06	12,882	38.17	10,139	30.14	163	0.40	33,633
2006/07	11,457	31.43	13,594	37.29	11,044	30.29	362	0.99	26,457
2007/08	12,052	30.02	15,050	37.49	12,779	31.83	258	0.64	40,139
2008/09	13,246	29.86	16,770	37.80	14,005	31.57	341	0.77	44,362

Source: IRD, Annual report of 2008/09

Figure 4.6 Status of Tax Returns



The table 4.6 and figure 4.6 reveal that the credit return is higher than the debit return. This is considered something not so good for the VAT system. In the fiscal year 2000/2001, the ratio of debit return to the total return is 35.39% whereas the credit return stood at 41.86%. From then onwards, the figure just seemed to rise consistently. The nil return in that particular period was 22.68% and the undecided percentage was 0.07. Understandably, at the initial periods, the credit return might rise due to the provision to carry forward of credit from the sales tax and the provision also of getting credit facility of old stock. But the continuous increase of the credit return is definitely not a good sign for the government who needs to think about this in time.

It is duty of inland revenue department to seriously come up with measures to make sure this doesn't happen in future. Unless the government is proactive enough to figure out the actual cause behind the increasing trend of credit return, nil return and undecided return which in the above table is not high though, the government's intension to mobilize VAT as resource may be just a day dream. So, complete tax audit and investigation on these issues must be a top priority of the government.

4.1.6 Revenue Collection from VAT

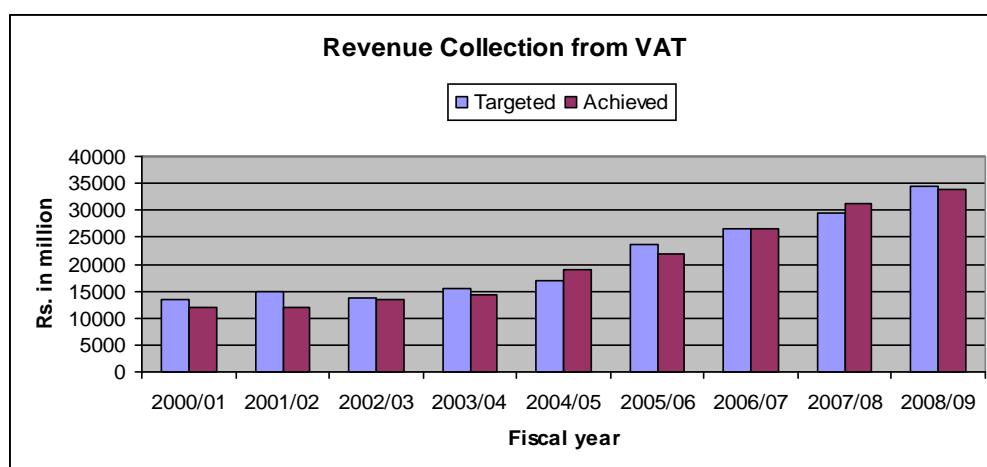
VAT is considered as modern and scientific tax system in sales tax family. Nepal has adopted VAT since fiscal year 1997/98. Since then the actual collection of VAT from the fiscal year 2000/01 to 2008/09 has been shown below.

Table 4.7 Revenue Collection from VAT (Rs in million)

Fiscal Year	Targeted	Achieved	% Change
2000/01	13500	12050	-11
2001/02	14750	11947.95	-19
2002/03	13730.05	13449.12	-2
2003/04	15503.30	14448.89	-7
2004/05	16950.00	18894.63	11
2005/06	23650.00	21946.01	-7
2006/07	26463	26704.18	1
2007/08	29532.90	31154.63	5.5
2008/09	34423.60	33792.42	-2

Source: IRD, Annual report of 2008/09

Figure 4.7 Revenue Collections from VAT



In the fiscal year 2001/02 achieved 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 whereas the

collected revenue amount 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. 21946 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%. The increasing trend continues in the fiscal year 2007/08 also by exceeding the targeted figure by 5.5 percent. But in 2008/09 it was gone down by 2%. 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 it can be seen in the figure above, after for the last years, comparatively the trend of revenue collection is good one although it is still in a fluctuating nature.

4.1.7 Composition of VAT Revenue

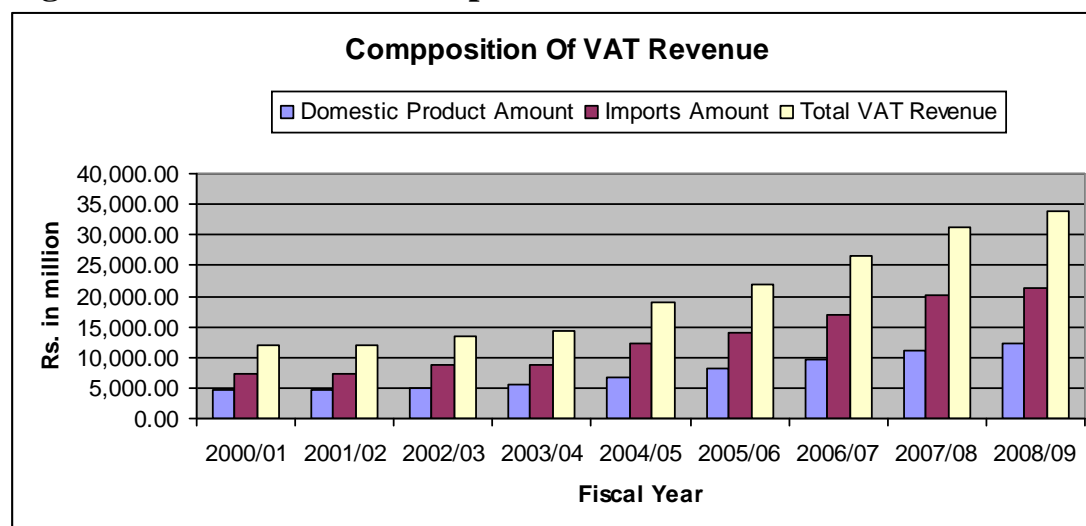
VAT is levied on both domestically produced goods and services and imported goods and services. Nepalese economy is agricultural based. More than 60% people are farmer and the farming is unorganized. Agriculture production through unorganized sector is exempted from VAT. Most of the products and services are imported from neighbouring 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 the table below:

Table 4.8 **Composition of VAT Revenue** **(Rs in million)**

Fiscal Year	Total VAT Revenue	Domestic Product		Imports	
		Amount	%	Amount	%
2000/01	12,050.00	4,744.72	39.38	7,303.04	60.61
2001/02	11,947.95	4,608.37	38.57	7,339.58	61.43
2002/03	13,449.12	4,819.61	35.84	8,629.51	64.16
2003/04	14,448.89	5,604.12	38.79	8,874.77	61.42
2004/05	18,894.63	6,624.33	35.06	12,270.29	64.94
2005/06	21,946.01	8,057.43	36.71	13,888.58	63.29
2006/07	26,704.18	9,689.98	36.29	17,014.20	63.71
2007/08	31,154.63	11,109.74	35.66	20,044.89	64.34
2008/09	33,792.63	12,368.37	36.60	21,424.05	63.40

Source: IRD, Annual report of 2008/09

Figure 4.8 **Composition of VAT Revenue**



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, it is 35.83% and 64.16% In the fiscal year 2008/09, domestic products contributed 36.60 % whereas imported goods contributed 63.40% in the total VAT revenue. In Nepalese VAT structure,

collection from imports share is about two-third and collection from domestic source occupies one-third only.

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

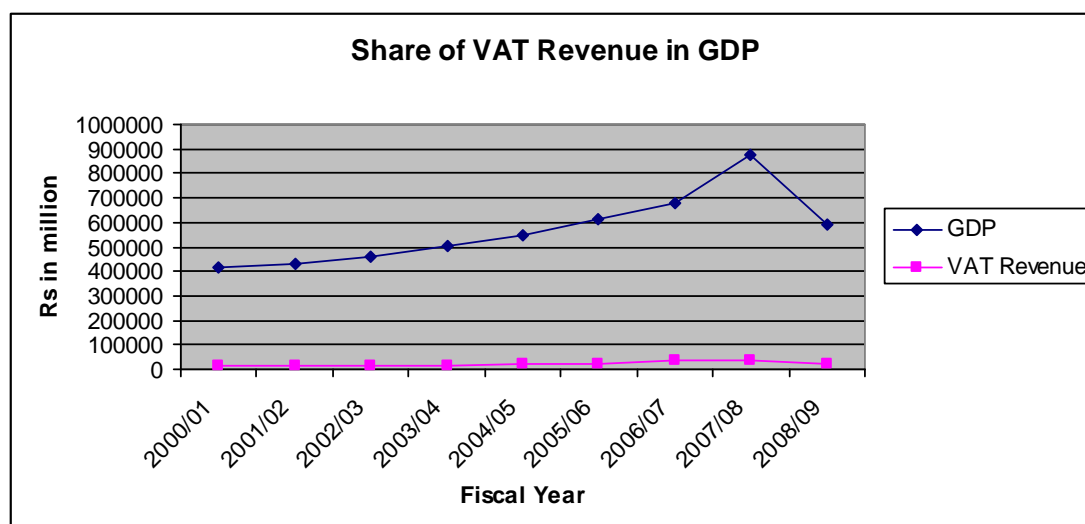
Gross Domestic Product is the total final output of goods and services produced by the country's territory by residents and non-residents, regardless of its collection between domestic and foreign claims. The VAT/GDP ratio measures the consistency of the growth of VAT revenue with the corresponding growth 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 4.9 VAT Revenue as Percentage of GDP (Rs in million)

Fiscal Year	GDP	VAT Revenue	% of GDP
2000/01	4,13,428.70	12,050.00	2.91
2001/02	4,30,396.60	11,947.95	2.78
2002/03	4,60,325.30	13,449.12	2.92
2003/04	5,00,699.10	14,448.89	2.89
2004/05	5,48,484.70	18,894.63	3.44
2005/06	6,11,088.50	21,946.01	3.59
2006/07	6,75,484.00	26,704.18	3.95
2007/08	8,75,393.00	33,792.42	3.86
2008/09	5,92,901.54	20,487.53	3.35

Source: IRD, Annual report of 2008/09

Figure 4.9 VAT Revenue as Percentage of GDP



Above table reveals that share of VAT revenue in GDP is 3.35% in an average through the analysis period. The contribution made through VAT in GDP is very low. In fiscal year 2000/01, total amount Rs. 12050 million was collected as VAT which was only 2.91% of GDP. However, though insignificantly, the percentage shows that increasing trend, but very low percentage of GDP throughout all the years of analysis. The highest percentage i.e. 3.95% was recorded in the fiscal year 2006/07 with VAT revenue amounting to 26704.18. So, it can be said that the trend shows 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.

4.1.9 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 is shown in table 4.10.

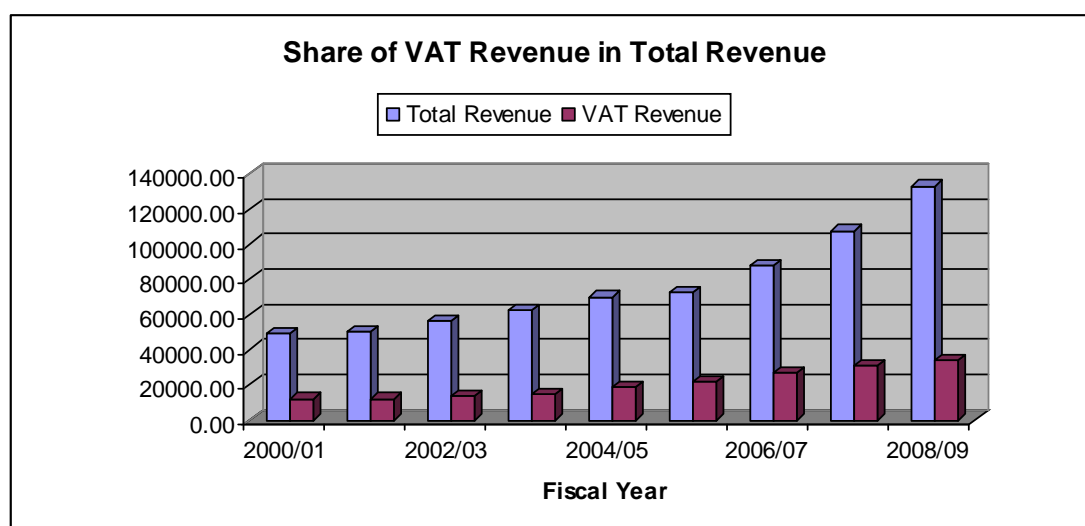
Table 4.10 VAT Revenue as Percentage of Total Revenue.

Fiscal Year	Total Revenue	VAT Revenue	% of Total Revenue
2000/01	48,893.90	12,050.00	34.65
2001/02	50,445.60	11,947.95	23.68
2002/03	56,229.70	13,449.12	23.92
2003/04	62,331.00	14,448.89	23.18
2004/05	70,122.70	18,894.63	26.95
2005/06	72,282.10	21,946.01	30.36
2006/07	87,712.08	26,704.18	31.00
2007/08	1,07,622.48	31,154.63	28.95
2008/09	1,32,953.40	33,792.42	25.41
Average	76,510.33	20,487.53	26.45

Source: MOF, Economic Survey 2008/09

Above table reveals that an average contribution of VAT to the total revenue is 26.45 %. In the fiscal year 2000/01, its contribution was 24.65%, it kept increasing in the following years ending up with 31%, the highest one in the fiscal year 2006/07. But in fiscal year 2008/09, its contribution declines to 25.41%. The same figure can be better viewed in the following chart.

Figure 4.10 VAT Revenue as Percentage of Total Revenue



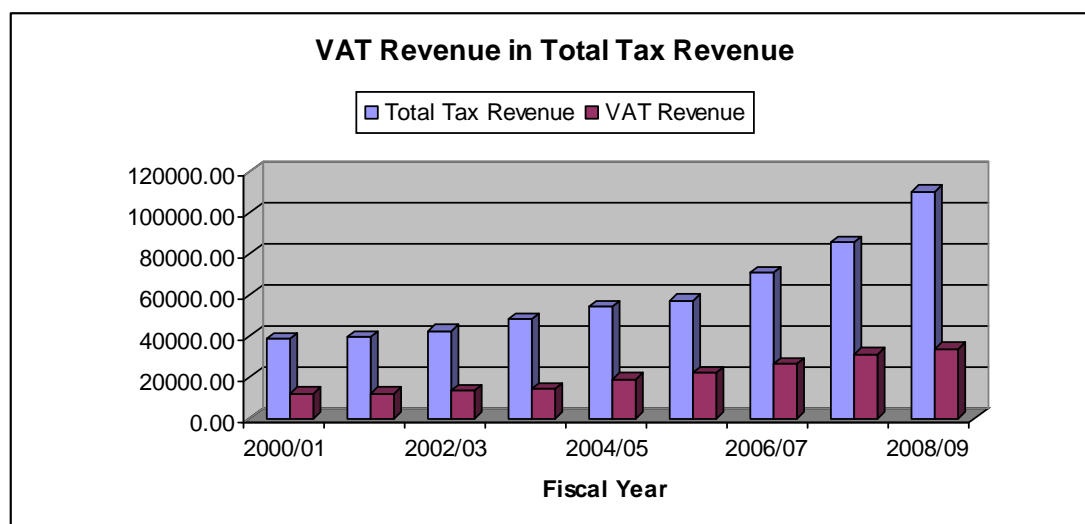
4.1.10 Share of VAT Revenue in Total Tax Revenue

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

Table 4.11 VAT Revenue as Percentage of Total Tax Revenue

Fiscal Year	Total Tax Revenue	VAT Revenue	% of Total Tax Revenue
2000/01	38865.10	12,050.00	31.00
2001/02	39330.60	11,947.95	30.38
2002/03	42586.90	13,449.12	31.58
2003/04	48173.00	14,448.89	29.99
2004/05	54104.70	18,894.63	34.92
2005/06	57430.40	21,946.01	38.21
2006/07	71126.73	26,704.18	37.54
2007/08	85155.46	31,154.63	36.59
2008/09	110621.86	33,792.42	30.54
Average	60821.63	20,487.53	33.41

Figure 4.11 VAT Revenue as Percentage of Total Tax Revenue



The above table shows that there is high share of VAT in total tax revenue in Nepal. In the fiscal year 2000/01, the percentage of VAT in total tax revenue is 31% similarly in the fiscal year 2005/06 it was increased to 38.21% and in 2008/09, it was 30.54%. The average contribution of VAT to the total revenue is 33.41% 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.

4.2 Presentation and Analysis of Primary Data

This section presents and analyzes the data collected from the primary sources.

4.2.1 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 this regard, Shoup (Shoup 1998) 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 a less than comprehensive manner to affect only imports, manufactures, extra active industries and perhaps wholesales. (Shoup, 1998: 149). Poor administration can hinder the utility of VAT in Nepal. VAT is a modern and new tax system which cannot be implemented without efficient and modernized administrative setup. Nepalese industrialists 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. The 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 stereotyped promises to

facilitate the business communities but all 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 VAT administration question was asked and the result so obtained has been presented in the table as follows:

Table 4.12 Efficiency of Nepalese VAT Administration

Respondents	Tax Officials		Business Persons		Consumers		Total	
	No.	%	No.	%	No.	%	No.	%
Efficient	6	60	2	10	2	13.33	10	22.22
Inefficient	1	10	7	35	6	40	14	31.11
Needs improvement	3	30	11	55	7	46.67	21	46.67
Total	10	100	20	100	15	100	45	100

According to above table, 31.11% view that present administration absolutely unable to handle VAT. However, 46.67% are optimistic. Their view is that if certain improvements can be made within the tax administration, there will certainly be possibilities of positive results. According to them:

1. Past records reveal that the revenue administration has mostly failed to fulfill the administrative requirement for various taxes while expected outcome has become 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.

2. 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 a 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.
3. Regarding VAT, the case is more or less similar in that the government is still unable to shatter its status quo. The government should convince the business communities and make them a part 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.

4.2.2 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 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 4.13 Best Way to Increase Public Revenue through VAT

Respondents	Tax Officials		Business Persons		Consumers		Total	
	No.	%	No.	%	No.	%	No.	%
Increasing Tax	1	10	-	-	-	-	1	2.22
Widening its coverage	7	70	15	75	9	60	30	66.77
Discouraging tax evasion	2	20	4	20	6	40	13	28.89
Others	-	-	1	5	-	-	1	2.22
Total	10	100	20	100	15	100	45	100

(Source: Survey, 2011)

Above table shows that the best way to increase public revenue through VAT is to widen its coverage because 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.

4.2.3 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 bills. So, this habit can be taken as the critical problem for the smooth implementation of VAT system. The respondents gave following variegated answers when asked about this.

Table 4.14: Habit of taking Bills on purchase

Respondents	Tax Officials		Business Persons		Consumers		Total	
	No.	%	No	%	No.	%	No.	%
Alternatives Choices			.					
Yes, on every purchase	5	50	5	25	2	13.33	12	26.67
Yes, on most of the purchase	5	50	13	65	3	20	21	46.67
Yes, but not regularly	-	-	2	10	9	60	11	24.44
No, I never get any bill	-	-	-	-	1	6.67	1	2.22
TOTAL	10	100	20	100	15	100	45	100

(Source: Survey, 2011)

Above table shows that 50% of tax officials, 65% of business and 20% of consumers have the habit of taking bills on most of their purchases. In total 26.67% of people take bills of their purchases. About 42.67% of people have the habit of taking bills on most of their purchases. About 24.44% 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. About 2.22% 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 demands for bills are the lawful right of every customer.

4.2.4 Percentage of Customers Demanding Bills:

Because of different factors, like lack of awareness among customers and so on, the customers themselves feel cumbersome to ask for the bills from the salesman, 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 rules:

Table 4.15: Percentage of Customers Demanding Bills

Respondents Percentage	Tax Officials		Business Persons		Consumers		Total	
	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
Above 80	-	-	2	10	-	-	2	4.44
TOTAL	10	100	20	100	15	100	45	100

(Source: Survey, 2011)

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.

4.2.5 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 VAT will increase the price of the goods and services so they don't want 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 4.16: Effective Media for VAT Education

Respondents	Tax Officials		Business Persons		Consumers		Total	
	No.	%	No.	%	No.	%	No.	%
Radio / TV	2	20	12	60	5	3.33	19	42.22
Newspaper	5	50	3	15	7	46.67	15	33.33
Booklets / Pamphlets	-	-	2	10	1	6.66	3	6.67
Wall Painting / Banner	2	29	1	5	1	6.67	4	8.89
Seminars	1	10	2	10	1	6.67	4	8.89
TOTAL	10	100	20	100	15	100	45	100

(Source: Survey, 2011)

The above table shows that 42.22% suggest radio and TV as the effective media for 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.

4.2.6 Weakness in VAT Administration:

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

Table 4.17: Weakness in VAT Administration

Respondents	Tax Officials		Business Persons		Consumers		Total	
	No.	%	No.	%	No.	%	No.	%
Lack of Expertise	4	40	2	10	5	33.33	11	24.44
Lack of trained manpower	2	20	14	70	6	40	22	48.89
Corruption and bribing	-	-	4	20	4	26.67	8	17.78
Lack of physical infrastructure	3	30	-	-	-	-	3	6.67
Lack of sufficient field offices	1	10	-	-	-	-	1	2.22
TOTAL	10	100	20	100	15	100	45	100

(Source: Survey, 2011)

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. Above table 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 manpower while 17.78% boldly accused the officials of corruption and bribing while tax officials remain silent about this. According to them, the corruption and bribery is deeply rooted in the Nepalese administration.

4.2.7 Behaviour of VAT Administrator towards Taxpayers:

The following survey shows what the respondents which are only business persons feel about the administrators' behaviour towards them:

Table 4.18: Behaviour of VAT Administrator Towards Taxpayers

Respondents	Business persons	
	No.	%
Alternative Choices		
Very Helpful	10	50
Helpful	5	25
Very troublesome & Slow in their work	4	20
Disrespectful, treating badly	1	5
TOTAL	20	100

(Source: Survey, 2011)

Above table shows that about 25% of businessmen have the view that the VAT administrators are helpful. About 20% view that tax officials 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 bribed.

4.2.8 Problems in VAT Collection:

The reason behind the introduction of VAT is mainly to increase public revenue. VAT is collected from taxpayers. Modern and scientific as the VAT, it is expected that tax collection will pick up significantly through VAT, but the result has not been satisfactory yet. The crucial question is that what are the problems behind it? There may be various problems

causing a setback to the collection of VAT. Four alternatives were given to the respondents that they can rank them at will. Total marks given by tax officials, businessmen and consumers can be seen from the table below:

Table 4.19: Problems in VAT Collection

Respondents	Tax Officials		Business Persons		Consumers		Total	
	No.	%	No.	%	No.	%	No.	%
Alternative Choices								
Registration	2	20	6	30	4	26.67	12	26.67
Account Keeping	3	30	6	30	5	33.33	14	31.11
Billing	4	40	3	15	5	33.33	12	26.67
Tax Refunding	1	10	5	25	1	6.67	7	15.55
TOTAL	10	100	20	100	15	100	45	100

(Source: Survey, 2011)

As shown in the above table, about 31.11% believe that account keeping is the biggest problem in VAT collection. Among them 30% of tax officials, 30% of businessmen 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. About 15.55% say that tax refunding is problem in the collection of VAT in Nepal.

4.2.9 Problems in Account Keeping:

Account keeping is also one of the problems in the successful implementation of VAT. Most of the businessmen 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 answer is?

Table 4.20: Problems in Account Keeping

Respondents	Tax Officials		Business Persons		Consumers		Total	
	No.	%	No.	%	No.	%	No.	%
Alternative Choices	2	20	2	10	3	20	7	15.56
Illiteracy	2	20	2	10	3	20	7	15.56
Not used to A/C Keeping	3	30	14	70	4	26.67	21	46.67
Rules & Regulations 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

(Source: Survey, 2011)

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.

4.2.10 Problems in the Implementation of VAT:

Respondents were asked what problems there might be in successful implementation of VAT. Their response is recorded in the following table:

Table 4.21: Problems in Implementation of VAT

Respondents	Tax Officials		Business Persons		Consumers		Total	
	No.	%	No.	%	No.	%	No.	%
Administration	1	10	5	25	3	20	9	20
Incapability								
Under Invoicing	2	20	1	5	4	26.67	7	15.56
Frequent change in Acts	1	10	4	20	1	6.67	6	13.33
Lack of public awareness	2	20	3	15	4	26.67	9	20
Lack of long term policy & strategy	2	20	3	15	1	6.67	6	13.33
Taxpayer unknown to VAT	2	20	4	20	2	13.33	8	17.78
TOTAL	10	100	20	100	15	100	45	100

(Source: Survey, 2011)

Table 4.21 reveals that 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 for bills on their purchase. Total 20% consider administrative incapability as a hindrance to VAT implementation. Tax payers are oblivious to the term VAT itself.

4.3 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 13 years of its operation and enters into 14 years. But the data presented in this research is only of the 11th year i.e., 1997-98 to 2008-2009 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 already, 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. But 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 intention 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 daydream.

There is little knowledge about VAT to taxpayers and low public consciousness level in Nepal. To educate taxpayers and all the concerned bodies, educational program has to be launched in an effective way. But whatever program has been underway is not sufficient to create its impact on people. Most of the respondents suggest that Radio / TV might be the 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 businessmen do 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 accounts. Tax evasion is very difficult if account is properly maintained. Some are illiterate and some desire to evade tax.

Administrative incapability, under invoicing/non-billing and lack of public awareness towards VAT are main problems in the process of VAT implementation in Nepal.

7. Number of taxpayer's registrants under VAT has been increasing year after year. But the ratio of registrants just kept fluctuating, decreasing sharply. This is certainly not a good sign which will

have a long term bearing on revenue collection. Number of taxpayers cancelling their registration under VAT is also generally in the increasing trend as this has increased to 123 in the fiscal year 2008-2009.

8. The status of non-filers is not also satisfactory. In the fiscal year 2005-2006, it had increased up to 28.18%, although it had decreased to 12.46% in the fiscal year 2008-2009. But the trend seems to be fluctuating. There is never a constant proportionate increase.
9. Credit returns status is on the increasing trend from every fiscal year. Nil tax return and undecided tax return is also increasing year after year. There is not a good sign for Nepalese revenue. Unless the government is active to find out the increasing trend of credit return, nil return and undecided return, VAT cannot be the effective tool for revenue generation.
10. Up to the fiscal year 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. Even after the implementation of VAT 10 years ago, the government could never get rid of this dire situation.
11. In Nepal, collection of VAT has been classified as imports and domestic sources, out of which collection from imports has significant share i.e. Rs. 21,424.05 million in the fiscal year 2008-2009 as compared to domestic contribution amounting to just Rs. 12,368.37 million or just 36.60% of the total VAT revenue in the same fiscal year. This surely indicates that there is a heavy dependence on imports rather than domestic products.

12. The contribution of VAT to GDP is just 3.35% in an average of 9 years. The contribution of VAT to GDP reached 3.95% in the fiscal year 2006-2007. So the VAT / GDP ratio is very low.
13. The contribution of VAT in total revenue is not up to the satisfactory level either. In an average, it could contribute just about 26.45% to the total revenue which is way above the VAT / GDP ratio.
14. Hopefully, an average share of VAT revenue in total tax revenue is pretty good, i.e. 33.41% which simply indicates that VAT though implementation wise, faring very poorly, is still emerging as the important source of revenue generation.
15. 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.

CHAPTER – V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This chapter provides a summary of the study, conclusions drawn there from, and the recommendation offered for the effective implementation of the VAT system in the country.

5.1 Summary:

This research work entitled “**AN ANALYSIS OF VAT IN NEPAL**”, 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, different analysis has been done with the help of 9 years data (i.e. from the fiscal year 2000/2001 to 2008/2009) and questionnaire developed by the researcher.

The study has been divided into five broad chapters. 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 of VAT, types of VAT, methods of computation of VAT, origin vs. 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 which have been used to conduct the research.

The fourth chapter is the main body of the research 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 45 concerned people consisting of tax officials businessmen and consumers was conducted to throw light on the administration of Nepal. About 9 questions were asked to 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 revenue 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 further action plan to ensure the growth of the ratio. For studying these various issues, data from the 8 fiscal years, i.e. from 2000/2001 to 2008/2009 has been used. After all these studies were made, the study came up with major findings 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 the broader coverage and basis. Elimination economic distortion caused by tax system, elimination of cascading and pyramiding effects, creation of the competitive business environment, strengthening foreign trade etc., as it were, as other features of VAT theoretically, expected to be fulfilled in the real practice.

5.3 Recommendations:

On the basis of conclusion of the study, the following recommendations provided for the effective administration and implementation of VAT system in Nepal.

-) A proper coordination between IRD and MOF should be established. Unpractical acts, rules and regulations should be amended. VAT laws needs to reviewed on the basis of experience gained so far and VAT laws should be effectively implemented.
-) Some of the unproductive, corrupted, inefficient staff lacking practical and specialized training is a serious problem. So, providing training to such staff is highly essential.
-) The tax administration should be very watchful to prevent any kind of malpractices, fraud and tax evasion. Utmost care should be taken to prevent any kind of bribing and corruption.
-) Emphasis should be given in educating the tax payers. The issuance of proper bill for every taxable sells must be made mandatory.
-) Emphasis should be given on mass media. Awareness towards VAT system should be created among general public, non-governmental and government organizations.
-) Computer system and networking program through online service must be developed and linked so as to make the work simple and easy. Computer link between tax offices and custom offices should be maintained.
-) Tax refund is one of the sources of tax leakage. Therefore, tax authority should manage tax refund facility properly.
-) Research and investigation should be conducted on various issues, such as the effect of VAT on price, according to recommended by the expert group.

-) The accounting system should be transparent. Taxpayers should be encouraged to register their business voluntarily.
-) 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.
-) VAT collection on import is remarkably higher than domestic production. Government should take effective steps to encourage domestic production.
-) Lots of efforts should be made to re-establish a functionally well-organized organization where the tasks are carried out in a modern, effective, efficient, transparent and service-minded manner.
-) VAT should also be levied on agriculture sector with sufficient exception for generating more tax revenue. This will increase VAT / GDP ratio.
-) Tax administrators should be consumer-focused and result oriented.
-) 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.

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QUESTIONNAIRE

Dear Sir and Madam,

Namaste !

First and foremost, I would like to introduce myself. I am a student of Central Department of Management, currently engaged in the research work on “An Analysis Of Value Added Tax in Nepal” for the fulfilment of my dissertation paper on management for the Master’s Degree Of Business Studies (MBS), Tribhuvan University, Kathmandu. To fulfill my thesis work, I do need a kind help from you. I request you to fill up the following questionnaire.

I look forward to your kind cooperation and also assure you that whatever information you provide me solely be utilized in the research work.

Thank you!

Regards,

Rajan Bhattarai

Central Department of Management,

Kirtipur.

AN ANALYSIS OF VALUE ADDED TAX IN NEPAL

(Please tick your answer in the following number, if the question is provided with two alternatives and put in order of preference from one to last numbers if there are more than two alternatives).

1. Have you ever been to any of the Inland Revenue Office in Nepal to make enquiry /or payment of value added tax?
i) Yes ii) Often iii) Sometimes iv) No, never

2. If your answer to above question is yes, how do you find the efficiency of the VAT administration?
i) Efficient ii) inefficient iii) Needs improvement iv) No idea

3. Do you ask for bill with the seller/service provider after purchasing any goods or service?
i) Yes, on every purchase ii) Yes, on most of the purchase
iii) Yes, but not regularly iv) No. I never ask for the bill

4. Which one of the following options do you think the best to increase public revenue through VAT?
i) Increasing Tax ii) Widening its coverage
iii) Discouraging tax evasion iv) Others

5. Which one of the following do you think is the best way to educate people about VAT?
i) Radio / TV ii) Newspaper iii) Booklets / Pamphlets
iv) Wallpaper / Banner v) Seminars

6. What do you feel about the administration of VAT?
 - i) Lack of expertise
 - ii) Lack of trained manpower
 - iii) Corruption & bribing
 - iv) Lack of physical infrastructure
 - v) Lack of sufficient field officers

7. As being a business person, what kind of behaviour of VAT administrator towards tax payers do you found?
 - i) Very helpful
 - ii) Helpful
 - iii) Very troublesome and slow in their work
 - iv) Disrespectful, treating bad

8. Rank the following problems which you have faced during VAT collection.
 - i) Registration
 - ii) Account keeping
 - iii) Billing
 - iv) Tax refunding

9. Some traders in fact don't want to keep the transparent and clean record of the Transactions, why so?
 - i) Illiteracy
 - ii) Rules & regulations still confusing
 - iii) Not use to account keeping
 - iv) Tax evasion is difficult under VAT

10. What problems do you think there might be in successful implementation of VAT?
 - i) Adm. Incapability
 - ii) Under invoicing
 - iii) Frequent change in acts
 - iv) Lack of public awareness
 - v) Lack of long term policy & strategy
 - vi) Taxpayer unknown to VAT