

CHAPTER - I

INTRODUCTION

1.1 General Background of the Study

Tax is the largest source of public revenue of the modern governments. 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, a government has to spend a lot of money to fulfill its responsibility towards its people. The responsibility may be either for security, for 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 show 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 government imposes tax on the people to repay the external debt, as a consequence of which the capacity or people to work to save decline.

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 expenditure 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 & security, to maintain law & Order and other public welfare

actives. The government collects revenues from various sources such as tax, revenues from public enterprises, special assessment, fees, fines, grants and assessment 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 taxpayers according to law. It is used for common interest of the people. The taxpayer could not get direct personal benefits. The tax can be classified in two types. They are; 1) Direct tax 2) Indirect tax. A Direct is a tax paid by a person on whom it is legally imposed. In Direct tax, the person paying & bearing tax is same. It is not shift able to others. For examples; Income tax, property tax & Gift or prize tax are direct tax. Similarly, Indirect tax means that tax which is imposed on one person but partly or wholly paid by another. In Indirect tax, the person paying & bearing tax is different. It is shift able to others person. In other words, those types of taxes are ultimately paid by consumers' not a businessman or entity they are only mediators. For examples; Excise duty, custom duty, & Value added tax (VAT) are Indirect tax. Among the Indirect tax, VAT is the most recent innovation in the field of taxation.

In Nepal, however, the tax policy is mostly guide by the revenue consideration. 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 expenditure and deficiency of government revenue there is a need of entire reforms. In existing tax system of Nepal in order to meet development goals as well as short terms stabilization and long term structural reform in Nepal. The global trend should be encouraged Nepal to

changes its tax system to meet the worldwide scenario. But there is no compulsion to flow in the world flood, a tax system should be structured depending on the countries own economic and social condition or tax reform should be as per the industrial and trade situation of the country but minimum adjustment or reforms must be made to meet the global changes. Thus we cannot go back to the global trend we should follow it ultimately. Developing countries try to mobilize internal source. So the government should be trying to reform policy and strategy. Nepal also changes its policy and strategy to achieve more internal resources by replacing sales tax in to value added tax. (VAT) VAT is the most recent innovation in this field of taxation. it is the tax imposed on value added by business firms on good and services at the successive stages of production and distribution, value is added.

Personal end-consumers of products and services cannot recover VAT on purchases, but businesses are able to recover VAT on the materials and services that they buy to make further supplies or services directly or indirectly sold to end-users. In this way, the total tax levied at each stage in the economic chain of supply is a constant fraction of the value added by a business to its products, and most of the cost of collecting the tax is borne by business, rather than by the state. VAT was invented because very high sales taxes and tariffs encourage cheating and smuggling. It has been criticized on the grounds that (like other consumption taxes) it is a regressive tax. In such, production distribution is in successive stage. Value addition on a commodity or service is simply 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

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 which has grown as a heterogeneous of turnover tax and retail level sale tax.

Thus VAT is the multistage sales tax, which is levied on the value added of business enterprises at different stages of production and form of old sales tax. VAT is the important tax innovation on the second half-twentieth century. VAT is a scientific tax system. Which was first introduced in 1954 in France. VAT has been spreading all over the world. Since late 1960s and now this tax has become one of the main stays of the tax system in over the world 130 countries.

In south Asia Pakistan adopted a CAT in 1990 and Bangladesh and Sri Lanka have since 1991 and 1995 respectively. Also in India, VAT is adopted in a restricted form called modified value added tax (MOD VAT) with effect from 1986. The MOD VAT is limited in scope it covers only a half of the revenue collected. India has just adopted full VAT since the year 1999.

Nepal economic policy has been changed after the restoration of democracy in 1990. Nepal's economic policy is moving towards liberalization, privatization and open market. Current Nepalese economy is characterized by raising government expenditures, low government revenue, increasing foreign loan, increasing deficit financing, low mobilization of internal resources, wide resource gaps, industries sickness, etc. Furthermore, Nepalese revenue is depending upon imports duty. Each and every government wants to search the source of revenue by introducing new taxes or changing tax base and tax rate. In this regard, government of Nepal has been implemented VAT since 16 November, 1997. Nepal is considering a VAT since 1992. The first intention to move towards VAT could be found in eight planes (1992-97).

A commitment to implement a VAT in Nepal was made in 1995/96 budgets and it was scheduled to come into effect from April 1997.

In conclusion , VAT has been the most essential choice for the most developing countries as an ingredient of their tax reforms because it is the most improved form of sales tax, which leads to revenue the enhancement and economic efficiency. It is an important instrument for the mobilization of internal resources.

After the restoration of multiparty democratic system, Government of Nepal has introduced the comprehensive tax reform programs. The implementation of value added tax has been taken as an important part of tax will become wider thereby increase tax collection, make the system economically efficient and increase transparency in entire tax system of the nations. In order to create a conducive policy environment to implement value added tax more effectively, Government of Nepal made several changes in the customs and income tax system. The sources of Government revenue can be broadly classified into two categories of tax revenue. The Government receives tax revenue as a compulsory payment whereas non-tax revenue is conditional one. In general, tax can be grouped in two groups, direct tax and indirect tax. If person bearing and paying tax is same, it is called a direct tax. In the word of Dalton, a direct tax is really pad by the same person on whom it is legally imposed. Direct tax includes: Income tax, Property tax, Vehicle tax, Gift tax and Interest tax which is different. Again in the word of Dalton, an indirect tax includes: Value Added Tax (VAT), Sales tax, Entertainment tax and Hotel tax, Excise Duty, Import and Export Duties etc. The indirect tax is a commodity tax, which partly or fully passed on by forward and backward shifting process (Tiwari, 2052). It is unanimous that all government needs resource mobilization from internal resource or

external resource to fulfill their declared policies and programs. When the country depends upon foreign grant and loan assistance because of lacking in internal resource of revenue, the country has to increase its capability of resource mobilization for sustainable development and reduces dependency over foreigners. Considering this fact, Government of Nepal has introduced VAT Act, 2054 to obtain the objectives for increasing revenue mobilization by making effective the process of collecting revenues required for the economic development of the country. It is expedient to impose a value added tax on all transactions including the sales, distribution and delivery, importation of goods or services and to collect revenues effectively by regulating the process of collection.

VAT is a part of indirect tax and it is considered as one from the sales tax. It is a tax imposed on value added by business firms on goods and services at the successive stage of production of goods and distribution of goods and services. The value Added Tax is a tax imposed upon the value that the activity of a business firm adds to the goods and services. It purchases from other firms that is upon the excess of sales during a period over the amounts paid for goods and the services acquired from other business firms during that period (Ojha, 2053).

VAT is levied on all goods and services excluding those that have been exempted by the law and it lived on each level of sales from the production and import to the distribution of all goods and services except ones.

1.2 Significance of the Study

Though the system of vat in existing tax system has widely been recognized and accepted but the success of failure of this system can be ganged after getting the feedback of its implementation. Theoretical soundness will not only deserve the criteria for the success.

VAT has been implemented in Nepal after a long discussion, interaction and preparation since 16, November 1997. The success of failure of VAT implementation could be known after the long period of its implementation. Implementation itself will not be sufficient, its sound application and performance is yet to be evaluated. In the context of tax reform in Nepal, the adoption and implementation of VAT is a right step in the history of taxation as it checks tax evasion and avoidance, it checks tax evasion and avoidance, it creates broad base of taxation and thereby generating more revenue. So, the significance of this study is to find out whether its application and implementation has enabled the government to achieve the above mentioned objective.

This study mainly concentrates on the analysis of the impact of VAT application in Nepalese economy and the situation of VAT performance in Nepal. This study also gives suitable suggestions for making VAT system more effective.

1.3 Statements of the Problems

Major sources of public financing are revenue mobilization, foreign grants and loans, internal loan and change in cash balance. Nepal is an underdeveloped country where most of the people live under the poverty line. Population growth rate of the nation is greater than GPD. The

growth rate is increasing rapidly. In comparison, government revenue is nominal than government expenditure. The government expenditure is increasing but government revenue is not growing equivalently as per the expenditure. There are many reasons for increasing expenditure. The main reasons are unstable political situation, unstable economic growth etc. Due to such reasons, the government revenue is not satisfactory, as it has been expected. So the government face deficit financing year by year. The deficit financing increases share of external as well as internal loan and foreign aids. For the payment of external as well internal loan and financing the government expenditures, internal revenue is the main source. Tax revenue is one of the most important sources of government revenue. VAT is a strong complement of tax revenue. But lack of proper implementation of tax policies, lack of knowledge, lack of public awareness and lack of efficient tax management are creating obstacles on revenue collection (Mainali,2061).

At this critical situation, the government introduces the VAT system as a scientific and modern tax system. Introducing of VAT is a positive process on revenue collection, which helps to increase the government revenue. For easily operation of VAT, its implementation part must be strong. But we don't feel that situation. Before the implementation of VAT, our existing tax system faces unskilled manpower, weak administration, inefficient management and other problems.

Availability of information about VAT is very essential to make people conscious about VAT. So, the researcher selects this topic (An Analysis of VAT is Nepal) for providing a lost of information about VAT to the businessman, consumers, researchers and other interested parties who like to collect information about it and to provide suggestions and give recommendations to the concerned authority with the view to improve existing taxation system.

1.4 Objectives of the Study

The principal objective of this study is to examine the application and performance of VAT in Nepal. The study includes the following specific objectives:

- a. To analyze the tax structure of Nepal.
- b. To find out the contribution of VAT in GDP, total revenue, tax revenue and non tax revenue.
- c. To show the significance of VAT in the Nepalese tax system.
- d. To identify effective measures that government should introduce for effective return from VAT.
- e. To identify the major problems of VAT implementation in Nepal and suggest possible corrective measures.

1.5 Limitations of the Study

Each and every study has its own limitations and boundaries. This study also has various limitations. Some of which are given below:

This study is based on the following limitations.

1. This study covers the period from F/Y 2002/2003 to 2010/2011.
2. This study is based on published secondary data and information.
3. This study does not deal with the process of VAT implementation and administrative efficiency.
4. Due to the lack of time and resource constraints the opinion survey is kept limited to Chitwan district. The sample size, which may not fully represent Nepal as a whole.
5. The sample size is taken only fifty, which may not fully represent Nepal as whole.

6. The reliability of secondary data is not examined.
7. The study has not considered the thesis paper after 2009.

1.6 Plan of the Study

This study is divided into five major chapters, which are as follows.

Chapter - I: This is the introduction chapter. This chapter includes background, statement of problem, objective of the study, significant of the study and limitation of the study.

Chapter - II: This is the literature review chapter. This chapter includes conceptual framework of income tax and review of related available studies.

Chapter - III: This is the research methodology chapter. This chapter includes research design, population and sample source of data, data collection procedure etc.

Chapter - IV: In this chapter data are presented, analyzed and interpreted by using statistical tools, mathematical tools and other accounting and financing tools etc.

Chapter - V: The final or last chapter contains the summary of the whole study. The conclusions of the study have been presented and at last suitable points are suggested in the form of recommendation. Bibliography and appendixes will incorporate in the end of the study.

CHAPTER - II

REVIEW OF LITERATURE

2.1 Theoretical Background

2.1.1 Concept of VAT

Tax is the internal source of government. Government uses this resources in the sector of economic and social development. A tax is compulsory levy paying or to be paid by natural or artificial person to the government. There are two types of tax direct and indirect. Value added tax is one of the them. VAT is the latest innovation in the field of indirect tax system. VAT is the youngest member of sales tax family. It was the buzzword some years back. It is more scientific, modern and progressive as compared to sales tax. It is based on self-assessment system and provides the facility of tax credit and tax refund. It avoids cascading effect existed in sales tax and contains catch up effect. It is based on value added principle value added can be obtained either by adding payments to factor of production.

Due to the limitation of direct tax and its low performance in revenue collection indirect tax has been given preference by Nepalese government. So to enhance for revenue mobilization VAT was introduced in Nepal. Income tax and custom administrations made more transparent and supportive, attracting all entrepreneurs and the business communities to come under the Network of VAT. Since the VAT is one of the components components of indirect taxes developed in past, is probably the best tax system that had never been at the top of tax system.

This tax is levied on the value addition at each stage from the time of production to consumption of all goods and services. VAT is imposed on each stage of transaction such as production, import and distribution stages of goods and services. It affects only the added portion of price i.e. the value of goods and services added in the various stages of transaction. VAT is levied in the accordance with the price rise at different levels from the production of goods and services to their distribution.

2.1.2 Historical background

In the history of Taxation value added tax is the latest and the emerging tax. Value added approach was discussed as early in 1918. However, this tax was first recommended by William von Simens in 1919 in Germany replaced Simens in 1919 in Germany to replaced the multi stage turnover tax in order to avoid the undesirable particularly cascading and vertical integration of the later tax. The VAT proposal was seriously considered by the then German government but as the tax was new and through to be complicated. Then it was developed further in 1949 A.D. by a tax mission to Japan headed by Prof. Carl Shoup. It was remained as only topic of academic interest until 1953. After three and a half decades of the evolution of the concept of VAT, France took the courage to put VAT into practice. However the credit of rising VAT at first to France. This country introduced VAT in 1954 A.D. In the 1960s in the process of establishing the European Union (EU), the policy to adopt a standard tax system among the members of the community was also adopted. Since it became a precondition to adopt VAT to become the member of the EU, the member countries started to introduce VAT into their tax systems and gradually it became the standard tax system of European country. VAT started to spread worldwide.

Among the nations of SAARC region Pakistan and Bangladesh have already adopted VAT. The VAT has been considered great in India and introduction of the VAT is now figuring prominently in agenda of government, both at the center and states voices toward VAT in India are increasing day by day. However this country introduces VAT in different ways under the name of modified Value Added Tax (MODVAT) since 1986, which is designed to collect excise duty. The tax reforms committee, India headed by Professor Raja J. Chelliah has recommended a genius VAT in place of central excise which is in course of time, could be extended down to the wholesale level. The scope of MODVAT was extended 1994/95. (Bajchi, 1995)

In the context of Nepal, Tax reform which was a part of economic reform and VAT emerged as the main feature of the tax reform program prior to the introduction of value added tax in 1997. Nepal used to levy several independent domestic trade taxes on goods and services i.e. sales tax excise duties, hotel tax, contract tax, entertainment tax, air travel tax. To bring sustainability in internal resource mobilization, His Majesty Government of Nepal (HMG / N) adapted the policy to integrate the prevailing commodity taxes under VAT within the period of the Eighth Five Year Development Plan (1992/93-1996/97). For regular operation, collection and proper management, VAT act 2052, VAT regulation 2053 has been implemented.

Although the act has passed 2052 its implementation was delayed due to political instability and strong opposition from the business community. VAT has been fully implemented with effect from 16 Nov 1997 (1 Mangsir 2054). It has replaced sales tax hotel tax, contract tax and entertainment tax. It was replaced since the collection of both custom

duties and income tax depended to a great extent upon the effectiveness of VAT. There are several reasons to introduce VAT in Nepal. They are:

-) To introduce VAT in order to broaden the base of domestic trade taxes.
-) To make tax system Neutral and efficient.
-) To increase revenue mobilization by broadening the tax base.
-) To minimize the cost of taxation.
-) To establish a transaction based transparent tax system.
-) For economic development.

The ideas of introducing a VAT in Nepal was originated in the early 1990s and the government adopted a policy to introduce VAT in place of several domestic trade taxes within the period of the 8th 5 year plan. To this end, in September 1993, a VAT tasks force was constituted to make necessary preparations for the introduction of VAT. A VAT steering committee was also set up to evaluate and monitor assistance was provided by various development agencies i.e. United States Agency for International Development (USAID) Harvard Institute for International Development (HIID) (DANIDA).

2.1.3 Types of VAT

Value added tax could be classified into three groups, they are as follows:

a. Consumption type VAT

Under this type of VAT, no discrimination is made with respect to capital or consumable goods. Whatever is purchased for the use of business is

traded at par. this implies that full credit of inputs is provided it is indeed the most superior form of VAT and is universally practiced. The tax base under this type is the total private consumption, be it durable or non-durable consumption. Consumption does not imply its true consumption but only expenditure for consumption. Since no discrimination is made, this system is neutral and does not lead to alteration or substitution between methods of production

b. Income Type VAT

The income type VAT does not exclude capital goods purchased from other firms from the tax base in the year of purchase. This variant however excludes depreciation from the tax base in subsequent years. The tax falls both on consumption and net investment and the conceptual tax base of this variant is the net national income. This type of VAT has the difficulty of calculating income for a particular period. As a result only few countries practice this type of VAT.

c. Gross Product Type

Under this type of VAT, no input tax credit for capital goods used in production are allowed i.e. there is cascading effect. Corollary to this, it can be said that this type of VAT provides incentives for labor intensive production. Here the principle of neutrality of tax is defeated. That is why, of all the types, this is the uncommon and is rarely practiced in any country, it has only academic value.

From an economic growth perspective both the income and gross product VAT has an anti-investment bias. The distinction between the purchase of capital goods and intermediate goods is not needed under consumption

type VAT where as it is essential under income type and gross product type of VAT.

Among these three types of VAT consumption type of VAT is superior due the following reasons:

a. The consumption variant is attractive from the point of view of tax administration as there is no need to distinguish between the purchase of intermediate goods and goods under this variant which is necessary under this variant. 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.

b. Likewise, the consumption variant is more attractive than the income variant form the consideration of foreign trade because the consumption variant is compatible with the destination principle of taxation, which has been used by many countries.

2.1.4 Method of Computing VAT

There are three methods of computing VAT. They are as follows:

a. Addition Method

Under this method value added is the total sum of the factor payments made by the business firms, which is equivalent to the gross income received by the factors of production. The tax base is computed by adding the payments made by the firms to factors of productions employed in turning out the product, such as wages, interest, rent, royalties and profits. Thus, VAT under additional method is the function of the total factor payment as given by:

VAT = f(W+R+I+P) Where,

W = wage,

R = rent

I = interest,

p = profit

Table No. 2.1

Calculating VAT liability under Additional Method

Stage of production and distribution					
Items	Primary Producer	Producer	Whole Seller	Retailer	Total
Wages	1200	200	400	170	1970
Rent	450	60	130	80	720
Interest	300	50	100	60	510
Profit	950	190	270	190	1600
Value Added VAT	2900	500	900	500	4800
Liability 13%	377	65	117	65	624

Additional : T = t (wages + rent + interest + profit)

b .Subtract Method

Under this method value added is determined as not turnover which is obtained by subtracting the cost of materials from sales proceeds and the procedure was used in the Michigan VAT. Value added is obtained by subtracting purchase of produced goods from the figure of sales during the period, as given in the functional form by,

$$\text{VAT} = f(S_v - P_v)$$

Where,

S_v = Sales value

P_v = purchase value

This method of calculating VAT is suitable for the consumption variant of VAT. It is not well suited for discrimination among types of consumer goods but it needs not any adjustment to operate correctly for imports under the origin principle. Some thing also happens to the addition methods. However, under the destination principle, these principles, these both methods of direct calculation can not supply the information needed to compute precisely the export rebate or the import compensating tax when there is not uniform rate to all stages of value added of all goods and services.

Table No. 2.2

Calculating VAT liability under subtraction method

Stage of production and distribution	Net purchases price A	Sales Price B	Value Added B-A = C	VAT liability @ 13%
Primary product	-	30000	3000	390
Producer	3000	3600	600	78
Wholesaler	3600	4500	900	117
Retailer	4500	5700	600	78
Total	11100	16200	5100	663

Subtraction method $T = t (\text{output} - \text{input})$

c. Tax credit Method

Tax credit method is also known as the invoice method and uses an indirect subtraction technique to compute the tax liability. Value added as such never calculated at all. In this method, but the effect is exactly the same as if the figure was calculated and the tax rate applied. Since, the firm deducts the amount of the tax paid on its purchases during the period from the figure calculated by applying the tax rate to its figure of taxable sales for the period. Under this method taxpayers are allowed to subtract the taxes already paid by the supplier and passed on to them from the gross tax liability, which is levied on the total value of their sales. Thus, in contrast to the subtraction method, which deducts purchases from sales and levies taxes on the difference, tax on purchases is subtracted from the tax on sales under the tax credit method.

Hence net tax liability is given by:

$$\text{VAT} = f (\text{Outputs} - \text{Inputs})$$

Where,

Outputs= tax collection from sales

Inputs = tax paid on purchases

Table No. 2.3

Calculation of VAT liability under Tax Credit Method

Items	Stage of production and distribution				Total
	Primary Producer	Producer	Whole Seller	Retailer	
Purchase	-	3000	3600	4500	11100
Tax on purchase	-	390	468	585	1443
Sales	3000	3600	4500	5700	16200
Tax on sales	390	468	585	663	2106
Net VAT liability 13%	390	78	117	78	663

Tax credit method $T = t$ (output - input)

Among the above three method of computing VAT, the tax credit method is widely favored in the countries. The invoice method is used generally in European countries. The tax credit method is so superior to the other method in terms of application and enforcement as well as adaptability to various rates modification that is now universally employed.

2.1.5 Exemption and Zero rating

These are two approaches for fleeing tax on some goods and service on the ground of social welfare consideration as to reduce complexities in admnition which are exemption, zero rating method.

Exemption

Exemption is granted when a particular product or transaction is desired to exclude from the tax base on the grounds of administrative complexity, social welfare and equity. Certain goods, service or transactions such as products of agriculture or forestry financial services,

very small vendors are exempted basically due to the administrative reason. Similarly, exemption is given to basic necessities like foodstuffs to improve equity aspect by introducing progressivity in VAT. However, exemption is not an effective measure to achieve progressivity because some of the rich may spend relatively large which some of poor may spend little on necessities depending on their habits, choices etc. In the similar manner, there are some goods and services such as goods for children, educational and medical services, cultural activities etc. Which demand exemption to encourage their production and consumption? However, exemption needs to be minimized since it creates several undesirable effects. Firstly, a VAT system with many exemptions gives an incentive to producers as well as consumers to divert their resources from taxed to tax- exempt goods and a service creates inconvenience to taxpayers. Further, firms selling both exempt and taxable goods must claim only the portion of credits that is equal to the ratio of taxable to total sales, which increases burden to taxpayer. Fourthly, tax evasion is easier under many exemptions. Lastly, it is clear that there will be loss of revenue by exemption. It is, therefore, desirable to limit exemptions only to those goods or services or transactions that are extremely difficult to bring into the tax net from the administrative point of view. (Aaron, 1981:7)

Zero-rating

Zero rating simply means that VAT is levied at a zero percent rate on some selected goods and services. The provision of Zero-rating in VAT is guided by the two basic purposes, to promote social welfare and to stimulate the exportable industrial products. If zero-rating is applied, credit for VAT paid on inputs can be claimed and thereby a full rebate is

obtained. Thus, it is the total relief from the burden of VAT. (Ashar, 1988)

In most of the country's exports are zero-rated so that the exporter is able to get the refund of the tax paid on his purchases that he has used for producing the exportable items. As zero-rated items or transaction are within the tax net, although effectively they do not attract any VAT a purchaser will obtain a repayment of input tax borne on his purchase of goods and services, meaning that zero-rated items or transactions don't bear any tax. So it is better to choose zero-rating instead of exemption if the objective is the full exemption. A zero-related goods does not bear any tax at all while exempted goods may bear a tax element in its price. Further, differentiation between these two aspects is based on the administrative work. Business enterprises concerned with the zero-rated goods and services are the formal member like all other VAT registered members and hence they have to fulfill all the formalities associated with the VAT operation. But business enterprises having the tractions of only exempted goods and services have no concern with the VAT administration.

2.1.6 Principle of VAT

There are two principles for levying VAT.

a. Origin Principle

Under this principle tax is levied at the place where it is produced or rendered irrespective of whether they are consumed or not. In this principal, preference is given to imported goods or service over domestic production because all imports are treated as taxable whereas all import are treated as non-taxable. These sorts of principle may be beneficial

where common trade is enlisted like European Union, otherwise rest of the countries do not prepare this principle.

b. Destination Principle

Contrary to the earlier, destination principle is imposed at the place where it is consumed irrespective of where it is produced for referred. Neither it prefers imported goods or service nor the domestic goods or services. Equal preference is given to both imported as well as domestic product. In this ground it is assumed as neutral principle. For the purpose or boosting exports, many countries prefer to apply this principle of taxation. Nepal's VAT system is also characterized by the principle of destination.

2.1.7 Legal Provisions of VAT in Nepal

a. Registration

Registration is the preliminary process of VAT system. Threshold limit for the registration is fixed at Rs. 2 million. All the taxpayers whose taxable transaction is above the threshold are compulsorily required to register in VAT. VAT is levied on goods and services. Person whose taxable turnover is below the threshold is considered as small vendors. A special privilege is provided to small vendors from the requirement of registration and filing the tax returns. But they are not kept outside from the VAT net if they voluntarily want to register.

b. Deregistration

Criteria and process of deregistration must be as simple as registration for the effective implementation otherwise without exit

system no one want to come in. only huge number of registrant dose not satisfy the objective of VAT. A tax officer may cancel the registration of registered person in any one of the following cases:

1. In the case of an incorporated body, if the incorporated body is closed down, sold or transferred or if the incorporated body otherwise ceases to exit.
2. In the case of an individual ownership, if the owner dies.
3. In case of a partnership firm, its is dissolved,
4. If a registered person ceases to be engaged in taxable transaction, and
5. If a person is registered in error.

Person who is willing to deregister should provide the information prescribed in schedule 11 of VAT regulation 2053. no one is permitted to deregister before the completion of a year of its registration.

c. Tax Base

Provision of the tax base is the major part of VAT system. Though VAT is considered as broad based tax, all the goods and services can't be bought within the purview of tax-net. Various issues play important role in determining the tax base. VAT act 2052 has provided the authority to impose on all goods and services as mentioned below.

1. Goods and services supplied into the kingdom of Nepal.
2. Goods and services imported into the kingdom of Nepal.
3. Goods and services exported outside the kingdom of Nepal.

It is based on taxable of every transaction. Considering the administration difficulties and social desire, a list of exemption for tax has also been

provided in the schedule of VAT act 2052 (Appendix-II). List of exemption changes the tax base in general. The taxable value does not include the VAT itself since it is refunded. The amount of all the expenditures related to transaction and distribution which was borne by a supplier in connection with the transaction, and the amount of profit and excise and all other taxes but except VAT itself are incorporated in taxable value. It does not include the amount of discount, commission or other similar commercially related granted on value in supplying goods or services. The taxable value of any goods or services exchanged or bartered shall be equal to the market value of goods and services so exchanged or bartered. Including transportation, insurance of agents and other person plus other taxes were also included in the taxable value for imported goods.

As system required all the exports have exports have been relived completely from the burden of tax through zero-rating.

d. Tax Period

For the purpose of submission of return and amount of tax, taxpayer has been classified broadly in the following tax period.

a) Monthly Tax Period: Person who is statutory bound to register in VAT are fall in this period. Whose turnover is above the threshold i.e., Rs 2 million is automatically fell in this period.

b) Trimester Tax Period: Whose taxable turnover is below the threshold but registered in VAT voluntarily are fall in this period. All the small vendors who have registered voluntarily are entitled to get special

facility four month period for the submission of return and due amount to tax officer.

Finance Act,2001 has also provided a two-month tax period facility only to businessman of Hotel and tourism sector if they seek for the same.

e. Invoicing

Every registrant is required to issue a tax invoice to the recipient in supplying any goods and services. The specimen of on invoice has been prescribed in schedule 5 and 6 of VAT Regulation 2053. It is necessary to mention seller's PAN, buyer's 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 on the tax invoice. The invoice must be issued in sequential order from 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 issue for transaction exceeding Rs 5000, 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 an abbreviated tax invoice shall not be allowed to credit the input tax. In an abbreviated tax invoice, tax is calculated by multiplying the sales value by rate of tax divided by adding 100 to the rate of tax.

f. Accounting

All the registered taxpayers are required to maintain following account as referred to schedule 7, 8, and 9 of VAT Regulation.

- a) Purchase Account
- b) Sales Account
- c) Value Added Tax Account

Purchase account reveals the purchase details whereas sales account shows the sales details of the taxpayer of specified period. VAT account gives the taxable summary of both accounts. The specimen of above mentioned accounts are designed in a way that even a person who knows the simple calculation idea can keep it easily. One can issue tax invoice and maintain his accounts on computer also with prior approval of tax administration.

A VAT registrant must update the account. All document and account relating to the business must keep for the period of six years.

g. Tax Credit

VAT is grounded on tax credit method. All the tax paid on purchase of goods and services, including assets, stationery and other expenses, related to business are allowed to credit full amount from the output tax collected on sales. There are some goods, which is very difficult to ascertain whether they have been used for the purpose of the business or personal purpose. As stated in rule 41(1), tax may not be deducted in respect to the following goods and services:

- a) Beverages,
- b) Alcohol or alcohol mixed beverages such as liquor and beers,

- c) Petrol,
- d) Entertainment expenses

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

- a) On all aircraft, 40 percent of purchase value,
- b) On automobiles (any motor vehicle with three or more wheels used on a road for carriage of passengers), 40 per cent of purchase value,
- c) On computer, 60 per cent of purchase value.

h. Return Filling

VAT is based on self-assessment system. Taxpayer himself calculated all taxes. Every registered taxpayer required submitting the return to a tax officer within 25 days after the close of tax period. Such return shall have 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 as; Nil return or credit Rs 1000 flatly. Debit return -0.05 percent per day of due amount or Rs 1000 whichever is higher.

i. Management Tax Assessment

VAT is self assessed tax. Taxpayers assessed their liability themselves. They are self-allowed to get credit tax paid on purchase. Self-assessment system is developed in the assumption that all the taxpayers would be genuine. In reality all the times, this 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 done by the tax officials. Following criteria have been fixed for tax assessment.

If tax is not filed,

If tax return is filed late,

If tax return contains incomplete information, and

If tax official has reason to believe the tax is not genuine.

j. Tax Refund

Excess of input tax over output tax in any tax period can be adjusted in the following tax 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 taxpayer. It is allowed to claim either by regular export basis or by regular six months credit basis. Exporters having more than fifty percent export of total sales are treated as regular exporters.

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

k. Appeal

A taxpayer may file an appeal to the Revenue Tribunal within 35 days against tax assessment or penalty charged by an officer or an order by the Director General has also been included in first amendment in VAT act as a choice to taxpayer.

Before filing the appeal, the taxpayers must deposit the disputed amount of the assessed tax due; the rest of the amount of tax due plus the whole amount of the fine shall have to be deposited or a bank guarantee of the same has to be provided

Tax credit is the main feature of VAT. It is due to this reason that VAT is also taken to be an improvised version of sales tax. For the sake of simplicity tax credit mechanism was selected. Under this system, a tax collector is required to levy VAT at the rate of 13% on his selling price. He/she has to add collected VAT on sales and paid VAT on purchase for each tax period and set off the latter from the former and pays the balance to the Government. It is called tax credit mechanism. If tax credit is not implemented effectively the complete benefits from VAT cannot be availed of. If tax administration is not capable or is inefficient or if the tax payers misuse the provision for tax credit, it can result in large revenue leakages.

A partial credit is granted for goods such as cars and computers that can be used for both business and personal purpose. An input tax credit is not granted for some items such as liquor, soft drinks, light petroleum fuel and vehicles and entertainment expenses, since it is very difficult to ascertain whether these items have been used for business or personal purpose.

2.1.8 Tax Rates

Experts recommended a single rate of VAT for any country. A single rate, experts argue, can be helpful in terms of implementation of VAT system. However, of about 130 countries following the system, only about a dozen countries have followed the advice. Whether to follow a single rate or multiple rates is a subject depending solely on the ground realities of the country under consideration. There are many countries that started with single rate and switched on to multiple rates and vice versa.

A single rate VAT appears to be the most effective and the least expensive to operate. It is thus, desirable to levy VAT with single positive rate to make the operation simpler. With dual objectives of achieving simplicity and increasing somewhat the revenues from VAT, Nepal had been adopting a single 10% rate of VAT. But, Nepal has adopted a single 13% rate of VAT from the FY 2005/06.

2.1.9 Coverage

Generally, VAT covers a large number of goods and services, transaction, or dealers in the worldwide. It is levied, as in the EEC and elsewhere on the supply of a wide range of goods and services and also on importation, unless specifically exempt. It is desirable to include all goods and services are brought under the VAT net unless there is strong justification for their exclusion. In Nepal, although most goods are subjects to commodity taxes, several times are excluded from the tax net on various grounds such as equity, economic, education, health, religion or cultural grounds and so on which need to be scrutinized under the VAT system. The VAT in Nepal is implemented in place of the sales tax, contract tax, entertainment tax and hotel tax.

VAT system levied on a wide range of goods and diversion of resources from one commodity to another either by producers or by consumers in response to tax. Such a tax system with wide coverage reduces the burden on the part of both the taxpayers and tax collector since the former do not have to keep separate records for taxed and untaxed goods. While the later do not have to check them resulting in lower administrative and compliance costs. It is important remember on the ground of revenue that under the wide coverage VAT system, lower rates can generate the required amount of revenue, lower rates reduce the

urge for tax evasion leading to a simple tax administration. All transactions and persons relating to taxable goods and services bring under the VAT net.

2.2 Resume of Earlier Studies

The history of value added tax is not so long even in global context. Several studies and experiments have been undertaken on VAT, which has been major instrument of tax reform since last four decades. Most of the economists have studied on VAT in the world. Their findings are found in various books, research papers, seminar papers, reports of international institutions and issues of journals and articles. IMF staffs undertook a study of seven developing countries that had adopted VAT in their respective countries. From the empirical study of seven developing countries, it was found that the effectiveness of the VAT largely depends upon the administrative capacity. The study shows that VAT helps to increase the government revenue by 10 to 30 percentages.

Due and Fried in their book “Government Finance” reached in the conclusion that the main visualized problem of VAT in developing country is the administrative complexity.

Tiwari (2052) in an article stated that VAT is considered as the mostly growing trend in the field of taxation. The authors focuses the problems of Nepalese sales taxes such as administrative inefficiencies very large number of small tax payers’ with no record keeping and issuing the invoices and sales tax concentrated only on import / manufacturing level.

Silwal (1988), stated that most of the developing countries are now engaged in the study of VAT very seriously and most of the economists of all countries have realized that the VAT only is the source of tax revenue, which has very high tax potential yield among the existing tax

systems. VAT is said to be consumption tax by when the taxable goods and services are consumed will ultimately pay the tax. If any goods become spoiled before consumption, it is not liable to tax. The features of VAT are as follows.

-) Input tax credit
-) Neutrality
-) Compulsory invoice system
-) Wide tax converge

Similarly possibility of tax evasion and cheating are also minimized pointing out the problems of VAT in Nepal, the researcher writes “When retail level sales tax was introduced firstly in 1965 there appeared several absurdities such as very low monitoring and supervision skill of the tax administration, very informal retailing system, lack of compulsory invoice system and lack of skilled and experienced administrators. The researcher recommended that before introducing VAT. Some necessary conditions should be fulfilled. They are given below.

-) Change in the origination of the tax administration.
-) Development in personal and staff.
-) Sufficient information system about VAT should be developed and introduced.

Binguag Hsiung (1991) had conducted a study to evaluate the VAT in Taiwan, which was in effect since 1986. The study showed the good result of VAT after some years of experiences. The impact of VAT showed the business tax revenue increased considerably due to cross

checking procedure of VAT. Adoption of VAT did not cause price fluctuation.

John F. Due and Francis Greony (1991), wrote successful stories of VAT in Trinidad and Tobago. A VAT of general type went into effect in Trinidad and Tobago in 1990. Development of VAT was carefully planned and it went through the several phases from 1986 to 1989. The tax performance committee was established in 1987. The first task of the committee was to review the current tax system and develop a preliminary recommendation in direction of reform. The studies showed that the existing tax system was an urgent need of revision for several respects. The value added tax was put forward as an alternative. Further the issues such as choice of rate structure exemptions tax administration etc. were resolved for the final adaptation of VAT. The structure of VAT was drafted in the final report after the careful examination of several issues including revenue and equity with the development of analytical models. After so many detailed works, it was finally drafted and passed by the registration in 1989.

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

Khadka (1997), in his book entitled “VAT in Nepal” has described the theoretical background and the development of VAT in Nepal. Being a researcher and a VAT advisor, he has spent a lot of time in preparatory work of VAT and has played a significant role in formulation of tax policy.

Different aspects of VAT have also been analyzed in his book entitled “The Nepalese Tax System”. In his own words “Tax compliance is very poor in Nepal and different taxes are not being fully paid as per the law. There is a lack of transparency. Both the tax payers and tax collectors take undue advantage of the situation. There is lack of co-ordinate approach and long-term strategy. Several tax measures were introduced in 1997/98 without any consideration and their possible effects.

Nepal Chamber of Commerce also made a study to analyze the possible effects of VAT in Nepalese economy in 1997. Dr. Puspa Raj Karnikar heading the team. The main finding of the study report was as follows:

-) VAT effects adversely in price level. It increases the price of imported goods. Ultimately increases the cost of production there by reduces the export business.
-) Requirement of book-keeping is complicated.
-) It will finally affect the small traders.
-) It is untimely to implement.
-) It would be unjustifiable on social ground.
-) Present administration is incapable for handling VAT.
-) Computerization system is not sufficient and it is new concept for the tax administrator.

The study report suggested for a partial VAT on some commodities. It was in favor of phase wise implementation of VAT. The study analyses negative impact of VAT neglecting its positive impact.

Ghimire (1998), in his dissertation explains that administrative capacity, organizational structure, audit and inspection system, reward and punishment, political intervention, selection of skilled and experienced manpower are needed to improve for effective implementation of VAT. Among which the first one is most challenging. There are large numbers of small trader. So more revenue can be generated only in VAT is extended through retail level. To make the retail stage VAT more effective and efficient, the major suggestions of this research are to improve the following aspects.

-) Administrative power and creditability
-) Tax payers' identification system
-) Registration and educational programme
-) Some incentive for small trader

The existing major problem of VAT implementation in Nepal are existence of small traders in large proportion, lack of accounting records, illiteracy and high compliance cost, open boarder with Indian market etc. which create a question for the successful implementation of VAT. The essential pre-requisites for the successful implementations of VAT in Nepal are strong administration, educational programme, technical date base system, combination of various revenue offices, high level VAT implementation team, co-ordination of VAT department and closed co-operation between government and the private sector.

Khanal (2000), in his dissertation examined the issues and options in Nepal. In his study he opined that VAT would be an improvement over the sales tax system. Adoption of VAT in the place of Sales tax would insure certain 'gain' though the gain may be at least amount. That is why a move towards VAT would be 'better' but not an 'ideal' step. It is because the allegedly overemphasized theoretical advantages of VAT would crash down on earth when it comes to reality due to the absence of a 'good' environment for the applicability of the tax. Thus one biggest problem for implementing a VAT in Nepal is its applicability. The applicability issues assume greater importance and demand a very careful examination as well as solution for the implementation of VAT in Nepal.

He found that the major hurdles for the applicability of VAT in Nepal are the existence of large proportion of small traders in trading activities, unfavorable business structure and practices, weak administration, existence of open boarder and large amount of unauthorized trade from India to Nepal, under valuation of imports, tax evasion and low tax consciousness of the people.

Dhakai (2000), in his dissertation analyzed the Nepalese tax structure and potential revenue of VAT in Nepal. He has provided the following conclusions. Theoretically VAT is the attractive alternative of sales tax on the ground of revenue productivity equity norms, supporting economic growth without economic distortions; export promoting, price stability and neutrality on production and distribution etc. Further, the hypothesis of self polishing or 'Cross-checking' channels without cascading and pyramiding effect has made VAT 'mile stone' in the history of reforming of the indirect tax. Empirically, he has found that VAT has high revenue potential power. Even the broad coverage of VAT would generate more revenue without addressing the equity norms. But, it would be noted that,

achieving both efficiency and equity objectives simultaneously is a difficult task under the consumption levy. Practically, he has found that the VAT is going to become 'hot milk in mouth' due to inefficient tax administrators.

He has expressed that VAT is suitable both theoretically and empirically but the practical aspect is extremely weak. Thus only the introduction of VAT is not really acceptable as tax reform. The system of VAT itself has great need of reforming for the Nepalese context.

Laudari (2001), in his dissertation found that before the introduction of VAT the revenue contribution from the areas replaced by VAT was generally increasing whereas after the introduction of VAT, contribution was gradually decreasing. This study shows that there will be improvement in revenue mobilization due to VAT. The reason behind this claim is that theoretically VAT system is transparent; it broadens that tax base and discourages the tax evasion. The study shows that the main problem for business houses are account keeping billing and the weakness of VAT administration are lack of motivation and service minded attitude among the tax officials, lack of honesty in VAT officers.

The study concludes that because of the problems such as lack of strong and honest tax administration, lack of motivation and service minded attitude among tax officials, lack of co-operation from business community, lack of strong co-ordination between tax collectors and the tax payers, lack of strong political commitment and weak public consciousness are putting the obstacles in front of the revenue generation process of VAT. That's why VAT is running little behind its expectation from the revenue generation point of view.

For the betterment of the VAT system the study recommends following suggestions:

-) Tax education programmes must be provided to give the right view about VAT to the different people.
-) Close co-operation is necessary between the private sector and government in the VAT implementation process.
-) The government should pay its attention to design strong administration.

Laudari (2001), in his dissertation “Analyses the problems and prospects of VAT in Nepal” concludes that VAT will have effect on economic growth major problems associated with the VAT system business houses are account keeping and billing. Weakness of VAT administration are lack of motivation service minded attitude and dishonesty in VAT officers. VAT system the best and advanced fiscal tool in theoretical sense could not yielding the expected returns in Nepal because of the lack of strong and honest tax administration lack of co-ordination between tax collectors and tax payers’ lack of strong political commitment.

Jyoti in articles “Analysis and suggestion of VAT” (2001) concludes that under the VAT system a self-enforcing environment is created where a one-tax payer ensures compliance by the previous taxpayer. Honest taxpayers are able to conduct their business in a simple and proper manner. This is one of the biggest positive aspects of VAT. But many are experiencing problems in the implementation of VAT in the trading sector. This is not because of any weakness or defect in the legal aspects of VAT but due to the lack of effective implementation of VAT in the right manner.

In his opinion, there are two main issues that are obstructing the proper implementation of the VAT.

Lack of invoicing or invoicing with the correct value.

Lack of effective implementation of VAT threshold.

Lene Bendix (Chief Technical advisor at the VAT project 2001), an article. “4 years of value added tax’ includes that there were a lot of constraints and difficulties in introducing and implementing VAT in Nepal. The first two years of VAT were very turbulent. Despite this, VAT was introduced and survived because of the efforts of a small group extremely dedicated, motivated and hard working people. Since its establishment in 1997, the VAT administration had been improving gradually until the early summer of 2001. The merger between the former VAT Department and the former Department of Taxation into the Inland Revenue Department took place in April 2001. This made it very difficult to keep focus on various important activities and decisions that needed to be carried out and to continue the VAT implementation process by the new Inland Revenue Department (IRD). Some difficulties were expected after the merger and some of the problems have already been solved still lots of challenges are left to be resolved.

In future the IRD with support from the VAT project will have to focus on the overall mission of any modern tax administration i.e. to collect revenue in the most efficient, effective and transparent manner and to increase the level of voluntary compliance. A lot of effort will have to be made to reestablish a functionally well-organized organization where the tasks are carried out in a modern effective, efficient, transparent and service minded manner.

At last, she emphasized that committed, dedicated, motivated and hardworking persons to carry out this difficult job are there.

J.B.R. (Member of Parliament of Lower House).2001, In his views published on “4 Years Implementation of VAT” conclude that, revenue plays an important role in the country’s development and tax is the primary source of revenue mobilization. Finding new source of revenue as a VAT was a timely action. This tax reduces the possibility of leakage by maintaining two accounts and also creates an environment of fair competition amongst the industrialists and businessmen such types of weakness must be corrected in order to make VAT effective. To support the economic development and to make this tax effective it is necessary to solicit the co-operation of industrialists and businessmen. Similarly to make VAT successful it is necessary to raise the level of awareness of the consumers.

Silwal (2001), an article “VAT its Past, Present and Future” on VAT 4 years of implementation books concludes that VAT could no broaden the tax base as desired. The crux of the problem was lackluster invoicing. The success of VAT system hinges on how the billing habit will be improved in future. The post of VAT was full of turmoil but even then it had been glorious. Its present is less than immaculate but its future will be glorious again. Today, there is an overall economic down turn through which the VAT is flourishing. It is going to remain the mainstay of revenue forever.

Dawadi (2001), an article “Let us support VAT” on book 4 years implementation of VAT concludes that each individual can become rich only if the country becomes rich. Therefore, let us all tax payers, tax administrations and the general public commit ourselves to sacrifice for

the welfare of the nation and take conscious measures to make VAT success.

Phuyal (2001), an article on VAT concludes that VAT can help to raise the level of economic development of a country. The economic development of any nation depends on the resources and the resource in which the development is based on is revenue. The source of revenue is income tax, custom duties and VAT. The only tax system that is popular worldwide scientific and transparent is VAT. Therefore, we should consider it seriously. He emphasizes that all industrialists and traders should register under VAT to increase the revenue source of the country to build out nation ourselves. Why should we always depend on foreign aid and spread our hands and ask for donation ad alms? It is drop by drop that a jar gets filled and hence let us all get together and do what we can do to make our nation self dependent. Businessmen can make a major contribution by issuing invoice keeping accurate and proper accounts. VAT office should provide help by maintaining a supportive attitude. The consumer should be more alert and demanding in terms of asking for and taking invoice.

Ghana Shyam Gautam (2002), in his dissertation “Problem and Prospects of VAT in Nepal” concludes that successful operation of VAT is extremely challenging for a burgeoning economy like Nepal.

Where is a long boarder a large segment of the economy is yet to be magnetized, business system is still running in a traditional way, geographical structure is rugged, non adherence of standard norms and codes is wide spread, public consciousness level is very low, existing practice of smuggling and under valuation in the border areas is supporting for the under invoicing the successive stages of production and distribution. Further all the rules and regulations are not seen in real

practice. Corruption and bribing is wide spread in the tax administration and all other sector of economy. These are the facts, which encourage businessmen for the tax evading practices and make them less responsible to the system.

Upadhaya (2002), in his study paper finds that although some achievements have been realized in the field of registration and refund and in reducing the number of non filers the result are still far from satisfaction. He also finds that the implementation part of Value Added Tax is not working properly. He has found the following problems in the VAT implementation.

Proper invoicing system has not been established.

Under valuation of imported goods in customs point.

There is no proper co-ordination between tax collecting departments of Nepal government.

The fixation threshold has been a debatable issue between tax payer and administration.

Controlling the exemptions of tax on goods and services has been also a challenging job for VAT administration.

All the consumers are not aware of VAT.

Prasai (2002), in his study concludes that VAT puts greater significance in revenue mobilization in Nepal. Adoption of VAT in Nepal is both a compulsion and a necessity. It cannot curtail its development projects for which more revenue is required. Due to the numerous reasons the revenue collection from other source of taxation such as income tax, customs duties and excise duty are drastically decreasing or remaining unchanged. So to get the pace to revenue generation, VAT is an

appropriate path or element. The implementation of VAT will help to reduce the burden of foreign debt and will provide a great relief to our future generation.

Despite its significance it has been facing numerous problems, which minimize its merits and effectiveness. He finds that the good implementation of VAT depends on the behavior of people relating to the VAT. If tax administrators, businessmen and consumers take VAT as serious matters and behaved as per their full potential and implementation factor will not be concerning factor. He also concludes that despite having a good VAT system the revenue collection is not increasing as it was expected. To get the great amount of revenue generation the responsibility and accountability in every section of the economy is its basic requirement as well as honesty and confidence between the business community and administration.

Thapa (2003), on his dissertation “Resource mobilization through VAT in Nepal’ stated that the main objectives of introducing VAT are listed below.

Collecting the revenue at low rate.

Export promotion.

Evolving clear and transparent accounting system.

Reduce the economic inefficiency.

Removing of unfairness of sales tax expanding the tax net.

Accelerating the development by abolishing / reducing cascading / paramedic effect of sales tax.

For the Nepalese context, VAT is suitable both theoretically and empirically but the practical aspect is extremely weak. Thus, only the introduction of the VAT is not acceptable as a tax reform. The system of

VAT itself has a great need of reforming for the Nepalese context and the percentage of export of goods materials and equipment. The average percentage of import before the introduction of VAT was 75% whereas the average percentage of exports was 25% only. Similarly, the average percentage of import was 70.2% and the average percentage of export was the introduction of VAT in Nepal. It shows the introduction of VAT in Nepal improves the inclination of export to some extent of 4.8%.

Khadka (2004) an article as “Overview of VAT in Nepal” concludes that VAT in Nepal was introduced as a major part of the overall tax reform programme initiated in the early 1990s. A detailed preparation was made for the implementation encountered various obstacles due to mainly the political instability and the opposition from the business community. Despite this, the number of VAT registrants and the VAT revenue collection has been increasing gradually. The tax refund system is also becoming institutionalized. The tax has been accepted by the business community and others and is well established. The implementation of VAT will broaden the tax base and develop a stable and reliable source for future revenue generation.

Kandel (2004), in his dissertation finds that Value Added Tax puts greater significance in revenue mobilization in Nepal. The reason behind this is that VAT system is transparent, broaden tax base and discourage tax evasion. VAT is the most scientific, innovative and powerful tax with built-in quality of universal application for both developed and developing economies. The biggest virtue of VAT is revenue buoyant and highly instrumental for resource mobilization especially in an economy with acute shortage of resource. Although, VAT was introduced as part of the national tax reform program but VAT system in Nepal from its inception has been facing innumerable problems, which curtails its merits and effectiveness. Theoretically, Nepalese VAT system has no weak provisions. It is one of the best models in the world. In practice, however the system is not effective due to the problems

concerning the operation of VAT. The government needs to take necessary steps to sort out emerging problems in implementation of VAT. The government need full co-operation from the tax administration, the tax payers and businessmen as well as consumers in its effort to generate more revenue. VAT must be made successful and this largely depends upon honesty faith and morality of tax officials and business people. He suggests that in the absence of growth of economic activities, revenue generation cannot be increased. Thus it is time of action and improvements for effective and successful operation of VAT in Nepal for further perspective as well as present needs of economic development.

Raju Dhakal (2009) in his dissertation “VAT in Nepal: An Analysis of Its Problems and Prospects” has concluded that the main problems for business houses are 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 assure that VAT system is the best and advanced fiscal tools, its effect in the context of Nepal is not as expected because of the lack of strong and honest tax administer, lack of motivation and service minded attitude among the tax officials, lack of cooperation of business community lack of strong co-ordination 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 programmers with professor, 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 those 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, investigation and collection visits and integrated approach to total tax system should be introduced for successful implementation of VAT.

Bishowraj Adhikari (2009) in his dissertation “Performance of Value Added Tax in Nepal” has concluded that implementation part of VAT is not working properly. Self-policing feature and catch-up effect of VAT has not been satisfied in Nepal. No progress has been realized in the field of valuation even after adoption of transaction value and VAT. There is no proper co-ordination between tax collecting departments of HMG. Tax administrator and taxpayers have opposite interest in regarding to exemption goods and services. Even after four and five years of VAT introduction all the consumers are not aware of VAT system and thereby not sensitive of tax paid with the purchase of goods and services. He has recommended that higher VAT paying taxpayers are to be provided with some monetary attractions as incentive to get real bill. Vigorous attempt should be done to exercise the provision provided by the law for the correction of under-invoicing. A compulsory price tag system must be developed and maintained so that consumers become aware to the price of goods and services. Computer networking system should be established so that related information can be assessed to all concerned officials. In depth training system must be provided to tax officials to expertize them in the field of taxation.

2.3 Research Gap

From the above review of literatures, I got that the countries except Nepal are operating VAT in positive way, contribution of VAT in these countries are increasing day by day. These countries have emphasized on the positive impacts. Positive thinking of these countries towards VAT also has resulted positive. But in Nepal VAT related persons researchers, and general people have been viewed to the impact of VAT from negative side rather than its positive sides. The researchers and the journalists (related with VAT) have concluded many problems towards the implementation of VAT in Nepal. These problems are: inefficient tax administration lack of modern accounting system, lack of political commitment lack of cooperation between custom offices and Inland Revenue department lack of cooperation between private sector and government bodies, lack of public consciousness etc. But nobody has looked towards the factors creating the above problems. Nobody has focused on the contributions of VAT. VAT introducing in any country is the long run objective. None study has focused on introducing a VAT as a long term objective. We can't result about the success or failure of VAT introducing within a short period of time.

This study will be distinct from others in such areas or subjects as first of all, this study views the impact of VAT from positive side emphasizes on the factors creating the problems on implementation of VAT in Nepal and recommends the best solutions of these problems. This research study will be fruitful to those interested persons, students, teachers, scholar, businessmen and government for academically as well as policy perspectives.

CHAPTER - THREE

RESEARCH METHODOLOGY

3.1 Introduction

The main objective of this research is to analyze and interpret the performance of VAT in Nepal. VAT is being applied instead of import/manufacturing level of sales tax, entertainment tax, hotel tax and contract tax. So, it should be sound and effective value added tax system results the increasing rate of indirect tax on tax structure as well as national revenue at satisfactory and reasonable level. Therefore the main concentration of this study is on the role of value added tax, VAT structure, VAT coverage and planning, organizing and administrative requirement. However, the major focus on performance, present practice and future prospects of VAT to implement effectively in Nepal.

The problem of delaying tax assessment, tax evasion and avoidance etc may be solved through efficient management system. After performing analytical system on this subject matter, it tries to recommend for tax administration to execute policy of VAT effectively. To achieve these objectives a research methodology has been designed in this chapter.

3.2 Research Design

This study describes situation and events occurring at present by accumulating the past information and facts. So, this study is descriptive and analytical types of research. The study attempts to show the present situation of VAT implementation in Nepal and predicts the prospects of VAT in future by the analysis of past information and records. So, descriptive and analytical research design has been adopted to conduct the research.

3.3 Nature and Source of Data

In order to achieve the real results of this research, primary as well as secondary data were collected from different sources.

3.3.1 Sources of Primary Data

The primary data were collected from the person representing from various sector conducting VAT. Likewise; businessman, tax administrators, tax experts, intellectuals, consumers and general people discussions with business person, tax experts and consumers through personal interview, opinion survey, questionnaire, field visit, interaction with tax payers, visit on Inland Revenue office etc.

In this study, the questionnaire has been distributed to 50 respondents in the different sector.

Table 3.1 No of respondents form different sector

Respondents	Number
Businessmen	20
Tax expert	10
Customer	20
Total	50

3.3.2 Sources of Secondary Data

Further data needed for the study is collected from the secondary sources.

These sources consist the followings.

- a. Published and unpublished reports, articles and dissertations on the concerned subject.
- b. Publications and economic survey of various Fiscal Years of Ministry of Finance (MOF) HMG / Nepal.
- c. Publications and annual reports of Internal Revenue Department (IRD).
- d. Various books written by tax officers and scholars.
- e. Related articles and journals.
- F. Publication of VAT department
- g. Budget speech as and economic survey of various fiscal years.
- h. World Bank reports

3.4 Data Collection processing and analysis procedure

A total 50 sets of questionnaire were distributed to the selected respondents in order to get actual and accurate information distribution work is done personally rather than sending by any means to get accurate and actual information in time.

The information received from primary and secondary sources are firstly tabulated in to separate format symmetrically in order to achieve the desired objectives. After that these data are tabulated and analyzed. For the purpose of analysis generally simple statistical tools have used which are simple percentage method, ranking method, graphs, charts and diagrams.

3.5 Method of Data and Information Analysis

With reference to the research methodology, different tools and techniques are used by the researcher to present and analyze the performance of VAT in Nepal. Basically the tools and techniques used to analyze and present are as follows.

- a. Trend Analysis
- b. Percentage
- c. Bar-Diagram

CHAPTER - IV

DATA PRESENTATION AND ANALYSIS

The presentation of data is the basic organization and classification of the data for analysis. The analysis of data consists of organizing; tabulating and performing statistical analysis. Keeping in mind the objectives of the study, data have been presented and analyzed through the help of statistical tools i.e. tables and figures.

4.1. Performance of VAT

Excluding foreign aid, tax is the main income source of nation's budgetary system. For self-reliance in economic growth of the country, the government has to extend the domestic and international tax value generating the various resources and increase the per capita income of the people. For the developing countries like Nepal, the role taxation in the process of economic development is thus considerably significant. In this respect, the tax structure has vital role in economic development. Government has introduced several taxes mainly to raise revenue. The trend and composition of tax revenue in the recent years is examined here in this chapter.

4.1.1 Registration:

Registration is the entry point of the tax system. Participants of tax payers to the tax system can be assessed by the trends of registration. All vendors whose taxable transaction is above the threshold are required to register for VAT. VAT registration began on 16th November 1997 when all sales tax registered manufactures were required to convert in to VAT registrations if they had an annual turnover of more than Rs 2 million. In mid Nov. 1997, 2045 manufacturers were registered under the imports / manufacturing level sales

tax. There is no provision of registration threshold under this tax. According to tax office other vendors, who were not registered under the sales tax were required to register for VAT with in 90 days from 16th Nov. 1997. This rule is not applicable to them who deal with exempted goods and services only. Similarly, small vendors falling below the threshold limit are exempted from VAT registration. VAT registrants are issued a registration certificate as well as tax payer identification number (TIN). In the mean time it has made compulsion to all concern to state the TIN on all specified documents including the tax invoice. The trend of vat registration is shown in Table 4.1.

Table No: 4.1
Trend of VAT Registration

Fiscal Year	Number of Registrants	Growth %
2002/03	29872	18.78
2003/04	34174	14.75
2004/05	39776	16.39
2005/06	46831	17.74
2006/07	52965	13.09
2007/08	59775	12.85
2008/09	69653	16.52
2009/10	82433	18.35

(Source: Annual report of fiscal year 2009/10, Inland Revenue department)

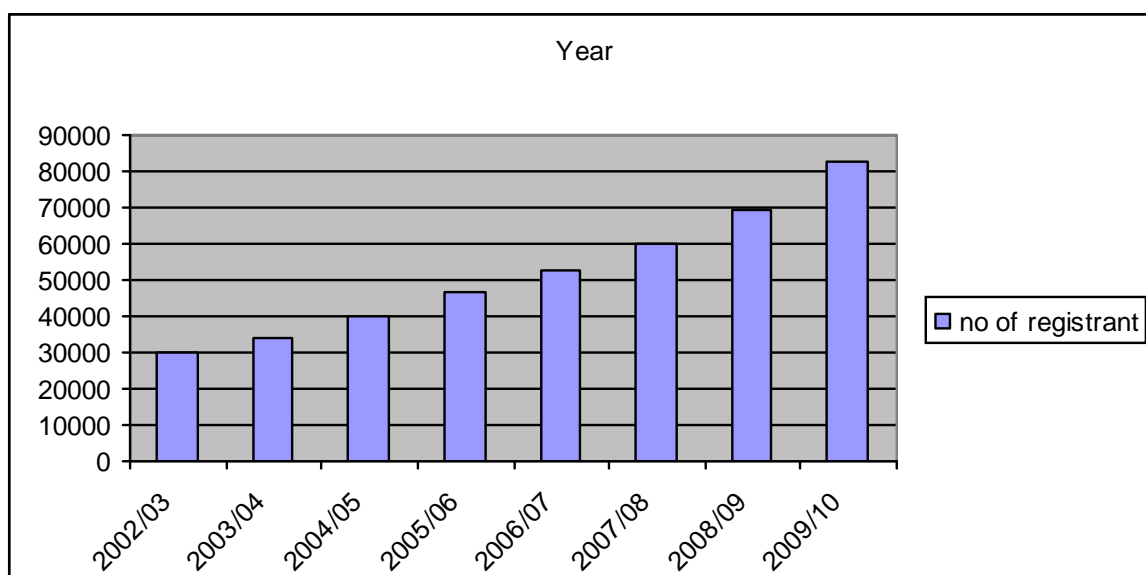
Despite having several problems in its operations, the total number of VAT registrants has reached exactly 82433. As shown in the table 4.1, the number of VAT registrants has increased consistently in the last seven years from 29872 in FY 2002/03 to 34174 in FY 2003/04; similarly, 39776 in FY 2004/05. After that, no. of registrants reached at 46831 in FY 2005/06. In year 2006/07 it reached at

52965, 59775 in year 2007/08, 69653 in 2008/09 and finally 82433 in 2009/10.

This shows that the increase in number of VAT registrants is impressive.

The table has shown that the percentage increase in VAT registrants has fluctuations. It may have happened due to the national rebel and monetary policies of current government.

Figure No. 4.1
Trend of VAT Registrants



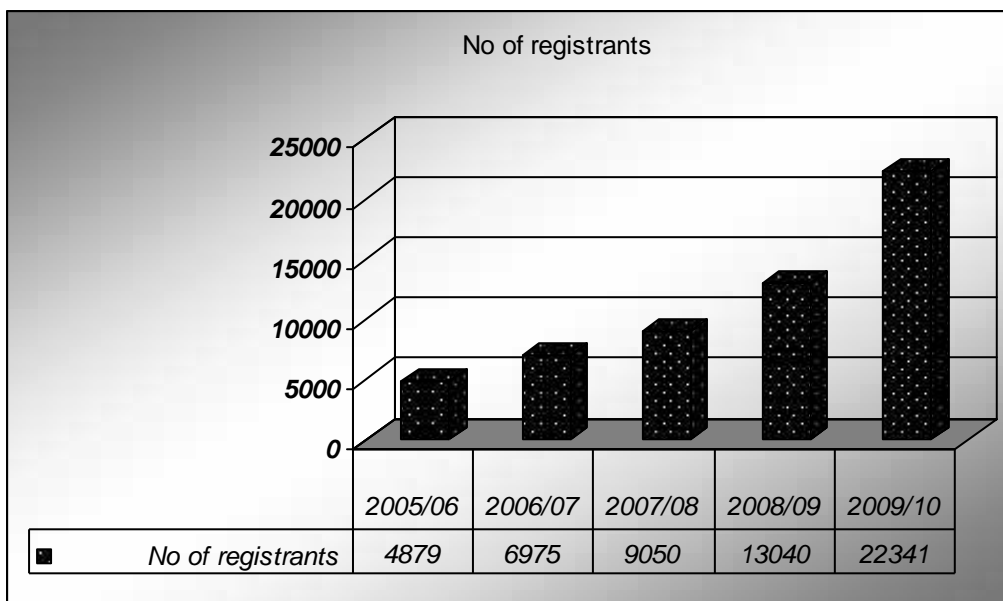
4.1.2 No. of VAT registrants not given details of VAT in time

In the context Nepal, weakness of education about VAT and inefficient administration similarly not have effective VAT rules and regulation maximum registrants not come in VAT office for given of vat details in time.the no of registrants not given details of vat in time increase year by year it is shown clearly in table 4.2 and the trend is also shown in figure no 4.2

Table 4.2
No. of VAT Registrants not given VAT details in time

Year	No of registrants
2005/06	4879
2006/07	6975
2007/08	9050
2008/09	13040
2009/10	22341

Figure no: 4.2



Due to the various problems the no of VAT registrants not given VAT details in time is increases year by year is shown in table 4.2 . In year 2005/06 the respondent is 4879,in year 2006/07 the number increases in 6975 similarly 13040 in year 2008/09 and in year 2009/10 the number is much increases to 22341.

4.1.3 Trend of VAT Collection

After implementation of VAT, the revenue collected figure is divided in to domestic and import component. The revenue collected figure is shown in table 4.3

Table 4.3
Status of VAT Collection
(In ten million)

Year	VAT collection	Domestic	Import
2002/03	13459.7	4845.5	8614.2
2003/04	14478.9	5646.8	8832.1
2004/05	18885.4	6610	12275.4
2005/06	21610.7	7996	13614.7
2006/07	26704.2	9689	17015.2
2007/08	29815.7	10808.2	19007.4
2008/09	39700.9	13918.4	25782.4
2009/10	54920.8	20379.8	34541

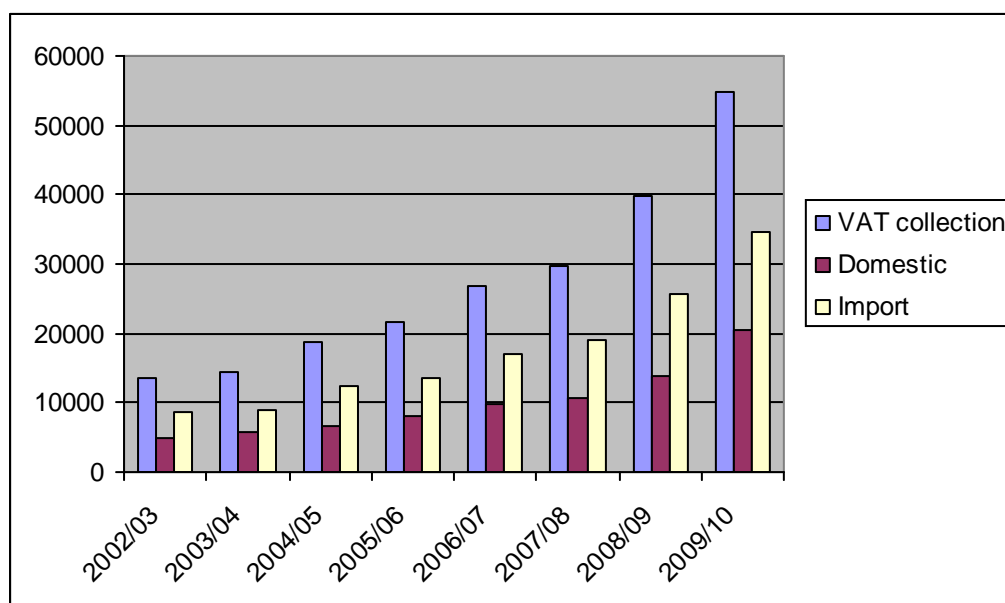
Source: - Annual report of IRD 2066/67(2009/10)

In above table 4.3 shows that 2/3rd of VAT revenue is generated from imports. And the rest is from domestic products. The collection of VAT revenue is in increasing trend. It is only 13459.7 ten million in fiscal year 2002/03 which is reached to Rs 54920.2 ten million in fiscal year 2009/10. The collection trend is satisfactory. Domestic VAT is divided in to three parts: Production, Distribution and Services. Under distribution, the tax collected at the dealer, wholesale and retail level is included. The relative contribution from distribution and service has been increasing. The VAT revenue is in increasing trend. It may be due to increasing trend of registration in to VAT.

The interview businessman revealed that the cause of not collection VAT as expected are economic slowdown, lengthy accounting system and lack of social recognition to businessman (Tax payer).

The interview with tax expert revealed that the VAT revenue can not collect smoothly due to lack of will power of Government and tax payers nation building.

Figure no: 4.3



4.1.4 Tax Structure of Nepal

Excluding foreign aid, tax is the main income source of nation's budgetary system. For self-reliance in economic growth of the country, the government has to extend the domestic and international tax value generating the various resources and increase the per capita income of the people. For the developing countries like Nepal, the role taxation in the process of economic development is thus considerably significant. In this respect, the tax structure has vital role in economic development. Government has introduced several taxes mainly to raise revenue. The trend and composition of tax revenue in the recent years is examined here in this chapter.

4.1.4.1 Trend and Composition of Total Revenue

Total revenue of Nepal can be decomposed into tax revenue and non-tax revenue. Tax revenue contributes about three quarters of total revenue while non-tax revenue represents about the quarter of total revenue. This is shown in table 4.4 and figure 4.4. During the study period, the amount of both tax and non-tax revenue in absolute term has increased. In FY 2003/04, the amount of tax and non-tax revenue were Rs. 42587 ten million and Rs. 12103.20 million respectively. And in the FY 2008/09, the share of tax revenue and non-tax revenue on total revenue were Rs. 117051.9 million and 13341.5 million respectively. Similarly, the contribution of tax revenue and non-tax revenue of FY 2009/10 were Rs. 156280 million and Rs. 23660 million respectively.

In percentage term, the contribution of tax revenue and non-tax revenue on total revenue for the FY 2002/03 was 77.87 percent and 22.13 percent respectively. These contributions were increase to 81.58 percent and 18.42 percent respectively in the FY 2008/09. And for the FY 2009/10, their contributions were 86.85 percent and 13.15 percent respectively. The dominant role of tax revenue is thus, quite satisfactory as its amount has been increased more significantly than the non-tax revenue over the period 2002/03 to 2009/10. But, this increased revenue amount is not sufficient to meet the demand of expenditure side of current budget. The revenue management should be awarded not increase the tax rate, but explain the taxable area.

The non-tax revenue comes to the form of fees, fines, penalties, dividend, interest, sales of goods and services and so on. There is some scope for generating more revenue through the rationalization of non-tax source particularly by improving pricing policies and operational performances. These sources cannot be used effectively as a revenue raiser since most of these sources are levied not for revenue purposes (Khadka, 2000).

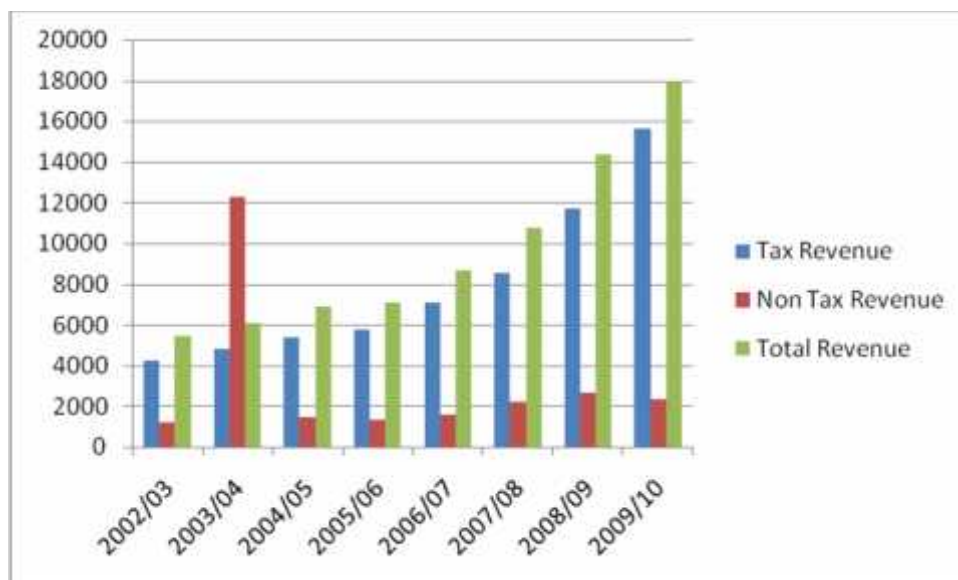
Table 4.4**Contribution of Tax and Non-Tax Revenue as Percentage of Total Revenue****In Ten million**

Fiscal Year	Total Revenue	Tax Revenue	% of tax revenue	Non Tax Revenue	% of total revenue
2002/03	5469.02	4258.70	77.87	1232.32	22.13
2003/04	6048.05	4817.30	79.65	12307.5	20.35
2004/05	6887.47	5410.47	78.55	1477.03	21.45
2005/06	7076.84	5743	81.15	1334.15	18.85
2006/07	8668.40	7112.67	82.05	1555.93	17.95
2007/08	10762.25	8515.55	79.12	2246.70	20.87
2008/09	14347.45	11705.19	81.58	2642.26	18.42
2009/10	17994	15628	86.85	2366	13.14

Source: Economic survey (2009/10)

Figure No: 4.4

Comparison of Tax Revenue, Non Tax Revenue and Total Revenue over 2002/03 to 2009/10



4.1.4.2 Total Revenue, Tax and Non-Tax Revenue in GDP

In order to understand the growth pattern of taxation properly, it would be desirable to examine the share of total revenue, tax revenue and non-tax revenue in GDP table 4.5 in this connection presents an account of the total, tax revenue and non-tax revenues as percentage of GDP. In the GDP, tax revenue has been increasing much higher than the non-tax revenue over the period 2002/03 to 2008/09 but there is a considerable decrease in non-tax revenue for the period 2009/10. While the share of tax revenue increased from 8.70 percent of the GDP in FY 2002/03 to 11.80 percent in FY 2008/09, the share of non-tax revenue has slightly decreased from 2.80 percent of the GDP in FY 2002/03 to 2.7 percent in FY 2008/09, the share of tax revenue and non-tax revenue of the GDP were 13.30 percent and 2.0 percent respectively in FY 2009/10.

The relationship between tax and GDP is known as tax/GDP ratio. This is an indicator of the utilization of taxable capacity. The table shows rather disappointing scenario of tax/GDP ratios for the study period. However, it

increased from 11.4 percent in FY 2002/03 to 15.4 percent in FY 2009/10. But this growth is not satisfactory. The ratio is still much lower than that of many other developing countries. By world standard, this is a very low level of taxation.

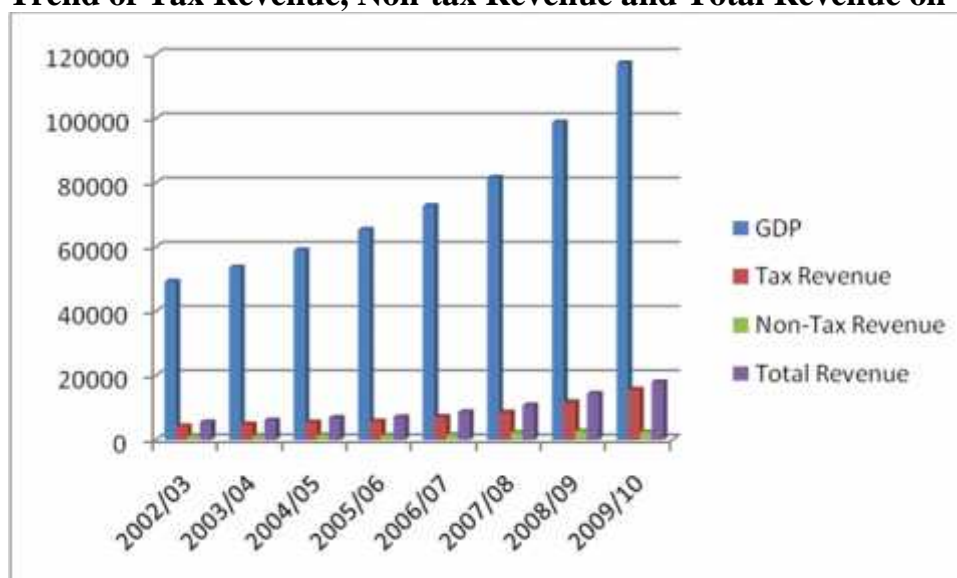
Table 4.5
Total Revenue, Tax Revenue, Non Tax revenue as percentage of GDP

Year	GDP (ten million)	Total Revenue	Tax Revenue	Non Tax revenue	Percentage of GDP		
					Total revenue/GD P	Tax revenue/GD P	Non tax revenue/ GDP
2002/03	49223.13	5469.02	4258.70	1232.32	11.10	8.70	2.50
2003/04	53674.89	6048.05	4817.30	1230.75	11.26	9.00	2.30
2004/05	58941.16	6887.47	5410.47	1477.03	11.68	9.20	2.50
2005/06	65408.40	7076.84	5743	1334.15	10.82	8.80	2.03
2006/07	72783	8668.40	7112.67	1555.93	11.90	9.80	2.13
2007/08	81566	10762.25	8515.55	2246.70	13.19	10.40	2.70
2008/09	98805	14347.45	11705.19	2642.26	14.52	11.80	2.67
2009/10	117190	17994	15628	2366	15.30	13.30	2.00

Source: Economic Survey 2009/10

Figure No: 4.5

Trend of Tax Revenue, Non-tax Revenue and Total Revenue on GDP



4.1.4.3 Composition of Indirect Tax

Indirect tax has been dominant role in tax revenue. Similarly, sales and value added tax has dominant position in indirect tax. For the comparison purpose taxes from contract, hotel and entertainment have been included in sales / value added tax because after the adoption of VAT all these taxes were replaced.

Table 4.6
Composition of Indirect Tax

(Rs in million)

Fiscal Year	Custom duty	Sales /VAT	Excise duty	Total	% of custom duty	% of sales/ VAT	% of excise duty
2002/03	14236.4	13459.7	4787.5	32481.2	43.24	40.88	14.53
2003/04	15554.8	14478.9	6226.7	36260.4	42.34	39.41	16.95
2004/05	15701.6	18885.4	6445.9	41032.4	37.79	45.45	15.51
2005/06	15344	21610.7	6507.6	43465.5	34.78	48.98	14.75
2006/07	16708	26098.6	9343.2	52146.4	31.75	49.59	17.75
2007/08	21062	29815.7	11189.6	62067.8	33.93	48.03	18.02
2008/09	26793	39701	16220.9	82714.9	32.38	48.00	19.61
2009/10	37903.2	54920.8	18631.2	111454.4	34.00	49.27	16.71

Source: Economic survey fiscal year 2009/2010

Note:-

Excise duty =Industrial product + liquor contract

Custom duty =imports +exports + Indian excise retuned + others

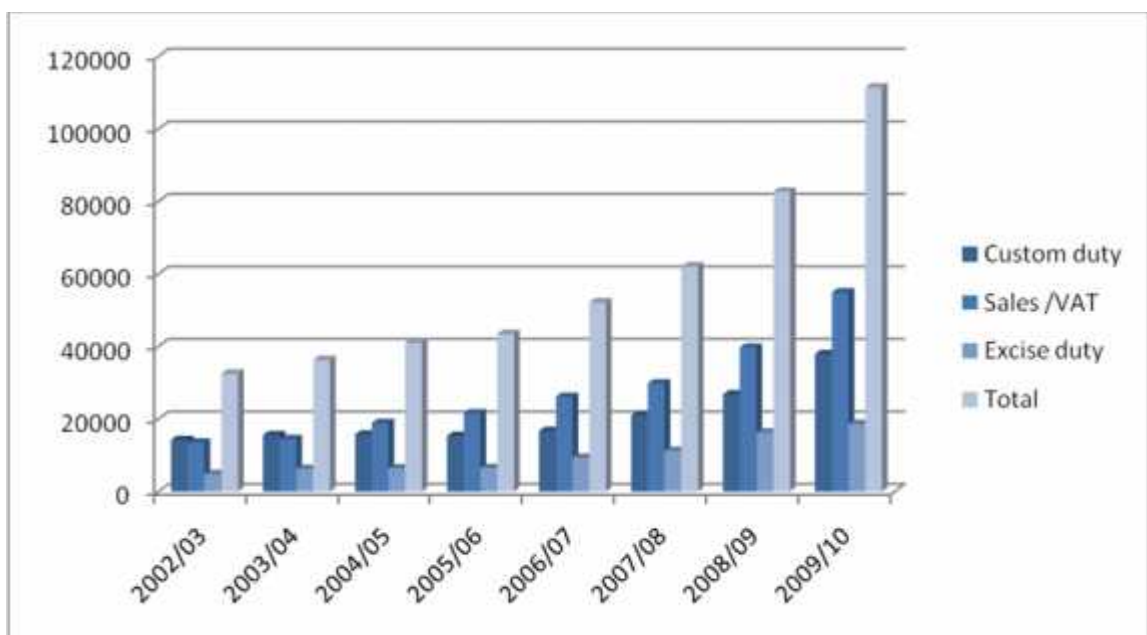
Sales Tax / VAT =Sales / VAT + Entertainment tax + Hotel tax + Contract tax

The table illustrates the composition of indirect tax. But after the implementation of VAT the revenue received as custom duty has actually decreased from Rs 15701.6 million to 15344, but continuing an increasing trend after that reaching to Rs. 37903.2 in 2009/10. In the initial years, custom duty actually was the more significant source of revenue, but after 2004/05, it

was outpaced custom duty revenue with a large margin, reaching 54920.8 million in 2009/10. Revenue from excise duty, though not as significant as the rest two, is also showing an increasing trend over recent years. Inconsistencies in revenue collection can be blamed to poor supervision and administrative capacity of tax office and not proper billing system from businessman.

The interview with FNCCI members revealed that consumer behavior is characterized by certain aspects like compulsion, luxury and planned shopping. Things like medicine, food and clothing are compulsory purchases; planned shopping is related to shopping is affected if the cost of the compulsory requirement goes up, as the budget will not permit it. And then there is luxurious shopping which happens only after the compulsory and the planned shopping have been taken care of. But the slowdown in economy has definitely had an impact on both planned and luxurious shopping. If such shopping cannot be flourishing, the VAT revenue cannot be collected.

Figure No. 4.6
Composition of Indirect Tax



4.1.4.4 Contribution of indirect tax in GDP

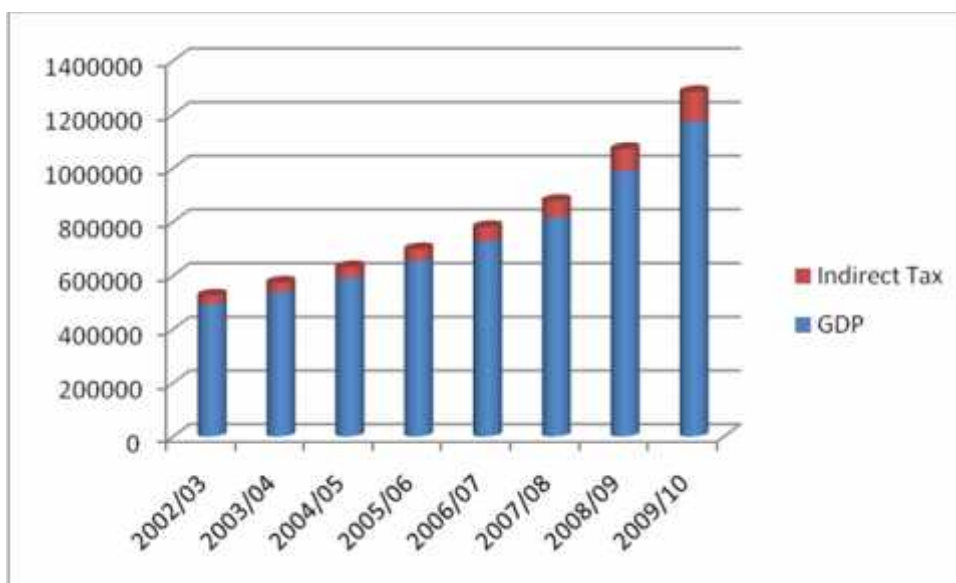
Table 4.6 indicates the share of indirect tax revenue on GDP. In terms of GDP, the share of indirect tax revenue is increasing steadily, from 6.60% in FY 2002/03 to 6.96 in FY 2004/05. After a sudden dip in 2005/06, the pace is continued from 7.16 in 2006/07 to 9.51% in the FY 2009/10. The data reveals to us the fact that indirect tax is in fact a significant source of GDP for the government.

Table 4.7
Contribution of Indirect Tax (figures in million)

Fiscal Year	GDP	Indirect Tax	% of Indirect Tax on GDP
2002/03	492231.30	32481.2	6.60
2003/04	536748.90	36260.4	6.75
2004/05	589411.60	41032.4	6.96
2005/06	654084.00	43465.5	6.64
2006/07	727830.0	52146.4	7.16
2007/08	815660.0	62067.8	7.61
2008/09	988050.0	82714.9	8.37
2009/10	1171900.0	111454.4	9.51

Source: Economic survey fiscal year 2009/2010

Figure No. 4.7
Contribution of Indirect Tax in GDP



4.1.4.5 VAT Revenue as percentage of GDP

VAT contribution to gross domestic product is shown in following table and diagram.

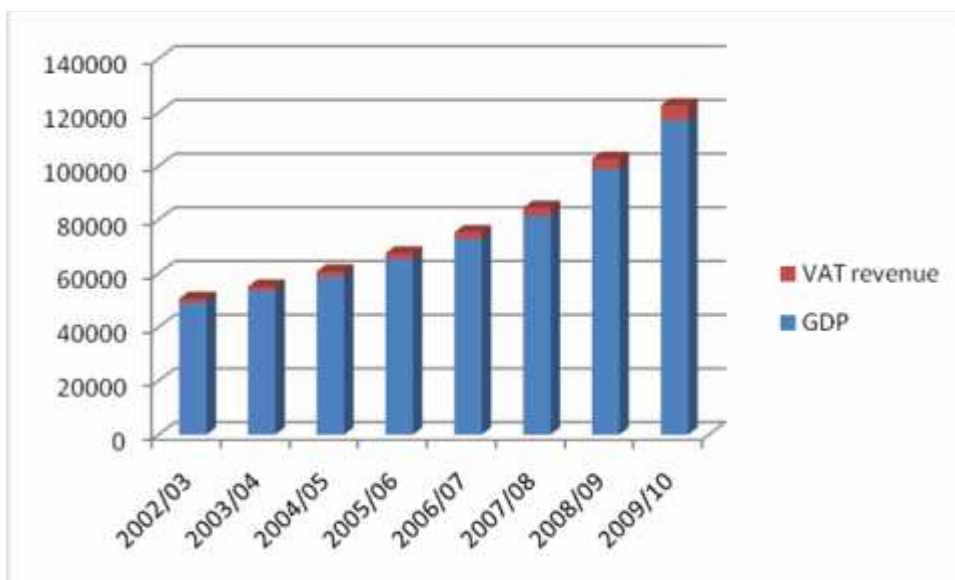
Table 4.8
Share of VAT Revenue in GDP (in ten million)

Fiscal Year	GDP	VAT revenue	%of GDP
2002/03	49223.13	1345.97	2.72
2003/04	53674.89	1447.89	2.69
2004/05	58941.16	1888.54	3.20
2005/06	65408.40	2161.07	3.30
2006/07	72783	2609.86	3.58
2007/08	81566	2981.57	3.65
2008/09	98805	3970.10	4.01
2009/10	117190	5492.08	4.69

(Source: Annual report of fiscal year 2009/10, Inland Revenue department)

The increasing share of VAT revenue in total revenue clearly indicates a crucial role of VAT in uplifting the total GDP of the nation. As shown in the table, the VAT percentage on GDP has been increasing continuously after an initial dip from 2002/03 to 2003/04. Over a period of just over half a decade the percentage has drastically increased. With a 4.69% contribution on GDP in the current fiscal year, VAT continues to have a strong influence on GDP increment.

Figure No: 4.8
Contribution of VAT Revenue on GDP



4.1.4.6 Contribution of VAT in total revenue

VAT plays a vital role for revenue generation. The share of VAT in the total revenue is shown in the following table.

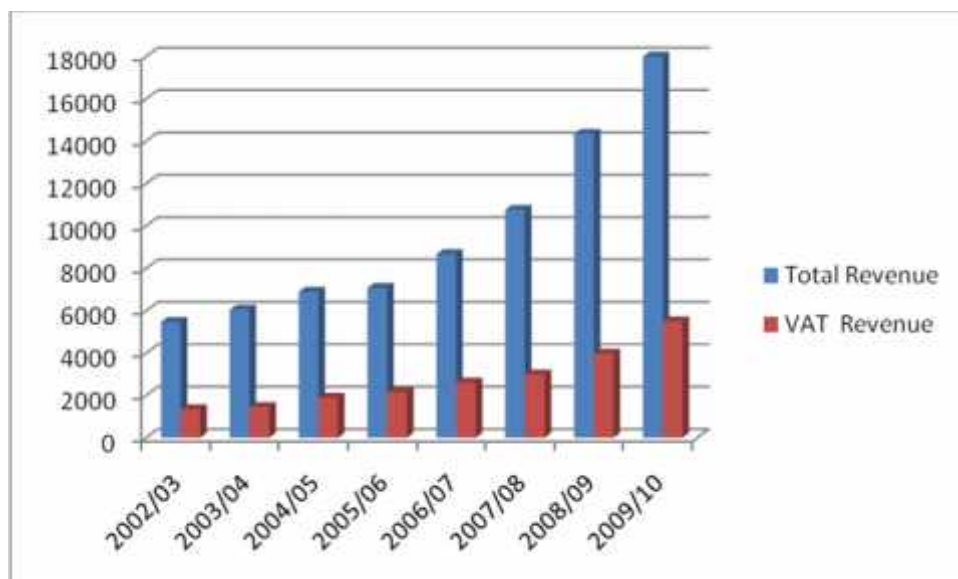
Table No. 4.9
Contribution of VAT in Total Revenue (in ten million)

Fiscal Year	Total Revenue	VAT Revenue	% of VAT on Total Revenue
2002/03	5469.02	1345.97	24.61
2003/04	6048.05	1447.89	23.94
2004/05	6887.47	1888.54	27.38
2005/06	7076.84	2161.07	30.54
2006/07	8668.40	2609.86	30.10
2007/08	10762.25	2981.57	27.70
2008/09	14347.45	3970.10	26.93
2009/10	17994.00	5492.08	31.75

Source: Economic Survey (MOF)

The above table shows the significant contribution of VAT in total revenue. In spite of a slight fluctuation over some years, the contribution of VAT is increasing on the total revenue. The descending changes in the VAT percentage on Total Revenue have occurred during financial transition from 2002/03 to 2003/04 and similarly to three consecutive financial years. The current financial year 2009/10 however has shown a significant increase with a figure of 31.75%.

Figure No: 4.9
Contribution of VAT in Total Revenue



4.1.4.7 Share of VAT revenue in total tax revenue

To examine the contribution of VAT revenue in total tax revenue, the following table examines the ratio of VAT to total tax revenue.

Table 4.10
Share of VAT Revenue in Total Tax Revenue

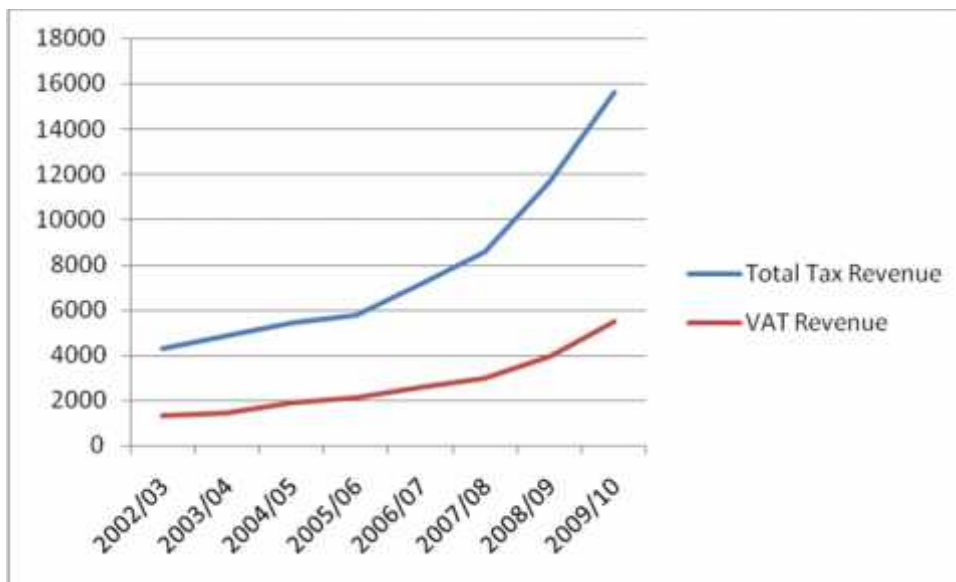
(figures in ten million)

Fiscal Year	Total Tax Revenue	VAT Revenue	% of Total Tax Revenue
2002/03	4258.70	1345.97	31.60
2003/04	4817.30	1447.89	30.05
2004/05	5410.47	1888.54	34.90
2005/06	5743.00	2161.07	37.62
2006/07	7112.67	2609.86	36.67
2007/08	8515.55	2981.57	35.01
2008/09	11705.19	3970.10	33.91
2009/10	15628.00	5492.08	35.14

Source: Economic survey fiscal year (2009/2010)

Table shows that on an average the VAT revenue is around one third of the total tax revenue. This is a significant contribution indeed. The ratio of VAT collection with tax revenue has been marred by the people's revolution and the lack of firm government policies. Consequently, a slight decreasing trend has been observed from 2005/06 to 2008/09. However, recent times have shown some hope with an impressive figure of 35.14%. This is a good signal to our economy.

Figure No: 4.10
Contribution of VAT in Total Revenue



4.2 Opinion Survey Result

Opinion survey is the primary source from which we prepare the respondents argue about the performance of VAT and problems faced by government to implement the VAT system in nepal . It is viewed that this system has not been implemented effectively as expected. There was a strong opposition from the business community during the earlier period of VAT implementation. In that time, there was a negotiation between private sector and government on the

different aspects and provisions of VAT. After that, VAT was extended through the retail level and thus implemented in its full-fledged form. In the beginning period of VAT implementation, there was lack of skilled and trained manpower and setup properly. But currently different informative programmes, seminars and meeting were held to make the businessmen. Consumers and people know to the VAT currently business community is also in favour of VAT and further demanding to identify and include into the tax net. In such situation an empirical study is done to know the views of person of different field on different aspects of VAT. For the purpose of survey, different questionnaire were prepared to know the opinion of the various persons of different field (i.e. tax experts, businessman, consumer). The responses received from various respondents have been arranged tabulated and analyzed in order to facilitate the descriptive analysis of the study.

The questionnaires were asked either for a yes/no response or for ranking of choice according to number of alternatives, where first choice was most important and last choice was least important for analysis purpose. Choices were assigned to weights according to number of alternatives. If the number of alternatives were seven, then the first preferred choice got seven points and the last preferred choice got one point. Any alternatives, which were not ranked did not get one point. The total points available to each choice were converted into percentage in reference to the total point available for all choices. The choice with the highest of score of percentage was ranked as the most important choice and one with the lowest percentage being ranked as last choice.

4.2.1 Important factor for the effectiveness of VAT in revenue collection

To know the most important factor for the good performance of VAT in revenue collection in Nepal. Firstly visit the respondent and ask what is the most important factor for the good performance of VAT in revenue collection. The responses of the respondents are presented as follows.

Table 4.11
Views on important factor for the effectiveness of VAT in revenue collection

S.N	Alternatives	Respondents			Total points	Percentage	Rank
		business men	Tax experts	Customer			
1	Effectively implementation	38	60	72	170	24.78	3
2	Education about tax	45	70	36	151	22.01	4
3	Effective and efficient Adm.	40	45	90	175	25.51	2
4	specific VAT law and regulation	30	85	75	190	27.70	1
5	Total	153	260	273	686	100	

Source: Opinion Survey

By observing the above table, according to the respondents' point of view the main important factor for the good performance of VAT in revenue collection are ranked as follows:

-) Specific VAT law and regulation.
-) Effective and efficient administration.
-) Effectively implementation.
-) Education about tax.

From the above table and other discussion with respondents, it can be concluded that the main factor for the good performance of VAT in revenue collection are specific VAT law and regulation, effective and efficient administration, effectively implementation, education about tax

4.2.2 VAT and Single Rate

It is often argued whether the single rate of 10 percent is appropriate in Nepal. Some have suggested multiple rates-lowers rate for basic necessity goods, medium rate for general goods and high rate for luxurious goods so as to make the VAT more progressive. Most of the nations in the world have adopted a single rate for VAT while some have adopted dual rates and some have adopted multiple rates.

From the administration point of view, a single rate of 10 percent is appropriate hen multiple rates. A single rate simplifies the VAT system. Under multiple rates, complications arise as the need to classify commodities into different groups according to their rates arises. Taxpayers need to maintain separate records and have to supply more pieces of information while preparing their tax return, thus resulting in greater burden to the taxpayers as well as tax administration. From the economic point of view as well, a single rate is desirable than multiple rate because a multiple rate system induces producers to divert their resources from higher-rated to lower-rated industries to save on tax payment.

Table 4.12
Appropriate to apply a single rate of VAT in Nepal

Respondents	Total	Yes		No		I don't know	
Businessmen	20	20	100%	0	0%	0	0%
Tax Experts	10	10	100%	0	0%	0	0%
customers	20	10	50%	6	30%	4	20%
Total	50		40		6		4

Source: Opinion Survey

Out of the 50 respondents, most of the 40 person in total response that single rate of VAT is appropriate. About 80% thought that a single rate of VAT is effective to simplify the system. All the businessman, tax experts whose opinions expressed that a single rate is appropriate under the present situation. However, only 50 % of the customers found the single rate appropriate.

4.2.3 Responsible for Tax Evasion in Nepal

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

Table No. 4.13
Responsible person for tax evasion in Nepal

Respondents	Total	Tax payer		Tax Administrator		Inefficient Administration	
		Count	Percentage	Count	Percentage	Count	Percentage
Businessmen	20	0	0%	5	25%	15	75%
Tax experts	10	10	100%	0	0%	0	0%
Customers	20	13	65%	2	10%	5	25%
Total	50	23		7		20	
Percentage	100%	46%		14%		40%	

Source: Opinion Survey

Out of the total respondents, about 46% attributed the taxpayers for tax evasion in Nepal and this seems to be very much true. About 40% blamed inefficient administration was responsible for tax evasion in Nepal. The tax officials blamed taxpayer completely for tax evasion. As per them, taxpayers engage in under invoicing and maintaining of dual accounts to evade tax. On the country, taxpayers opined that had the tax administration been more alert and effective, evasion would have been controlled. Also, some of them revealed that it was the taxpayers who encouraged them to evade taxes.

4.2.4 View of billing system

Billing System is one of the most important aspects of the VAT system. All businessmen have to receive the bill of actual transactions, while importing or buying the goods. In the bill, the price of goods with and without VAT has to be mentioned explicitly. While selling the goods purchase should compulsorily be given the same types of bill. The business has to pay the difference between tax collected in sale and paid in purchase to the VAT office. In other words, he gets back the tax paid in purchase. The profit is determined on the basis of sale and purchase bill and has to pay income tax in terms of that profit. At the same time the tax department also has to collect the tax on the basis of the very profit. Thus the billing system plays a crucial role in the field of VAT system. Therefore, it should be compulsorily implemented, through it is one of the burning problems in Nepal, the respondents related to different fields have given their views on billing system on the basis of ten years experience in the country as well as the experience from different countries.

Table No. 4.14
View of Billing System

Respondent	Possible		Impossible		I don't know		Total
	No.	%	No.	%	No.	%	
Businessmen	10	50	6	30	4	20	20
Tax experts	10	100					10
customers	5	25	10	50	5	25	20

Source: Opinion Survey 2011

From the field survey, it is found that all tax experts advocate for the possible of billing system in VAT system. 50% businessman claimed that billing system is possible at the same time 30% argue that it is impossible and 20% are

unknown about it. 25% consumers says that there is possibility, 50% say impossible and 25% say I don't know.

4.2.5 View on Rising in price due to VAT system.

In the beginning years, there was a beter protest against the VAT system. One of the reasons was that the businessmen thought that there would be rise in price in goods and services because of VAT. In recent years the consumers have complained that the businessmen charge more prices without following the act of VAT. here an endeavor has been made to get the information from the respondents to fidns out whether there will be raise in price due to VAT system.

Table No. 4.15
View on rising in price due to VAT system

Respondents	Yes		No		I don't know		Total
	No.	%	No.	%	No.	%	
Businessmen	14	70	4	20	2	10	20
Tax experts	4	40	6	60			10
Customers	12	60	5	25	3	15	20
Total	30	60	15	30	5	10	50

Source: opinion survey 2011

The study shows 40% tax experts, 70% businessmen and 60% customers claiming that there is a raise in price because of VAT system. While 60% tax experts, 20% businessmen and 25% customers says that there is no raise in price similarly 10% businessmen, 15% customers unknown about it.

4.2.6 VAT and its Problems in Nepal

It has been more than 8 years since VAT was implemented in Nepal. One of the reasons behind implementing VAT is to control tax evasion. As per the principles of VAT, tax evasion cannot take place. However in reality, tax evasion can still place owing to many reasons, one of them being the non-issuance of invoice at the retail level. VAT in Nepal is not without problems. There are obstacles in the smooth implementation of VAT in Nepal as discussed below:

1. Non-issuance of invoice

The major problem associated with VAT is the lack of compliance on the part of businessmen with the billing requirements. They hardly issue bill to customers, though it is mandatory under the VAT Act. And, if customers insist, they would charge extra money. Such practice has also discouraged the customers to demand VAT bill. Low valuation of imported goods at the customs is another major obstacle in the successful implementation of VAT and is the root cause of the failure of the billing system.

As we know, issue of an invoice is a must under VAT system. Likewise, it is the responsibility of the consumer to ask for the invoice. However, at the retail level, on one hand, consumers are not interested in asking for an invoice as they consider it useless and wastage of time, on the other hand, retailers are under no pressure to issue an invoice. Thus At the retail level, evasion is most likely to take place because cross-checking is not possible at this level. Even the registered ones may not be interested to obtain invoices from the sellers. The reason behind this is by not taking an invoice; they can omit some of their transactions from the books of accounts. By understating purchases, they can understate their sales. Thus, they would be able to avoid both VAT as well as income tax. On the other hand, they would get a price reduction for their purchases.

Until a situation is created where the consumers is self-motivated to ask for an invoice, it will be an uphill road for VAT.

2. Under-invoicing practices:

One of the challenges lying ahead of VAT implementation is the rampant practice of under invoicing. In Nepal, a majority of goods are imported and the imports are allowed to enter the country only after paying custom duty at the specified rate. Depending upon the price of the goods imported, less or more custom duty has to be paid and as a result, other taxes are also affected.

Therefore, if an invoice with a less amount is made and goods are imported. Then less custom duty has to be paid. This practice of making invoices with less-amount on imported goods so as to evade customs along with other taxes is called under invoicing. Once the goods enter the country by undervalued billing, the VAT revenue along with customs duties are evaded and this cannot be caught up in later stages of distribution if similar undervalued billing continues to take place.

Retailers complain that they are not able to issue invoices because they themselves do not get proper invoices from the suppliers. They get an invoice for a less amount than what they actually pay. Such a situation arises due to the low valuation at the customs. Through under valuation, the importer pays less custom duty and VAT. Since the importer has a document showing artificial price that is lesser than the actual price paid by him. it creates problems to maintain proper records all the way to the retail level. So, he is bound to issue a bill for lesser amount than what he charges to his customer. The customer who may be a wholesaler would do the same as the importer. A similar process would occur at the retail level.

This is in fact a serious problem. It was the government who had encouraged under invoicing in the beginning and the practice has remained till now. Currently, the legal business of the third countries is in the decline whereas the business of the northern and southern borders of Nepal is flourishing. In the border areas, business transactions can be conducted without opening letter of credit including other banking documents and so under invoicing still gets a boost.

3. Administrative Weakness:

Another outlet for tax evasion is administrative weakness. The effort that should have been put by the administrative staff has not been made. Qualified, well-trained and competent manpower is necessary to investigate and audit the business transactions for tax purposes. More important is the good attitude and service-orientation on the part of VAT administrators. In other words, administrative capability is the prerequisite for success of VAT in Nepal. Administrative weaknesses can be in the following forms:

1. Failure to detect fake records and invoices
2. Failure to protect high claim of tax credit
3. Failure to detect over refunding

4. Refund Aspect:

To impart confidence among the taxpayers on the VAT system, the VAT administrators should not neglect the refund aspect. Though the VAT Act prescribes a fairly simplified procedure for this in reality, it is quite different. There have been widespread complaints regarding the system of tax refund. The tendency is to set off cash refunds against future earnings even when cash refund is due. This is of particular concern to taxpayers at the time of capital investment or at the time of declining business environment.

The number and volume of refund claims made so far is found to be still very low compared to the potential refund number and amount.

5. Lack of confidence

On one hand, the taxpayers do not have confidence on the tax officials, on the other hand, the tax officials do not have confidence on the taxpayers. Taxpayers do not believe that the tax officials will follow the principles of VAT but believe they would run VAT in a similar way as other taxes. Likewise, the tax officials are of

the opinion that the taxpayers would understate the taxable value to pay less tax as they do not need to get the prices approved by the tax officials.

6. Geographical Problems

Nepal shares an open border with India, which encourages large volume of smuggling business. Most of the imports are made through the secret ways without having to pay custom duties and VAT. Unless this practice of smuggling is not solved, VAT can do nothing to prevent evasion. To overcome this problem, the border areas should be strictly guarded.

Table 4.16
Most serious problem of VAT in Nepal

Respondent	Total	Administrative Inefficiency		Lack of public awareness		Lack of proper accounting		Lack of cooperation by businessmen		Lack of information to tax payer	
		Count	Percentage	Count	Percentage	Count	Percentage	Count	Percentage	Count	Percentage
Businessmen	20	14	70%	0	0%	0	0%	0	0%	6	30%
Tax experts	10	0	0%	0	0%	4	40%	6	60%	0	0%
Customers	20	8	40%	6	30%	0	0%	6	30%	0	0%
Total	50	22		6		4		12		6	
Percentage	100	44		12		8		24		12	

Source: Opinion Survey, 2011

Out of the 50 respondents, 44% attributed administrative inefficiency as the major problem. About 24% viewed lack of cooperation by businessmen as the major problem. 12% viewed that that lack of public awareness was the major

challenge for VAT implementation and 8% viewed lack of proper accounting and the remaining 12% thought that even at present, most of the businessmen themselves are ignorant in many aspects of VAT which has been a serious impediment in VAT implementation.

4.2.7 A view on VAT as superior to Sales Tax

VAT is developed from of sales tax system. VAT is adopted in many countries of the world. It is superior over sales tax system. The main result of survey is summarized in the following table.

Table 4.17
Views on VAT as Superior to Sales Tax

Respondents	Yes it is		No, it is not		I don't know		Total
	No	%	No	%	No	%	
Businessmen	20	100	-	-	-	-	20
Tax experts.	8	80	2	20	-	-	10
Customers	12	60	3	15	5	25	20
Total	40	80	5	10	5	10	50

Source: Field Survey

According to field survey 80% of the total respondents provided their view regarding superior of VAT over sales tax. 10% of total respondents are opposite of that question and 10% respondents unknown about this view. In the above table show 100% Businessmen, 80% Tax experts and 60% Customers agreed about the superior of VAT over sales tax. Like this 20% Tax experts and 15% Customers said that it is not superior to sales tax. Similarly 25% Customers agreed unknown

about this question. That is why it is clear that VAT is superior to sales tax in respect of revenue collection, coverage and transparent.

4.2.8 VAT and Its Prospects in Nepal

Though VAT, at present, is still facing problems, these problems can be overcome if

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

1. Creating public awareness about VAT:

In Nepal, the main glitch in the VAT system is the lack of public awareness. Many people are still not clear about the concept of VAT. Even after 8 years of its implementation, the working of VAT and its effects are still unclear to them. The culture of asking for bills while purchasing goods has not developed so far. Until the bills are not issued, VAT cannot be effective.

At the time when VAT was introduced, the government had launched campaigns through TV, radio and newspapers to educate the public. The efforts to educate the public should be continuous. At present, the Inland Revenue Department through the media has been creating awareness among the consumers on their need to ask for the invoice for purchases. The advertisements and hoardings have been quite successful in convincing the customers of their rights and how the vendors have exploited them. Thus, the vendors will be bound to issue invoices.

2. Educating Taxpayers:

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

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

3. Decreasing the Custom Duties:

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

4. Simplifying the Refund System:

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

Even now, the question that arises is “Why is the number of refund claims so low as compared to the potential number of refund claims?” The reason may be any of the following:

- i. Taxpayers do not have confidence in the refund system since they already have faced a lot of hassles in the past while trying to get the money back.

ii. Taxpayers do not want their records audited due to the fact that they have not been maintained properly.

iii. Taxpayers do not have enough knowledge about the refund system.

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

5. Increasing Administrative Efficiency:

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

4.2.9 Appropriation of Legal Provisions

Nepalese VAT administration has been suffered 11 years of implementation. The legal provision is closely related to VAT administration. Now, the vat act and rule/regulation have not covered the increasing trading and improving business. So the respondents are requested for giving their opinion about legal provision. That is given in following table.

Table 4.18

Respondents	Appropriate		Not appropriate		I don't know		Total
	No.	%	No.	%	No.	%	
Businessmen	10	50	7	35	3	15	20
Tax experts	6	60	4	40	-	-	10
Customers	10	50	6	30	4	20	20
Total	26	52	17	34	7	14	50

Source: Field Survey

According to field review 50% Businessmen, 60% tax administrators, and 50%, Customers were agreed that legal provision of VAT is appropriate. Similarly, 35% Businessmen, 40% Tax experts, and 30% Customers were disagreed about legal provisions of VAT. Out of total respondents, 52% agreed about legal provision, 34% disagreed and 14% are unknown about these matters.

4.3 Findings of the Study

Value added tax is the alternatives of sales tax on ground of revenue productivity, equity norms, supporting economic growth without economic distortions, export promoting, price stability and neutrality on production and distribution etc. Further the hypothesis of self-policing or cross-checking channel without cascading and pyramiding effects has made the VAT „mile-stone“ in the history of reforming of the indirect tax system. The major findings of this study are as follows:

4.3.1 Findings from Primary Data

- J VAT has been most essential alternative of different tax reform programs for developing like Nepal. It leads to revenue enhancement, transparent and scientific tax system. There will be vital scopes for increasing the revenue from VAT in coming days.
- J It is equitable than the taxes to which is replaced because of its single and normal tax rate. Its effect on revenue mobilization is positive because of its broaden tax base, transparency, discourage tax erosion features.
- J Out of the total respondents, about 46% attributed the taxpayers for tax evasion in Nepal and this seems to be very much true. About 40% blamed inefficient administration was responsible for tax evasion in Nepal Similarly about 14% respondent blamed tax administrator is responsible for tax evasion in Nepal.
- J Billing system is one of the major aspect of the effective implement of VAT but businessmen hardly issue bill to consumers, consumers too are not much interested in taking bills due to miss-concept of increase in the price of goods such practice has discouraged the consumers to demand VAT bill and is the root cause of the failure of the billing system. , it is found that all tax experts advocate for the possible of billing system in VAT system. 50% businessman claimed that billing system is possible at the same time 30% argue that it is impossible and 20% are unknown about it. 25% consumers says that there is possibility, 50% say impossible and 25% say I don't know.
- J 40% tax experts, 70% businessmen and 60% customers claiming that there is a raise in price because of VAT system. While 60% tax experts, 20% businessmen and 25% customers says that there is no raise in price similarly 10% businessmen, 15% customers unknown about it.
- J Administrative inefficiency as the major problem similarly lack of public awareness, proper accounting, co-operation by businessmen, and information to taxpayer is also responsible for smoothly progress VAT system in Nepal.

Geographical problem and non issuance of invoice is the obstacles in proper implementation of VAT in Nepal.

-) 50% Businessmen, 60% tax administrators, and 50%, Customers were agreed that legal provision of VAT is appropriate. Similarly, 35% Businessmen, 40% Tax experts, and 30% Customers were disagreed about legal provisions of VAT. Out of total respondents, 52% agreed about legal provision, 34% disagreed and 14% are unknown about these matters.
-) 80% of the total respondents provided their view regarding superior of VAT over sales tax. 10% of total respondents are opposite of that question and 10% respondents unknown about this view. In the above table show 100% Businessmen, 80% Tax experts and 60% Customers agreed about the superior of VAT over sales tax. Like this 20% Tax experts and 15% Customers said that it is not superior to sales tax. Similarly 25% Customers agreed unknown about this question

4.3.2 Findings from Secondary Data

-) In the current context of Nepal, the share of tax revenue has been greater than share of non tax revenue.
-) In developing countries like Nepal, indirect tax plays more significant role for internal resources mobilization which is now the principle source of revenue collection. The average ratio of indirect tax revenue to total tax revenue is 80.31% and direct tax revenue to total tax revenue is 19.69% during the studying period.
-) The direct tax structure and customs duties are the chief contributors to revenue collection. However, VAT is growing to be the major contributor in total indirect tax revenue.
-) The contribution of VAT revenue to total revenue is in increasing which is beneficial for sound economic development. In F/Y 2002/03 the revenue

collection from VAT was merely Rs 13459.70 million which has now increased to Rs. 54920.80 million in the F/Y 2009/10. Average collection from VAT is 14636.8 million, with a significant contribution to total revenue.

-) Comparisons of ratio of VAT with other significant statistical variables have revealed us the increasing significance of VAT revenue collection in Nepalese economy. Though slight irregularities in the increasing trend has been revealed there are more likely to have been resulted by the effects of people's revolution and some obvious loopholes in the government's policies.

CHAPTER - FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

As the final chapter of the study, this chapter briefly deals the summary and conclusion of the study and endeavors to offer various recommendations to implement VAT effectively in the future.

5.1 Summary

The study has been carried out and having the main objective to examine the application and performance of VAT and to identify the major problems of effective VAT implementation and provide their possible corrective measures. To achieve those objectives, tables and figures with 8 years data have been presented for analyzing the collected data, opinion survey has been done and questionnaire developed by the researcher.

The study has been divided into five chapters. They are Introduction, Review of Literature, Research Methodology, Presentation and Analysis of Data and Summary, Conclusion and Recommendations. In the first chapter, background of the study, taxation and economic development, statement of the problem, objectives of the study, significance of the study, limitation of the study and organization of the study have been discussed. Therefore, this chapter highlights the basic aims and outline of the study.

In the second chapter, introduction of VAT, origin and development of VAT, principles of VAT, types of VAT and methods of calculating VAT have been discussed under conceptual framework. Similarly, needs to introduce VAT in Nepal, development of VAT in Nepal, legal provisions of VAT in Nepal, tax rates, coverage, exemption and zero-tax rating have also been discussed in this chapter. And, finally, books and journals and earlier dissertations related to this study have been reviewed.

The third chapter has briefly explained about the research design, nature and sources of data and the statistical procedure and tools, which have been used to conduct the research.

In the fourth chapter, trend and composition of total revenue, tax revenue, direct tax revenue, indirect tax revenue, total revenue, tax and non-tax revenue in GDP, direct and indirect tax revenue as percentage of GDP, share of VAT revenue in total

revenue and in GPD have been presented with the help of tables and figures and analyzed under tax structure of Nepal. Similarly, registrations, VAT revenue performance, composition of VAT revenue and administrative situation of VAT have been discussed under current status of VAT in Nepal. VAT and single rate, tax evasion, inflation problems relating to VAT and its prospects in Nepal, and success or failure of VAT in Nepal have been explained with the help of opinion survey. And, finally, the major findings of the study have also been included in this chapter. The fifth and final chapter has consisted the summary of the four earlier chapters, tried to fetch out the conclusion of the study and attempted to offer various suggestions and recommendations to implement VAT effectively.

5.2 Conclusion

Taxation and economic development are interrelated. Taxation has an important role in country's economic development. In recent decades, many developing countries around the world have begun to focus their attention on reforming their poorly designed and defective tax structures as an integral part of their development efforts. Such reforms have broken some older leanings and estimated some new trends and axioms.

VAT in Nepal was introduced as a major parts of the overall tax reform program initiated in the early 1990s. it has been spread all over the world with in a short span of time. It has gain popularity that any tax system had gained earlier in the history of taxation in such a short period.

The conclusion of this research study is that the good performance VAT entirely depends on its implementation aspect. VAT has bright prospects in Nepal only when it can be implemented in a successful way. Further, the successful implementation depends on the strong, fair and capable administration, strong political commitment, cooperation between private sector and public sector,

cooperation between custom offices and Inland Revenue offices, systemization of open border, high public consciousness level, transparency and improvement of rules and regulations accordingly over time. Thus, VAT can be entrenched as an integral part of the Nepalese tax structure in the long run. With some fundamental reforms in policies, a more serious government concern following political stability, Nepal will also not be a country of exception in the line of successful VAT implemented countries in the world. In spite of these possibilities, the study has brought forward some key challenges persisting to effective implementation of VAT system. From the study of various data trend and experience of VAT offices shows the following problem: There may be weak owing to the lack of practice of issuing and receiving invoices. Similarly there may be problem of under invoicing at the customs has not been reduced.

-) There may be misunderstanding between tax payer and Tax expertsinistrator for refund of tax. One blame the VAT system has not been put in to proper practice while other complain that there is refund owing to the fact that the tax payers don't even comply with simple formalities.
-) There may be lack of publicity and effective monitoring. In the implementation of VAT the main glitch has been in terms of the lack of public awareness. Until a time when a situation is created where the consumer himself/herself, it will be an uphill road for VAT.
-) The fragile political situation and economic slowdown may be the cause of implementation VAT effectively.
-) A weak and unmotivated Tax expertsinistrator may be the cause of ineffective implementation of revenue collection. There is many positive remained vacant for a long time public service commission, high turnover of officers by the public service commission, high turnover of personal and

general disinterest in VAT as the VAT administration was considered the least attractive in the revenue administration.

-) In the absence of invoice/proper invoice, it is not possible to maintain proper accounts. In some causes vendors are maintaining two set of accounts; i.e. one for their business purpose and another for tax purpose.
-) Lack of proper book keeping has resulted in a discouraging status of returns, which can be seen from the excessive number of credit return.
-) Some public enterprises have not been depositing the VAT collection in the treasury due to their liquidity problem and some taxpayers do not pay VAT due to their large credit sales and so on.

According to researcher and interviewed person, in the first two years, since many compromises were made in the principles of VAT due to political instability and frequent change in government economic slowdown. VAT could not be fully implemented. In our environment where the tax awareness is minimal, the practice of maintaining tax accounts is negligible or improper, smuggling and under valuation is rampant and tax leakages take place with negotiations between the tax payer and the political instability only aggraded the situation and made it more complex. Until these trends are resolved, there will not be significant VAT collection have been eliminated.

5.3 Recommendation

Despite the existing constraints and oppositions, Nepal has implemented value added tax (VAT) since 1997. VAT Act, rules and regulations have been set up in the line of international standard and its preparation had been made comprehensive and much more extensive as compared to the other taxes. This preparation has assisted towards creating a favorable environment for the implementation of VAT and VAT is now gaining gradual acceptance of the

business community and general public at large scale.

Though the implementation of VAT is a great jump from the traditional tax system to a modern one, several things are still tacking to be done for the successful implementation of VAT in Nepal. In such circumstances, following recommendations have been made to make VAT effective and more efficient on the basis of findings and conclusion of the study.

1. Most of the taxpayer as well as general public are still unknown about the VAT and its effects on various aspects. They have developed a kind of misconceptions regarding to VAT. They do not think that sellers already include VAT in his goods price rather they do think VAT is an extra charge. So, proper publicity for all related persons is the fundamental tool to success of VAT. Tax related information should be published regularly through journals, magazines, newspapers, pamphlets, radios, television, etc. Interview programs with professors, researchers, tax experts and economists should be conducted and published through advertising media.
2. An effective computer program for invoicing and record keeping according to need of VAT should be developed and provided to different businessmen at nominal cost. Concentration must be given to apply the billing system in all business. Similarly, government should give the continuity the special gift program. Reward and punishment system must be strictly followed.
3. VAT is a transparent system at tries to make transparency. Revenue department should be transparent. Tax evasion and avoidance must be checked by various monitoring system like cross-checking, good governance program.
4. The key to the success of VAT implementation is now Nepal government should arrange the staff positions. The Ministry of Finance must bear in mind that in the absence of dedicated and committed staffs with a positive attitude, the system will not succeed. As customs and income tax administration get high preference in the internal position, the ministry must come out with some

institutional arrangements which retain qualified staffs in the administration of the VAT. Otherwise, there is a danger, which is a current saying, that why should be businessmen kill the VAT, the staff in the VAT will kill it themselves. So that the government should produce Gazzetted manpower and to train them well.

5. There should be a close cooperation between the private sector and public sectors for the successful implementation of VAT. Both sectors should always be taken into confidence by each other.
6. Border should effectively be controlled to prevent the illegal trade. There should be a border tax adjustment between Nepal and India, warehouse checking and highway checking should be practiced effectively to prevent any kind of illegal trade.
7. Finally, the effective and efficient implementation and development of VAT is only possible when there have fair understanding among the government, tax administration, taxpayers, and other concern parties. So that they must have committed, dedicated and self-motivated to implement VAT in future prospect.

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- f) Provision for tax on capital gain and dividend. (....)
- g) Provision of resident and non resident person. (...)
- h) Authorities and responsibilities of tax administrators and tax payers. (....)
- i) Other: (Specify)
- 5) Is there effective and efficient utilization of collected tax revenue in Nepal?
- a.) Yes (.....) b.) No (.....)
- If no, what should be the main cause?
- (Prioritize):
- a) Too much corruption. (.....)
- b) Wasteful Government expenditure. (.....)
- c) Problem in Implementing Programs. (.....)
- d) Defective administrative policies. (.....)
- e) Poor monitoring mechanism. (.....)
- i) Other: (Specify)
- 6) The trend of income tax collection before and after new act is not uniform.
- Why do you think to be so?
- a) Provisions of new act
- b) Effect of Change
- c) Other reasons than act such as conflict.
- 7) How is the income tax system in Nepal in your opinion?
- a) Sound and efficient b) Satisfactory c) Poor
- 8) How is the income tax Administration in Nepal in your opinion?
- a) Effective b) Satisfactory c) Poor
- 9) What change should be made in rules and regulation in your opinion to make income tax system more effective?
- a) No change
- b) Timely general changes in rate, amount and limit.
- c) Structural change in act and regulation.
- 10) How can be improved the effectiveness of tax administration system?

- a) No change
- b) General improvement such as decentralization and delegation
- c) Evolutionary change

11) How tax administration staffs can be made more responsible and energetic?


- a) Providing different incentives and trainings
- b) Tight rules and regulation in service
- c) Nothing is required

12) What is the most suitable way to make taxpayers more responsible?

- a) Awareness through media
- b) Harder provisions in rules
- c) Incentives such as prize and respect.
- d) Nothing is required

13) You have any other comments and suggestions about income tax in Nepal?

Please specify
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 Thank you for your kind Co-operation 