

CHAPTER I

INTRODUCTION

1.1 General background

Nepal has been trying to enter into a new era of economic change. In developing country like Nepal, government needs to perform various functions in the field of political, social and economic activities to maximize social and economic welfare. In order to perform these duties and functions government requires large amount of fund.

Now days, the prime concern of every nation of the world is rapid economic development and Nepal is not exception to this ever-continuing process. For the economic development, government has huge responsibility towards the people to fulfill the responsibility of government towards the people; government has to spend a lot of money. The responsibility may be either for security or health or education or other developmental activities. Government spends a lot of funds for protection of common people and for the creation of various socio-economic infrastructures. The main objective of government of any developing country is to improve living standard of people through the development process. In order to uplift the life standard of people, Nepal has given first priority of economic development through planned efforts and government has continued the implementation of several reform programs initiated in the past. Resource mobilization is the foundation for economic development of the nation. If the nation has sufficient funds, it will be able to achieve maximum social welfare. For the fulfillment of country's need, government expenditure is increasing year by year. Government expenditure is increasing because of demand of time, population growth, defense, increase in national income, Government subsidies, Debt servicing, expansion of administrative machinery, Development projects, urbanization, Industrialization, economic incentives, social progress, increase in price and so on, to meet the growing public expenditure; the government has to manage its fund. The government can mobilize both internal and external financial sources to bridge its expenditure. External sources of funds are more important for undeveloped and under developed countries like Nepal, but, these sources are uncertain, inconvenient and not good for the healthy development of nation. Continuous uses of external sources of fund are not good as it reduces the liquidity position of the government. The internal sources are more preferable to external one for sustainable economic development. External sources of funds are foreign grants and loans. This kind of funds is received from foreign countries

and international organization. Internal sources can be classified broadly into two groups i.e. Tax Revenue and Non-Tax Revenue.

Tax Revenue includes direct tax on income, corporate tax, capital gain tax and wealth tax and indirect tax on consumption. Whereas the revenue obtained by the government from sources other than tax is called Non-Tax Revenue. The sources of non-tax revenue are: - government fees, fines and penalties, Surplus from Public Enterprises, Special assessment of betterment levy, Grants and Gifts, dividend and royalties and so on. The non-tax income is important in raising revenue. Non Tax Revenue includes all revenues other than taxes, accruing to the Government. These are internally generated funds. Thus, the tax system plays an important role in generating Public Revenue.

In this modern age, a government entails a lot of revenues in order to influence the macroeconomic performance of the economy or fiscal policy, to carry out functions of the government such as national defense and to redistribute resources among individuals or classes in the population. In this context, a tax is a significant and inseparable source of state Revenue of the government. According to its nature it is most reliable, certain, flexible, and convenient to obtain the required amount. Therefore, the government of any country upholds the main priority in tax revenue.

Taxation has become one of the important resource mobilizations to meet the financial requirement of the government. To fulfill the government responsibility towards the people, government has to spend a lot of money. The responsibility may be either for security or health or education or other development activities. In order to carry out above mention activities, a nation requires sufficient funds, the government collects required fund from two sources: debt and revenue. The revenue of the government comes basically from two sources tax and non-tax. Income tax, property tax, values added tax and other direct and indirect tax are fall under the head of tax revenue. In Nepal around 70% of the government revenue comes from taxation. Hence tax is a major source of government revenue. Tax can be classified into two groups. They are direct and indirect tax.

1. Direct Tax: The term direct tax generally means a tax paid directly to the government by a person or organization on whom it is imposed. A taxpayer pays a direct tax to a government for different purposes, including real property tax, personal property tax, income tax or taxes on assets. A direct tax cannot be shifted to another individual or entity. The individual or organization upon which the tax is levied is responsible for the fulfillment

of the tax payment. Tax is a compulsory burden to the people who have taxable income .It is the major source of government revenue .In other words tax is any compulsory levy from individuals, householders and firm to central or local government. A person or entity having taxable income is liable to pay tax without expecting any direct benefit from the government. Tax is computed and paid as per prescribed in the law.

2. Indirect Tax: Indirect taxes are those taxes which are paid in the first instance by one person and then are shifted on to some other persons. The tax imposed is on one person but the impact is on the other. It is levied on the goods and services. The business persons collect the taxes from the consumers and pay the amount to the government. Value Added Tax (VAT), excise duty, Entertainment Tax, Hotel Tax, Export and Import duty etc are some of the examples.

Hence, both direct and indirect taxes are essential to bring adequate revenue to the state for meeting the increasing public expenditure. Both taxes are essential to promote economic growth, fill employment and economic stability. Direct and indirect taxes should side by side & balance each other. However in developing countries, direct taxation has limited scope and hence indirect taxation plays a more significant role. A well oriented system of taxation requires combination of direct & indirect taxes in different proportions.

1.2 Introduction of Value Added Tax (VAT)

Tax becomes the main source of revenue of the state. Value Added Tax is the latest innovation in the field of taxation. VAT is considered as the reform tax system of the 21st century, which has already been implemented popularly in more than 135 countries in the world. VAT is multi staged, commodity and services based tax which is levied on the value added of business at different stages of production and distribution. It is imposed on different stages. It imposed on value of goods and services. The value added tax is indirect tax depends upon consumer. (*Source: System of Value Added Tax in Nepal- An Overview*)

The VAT is broad -based indirect tax. The term value added tax is not universal. The term exists, in English form value-added tax. It is nearest from the French Term added value tax. But it is not familiar as Value Added Tax. In some states, the term VAT is preferred to say

as 'goods and services tax'(GST). However the VAT is most familiar word. It is a modern tax system intended, when fully operational, to improve the collection of taxes, to increase efficiency and to lessen tax evasion. The value-added tax is not perfectly new form of taxation. It is a commodity based refined form of sales tax. In other words, it is improved and modified form of sales tax that is escaped from cascading effect. Except few exceptions it is levied on value added at each stage in the process of production as well as distribution. These stages may be as import, manufacturing wholesale and retail. The value added for the firm is the gross receipts from sales minus all expenditure on goods and services purchased. From economic point of view, a properly implemented value added tax is equivalent to a corresponding single stage tax. The unique nature of VAT is its potential scope in identifying and taxing the economic contribution or added value made by any economic operator in connection with any activity of a business or any commercial nature.(Source: <http://narecnepal.org.np/?p=54>)

In Nepal, Value Added Tax (VAT) was introduced on 16th Nov.1997. This tax was levied in place of the Sales Tax, Hotel Tax, Contract Tax and Entertainment Tax. However, it could not be implemented fully until the FY 1998/99 due to political instability and strong opposition from the business community. (VAT) is a broad-based tax as it also covers the value added to each commodity by a firm during all stages of production and distribution. It is a modern tax system to improve the collection of taxes, to increase efficiency and to lessen tax evasion. It is also regarded as the backbone of income tax system in Nepal. (Source: <http://www.ird.gov.np/ird/index/content-36-7.html>)

Value Added Tax (VAT) is nothing but a general consumption tax that is assessed on the value added to goods & services. It is the indirect tax on the consumption of the goods, paid by its original producers upon the change in goods or upon the transfer of the goods to its ultimate consumers. It is based on the value of the goods, added by the transferor. It is the tax in relation to the difference of the value added by the transferor and not just a profit.

All over the world, VAT is payable on the goods and services as they form a part of national GDP. More than 135 countries worldwide have introduced VAT over the past 3 decades. It means every seller of goods and service providers charges the tax after availing the input tax credit. It is the form of collecting sales tax under which tax is collected in each stage on the value added of the goods. In practice, the dealer charges the tax on the full price of the goods, sold to the consumer and at every end of the tax period reduces the tax

collected on sale and tax charged to him by the dealers from whom he purchased the goods and deposits such amount of tax in government treasury.

Value Added Tax was first introduced in France in the year 1954 and its scope was expanded to include services in 1978, agriculture in 1983 thus resulting in Value Added Tax becoming one of the most important accounting innovations in the present century. It is presently adopted by over 115 countries all over the world. VAT is the abbreviated form for Value Added Tax. For this purpose, Value Added is to be understood as “the value that a producer (whether a manufacturer, distributor) adds to his raw materials or purchases before selling the new or improved product or service to the user. The tax was first proposed by Dr. Wilhelm Von Siemens for Germany in 1919. The income tax, excise duty and customs duty constitute the major sources of tax revenue to the central government; the state government substantially depends on sale tax as the main source of revenue. It is implemented on all products related to food and beverages, medicines, transportation, telecommunications, amusement parks, cinema halls, properties owned etc.

Value added tax was first introduced by Maurice Maure, a French Economist and the joint director of the French tax authority in 1954. Though this tax system was first applied in France, it was soon adopted by a number of other European and Asian countries. So, it has become the main source of revenue of the state. (Source: *Journals-Recent Vat Data, Rabindra Tripathi, 2011*)

VAT is the recent innovation in the field of taxation in Nepal. Despite all the constraints and obstructions from the business communities. VAT was introduced in Nepal on 16th November, 1997 with the objective of increasing revenue mobilization by broadening the tax base and of instilling neutrality, efficiency, fairness and transparency in the administration. It was launched in place of the four different taxes, namely sales tax, contract tax, entertainment tax and hotel tax. In Nepal, consumption type VAT is being implemented. (Source: *Kamal Koirala, 2011*)

It is not a charge on companies. It is charged as a percentage of prices, which means that the actual tax burden is visible at each stage in the production and distribution chain. It is collected fractionally, via a system of deductions whereby taxable persons can deduct from their VAT liability the amount of tax they have paid to other taxable persons on purchases for their business activities. This mechanism ensures that the tax is neutral regardless of how many transactions are involved.

In other words, it is a multi-stage tax, levied only on value added at each stage in the chain of production of goods and services with the provision of a set-off for the tax paid at earlier stages in the chain. The aim is to avoid 'cascading', which can have a snowballing effect on prices. It is assumed that due to cross-checking in a multi-staged tax; tax evasion will be checked, resulting in higher revenues to the government.

VAT is multi staged, commodity and services based tax which is levied on the value added of business at different stages of production and distribution. It is imposed on different stages. It imposed on value of goods and services. The value added tax is indirect tax depends upon consumer. VAT is a broad based tax as it also covers the value added to each commodity by a firm during all stages of production and distribution. It is a modern tax system which enables to efficient collection system, to increase efficiency and to reduce tax evasion. It is also refereed as the backbone of income tax system in Nepal. (*Source: Wikipedia*)

In Nepal, **Value Added Tax (VAT)** was introduced on 16 Nov. 1997. VAT replaces the old Sales Tax, Contract Tax, Hotel Tax and Entertainment Tax. VAT replaces the old Sales Tax, Contract Tax, Hotel Tax and Entertainment Tax. It is believed that successful implementation of VAT will helps to generate customs duties and income tax also and it is expected to enhance the revenue collection and it is closely associated with the GDP. This Act classifies goods and services under three category they are Vat-able goods and services, exempted goods and services and zero rated goods and services. It is applied at a single rate (presently 13%, initially 10%) based on addition of value of the goods and services at each stage in the process of supply and delivery of goods and services. VAT is multi staged, commodity and services based tax which is levied on the value added of business at different stages of production and distribution. It is imposed on different stages. It imposed on value of goods and services. The value added tax is indirect tax depends upon consumer. VAT is a broad based tax as it also covers the value added to each commodity by a firm during all stages of production and distribution. It is a modern tax system which enables to efficient collection system, to increase efficiency and to reduce tax evasion. It is also refereed as the backbone of income tax system in Nepal. VAT plays great role in the revenue mobilization in Nepal. The reason behind VAT system, it makes transparency in all

kinds of transaction, helps to make the wide area of tax and discourages tax evasion. Land Revenue Tax which was supposed to contribute 95% of revenue to the government formerly & Land and Housing Tax, the only property tax of Nepal is shifted to the local authorities/ elected bodies for the collection. So the government of Nepal introduced VAT system. So it is needless to say that VAT is the most important sources of the government revenue. VAT applies to supplies of goods and services for consideration other than exempt goods by taxable persons. VAT is collected by taxable person. A taxable person is entitled to deduct the input tax from the tax collected by the sales. Similarly if the input tax exceeds the tax collected, the taxpayer may adjust in any tax payable. After adjusting it, if any tax amount remains, taxpayer is entitled to deduct from tax payable in next month. VAT Act has made provision regarding tax refund also. Conditions and procedures of tax refund are also stipulated in the VAT Act. Thus because of many features and contribution future prospects of VAT is good enough. From the past experiences of VAT in Nepal, it would show the clear picture of its incoming future as well. (*Source: Inland Revenue Department*)

In a conclusion, VAT is based on the principle of self assessment system. The Value Added Tax (VAT) is a general, broad based consumption tax assessed on the value added on the goods and services. It applies more or less to all goods and services that are bought and sold for use or consumption in the community. Thus, goods which are sold for export or services which are sold to customers abroad are normally not subject to VAT. The success of the VAT system depends upon the proper account keeping, registration of business, effective billing system and so on. Among the factors, non awareness of consumers is one of the main reasons of failure of billing system.

For VAT purposes, a taxable person is any individual, partnership, company or whatever which supplies taxable goods and services in the course of business. However, if the annual turnover of this person is less than a certain limit (the threshold), which differs according to the member state, the person does not have to charge VAT on their sales. Transparency is the most feature of VAT that will help to control the tax evasion.

1.3 Statement of the problem

Nepal, particularly being a trading community, has always believed in accepting and adopting loopholes in any system administered by State or Centre. If a well-administered system comes in, it will not only close options for traders and businessmen to evade paying

their taxes, but also make sure that they'll be compelled to keep proper records of sales and purchases.

Under the VAT system, no exemptions are given and a tax will be levied at every stage of manufacture of a product. At every stage of value-addition, the tax that is levied on the inputs can be claimed back from tax authorities.

VAT plays great role in the revenue mobilization in Nepal. The reason behind VAT system, it makes transparency in all kinds of transaction, helps to make the wide area of tax and discourages tax evasion. So it is needless to say that VAT is the most important sources of the government revenue. VAT was implemented after several preparations program such as publicity, campaign, workshop, training advertisements, publication of articles discussion on radio and television, commenced various booklets and other materials were published. In this process only the positive aspect of VAT were discussed and publicized. The negative aspects were not taken into consideration. So that shortcoming that can enter on the process of VAT implementation could not be discussed. The culture of doing business without maintaining proper books of accounts or maintaining multiple sets of books of accounts have made implementation of VAT difficult. VAT has some difficulties in the administrative aspect as well. Only a good tax system is not sufficient to make the revenue collection procedure effective, effective implementation of the system is also necessary. VAT is a scientific, simple and very good tax system. However there are so many problems regarding implementation of VAT system. It has been about 13 yrs of VAT implementation in Nepal , but there are so many problems in its effective implementation. Implementation of VAT was not easy in the initial days. It was a matter of great debate. Even after the enactment of law, there were a lot of constraints and difficulties in introducing and implementing VAT in Nepal. A large number of entrepreneurs, traders and business communities were against VAT system. The initial two year of VAT implementation was very turbulent. Now it has become familiar and VAT is currently well accepted by the consumers as well as business and industrial communities of Nepal. This is account based tax system that leads to transparency and accountability on the both part of tax payers and tax collectors. The present situation of VAT shows the need for understanding and commitment at the general taxpayer level, political level, and motivated tax administration, serious study of the negative aspects of the new tax system and honest and earnest attempts and environment to tackle the problem in order to make any tax

system revenue productive. It seems its right time to make an assessment the VAT by identifying it's problems that has been arisen are going to be arises in the due process of effective implementation and prospects of revenue mobilization through VAT in the country. How better is the system, if proper implementation is lacking there will be no benefit of the system. At present, the issues have become the effective implementation of VAT system in Nepal. It is not matter that VAT should be removing but the implementation aspect should be managed. VAT regime is extremely challenging in a burgeoning economy like Nepal. Resistance from the business community, ignorance of general people, lack of full support and commitments from the politicians and government officials forced the authority responsible for implementing VAT to make compromises on various aspects of VAT which has weakened the process of its implementation right from the beginning. The attitude of businessmen and tax administration also appear hostile to the effective implementation of VAT in Nepal. It is the most advance and scientific system of tax. Therefore Effective implementation of VAT system is necessary in Nepal. So the study tried to find out the major circumstances and obstacles that are faced in the implementation of VAT in Nepal. For the successful implementation of VAT system, it needs well trained personnel, proper account keeping, proper billing system etc. and of course, the registration is also an important factor. There are so many problems and challenges regarding implementation of VAT in Nepal. Now it is the time to review the existing provisions and problems which are the subject matter of this study.

1.4. Objectives of the study

If the tax is considered on a retail level, it offers all the economic advantages of a tax of the entire retail price within its scope. The direct payment of tax spreads out over a large number of firms instead of being concentrated only on particular groups, such as wholesalers & retailers.

Under VAT only buyers at the final stage have an interest in undervaluing their purchases, as the deduction system ensures that buyers at earlier stages are refunded the taxes on their purchases. Therefore, tax losses due to undervaluation will be limited to the value added at the last stage. Secondly, under VAT, if the payment of tax is avoided at one stage nothing will be lost if it is picked up at later stage. Even if it is not picked up later, the government

will at least have collected the VAT paid at previous stages. Where as if evasion takes place at the final/last stage the state will lose only tax on the value added at that particular point.

VAT is selectively applied to specific goods & business entities. In addition, VAT does not burden capital goods because of the consumption-type. VAT gives full credit for tax included on purchases of capital goods.

Most taxpayers cheat on sales not to evade VAT but to evade their personal and corporate income taxes. Operation of VAT resembles that of the income tax and an effective VAT greatly helps in income tax administration and revenue collection. Therefore, the general objective of this study is to analyze the contribution of VAT in government revenue and challenges in its implementation (in the context of Nepal). The main objective of the study is to identify the problems in VAT implementation in Nepal and its effectiveness in Nepalese economy.

The specific objectives of this study are as follows:

- ❖ To present the existing trend of VAT registration.
- ❖ To examine VAT revenue collection.
- ❖ To analyze the problem of VAT implementation in Nepal.
- ❖ To point out the hurdles from the side of government in collecting revenues, especially VAT.
- ❖ To identify public view points towards VAT.

1.5. Significance of the study

The study has the following significance of VAT system.

- ❖ This study gives the present scenario of VAT implementation in Nepal. The significance of VAT to government revenue can be known from this study.
- ❖ This study analyzes the implementation, problems of VAT and its effectiveness in Nepalese economy.
- ❖ This study will also useful to the businessmen, policy makers, consumers and other related groups.
- ❖ This study will be valuable reference to the further researchers, who wants to carry on future research in this field.

1.6. Limitation of the study

While carrying out this study, to keep the research work viable, consequently planned, budget and time constraints, there are some limitations which are to be faced:

- ❖ Primary and secondary data both are going to be used so the validity and reliability may depend on the goodness of these data.
- ❖ For primary data collection Kathmandu valley has been selected purposively.
- ❖ Data is used from last five years so it won't explicit about before it.
- ❖ Primary data by questionnaire is collected from kathmandu only.
- ❖ Secondary data, primary information gathered from tax office, tax experts, businessman, tax payers and consumers are used in this study.

1.7. Organization of the study

This study has been categorized into five chapters. Prior to the body of the thesis, several pages of preliminary materials such as title page, Viva-voce sheet, Recommendation, Declaration of the researcher, Acknowledgements, Table of contents, List of tables, List of figures and Abbreviations used have been included.

Chapter I: Introduction

The first chapter is introduction which includes background of the study, Introduction of Value Added Tax, statement of the problem, objectives of the study, needs and significance of the study, and limitations of the study.

Chapter II: Review of literature

The second chapter is Review of literature which refers reviewing the research or other related published or unpublished literature, articles published in different economic journal, bulletin, dissertation papers, magazines, newspapers and websites in the related area's study, so that all possible relevant past studies, their conclusion findings and recommendation can be known through review of literature. The purpose of literature review is to find out what research studies have been conducted in one's chosen field of study, and what remains to be done. In other words review of literature is basically a stock taking of available literature in the field of research. It supports the research to explore the relevant and time facts for the reporting purpose in the field of study. In the course of research view of the existing literature would help to check the chances of duplication in the present study. This one can

find what studies have been conducted and what remains to go with. In brief this chapter includes conceptual framework and review of related studies

Chapter III: Research Methodology

The third chapter is Research Methodology. In order to achieve the objective of the study, appropriate research methodology has been adopted. It is purely explorative cum descriptive study. It includes the introduction, research design, nature and sources of data, data analysis tools, sampling procedure and definition of some key terms. The main objective of the study is to analyze, examine, highlight and interpret situation of VAT implementation, problem and its challenges in Nepal. Research methodology refers to the various sequential steps to be followed and adopted by a researcher in studying a problem with certain objectives in view.

Chapter IV: Presentation And Analysis of Data

The fourth chapter comprises presentation and analysis of data. This is the main and key chapter of research study. In this chapter sources of data are primary and secondary, which are presented in appropriate form. Analysis and interpretation of data have been performed thereafter. From this analysis and interpretation major findings have been deduced.

Chapter V: Summary, Conclusion and Recommendation

The fifth and the last chapter is concerned with the output of the study in the form of summary, conclusion and recommendation. This chapter consists of summary of the major findings of the study, concluding it with major recommendations and suggestions.

CHAPTER II

CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE

2.1 conceptual frameworks

2.1.1 Meaning of tax

Taxation is a payment levied by government for which no good or service is received directly in return - that is, the amount of tax people pay is not related directly to the benefit people obtain from the provision of a particular good or service. A government requires a lot of revenues in order to carry out the development plans, handle day to day operation, maintain peace and security and launch other public welfare activities. In this context, taxes are the most important and reliable sources of revenue of the government. It has become one of the important resource mobilizations to make the financial requirement of the government. It is a major source of government revenue. In general it can be defined as a levy or other type of financial charge or fee imposed by state or central government on legal entities or individuals. It is money which is the legal duty of every citizen to pay honestly to the government. It may be levied on income, property and even at the time of purchasing commodity. It is a liability which is contributed to the national revenue from the tax payers in a prescribed laws, rules and regulations.

Different persons have defined tax in different ways. In this respect, it would be better to take the definition given by Seligman. Tax is a compulsory contribution from a person to the government to defray expenses incurred in the common interest of all without reference to special benefit conferred.”(Seligman as cited in Kandel 2004). As the above definition, it can be said that firstly, a tax is a compulsory levy and those who taxed have to pay it without getting corresponding benefit of service or goods from the government. The taxpayer does not have any right to receive direct benefit from the tax paid.

Due to the compulsory nature people have expressed different views in satirical ways about the tax. Some says, “Nothing is certain in this world but death and taxes.” Some says, “Death and Taxes are both certain bit death in not annual.” While other says, “Death means stopping to pay tax.” (Kandel 2004). Here it should be noted that all compulsory payments are not taxes. For example; fines and fees are also compulsory payments without having any direct benefit to the taxpayers but they are not tax because their objective is not to collect revenue but to curb certain types of offences. Secondly, taxpayer cannot receive any quip pro-quo for the payment of the tax. The taxpayer does not receive equivalent benefit from the government. The tax is paid for the government for running public authority. In

case of tax, the amount is spent for common interest of the people. The tax is collected from haves and basically, spends for the interest of haves not in the society.

Findlays Shirras defined tax as “compulsory contribution to public authorities to meet the general expenses of the government which have been incurred for the public goods and without reference to special benefits.”(Source: Bhattarai &Koirala, 2068)

According to Prof. Seligman “Tax is a compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit conferred.” (Source: Bhattarai& Koirala, 2068)

In the words of Adam Smith “ A contribution from citizens for the support of the state.” (Source: Bhattarai & Koirala, 2068)

Similarly according to the Plehn “ Taxes are general contribution of wealth levied upon persons, natural or corporate to defray expenses incurred in conferring common benefits upon the residence of the states.” (Source: Bhattarai & Koirala, 2068)

In conclusion, it can be said that a tax is a liability to pay an amount to the state. The basis for the payment is that the assesses have income of a minimum amount from certain specified sources or that they own certain tangible or intangible properties or that they carry on certain economic activities or they consume certain goods and services which have been choose for taxation. One thing is noted that tax and taxes are not synonymous terms. Taxation is a device for imposing tax.

Essential elements of a tax

1. It is an enforced contribution.
2. It is generally payable in money.
3. It is proportionate in character.
4. It is levied on persons, property, or the exercise of a right or privilege.
5. It is levied by the State which has jurisdiction over the subject or object of taxation.
6. It is levied by the law-making body of the State.
7. It is levied for public purpose or purposes.

2.1.2 Principles of taxation

A number of important taxation principles arise in the study of public finance. These principles provide insight into causes and consequences of government taxation. A good tax system is pre-requisite to attain goal of required revenue. The principle of good taxation emerges since the start of the seventeenth century. The art of taxation is the art of plucking the goose so as to get the largest possible amount of feather with the least possible squealing. Likewise, the famous economist Adam Smith wrote “an enquiry into the nature and causes of the wealth of nations” in 1776 and mentioned four maxims of taxation.

Tax and expenditure policies reveal the fundamental ideology of a government and a political system. The government adopts various principles while formulating a good tax policy. These principles are referred to as the canons of taxation. The canons of taxation were first developed by Adam Smith as a set of criteria by which to judge taxes. They are still widely accepted as providing a good basis by which to judge taxes. Smith’s four canons as outlined in his book entitled “wealth of nation” are as follows:

1. Canon of equality:

The canon states that a good tax is that which is based on the principle of equality. In this principle it is maintained that the tax must be levied according to tax paying capacity of the individuals. Adam Smith has defined this principle as follows:

“The subject of every state ought to contribute toward the support of the government, as nearly as possible, in proportion to their respective abilities, that is, in proportion to the revenue which they respectively enjoy under the protection of state.”

This principle states that the burden of taxation should be fair and just. Thus, rich people must be charged higher taxes than the poor. The higher the income, higher the tax, lower the income lower the tax. Tax policy should not discriminate the persons with same income level.

2. Canon of certainty:

This canon states that the taxpayers should feel certainty regarding the time of payment, amount to be paid, methods of payment, the place of payment and the authority to whom the tax is to be paid. Every taxpayer must know the time of payment, manner and mode of payment, so that he may adjust his expenditures

accordingly. In the words of Adam Smith “the tax which is individual is bound to pay or to be certain and not arbitrary. The time of payment, the quantity to be paid, all ought to be clear and plain to the contributor and to every other persons”. Thus, certainty creates confidence in the contributor of the tax. On the other hand, uncertainty makes the tax system arbitrary and unfair to the taxpayers. If the tax is certain, no one can exploit taxpayers in any way.

3. Canon of convenience:

The tax should be levied and collected in such a manner that it provides maximum convenience to the taxpayers. The public authorities should always keep this point in view that the taxpayers suffer the least inconvenience in payment of tax. For Eg; land revenue should be collected at the harvest time. The income tax from the salary class be collected only when they get their salaries from their employers. To quote Adam Smith, “every tax ought to be levied at the time or in the manner which is most likely to be convenient for the contributor to pay it.” This canon helps to reduce tax evasion to a great extent.

4. Canon of economy:

The principle states that the collection expenses of tax should be less than the amount of tax collected so that a surplus to public revenue is generated and the country will be benefited. The amount that goes from the taxpayers pocket should not differ greatly with the amount that actually goes to government treasury. This principle also implies that a tax should interfere as little as possible with the productive activity and general efficiency of the community so that it may not create adverse effect on production and employment.

5. Canon of productivity:

This canon connotes that the fund raised through taxes should be utilized by the government in productive sector of the economy so that the taxpayers can see the utilization of their hard earned money paid as taxes. According to this principle, it is better to impose a few productive taxes than to go in for a large number of unproductive taxes. These unproductive taxes create complications both for the taxpayers, and the government. Therefore, tax must be imposed in a systematic way so that it may not discourage the productive capacity of the

individuals. Unfavorable taxes, usually, reduce the working efficiency which ultimately reduces the taxpaying capacity of the people.

6. Canon of Elasticity:

this canon signifies that the taxes should be levied in such a way the amount to be collected can be increased or decreased with the least inconvenience from time to time. In other words, the government can easily change the tax rates as per the need of the country. Instead of being rigid, tax rates should be made flexible to cope up with the changes in tax payers' income, properties and transactions.

7. Canon of diversity:

The tax system should not totally depend on one source of revenue. It is risky for the government to depend on a single source. The government should levy various taxes instead of imposing a single tax. The burden of tax should be scattered among different kinds of people. The burden of paying tax should not centralize on one group of people but it should be diversified in such a way that it ensures a smooth collection in different years.

8. Canon of simplicity:

This principle states that every tax should be simple and understandable to general public. There should be no administrative hassles. The tax payment procedure should not be too lengthy. If the tax system is complex and complicated, the taxpayers will have to seek the assistance of tax experts to understand its complications. This will bring irregularities and corruption.

9. Canon of neutrality:

The tax system should not affect badly to the production and distribution aspect of the nation rather it should facilitate them. The government should impose heavy taxes on harmful products and less tax or not tax on basic goods in such a way that the total tax revenue is not affected. The tax must not have any inflationary or deflationary effect on the economy.

10. Canon of co-ordination:

This canon of states that there should be coordination among various taxes raised in the country. Tax payers should not be imposed taxes of similar nature by various tax authorities (i.e. central government or local bodies).

2.1.3 Types and classification of tax

1. On the basis of structure

Proportional tax:

If tax is similar to all taxpayers, it is proportional tax through the tax rate is same, the amount of tax goes on increasing with the increase in tax base. A *proportional tax* is one in which income tax is the same percentage of income from every person no matter how much income the person makes. An income tax that takes the same percentage of income from everyone regardless of how much (or little) an individual earns.

There are arguments on both sides as to the merits and drawbacks of proportional taxes. One of the biggest arguments for proportional or flat taxes is that on their face they are the easily argued as the most "fair." Another argument is a flat tax provides more motivation for people to try and earn more, even at high income levels, because a person wouldn't lose more and more to taxes as he earned more and more money.

A proportion form of taxation to many seems quite fair as individuals pay according to their ability to pay. One point of view is that for the rich, based on the different high incomes, it is easier to pay off taxes because a smaller proportion of their income is spent on necessities. They therefore have more disposable income to spend on other goods/services also to invest within capital goods which said before may stimulate and benefit the welfare of the economy. Some may say that this system promotes a more fair and just society. Equity of taxation in this economy can be neutral. Increases in labor, which increases wages thereby increases income-taxes. The con for this system is that the government would receive less income tax. Less income tax therefore means that less would be available for government spending.

Advantage of proportional tax:

The aim of implementing a flat tax regimen is to make people pay a single tax rate. This would encourage people to pay taxes as there would be no differences in the rates applicable. Today, an individual earning more pays more and if the taxing system is changed to flat tax, it would encourage individuals to be more productive. A point to note here, exemptions are provided for people whose income is lower than a certain limit.

All forms of double taxation are removed if this system is followed. Taxes on dividends and capital gains are removed as they are incomes which after being taxed are again taxed. If these are removed, it would encourage people to invest, thereby creating more jobs. Implementation of flat tax would get rid of this part of the tax code and allow to report interest, dividends and other business tax at business level rather than at individual.

Today's tax system makes tax payers spend on resources, such as lawyers and accountant. On the other hand, flat tax system will help individuals to save on these expenses. It would consider the income generated within the national territory as taxable. Filing for flat taxes would become easy and fair. As per records, taxpayers spend more hours every year filing income tax returns. The time spent to find exemptions and loopholes is wasted and can as well be used on productive activities. Yes, no doubt the rich can spend a lot of money on hiring lawyers and accountants to evade taxes, but this money can as well be spent on investing somewhere else so that it generates more revenue for the country. Moreover tax evasions would be unlikely due to the lowered taxes.

As per the plan proposed, there would no difference in the rates between individuals and corporations, thereby removing loopholes which may be gained if you change the status of business. A lower rate of taxes would attract corporations from different countries and set up bases in the country, resulting in increase in the revenue for the country.

Disadvantages of proportional tax:

There has been a lot of opposition to implementing flat tax rates, the main reason being reduction in tax rates, which would mean that individuals who earn higher would pay less. This would drastically reduce government revenues. Taking into consideration that most of the revenue generated is from income taxes the loss would be huge. If there is a uniform tax rate for individuals and corporations, the government is likely to lose a huge amount of revenue. If there is no backup revenue source, it's likely to have a catastrophic effect. Even though there are associated benefits of reducing the tax rates, there is still an opinion among people that the rich should pay more.

Thus, there are several flat tax pros and cons, and there has been a lot of debate on the same. But from the overall debate it seems that implementation of this regimen would benefit the country as a whole.

Progressive tax:

If the rate itself of tax goes increasing with the increase in tax base, it is known as progressive tax. A [progressive tax](#) takes a larger percentage of income from high-income groups than from low-income groups and is based on the concept of [ability to pay](#).

The progressive income tax is effectively a means of income redistribution. Individuals who earn more pay higher taxes; those taxes are then used to fund social welfare programs that are used primarily by individuals who earn less. Critics of the progressive tax consider it to be discriminatory and believe that a flat tax system, which imposes the same tax on everyone regardless of income, is a fairer method of taxation.

Advantages of progressive tax:

-) The biggest advantage seen in a progressive tax is the wealthier individuals pay more of the tax burden. This protects the poorer classes from a heavy tax burden and also allows individuals who suffer a decrease in household income to lighten their tax burden. Proponents of a progressive tax also believe wealthier
-) Individuals should pay more for services provided by the government because the wealthy have the ability to pay for others from their wealth.

Disadvantages of progressive tax:

-) Opponents of the progressive tax system believe that progressive taxes are an invasion of individual rights because they are punished for their success. As they increase income and wealth, these individuals are constantly required to pay more in taxes. Because the taxes are then redistributed to poorer individuals through government aid programs, some see this as socialism. Some also believe progressive tax systems encourage off-shore banking, allowing high-income earners to hide their wealth from government taxes.

Regressive tax:

A tax which falls more heavily on people with low incomes than on those with high incomes, consumption of some commodities depends on the size of the family than on

income. The total revenue required by a modern state is so great that it cannot all be provided from direct or income taxes. All the indirect taxes imposed on the basic necessities are regressive in nature. It is the opposite of a progressive tax.

If the tax rate goes on decreasing with the increase in the ability to pay or tax base, it is called regressive tax. A tax that takes a larger percentage from low-income people than from high-income people. A regressive tax is generally a tax that is applied uniformly. This means that it hits lower-income individuals harder.

Few countries around the world employ the Regressive tax system. Regressive tax systems are favored by those who make a large income because a small proportion of their income is taxed. It is an incentive for many high net worth individuals. From a government point of view, the wealthy individuals have more disposable income to invest within the economy namely capital goods which in turn would stimulate it. On the other hand, those who make moderate or lower incomes have to pay a higher percentage of their income in taxes. A disincentive for low income earners.

Advantage of regressive tax:

1. Convenient: These taxes are paid in the shape of price of commodities. People pay these taxes when they buy commodities.
2. Increase in investment: The poor section of the economy bears the burden of these taxes. The aggregate demand increases which encourages the more investment.
3. No Evasion: The poor section of the economy is not in a position to evade these taxes.

Disadvantage of regressive tax:

1. All Taxes are not regressive: All indirect taxes are not regressive in nature. Many expensive articles that are taxed beyond the means of people in the lower income group.
2. In Justice: The tax burden decreases with increase of income. The incidence of tax is greater on poor than on the rich. Therefore it is unjust method of taxation.
3. Non Productive: These taxes are usually implemented on low priced commodities. These commodities are consumed by low income consumers. There is a discouragement in the production of these commodities.

2. On the basis of form

On the basis of shifting of burden, tax can be classified into two broad categories: direct and indirect tax.

Direct tax:

One of the most important and widely used classifications of taxes is direct and indirect taxes. A direct tax is a form of tax paid by a person on whom it is legally imposed. It is collected directly by the government from the person who bears the tax burden. Taxpayers need to file tax returns directly to the government. Therefore, direct tax cannot be shifted. The impact or the money burden and the incidence are on the one and the same person. It is equitable as it is imposed on person as per the property and income. It is flexible. The government can change tax rate with the change in the level of property or income. But with this it gives mental pinch to the taxpayers as they have to curtail their income to pay to the government. Tax payers feel inconvenience as the government imposes tax progressively. Income tax, Property Tax, Vehicle Tax, Interest Tax, Gift Tax, Casual Gain Tax etc are some of the form of direct tax.

Advantage of Direct Tax:

- (i) Direct taxes afford a greater degree of progression. They are, therefore, more equitable.
- (ii) They entail less expense on collection and as such are economical.
- (iii) They satisfy canons of certainty, elasticity, productivity and simplicity.
- (iv) Another advantage of direct taxes is that they create civic consciousness in people. When a person has to bear burden of tax, he takes active interest in affairs of state.

Disadvantage of Direct Tax:

- (i) It is easy to evade a direct tax than an indirect tax. Taxpayer is seldom happy when he pays tax. It pinches him that his hard-earned money is being taken by government. So he often submits false statements of his income and thus tries to evade tax. Direct tax is in fact a tax of honesty.
- (ii) Direct tax is very inconvenience because taxpayer has to prepare lengthy statements of his income and expenditure. He has to keep a record of his income up-to-date throughout the year. It is very laborious for taxpayer to prepare and keep these records.

(iii) Direct tax is to be paid in lump sum every year while income which a person earns is received in small amounts. It often becomes difficult by taxpayers to pay large amounts in one installment.

Indirect tax:

An indirect tax is a form of tax imposed on one person but partly or wholly paid by another. It is collected by intermediaries who transfer the taxes to the government and also perform functions associated with filing tax returns. Hence, indirect tax can be shifted. Indirect tax, the impact and incidence of tax are on different persons. In other words, “the person paying and bearing the tax is different.” Indirect taxes are those which are demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another. It is convenient as the taxpayer does not have to pay a lump sum amount for tax. There is a less chance of tax evasion as the taxpayer pays the tax collected from consumers. But, it is uncertain with the fluctuation in demand, the tax amount can also fluctuate. It is regretful as the tax burden to the rich and poor is same. VAT, Excise duty, Import duty, Export Duty etc are some of the examples of indirect tax.

Advantage of Indirect Tax:

- (i) It is not possible to evade indirect tax. The only way to avoid this tax is not to buy taxed commodities.
- (ii) They are more convenient because they are wrapped in prices. Consumer often does not know that he is paying tax.
- (iii) Another advantage of tax is that every member of society contributes something towards revenue of state.
- (iv) Indirect tax is also elastic to a certain extent. State can increase its revenue within limits by increasing rates of taxes.
- (v) If state wishes to discourage consumption of intoxicants and harmful drugs, it can raise their prices by taxing them. This is a great social advantage which a community can achieve from tax.

Disadvantage of Indirect Tax:

- (i) A very serious objection leveled against indirect taxation is that it is regressive in character. It is inequitable. Burden of tax falls more on poor people than on rich.

(ii) Indirect tax is also uneconomical. State has to spend large amounts of money on collection of taxes.

(iii) Revenue from indirect tax is uncertain. State cannot correctly estimate as to how much money will receive from this tax.

(iv) As tax is wrapped up in prices; therefore, it does not create civic consciousness.

(v) If goods produced by manufacturers are taxed at higher rates, it hampers trade and industry and causes widespread unemployment in the country.
stages of production and distribution.

2.1.4 Introduction of VAT

VAT is a general consumption tax assessed on the value added to goods and services. VAT is imposed on business at all levels of transactions. It means it is imposed at every level of transaction such as manufacturer, wholesaler, and retailer at their selling price. (K.c, 2008)

Value added tax (VAT) is known as the most recent and effective innovation in the taxation field. It is levied on the value added of the goods and services. Theoretically, the tax is broad based as it covers the value added to each commodity by a firm during all stages of production and distribution. Value added tax (VAT) is considered as one form of sales taxation. VAT is a multiple stage tax which has grown as a hybrid of turnover tax and retail level sales tax. Value added tax (VAT), however, differs from turnover tax as the turnover tax is imposed on the total value at each while VAT is imposed only on value added at that stage. VAT varies from sales tax in the sense that VAT is imposed at each stage of production and distribution whereas retail sales tax is imposed only at one stage, the final stage. VAT helps to minimize many problems related with tax evasion. Therefore, value added tax (VAT) is more productive and less destructive than retail sales tax.

Value Added Tax is a multi point sales tax with set off for tax paid on purchases. It is basically a tax on the value addition on the product. The burden of tax is ultimately born by the consumer of goods. In many aspects it is equivalent to last point sales tax. It can also be called as a multi point sales tax levied as a proportion of Valued Added. Value added tax or goods and services tax (GST) is a consumption tax on value added. In contrast to sales tax. VAT is neutral with respect to the number of passages that there are between the producer and the final consumer; where sales tax is levied on total value at each stage, the result is a cascade (downstream taxes levied on upstream taxes).By definition, exports are consumed abroad and are usually not subject to Vat; Vat charged under such circumstances is usually refundable. This avoids downward pressure on exports and ultimately

export derived revenue, a vat is an indirect tax, in that the tax is collected from someone who does not bear the entire cost of the tax.

VAT will replace the present sales tax in Nepal. Under the current single-point system of tax levy, the manufacturer or importer of goods into a State is liable to sales tax. There is no sales tax on the further distribution channel. VAT, in simple terms, is a multi-point levy on each of the entities in the supply chain with the facility of set-off of input tax - that is, the tax paid at the stage of purchase of goods by a trader and on purchase of raw materials by a manufacturer. Only the value addition in the hands of each of the entities is subject to tax.

Value Added tax, or VAT, is a tax that applies to most business transactions that involve the transfer of goods or services. Once when business turnover reaches a certain level the business will have to be registered for vat. This means that whenever business house buy or sell anything in course of its business it will have to charge Vat on its sales, keep proper vat records in its incoming and outgoing transactions and pay vat to respective inland revenue department (IRD). Even if the business turnover is below the registration threshold it could consider registering voluntarily for vat.

It is a modern tax system to improve the collection of taxes, to increase efficiency and to lesion tax evasion. It is also regarded as the backbone of income tax system in Nepal. The current threshold for vat registration is rupees two millions. Those vendors whose annual turnover is below the threshold can, however, register voluntarily.

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. Value added tax is the gross receipt from sales after subtraction all expenditure on goods and purchase from other firms.

“From the economist point of view, a properly implemented vat is equivalent to corresponding single stage tax, unlike the expenditure tax, the vat is not a genuinely new form of taxation but merely a sales tax administered in different form.”(Musgrave and Musgrave, 1976)

“Vat in its comprehensive form is a tax on all goods & services (except export and government services). Its special characteristics are being that it falls on the value added of each stage from the stage of production to retails stage.” (Indian taxation inquiry committee, 1993)

Value Added Tax (VAT) is a general consumption tax assessed on the value added to goods and services.

It is a general tax that applies, in principle, to all commercial activities involving the production and distribution of goods and the provision of services. It is a consumption tax because it is borne ultimately by the final consumer.

It is not a charge on companies. It is charged as a percentage of prices, which means that the actual tax burden is visible at each stage in the production and distribution chain.

It is collected fractionally, via a system of deductions whereby taxable persons can deduct from their VAT liability the amount of tax they have paid to other taxable persons on purchases for their business activities. This mechanism ensures that the tax is neutral regardless of how many transactions are involved.

In other words, it is a multi-stage tax, levied only on value added at each stage in the chain of production of goods and services with the provision of a set-off for the tax paid at earlier stages in the chain. The objective is to avoid 'cascading', which can have a snowballing effect on prices. It is assumed that due to cross-checking in a multi-staged tax; tax evasion will be checked, resulting in higher revenues to the government.

Over 130 countries worldwide have introduced VAT over the past three decades and Nepal is amongst the last few to introduce it.

India already has a system of sales tax collection wherein the tax is collected at one point (first/last) from the transactions involving the sale of goods. VAT would, however, be collected in stages (installments) from one stage to another.

The mechanism of VAT is such that, for goods that are imported and consumed in a particular state, the first seller pays the first point tax, and the next seller pays tax only on the value-addition done - leading to a total tax burden exactly equal to the last point tax. Therefore VAT is paid to the revenue authorities by the seller of the goods, who is the "taxable person", but it is actually paid by the buyer to the seller as part of the price. It is thus an indirect tax.

VAT, like other sales taxes is classified as an indirect tax because it is a consumption tax and borne ultimately by the final consumer. It is not a charge on business firms. VAT is charged as a percentage of prices, which means that the actual tax burden is visible at each stage in the production and distribution chain. It is collected fractionally, via a system of deductions whereby taxable persons can deduct their VAT liability the amount of tax they have paid to other taxable persons on purchases for their business activities. This mechanism ensures that the tax is neutral regardless of how many transactions are involved.

Value Added Tax (VAT) is unanimously acknowledges being a major reform in the direct taxation system for the following reasons:

It eliminates the cascading effect of taxes.

It promotes competitiveness of exports.

It has a simple and transparent structure and it improves compliance.

In Nepal the vat replaced the import/manufacturing level sales tax as well as the hotel, contract and entertainment taxes. This section highlights the rationale for the vat in Nepal.

Points out tax policy considerations that were important in the design of Nepalese vat system and describes the vat preparatory and implementation processes.

At present, the share of the total economy in Nepal that flows through market channels where indirect taxes can be administratively levied is relatively small. The potential tax base for all indirect tax systems is at best less than 25% of gross national expenditure (GNE). The potential tax base becomes even smaller when domestic trade taxes are collected at an early stage in the production and distribution process. Furthermore the large number of exemptions granted on sociopolitical grounds and a weak tax administration only aggravate the problem.

2.1.5 Advantages and Disadvantages of VAT:

Advantages of VAT:

1. VAT acts as check on tax evasion. Unless proper records are maintained availing credit is not possible under VAT. Hence VAT promotes maintenance of records thereby checking tax evasions.
2. VAT does not interfere in the decision of making purchases as the entire tax paid on purchases is allowed to set off. Thus VAT allows free play of market forces and competition.
3. VAT is a transaction based tax. It does not give room for interpretation thereby VAT tends to avoid confusion in the minds of the taxpayer.

4. It is a transparent tax. The buyer, the seller and also the Government is aware of the tax from the documentary evidence. Thus VAT helps the state government in taking decisions with regard to rate of tax.
5. VAT ensures better revenue collections and stability the revenue leakage to the government is minimum, as tax credit will be given only on the basis of proof of tax paid at the earlier state.
6. VAT promotes better accounting systems, as only proper accounting will ensure proper credit.
7. VAT does not have any impact on the retail price of the commodity the tax credit takes care of the cascading effect of prices due to tax.

Disadvantages of VAT:

1. VAT can be successful only when there is one rate applicable to all commodities and there is no exemption. If concessions are given the fundamental principle of VAT that it will eliminate cascading effect on price cannot be guaranteed.
2. VAT is transaction based it requires record keeping which increases the accounting cost. Small traders and firms may find it difficult to meet this cost.
3. VAT is charged on each value addition due to which there is a share of increase in working capital requirement.
4. VAT is a consumption tax i.e. the tax burden is on the final consumer. If the income spent on consumption is larger for the poor than for the rich VAT tends to be regressive.

2.1.6 Types of VAT

The types of VAT are determined on the basis of treatment of capital goods of a firm. Input tax paid for capital goods is allowed or not is the fundamental question in the study of types of VAT.

There are three different types of VAT. They are:

1. Gross Product variant
2. Income variant
3. consumption variant

Gross product variant

Under the gross product variant taxes paid on purchases of raw material and components alone is allowed as deduction. Taxes paid on capital goods are not allowed as deduction. This method is not in use, as it does not allow tax deduction of capital goods like plant and machinery on which the tax is large due to the price of the capital goods this method is discouraged, as it does not take into account all the taxes paid by the buyer.

Income variant

The income variant of VAT allows for deduction on purchases of raw materials and components as well as depreciation on capital goods. This method is also discouraged, as there is no one method by which depreciation can be calculated as depreciation always depends upon the life of the asset.

Consumption variant

The consumption variant of vat is the most popular method and is followed widely in many countries. This variant of vat allows for deduction of taxes paid on all business purchases including capital assets.

2.1.7 Methods of computing VAT

Value added tax is a tax on value addition. To calculate the tax component there are several methods used. However there are three methods, which are most commonly used. They are:

Addition method

Invoice Method

Subtraction Method

Addition Method:

This method of computing VAT is used under the income variant. Under this method all the payments including profit is aggregated to arrive at the total value addition and on this value addition the rate of tax is applied to calculate VAT. this is not a popular method, as this method does not facilitate the matching of invoices for detecting the tax evasion.

Invoice Method:

This is the most popular and commonly used method. in India this method is being followed both in central excise as well as state VAT. under this method tax is charged on the sale value, which reflected on the invoice issued to the buyer. The tax charged by the

seller which is reflected on the purchase invoice is taken into account for set off thus the net tax payable will be tax on sales minus tax on purchases. Any excess tax paid on purchases is allowed to be carried forward for set off against future tax liabilities. This method is also called as tax credit method or voucher method. Under the central excise act this method is known as cenvat credit. Even though tax evasion cannot be ruled out completely yet this method ensures that it is kept under check as only on raising an invoice for sale the tax paid on purchases can be set off.

Subtraction Method:

Under this method tax is charged on the value added portion alone at each stage of sale of goods. This method does not recognize set off or tax credit as the total value of goods sold is not taken into account. Under this method tax is not separately charged. For imposing tax the value added is the difference between the total sales and total purchases.

Under the direct subtraction method the total value of purchases exclusive of tax is deducted from the total value of sales exclusive of tax. The balance is the value added which is to be taxed.

Under the intermediate subtraction method the purchase value is taken as inclusive of tax and other parameters are as per the direct subtraction method.

2.1.8 Features of VAT

The main characteristics of value added tax (VAT) are stated as follows:

1. VAT is a form of indirect taxation.
2. VAT is a broad-based tax as it covers the value added to each commodity by a firm during all stages of production and distribution.
3. VAT is based on value added principle. Value added can be obtained either by adding payments to factors of production (i.e., wages+rent+interest+profit) or deducting cost of inputs from sales revenue.
4. VAT is a substitute for sales tax, hotel tax, Contract tax and entertainment tax.
5. VAT is based on self-assessment system and provides the facility of tax credit and tax refund,
6. VAT avoids cascading effect existed in sales tax and contains catch-up effect.

In a nutshell, VAT is an indirect tax that is imposed on different goods and services on the basis of value added amount in different stages of production and distribution. It is not a

genuinely new form of taxation but merely a sales tax administered in different form. Although it is borne by the final consumer, VAT is collected at each stage of production and distribution chain.

2.1.9 Principle of VAT

The following are the principles which govern value added tax (VAT):

1. Principle of Transparency

VAT is transparent tax. It is an account based tax system. VAT has made tax system transparent. Tax evasion is not pervasive where accounting system is transparent.

2. Principle of Removing Cascading Effect

VAT removes cascading effect. Cascading effect means tax on tax i.e. tax is charged on the value including tax. But VAT has removed this effect by not including the VAT in the cost price to the second stage of the distribution channel. But under sales tax system, sales tax paid at one stage is included in the cost price for another stage.

3. Principle of Neutrality

Neutrality means not to discriminate one to another. VAT does not discriminate one economic activity against others. Tax rate of goods or services to be taxed are not discriminate by VAT. So, in this regard, VAT is neutral.

4. Principle of Destination And Zero Rating

Under this principle, goods and services are taxed at consumption point, but based on production. Goods and services that are exported are taxed at zero rate(i.e. the taxpayers get refund of VAT earlier paid in purchasing raw materials and interrelated goods but they should not pay tax on added value.)

2.1.10 VAT system in Nepal

Tax becomes the main source of revenue of the state. Value Added Tax is the latest innovation in the field of taxation. VAT is considered as the reform tax system of the 21st century, which has already been implemented popularly in more than 135 countries in the world. VAT is multi staged, commodity and services based tax which is levied on the value added of business at different stages of production and distribution. It is imposed on different stages. It imposed on value of goods and services. The value added tax is indirect tax depends upon consumer.

VAT is a broad based tax as it also covers the value added to each commodity by a firm during all stages of production and distribution. It is a modern tax system which enables to efficient collection system, to increase efficiency and to reduce tax evasion. It is also referred as the backbone of income tax system in Nepal.

VAT plays great role in the revenue mobilization in Nepal. The reason behind VAT system, it makes transparency in all kinds of transaction, helps to make the wide area of tax and discourages tax evasion. So it is needless to say that VAT is the most important sources of the government revenue.

Implementation of VAT was not easy in the initial days. It was a matter of great debate. Even after the enactment of law, there were a lot of constraints and difficulties in introducing and implementing VAT in Nepal. A large number of entrepreneurs, traders and business communities were against VAT system. The initial two year of VAT implementation was very turbulent. Now it has become familiar and VAT is currently well accepted by the consumers as well as business and industrial communities of Nepal. This is account based tax system that leads to transparency and accountability on the both part of tax payers and tax collectors.

History & Development of VAT

Tax is collected by government to meet the need of budget. Among the various types of tax, the sales tax is one of the major sources. VAT is the most scientific system of sales tax. In the early days, the tax from the consumption and production is collected as sales tax. But now, it is almost completely replaced by the VAT. The concept of VAT was introduced in 1919 by Dr. Wilhem Von Sieman in Germany. This concept was brought to replace the "Usnatzsterller" (multi stage sales tax) due to its undesirable effects, particularly cascading and vertical integration of the latter tax (MST) for the first time. The Germany knew the administrative complication of the VAT system. So, it has the fear to implement. Therefore, the rate of unsatzsteuer is reduced instead of the implementation of VAT. In 1921, the America was implementing the corporate income tax. Pro. Thomas S Admas suggested the tax for the United State of America to replace the existing tax system. Until early 50s the development of VAT remained limited only in the theory.

France was the first implementer of VAT in 1954 covering only in the industrial sector. The VAT was limited to only up to whole level. But these countries limited the VAT only on import and manufacturing stage.

In late 60s, VAT started to become popular. Countries like Denmark and Brazil adopted this system of tax in 1967. France, the first implementer of VAT, extended it to the retail level for the first time. And Germany also adopted VAT in the same year. In 1969, the countries like Netherlands and Sweden also adopted VAT in their countries. In 1970, 1971 and 1973, Luxembourg, Belgium and Ireland introduced the VAT respectively.

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

In SAARC region, Pakistan was the first adaptor of VAT. It implemented VAT in 1990.

India introduced VAT first as modified value added tax (MOD VAT) in 1996. But actually in India, VAT replaced sales tax on 4 January 2005. Though some state did not opt for VAT (for political reasons), majority of the state embraced VAT, states like Andhra Pradesh and Maharastra taking the lead. The Empowered Committee, constituted by Government of India, provided the basic framework for uniform VAT laws in the states but due to the federal nature of Indian constitution, States do have a liberty to set their own valuations for the VAT levied in their own territory.

Nepalese ancient tax system was based on Vedas, Smritis and Purans. Directives propounded by Yagyabalka, Chanakya were main sources of taxation system.

In Nepal, Value Added Tax Act was enacted by 1995 and started to implement only at 16 Nov.1997. Value Added Tax Act repelled four different Tax Act such as Sales Act, Hotel Tax Act, Contract Tax Act and Entertainment Tax Act.

VAT replaces the old Sales Tax, Contract Tax, Hotel Tax and Entertainment Tax. It is believe that successful implementation of VAT will helps to generate customs duties and income tax also and it is expected to enhance the revenue collection and it is closely

associated with the GDP. This Act classifies good and services under three category they are Vat able goods and services, exempted goods and services and zero rated goods and services. It is applied at a single rate (presently 13%, initially 10%) based on addition of value of the goods and services at each stage in the process of supply and delivery of goods and services.

Since then second amendment have already been made on Value Added Tax Act, 1995, and 8th amendment have been made in the Value Added Tax Rules, 1997. Various directives have been issued by the concerned authority to implement the VAT in Nepal.

VAT applies to supplies of goods and services for consideration other than exempt goods by taxable person. VAT shall be charge on any supply of goods or services. VAT is a tax on trading transaction. The real VAT payer is the consumer not the producer.

The VAT is a broad based tax as it covers the value added to each commodity by a form during all stage of production and distribution. It is a modern tax system to improve the collection of taxes, to increase efficiency and to reduce tax evasion. It is also regarded as the backbone of income tax system.

VAT is levied in the final price of the Supply.

VAT is a indirect tax. However it is not new form of taxation. It is improve and modified form of traditional sales tax.

VAT is levied on value added at each stage of production and distribution activities. The stage may be import, export, manufacturing, wholesaling, and retailing.

VAT is of different types. They are categories on several bases. The most important of them is the classification of VAT on the base of its treatment to capital goods. The VAT has typically been classified into three

-) The consumption type
-) The income type
-) The gross national product type

Nepal has adopted the consumption type multistage vat system. In other words under this system tax is levied on value added at each stage in the process of production and distribution. In this system there is a provision of input tax credit mechanism from producer to the retailer level. So, VAT is calculated indirectly using input tax credit mechanism. In which the tax payer pays vat on its value added only. In other words the registered tax collector pays tax after deducting the amount already paid input vat from the tax on sales of product or services. Because of destination based principle Nepalese vat system has made the provision of tax free to export.

Table : 2.1

Calculation of VAT in Nepal

Stage	Investment on Purchase (Rupees)	Net Sales	13% VAT	Gross Sales Price (incl. VAT)	Credit on purchase	Net VAT load on this stage
<i>Raw material</i>	-	1000	130	1130	-	130
<i>Spinner</i>	1130	1500	195	1695	130	65
<i>Textile producer</i>	1695	2500	325	2825	195	130
<i>Whole- seller</i>	2825	4000	520	4520	325	195
<i>Retailer</i>	4520	5000	650	5650	520	130

2.1.11 Basic Features of Nepalese VAT System

The type of VAT adopted by Nepal in conventional similar to that implemented over 136 countries around the world, it has injected some special features in to vat system to make it uniquely Nepalese. The following are the main features of the Nepalese vat system:

The adoption of consumption type of VAT because VAT is finally borne by the consumer

-) The consumption of VAT through tax credit method.
-) The principle of destination.
-) The level of threshold is Rupees 2 million.
-) The facility of tax refund

- J The application of VAT to all business turns over through the retail stages.
- J The rate of Vat is single and positive @ 13%
- J The provision of exemption and zero rate for the goods and services
- J The allowance of tax credit for taxable supplies including the zero rate supply
- J Small entrepreneurs are exempted to register in VAT office.
- J Self assessment system.

2.1.12 Major Legal Aspects of VAT in Nepal

2.1.12.1 Registrant of VAT

VAT is subject matter of law, for this registrant is most. The criteria for the registration in any business are based on annual taxable turnover or transaction of more than 2 million rupees.

Small vendors those who do have less than 2 millions annual turnover may also registered their business voluntarily.

2.1.12.2 Cancellation of the Registration

A VAT registration may be cancelled if one's total taxable sales for four consecutive calendar a quarter is not more than 2 million rupees and who has been registered for a full fiscal year or by persons who no longer has a commercial activity because of bankruptcy, receivership, or cessation of the business.

2.1.12.3 The obligations of the VAT registrant are as follows:

Play the role as the government agent for the purpose of the VAT collection

- J Submit VAT return and pay the collected VAT amount within the 25th day of the following month
- J Provide tax invoice to their customer.
- J Maintain purchase and Sales Book separately for the VAT purpose.
- J Keep their VAT record for a period of 6 years

- J Inform the Inland Revenue Office of changes to the business including new address, telephone number or a reorganization of a partnership within 15 days.
- J Put their Certificate of Registration in the premises where customers may easily see and read it,
- J Allow tax officers to enter the business to examine the business records and the stock on hand.

Most business will require only minor modifications to their record keeping. In order to complete his VAT return a taxpayer will need to ensure that his books and records provide:

- J The amount of VAT paid on purchases
- J The amount of VAT collected on sales
- J A method of distinguishing between taxable and exempt sales
- J The time the goods and services were supplied and
- J Evidences that goods were exported, if any

A taxpayer must keep the records of a purchase book, a sales book and a VAT account. The purchase and sales book should include the following things.

- J The invoice number
- J The invoice date
- J The supplier's name and PAN number in the purchase book
- J The customer's name and PAN number in the sales book
- J The taxable value, and
- J The amount of VAT

2.1.12.4 Administrative Review and Offences of VAT

Administrative Review

A tax collector who is not satisfied with the Tax Assessment made by Tax Officer may submit an application to the director of IRD (Inland Revenue Department) for review within 30 days from the time of receiving such decision. IRD bound to furnish their verdict within 60 days from the filing of application and IRD fails to do then collector may submit their appeal to the Revenue Tribunal.

Offences

Following acts are considered offence and fine and penalty will be imposed.

- J No registration within 90 days from the commencement of the Act
- J No publication of registration certificate within the business premises publicly.
- J Not giving information regarding transfer of location or area of business to the authority within 15 days from such transfer.
- J Not issuance of bill.
- J VAT collection without registration.
- J Not filing of tax statement as per the prescribed period.
- J Any kind of cheating forgery or fraudulent transaction.
- J Creating obstacle to the tax officer during the inspection of business transaction.

Conclusion

VAT is based on the principle of self assessment system. VAT applies to supplies of goods and services for consideration other than exempt goods by taxable persons. VAT is collected by taxable person. A taxable person is entitled to deduct the input tax from the tax collected by the sales. Similarly if the input tax exceeds the tax collected, the taxpayer may adjust in any tax payable. After adjusting it, if any tax amount remains, taxpayer is entitled to deduct from tax payable in next month. VAT Act has made provision regarding tax refund also. Conditions and procedures of tax refund are also stipulated in the VAT Act.

The Value Added Tax (VAT) is a general, broad based consumption tax assessed on the value added on the goods and services. It applies more or less to all goods and services that are bought and sold for use or consumption in the community. Thus, goods which are sold for export or services which are sold to customers abroad are normally not subject to VAT. The success of the VAT system depends upon the proper account keeping, registration of business, effective billing system and so on. Among the factors, non awareness of consumers is one of the main reasons of failure of billing system.

For VAT purposes, a taxable person is any individual, partnership, company or whatever which supplies taxable goods and services in the course of business. However, if the annual

turnover of this person is less than a certain limit (the threshold), which differs according to the member state, the person does not have to charge VAT on their sales.

At present, the issues have become the effective implementation of VAT system in Nepal. It is not matter that VAT should be removing but the implementation aspect should be managed. VAT regime is extremely challenging in a burgeoning economy like Nepal. Resistance from the business community, ignorance of general people, lack of full support and commitments from the politicians and government officials forced the authority responsible for implementing VAT to make compromises on various aspects of VAT which has weakened the process of its implementation right from the beginning. The attitude of businessmen and tax administration also appear hostile to the effective implementation of VAT in Nepal. The culture of doing business without maintaining proper books of accounts or maintaining multiple sets of books of accounts have made implementation of VAT difficult.

Hence, VAT has some difficulties in the administrative aspect. It is the most advance and scientific system of tax. Transparency is the most feature of VAT that will help to control the tax evasion. For the successful implementation of VAT system, it needs well trained personnel, proper account keeping, proper billing system etc. and of course, the registration is also an important factor.

2.1.13 EXEMPT GOODS AND SERVICES

Group 1

Basic agricultural products

- (a) Rice, wheat, maize, barley, millet, buckwheat, lentils, flour, semolina, grits, grams, beans, and similar basic, unprocessed agricultural food products and their residues.
- (b) Green and fresh vegetables, fruits, fresh eggs, and similar unprocessed agricultural products (apart from those consumed by hotels, restaurants, bars, guest houses, cafeteria, and other similar enterprises).
- (c) Unprocessed cash crops (e.g., sugarcane, cotton, cardamom, ginger, dried ginger, jute, unprocessed tobacco sold by farmers, tea leaves, orthodox tea produced by using organic fertilizers, coffee seeds, oil-extractable food items such as soybeans, peanuts, mustard

seeds, sunflower seeds, sesame seeds and their residue.

(d) Herbs (including their extracts)

Group 2

Goods of Basic Necessity

(a) Unprocessed mustard oil

(b) Drinking water supplied openly by tankers and taps

(c) Fuel wood and charcoal

(d) Kerosene (apart from aviation fuel)

(e) Salt

Group 3

Livestock and their products

(a) Goats, lambs, sheep, yaks, buffaloes, boars, pigs, rabbits and other similar livestock; their fresh milk (including pasteurized milk), yogurt, and other unprocessed, raw varieties.

(b) Cows, buffaloes, lambs, and their fresh milk (including pasteurized milk) and yogurt.

(c) Ducks, cocks and hens, turkeys, partridges and similar fowl and their fresh meat, other unprocessed varieties, and eggs.

(d) Fresh or dried meat (unpacked)

Group 4

Agriculture related products and equipment

(a) The seeds of crops and plants listed in Group 1

(b) Fertilizers, chemical fertilizers, and products used for treating the soil

(c) General equipment used for agricultural work

a. Hand equipment used for digging or cleaning the soil and for cutting wood, twigs, etc (apart from hand saws)

b. Small hand equipment used for separating the grains and cleaning the husk (dehuskers)

c. Hand equipment used for cutting animal fodder and the plough

(d) Chemical pesticides used exclusively or primarily in crops

(e) The following items used in agricultural work

) Tractor

) Cultivator

- J Hairo
- J Leveler
- J Equipment used for cutting animal fodder
- J Thresher
- J Fishing net
- J Readymade cages to keep fish
- J Fish incubator
- J Pumping pipe of up to 8 horsepower and its hose pipe of up to 30 meters

(f) The utensil in which hens are given drinking water, the box in which chick lets are kept.

(g) Specified ingredients used in animal feed and feed supplement

Group5

Medicines, medical treatment and other health services

Nepalese Customs Administration collects Customs duty, Value Added Tax, Excise and other taxes at the border points. It accounts 42% of the total revenue and 50% of the total tax revenue. Customs duty alone contributes 22 % of the total tax revenue. Customs Administration is in the forefront in terms of internal revenue mobilization. This does not mean that the Customs role needs to be confined to internal revenue mobilization. It is equally important to enhance trade facilitation by adopting international convention, recommendation and best practices without compromising with the national security. In fact, our effort is directed towards making our administration more adept, service oriented and transparent as it needs to go on making timely improvements in its role according to changes brought about in the international trade, technological development, national needs, open and liberal economy as well as to fulfill its important responsibility of improving government finances through internal resource mobilization for economic development.

Group 6

Education

(a) Research work carried out in schools and universities

(b) Commercial or professional training courses and refresher training courses organized

without profit motive

(c) Educational services provided by schools and universities

Group 7

Books, newspapers, printed material, and printing and publishing

(a) Books, newspapers, magazines, and periodic publications

(b) Newsprint paper

Group 8

Culture, arts and craftsmanship related services

(a) Fine arts, sculpture, architecture and similar handicrafts and related services

(b) Cultural programmes

(c) Entry fees to libraries, museums, art museums, zoos and botanical gardens (national parks)

Group 9

Passenger transport and goods transportation services

Air travel, non-tourist transport (apart from cable cars), and goods transportation services (apart from transportation of goods related to supply)

Group 10

Commercial or professional services

Institutional or personal services provided by artists, sportspersons, writers, designers, translators, and interpreters.

Group 11

Miscellaneous goods and services

(1) Postal service (only those operated by the Government)

Services related to transportation or handing over of letters, money and parcels

Various services related to services required for transportation or handing over of letters, money and parcels

) Postal stamp

(2) Financial and insurance services

(3) Bank notes and cheque books

- J The printing and releasing of Nepalese notes
- J The supply of bank notes into Nepal from outside Nepal
- J Cheque book

(4) Gold and silver

- J Gold, gold coins, and gold ornaments
- J Silver and silver coins (apart from readymade silver goods and ornaments)

(5) Electricity

(6) Raw Wool

(7) Battery-operated three wheeler and its chassis and battery

(8) All machinery and equipment used for the production of biogas, solar, and wind energy on the recommendation of the Alternative Energy Centre.

(9) Aero planes, helicopters, fire brigades, and ambulances

(10) Products made of jute

(11) only those industrial machineries on which a maximum of 5 % customs duty is levied, as per Part 84 of the Customs Tariff.

(12) Woolen carpets and their cutting, dying, washing and knitting.

(13) Aluminum, copper, and bronze scrapes, blocks, sheets, and readymade utensils.

(14) Cotton *saris*, *lungi* (wrap around), *dhoti* (for male and female), *petani*, and *gamcha* (small cotton towels)

(15) Cotton thread

(16) Woolen thread (apart from artificial and acrylic) used to knit handmade sweaters in the country

(17) Goods received as donation in any natural calamities or for philanthropic purposes with permission from the Ministry of Finance of Government of Nepal

Group 12

Building and land

Purchase, sales and renting of houses and land (apart from services provided by commercial enterprises such as hotels, guest houses, etc)

Group 13

Betting, casinos, and lotteries

- (1) Activities related to providing services to enterprises engaged in betting and gambling
- (2) Lotteries

2.1.14 Threshold:

Threshold is a point at which an indexation provision becomes operative. Thus, threshold is a VAT of an upper limit beyond which VAT system is in operation. The traders which have low level of transaction will have a lower revenue yield relative to the compliance cost and either they are capable to fulfill all the formalities of VAT. Further, it will create administrative complexity if all the small vendors are registered in VAT. In such a situation, threshold is also an important provision of VAT, which keeps the small vendors beyond the tax net. Thus, threshold is a kind of exemption, which is based in the amount of the transaction but not on the kinds of goods and services.

2.1.15 Zero-rated:

Exports performed by taxable persons are zero-rated which means that the supplies are exempted but the taxable person is entitled to claim refund for the VAT paid on the input. The supply of some goods is also zero-rated. It covers essential goods and services, consumed by low-income groups. Zero rating means taxing goods and services with zero rates. If zero rating is granted for particular goods, the goods are technically taxable and the taxpayer (supplier of goods) is required to fulfill all the formalities like that of a regular tax payer with the difference of that the zero rated goods do not have to pay tax.

The law provides for a list of essential goods zero-rated:

- Agricultural raw products
- Cattle, meat, fish, poultry and their natural products; milk, and all dairies products
- Salt, sugar, flour, rice, borghol, spaghetti and other kinds of pasta
- Bread

2.2 Review of related studies

Various researches have been conducted in Nepal as well as in the foreign countries about the value added tax (VAT). But only few researches and studies are available focusing internal issues of VAT in Nepal. Here, some relevant books, dissertation, journals and some other

reference materials were viewed on the topic. Essences of some useful and relevant ones are presented below in brief.

2.2.1 Review of books

Khadka (1997), in his book “*VAT and its Relevancy to Nepal*” explains about the general introduction of VAT on the eve of the introduction of VAT in Nepal. He has compared the VAT with sales tax in the use before the introduction of VAT. Nepal has the experience of implementing import/ manufacturing level sales tax; wholesale level sales tax and retail level sales tax. The Manufacturer’s Sales Tax (MST) had narrow base and suffered from the cascading effects. It also discriminates against the domestic indirect tax system and presents views of various committees and individual on VAT in India

Adhikari (2003), in his book “*Value Added Tax In Nepal: Theory and Practice*” deals with the theoretical concept of VAT which includes historical background, objectives merits and demerits of Vat, Introduction of VAT system in Nepal, different terminologies associated with VAT, Tax Administration System and legal provision made for the VAT implementation in Nepal and Value Added Tax rule 1997 and Value Added Tax Act 1996.

Adhikari (2003) published a book named "*Mordern Taxation in Nepal: Theory and Practice*". This book has been divided into five parts. In his first part, he described the theoretical aspect of tax. In second part, he described the Income Tax Act 2058. In third part, he described about Value Added Tax (VAT). In fourth part, he described property tax / house and compound tax in Nepal. At last in fifth part he described wind fall tax and other provision.

Bhattarai & Koirala (2006) in their book named “*Tax Laws and Tax Planning*” describes the income tax system in depth. This book includes the separate chapter of Value Added Tax. It describes VAT practice in Nepal with several theoretical as well as with examples. This book specifically designed for the study of MBS 2nd year under Tribhuwan University. However, the book has not mentioned about the legal provisions.

2.2.3 Review of Journals

Nepal Chamber Of Commerce (1997), made a study to analyze the possible effects of VAT in Nepalese economy. Its major findings are:

- J VAT effect adversely in price level.
- J Requirement of book-keeping is complicated
- J It will finally affect the small traders.
- J It is untimely implement
- J It would be unjustifiable on social ground.
- J Present administration is incapable for handling VAT.
- J Computerization system is not sufficient and it is new concept for the tax administrator.

The study report suggested for 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.

Nepal Tax Journals (2004) published news about taxation. In this news they include lack of taxpayer education program, taxpayer do not have fully knowledge about positive aspects of tax laws. The news was stressed that taxpayers are accepting income tax act, 2058 as a compulsory law.

The Kantipur daily (2005) published news about Income Tax and VAT. The news presented the terms used in Income tax and VAT are not clear. There is not friendly business environment between taxpayers and government. Similarly, the vocabularies used in tax act are very ambiguous and difficult.

Monthly journal published by federation of **Nepalese Chamber of Commerce and Industries (FNCCI)**, (2005) named "*Byabasaik Aacharan*". In the journal, tax expert Pandey and Bajracharya presented different aspects of Nepalese tax system.

2.2.2 Review of Dissertations

Shrestha (2003) presented a dissertation entitled of "*A Study on The Problem and Prospects of VAT in Nepal*". Her major objectives of the research work are as follows

- J To examine the problems in the implementation of VAT.
- J To examine the effectiveness of VAT in Nepal.

The major findings of the research work are mentioned below

- J VAT refund mechanism should be simplified, so that the refund can be made without deals and the taxpayer's have confidence in the system.
- J Incentives should be seemed to income registration and tax compliance. The no filers should be motive to file tax return.
- J As most of the taxpayers are still ignorant about account keeping under VAT and who get this job by paying other people, taxpayer's education program should be continued. Extensive taxpayer's education should be conduct from time to time familiarize the potential taxpayers and others with various aspects of VAT.

Chudali (2004), presented a dissertation named "*Effectiveness of Nepalese Tax policy on Various Business Sectors*". He had described various short coming of the tax system and policies. His main objectives of the study were as follows:

- J To analyzed the nature of the existing Nepalese tax policy.
- J To know the tax system of various business organization.
- J To find out the reaction of organization regarding Nepalese tax policy.
- J To draw specific finding and conclusion of Nepalese tax policy.
- J To make recommendations for the Nepalese tax policy.

Similarly, his major findings were as follows:

- J The Income Tax Act, 2058 should be revised which simplified language and ambiguity should be removed. The goods that are taxed once should be remarked so that double taxation should be avoided.
- J There should be clear and strict rule for reward and punishment. The person who conceals tax should be properly identified and given punishment. Tax authority should build up monitoring body for proper evaluation of the tax collection.
- J Entrepreneurs have indicated that tax officials are full of corruption so government should correct its bureaucracy. It should update its traditional and monotonous for tax collection which has encouraged corruption.

-)] Very sensible and service oriented business which provide basic requirement like health education and communication should be given tax exemption or subsidy so that these facilities can be available for all level.
-)] Nepalese tax system should be based on Nepalese economy rather than developed countries.

Bhandari (2006), submitted a dissertation named "*Tax Knowledge of Taxpayers in Nepal*".

His major objectives of the research work are as follows

-)] To find out the present position of taxation knowledge of taxpayer's in Nepal.
-)] To find out the present scenario of implementation of VAT system.
-)] To examine the effectiveness of VAT system.

His major finding was as follows:

-)] To increase income tax knowledge of taxpayer related information should be published regularly.
-)] Special taxpayer education program necessary for employees and small taxpayers.
-)] Professor researcher, taxpayers, tax experts should be taken while making tax policy.
-)] The school as well as campus level curriculum should include tax related education so that taxpayer education programs can be more effective.

Gairhe (2009), submitted a dissertation "*A Study on Problems In VAT Implementation in Nepal*". His major objectives for the research work are

-)] To review the Resource Gap in Nepal with a view to examine VAT revenue collection.
-)] To analyze the problems of VAT implementation that have been faced in Nepal.

His major findings of his research are follows:

-)] Tax revenue has greater share than non-tax revenue in total revenue structure where VAT revenue has average contribution which is in increasing trend
-)] People are not aware about the benefit of VAT, so different campaigns must be held out to make people aware of VAT system for its successful implementation in Nepal.

Gautam (2009), presented a dissertation entitled "*Taxpayers & Their Awareness towards Business Taxation: A Case Study of Baneshwor Area*". The main objectives of this thesis work are:

- J To know view of taxpayer about business taxation and their awareness
- J To find out the effectiveness of business taxation in Nepal

Similarly, his major findings are as follows:

- J Most of the peoples have knowledge about income tax, VAT & Custom duty. But current Tax & VAT rate is high which must be reduced.
- J VAT is superior to sales tax.
- J Major problems of VAT are lack of public awareness, ineffective tax administration etc.

Karn (2011), submitted a thesis entitled "*VAT Administration And Its Effectiveness In Nepal*".

The major objectives of the research work are as follows:

- J To evaluate & identify the problems of VAT faced by the public.
- J To evaluate the success of VAT administrations to collect VAT.
- J To assess the contribution of VAT on economic indicators.

Similarly, the result of the research work is presented below:

- J VAT results in rise in prices.
- J The successful implementation of VAT is measured through collection of VAT.
- J The collection of VAT is carried out successfully by the government.

Pant (2012), has submitted thesis entitled "*VAT Compliance in Nepal: Its Structure And Determinants*" to Shankar Dev Campus. The main objectives of his research work are as follows:

- J To examine the structure of VAT in Nepal.
- J To analyze the factors affecting VAT compliance in Nepal.
- J To provide measures improving the collection of VAT.

Similarly, the major findings of his research work are:

- J The government should concentrate more on introducing various discretionary measures rather than broadening the VAT base by reducing the tax-exempted goods & service.
- J Under billing system is prevailing in the market which lowered VAT amount.
- J Political instability is a major factor affecting VAT compliance.

2.3 Research Gap:

The country has experienced the VAT about the decade and these days various study has been conducted on Nepalese VAT system regarding its implementation and its effectiveness. Though, the topic of this research work is also similar to the previous research work but it is found that in previous researches, the research is mainly focused only on secondary data but here the researcher have taken the secondary data from the reliable source i.e the annual report of IRD for fiscal year 2067/68. Similarly, while collecting the primary data, the researcher have visited the respondents (consumers, businessmen and tax officials and experts) personally. Here, it is tried to found out the awareness of tax and VAT system in general people. Similarly, the problems that have been faced in implementation a VAT system in Nepal and its effectiveness after the implementation is pointed out.

Various researches have been undertaken on the VAT system in Nepal, with regard to its implementation and effectiveness. The primary data has been collected directly from the respondents. Whereas the secondary data has been taken from the annual report of IRD for the fiscal year 2067/68.

CHAPTER III

RESEARCH METHODOLOGY

3.0. Introduction of research methodology:

The system of collecting data for research projects is known as research methodology. The data may be collected for either theoretical or practical research for example management research may be strategically conceptualized along with operational planning methods and change management.

Some important factors in research methodology include validity of research data, Ethics and the reliability of measures most of your work is finished by the time you finish the analysis of your data. Formulating of research questions along with sampling whether probable or non probable is followed by measurement that includes surveys and scaling. This is followed by research design, which may be either experimental or quasi-experimental. The last two stages are data analysis and finally writing the research paper, which is organized carefully into graphs and tables so that only important relevant data is shown.

The goal of the research process is to produce new knowledge or deepen understanding of a topic or issue. This process takes three main forms i. e.

-) Exploratory research, which helps to identify and define a problem or question.
-) Constructive research, which tests theories and proposes solutions to a problem or question.
-) Empirical research, which tests the feasibility of a solution using empirical evidence.

Research is the investigation of a particular topic using a variety of reliable scholarly resources. It is a process of investigation. Research word can be divided into two parts: re and search, which means to search again and again. Previous researcher found some things and further researcher are not cover all the facts and findings. This study is undertaken to examine the implementation, scenario and relating to VAT and find out the best suggestions to be applied in the execution of value added tax system in Nepal. To achieve these objectives, the research methodology has been designed in this chapter. Due to the time and finance constraints, this research is not able to cover the whole nation. Therefore,

Kathmandu Valley is considered as Universe. It is assumed that where there is more business, there are more consumers too. As policy maker to businessmen and high class consumer to low class consumer inhabited here, the selected area is the best area. The category (Experts, Businessmen and Consumers) wise respondent is selected using random sampling method.

3.1 Research Design

Research design is considered as a "blueprint" for research, dealing with at least four problems: which questions to study, which data are relevant, what data to collect, and how to analyze the results. The best design depends on the research question as well as the orientation of the researcher. There are two major research designs: qualitative research and quantitative research. Researchers choose one of these two tracks according to the nature of the research problem they want to observe and the research questions they aim to answer:

Qualitative research:

Understanding of human behavior and the reasons that govern such behavior. Asking a broad question and collecting word-type data that is analyzed searching for themes. This type of research looks to describe a population without attempting to quantifiably measure variables or look to potential relationships between variables. It is viewed as more restrictive in testing hypotheses because it can be expensive and time consuming, and typically limited to a single set of research subjects. Qualitative research is often used as a method of exploratory research as a basis for later quantitative research hypotheses. The Quantitative data collection methods rely on random sampling and structured data collection instruments that fit diverse experiences into predetermined response categories. These methods produce results that are easy to summarize, compare, and generalize.

Quantitative research:

Systematic empirical investigation of quantitative properties and phenomena and their relationships. Asking a narrow question and collecting numerical data to analyze utilizing statistical methods. The quantitative research designs are experimental, correlational, and survey (or descriptive). Statistics derived from quantitative research can be used to establish the existence of associative or causal relationships between variables. Quantitative research is concerned with testing hypotheses derived from theory and/or being able to estimate the size of a phenomenon of interest.

To reach the stated objectives, the research design is mainly based on descriptive studies but primary data have objective of exploratory studies as well. The study of VAT Act, VAT rules and regulations etc are done as a part of descriptive research whereas analytical research has been carried out in terms of role of VAT in generating government revenue in Nepal. It is done mainly through the secondary source of data from various publications. For an empirical research an opinion survey has been conducted. The options of various hundred respondents associated with distinct denominations (groups) i.e. tax administrators, tax experts and tax payers were collected through structured questionnaire with reference to VAT system in Nepal, major problems of VAT system, remedy to minimize corrupt practice existed in Nepalese VAT system, the important factor for effectiveness of VAT including necessary suggestion for achieving effectiveness, problems to faced by taxpayers in filing returns, problems for getting VAT refund by taxpayers as well as tax administration etc.

3.2 Population and Sample

In order to benefit the research work, 40 sample sizes from Kathmandu Valley is selected out of total population. Persons included in the sample size are carefully selected. The respondents have been divided into four groups. The following table shows the group of respondents and the size of samples.

Table 3.1
Groups of Respondents and Size of Samples from each group

S.N.	Group of Respondents	Sample size
1.	Tax Experts	5
2.	Tax Officers	10
3.	Businessman	10
4.	Consumers	15
Total		40

3.3 Nature and sources of Data

3.3.1 Primary Data

Primary data is important for all areas of research because it is unvarnished information about the results of an experiment or observation. It is like the eyewitness testimony at a trial. No one has tarnished it or spun it by adding their own opinion or bias so it can form the basis of objective conclusions. Primary data is the specific information collected by the person who is doing the research.

The major tool used for the collection of primary data is questionnaire to the respondents. A set of questionnaire was developed and distributed to the selected 40 respondents so that actual result can be obtained.

3.3.2 Secondary Data

Secondary data is the data that have been already collected by and readily available from other sources. Such data are cheaper and more quickly obtainable than the primary data and also may be available when primary data can not be obtained at all.

The secondary sources of data are the data and information collected from the published sources. They are derived from books, journals, newspapers, reports and dissertations etc. The major source of secondary data are : publications and annual report of Inland Revenue Department, economic surveys of various fiscal years, dissertation related to VAT available at Central Library of T.U., Newspapers articles such as Gorkhapatra, The Rising Nepal, The Himalayan Times etc. and other relevant records and data related to the study.

3.4 Data Collection Procedure

As stated above, data have been collected using both Primary and Secondary sources. For the collection of Primary data, a set of questionnaire was developed and distributed the selected respondents. In order to get accurate and actual information interviews, informal dialogues and discussions with scholars have been used to some extent with the concerned persons. And secondary data are collected form different published documents, budgets speech, previous research, reports etc.

3.5 Data Processing and Analysis

Processing means a series of operations on data in a research work so as to obtain desired result. Analysis means the categorizing, ordering, manipulating and summarizing of data to

obtain answers to research questions. The collected information are compiled and tabulated in different headings. These data have to be patronized and graphed in different ways so as to make research understandable even at glance.

3.6 Tools for Analysis

To make research objective, to find result accurate and practicable, different tools are used. The information collected in different aspect of VAT from Primary and Secondary sources was first processed for tabulation and analysis. For analysis purpose simple statistical tools have been used which are as follows:

❖ **Bar diagram:**

A bar diagram is a visual display used to compare the amounts or frequency of occurrence of different characteristics of data. This type of display allows us to compare groups of data and to make generalizations about the data quickly

❖ **Pie chart:**

This type of diagram is used to show the break-up of a total into component part.

❖ **Trend analysis:**

Trend analysis is the practice of collecting information and attempting to spot a pattern or trend in the information. Although trend analysis is often used to predict future events, it could be used to estimate uncertain events in the past. It is an aspect of technical analysis that tries to predict the future movement of a stock based on past data. It is based on the idea that what has happened in the past gives traders an idea of what will happen in the future.

❖ **Simple percentage method:**

Simple percentage method is the method to represent raw streams of data as a percentage (a part in 100 - percent) for better understanding of collected data.

3.7 Reliability and Validity of data

During the collection of data, both qualitative and quantitative tools are applied. So, it has high possibility of getting most reliable data. Beside of this triangulation of information collected through questionnaire also assist to make data more reliable and valid. Some constraint may arise, as it could not symbolize the whole part of country and samples are collected only from Kathmandu valley, so there is also possibility of getting fake data which could not represent the whole part of country and probably could not access the real objective of research work. It is happened due to lack of proper financial assistance and time boundary for the research.

The researchers have tried their best to make this data as accurate as they possibly can. Also the fact that some of the information has come from the questionnaire itself. Due to the lack of financial assistance and time the research is not carried out throughout the country but only that of within Kathmandu Valley which could prove to be a inaccurate if compared to other reports covering the whole country.

CHAPTER IV

ANALYSIS AND PRESENTATION OF DATA

4.1 Analysis and presentation of secondary data

Taxation is one of the major sources of government revenue. Maintaining a continuous flow of revenue, there is a challenge to control tax leakage after identifying the possible leakage areas, and increasing the revenue mobilization especially through the VAT and Income Tax, which are the major instruments of tax revenue. Also a far greater challenge lies in enhancing work efficiency, also enhancing the standard of professionalism in the revenue administration.

4.1.1 Tax Revenue Structure in Nepal

Tax is essential contribution by the taxpayer to the government. Taxation is main source of income of the government excluding foreign aid. In the fiscal trend of Nepal, tax revenue expenditure is the combination of two tax elite. They are namely, direct tax and indirect tax. The table presented in next page shows that the trend of tax revenue has been increasing.

Table 4.1
Total Tax Revenue Structure

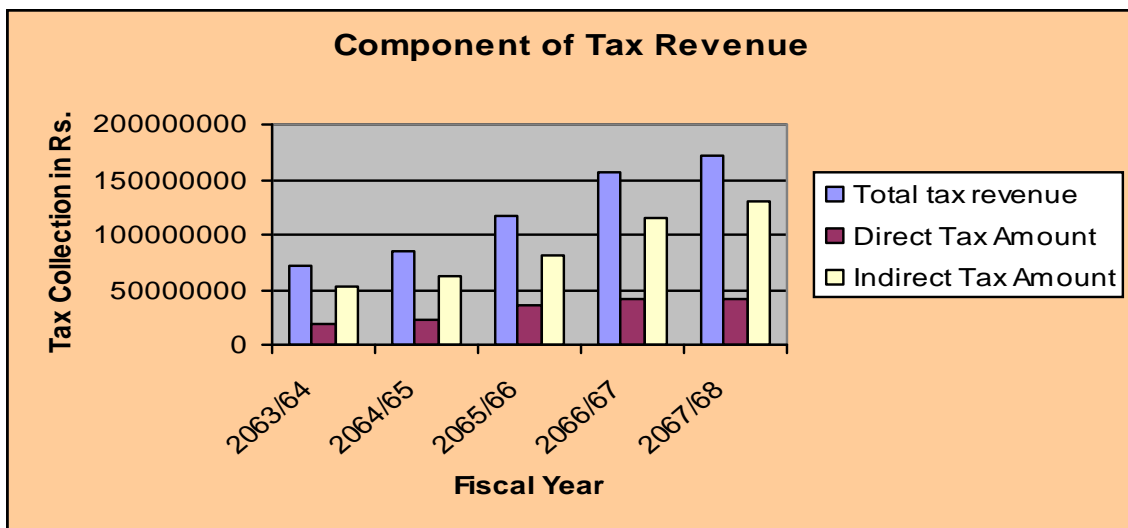
Rs. '000'

FY	Total tax revenue	Direct Tax		Indirect Tax	
		Amount	% as total revenue	Amount	% as total revenue
2063/64	71126728	18980298	26.69	52146430	73.31
2064/65	85155458	23087759	27.11	62067699	72.89
2065/66	116996653	35787477	30.59	81209176	69.41
2066/67	156294932	41750183	26.71	114544749	73.29
2067/68	171806676	41725731	24.28	130080945	75.72

Source: Annual Report FY 2067/68, IRD

From the above data, we can conclude that in developing country like Nepal indirect tax plays a vital role in revenue generation. This data shows direct tax contributes 24.28% to the total revenue whereas indirect tax contributes 75.72% in fiscal year 2067/68. Total Tax revenue has been increased by 9.92% in fiscal year 2067/68 as compared to fiscal year 2066/67. Such revenue was increased by 33.59% in fiscal year 2066/67 as compared to its preceding fiscal year. This data has also been presented in the following figure:

Figure 4.1



The bar diagram shows that the total tax revenue, direct tax, indirect tax is in increasing trend as compared to its previous fiscal years.

4.1.2 Internal Revenue Collection Trend (Inland Revenue Collection)

Internal Revenue is collected from VAT, Income Tax, Excise duty, house land & property tax. The main source of Internal collection are VAT, Income Tax and Excise and the revenue collected in the different fiscal years have been presented in the following table:

Table 4.2
Inland Revenue Collection Trend (Budgeted)

Rs. 'ooo'

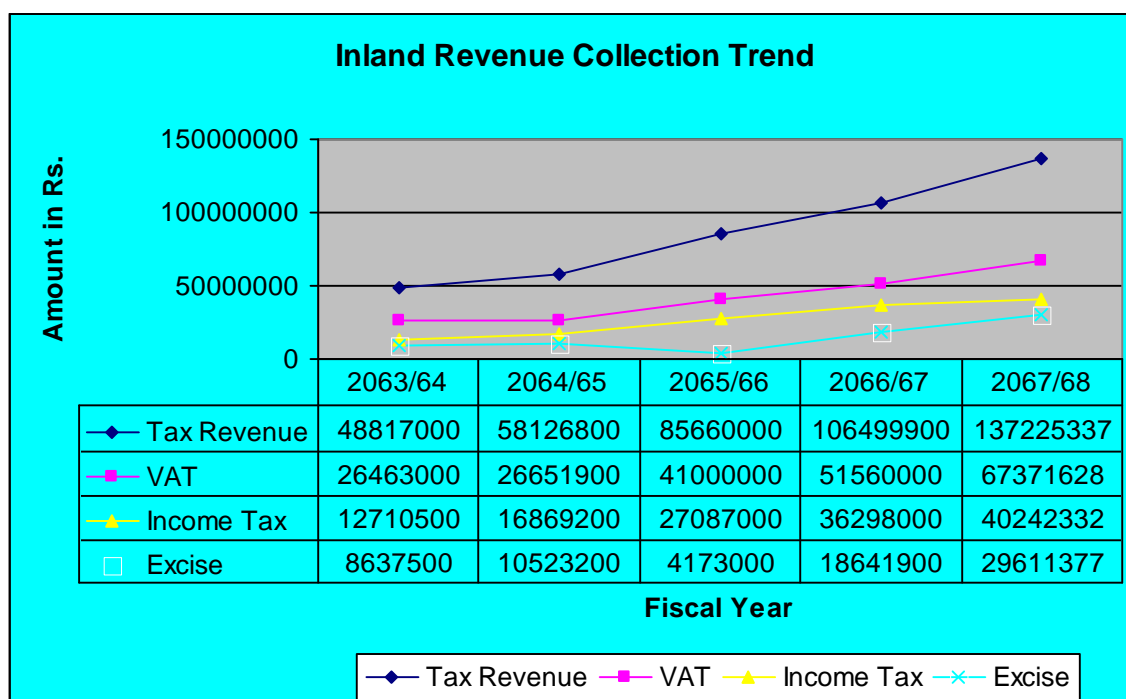
FY	Tax Revenue	VAT	Income Tax	Excise
2063/64	48817000	26463000	12710500	8637500
2064/65	58126800	26651900	16869200	10523200
2065/66	85660000	41000000	27087000	4173000
2066/67	106499900	51560000	36298000	18641900
2067/68	137225337	67371628	40242332	29611377

Source: Annual Report FY 2067/68, IRD

The Budgeted data of Inland Revenue Department of Revenue collection is Rs.137225337000 for the Fiscal Year 2067/68 where the contribution of VAT is 49.10%. Income Tax is 29.33% and Excise is 21.57%.

The Data Presented in the above table is followed by the trend analysis below.

Figure 4.2



This trend analysis shows that the Budgeted Tax Revenue is in increasing trend. This collection trend helps to generate a view point that VAT & Income Tax is in increasing trend but the Excise is decreased in fiscal year 2065/66 but afterward it is also in increasing trend.

Table 4.3
Inland Revenue Collection Trend (Actual)

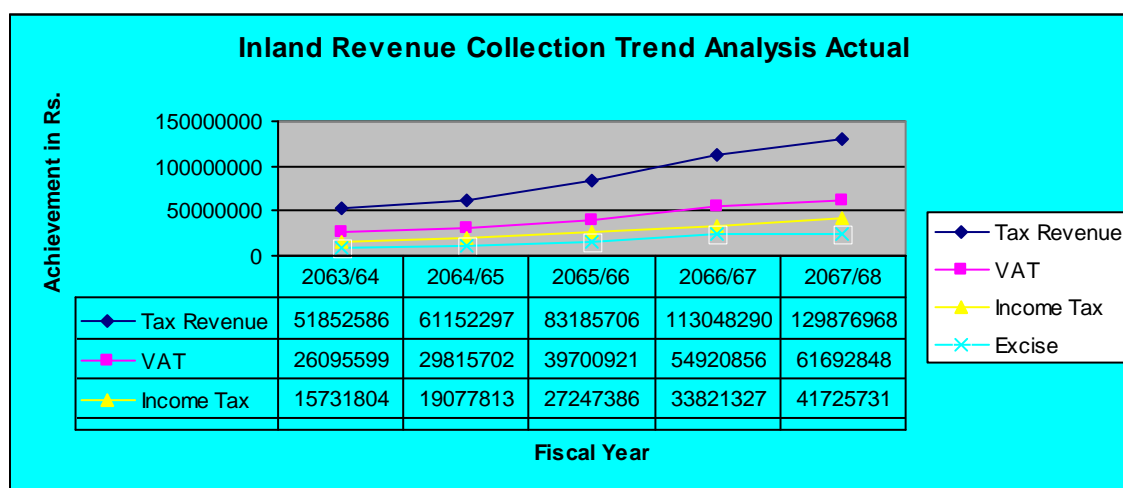
Rs. '000'

FY	Tax Revenue	VAT	Income Tax	Excise
2063/64	51852586	26095599	15731804	9343187
2064/65	61152297	29815702	19077813	11189575
2065/66	83185706	39700921	27247386	16237398
2066/67	113048290	54920856	33821327	24306107
2067/68	129876968	61692848	41725731	23458389

Source: Annual Report FY 2067/68, IRD

The Actual data of Inland Revenue Department of Revenue collection is Rs.129876968000 for the Fiscal Year 2067/68 where the contribution of VAT is 47.50%, Income Tax is 32.13% and Excise is 20.37%. As compared to the above budgeted data actual VAT is decreased but Income tax is increased where as excise too is decreased as compared.

Figure 4.3



The above trend analysis shows that the Actual Tax Revenue is in increasing trend. This collection trend helps to generate a view point that VAT, Income Tax and excise duty is in increasing trend. This trend analysis followed the above table which discloses the contribution of VAT, Income Tax and Excise duty in the tax revenue for the different fiscal years.

4.1.3 VAT Collection: Internal & Import

Table 4.4
VAT Collection: Internal & Import

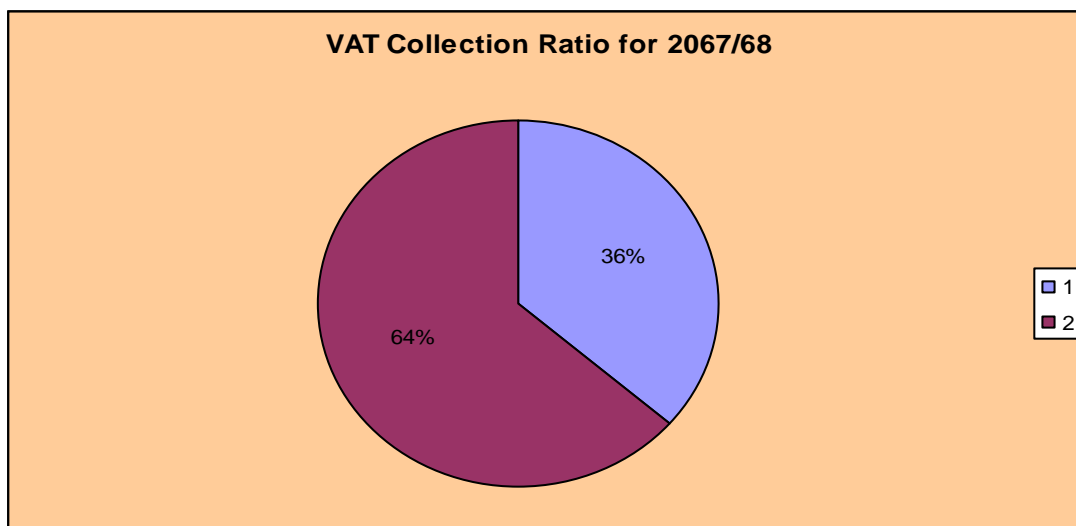
Rs. '000'

FY	2063/64	2064/65	2065/66	2066/67	2067/68
VAT Collection	26095599	29815703	39700921	54920856	61692848
Internal	9631330	10808241	13918493	20379831	22386275
Import	16464269	19007462	25782485	34541025	39306573
Internal / Import Ratio	37:63	36:64	35:65	37:63	36:64
VAT Increment %	20.74005035	14.25568	33.1544	38	12.33

Source: Annual Report FY 2067/68, IRD

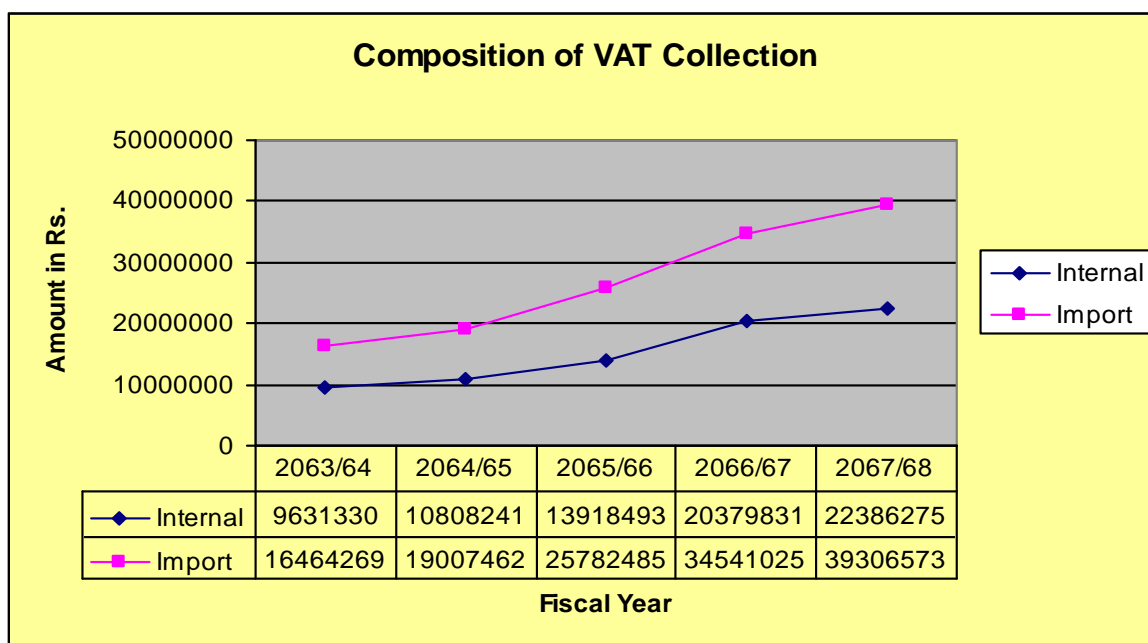
The above data shows the data of VAT collection from internal trade and from import from abroad. VAT collection from import from abroad goods is more than the collection from internal trade. The trend is in increasing ratio as in FY 2066/67 as it was 20379831 thousand from internal source and Rs.34541025 thousand from import while it was Rs. 22386275 thousand from internal and Rs.39306573 thousand from import in FY 2067/68. This data is followed by the pie-chart and trend analysis below:

Figure 4.4



The pie-chart shows the VAT collection of fiscal year 2067/68. In this fiscal year internal collection contributes 36% where import collection is of 64%. This shows import has higher contribution than internal.

Figure 4.5



The graph shows the VAT collection through internal and import collection in different fiscal years. This graph explains that the collection is in increasing trend.

4.1.4 VAT Collection: Internal Only

Table 4.5
VAT Collection: Internal Only

Rs. '000'

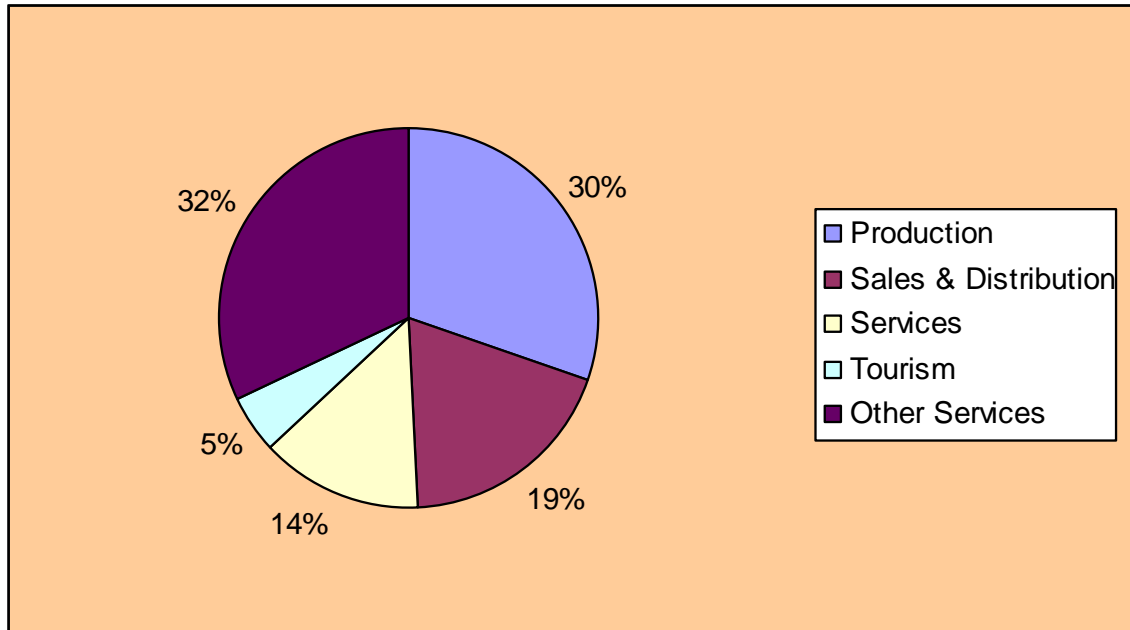
S.N.	Title	FY 2066/67	FY 2067/68	Growth Rate (%)
1	Production	6016115	6768301	13.8
2	Sales & Distribution	3299200	4251741	29.9
3	Services	2192454	3115281	41.9
4	Tourism	938855	1116891	19
5	Other Services	6649862	7134051	7.4
Total		19096486	22386265	17.8

Source: Annual Report FY 2067/68, IRD

The data above shows the VAT collection report for the fiscal year 2066/67 and FY 2067/68. VAT collection from different sources i.e. Production, Sales & Distribution, Services,

Tourism and other services are shown as their growth rate is 13.8, 29.9, 41.9, 19 & 7.4 percent respectively. This data is also shown in the pie- chart below:

Figure 4.6



4.1.5 Office Wise Registration Status

Table 4.6

Office Wise Registration Status of Business on VAT upto 2068 Ashad End

Office Code	Inland Revenue Office	Total Registration	Increased Nos In FY 2067/68
11	Bhadrapur	2773	370
12	Biratnagar	4016	418
13	Dharan	2446	356
14	Janakpur	2555	316
15	Lahan	2353	308
16	Simara	1589	179
17	Birjung	4454	587
18	Hetaunda	2154	254
19	Bharatpur	2934	597
20	Dhangadi	2658	395

21	Mahendranagar	1549	211
22	Pokhara	5132	999
23	Lalitpur	6189	1078
24	Bhairahawa	2101	274
25	Kathmandu 3	14682	2319
26	Nepalgunj	4113	573
27	Kathmandu 1	16740	2916
28	Kathmandu 2	9310	1287
29	Bhaktapur	3900	638
30	Krishnanagar	1003	170
33	Butwal	2557	492
51	Dang	1962	303
52	Large Taxpayer Office	563	12
Total Taxpayers		97733	15052

Source: Annual Report FY 2067/68, IRD

4.2. Analysis and presentation of primary data

4.2.1 Knowledge about VAT system

Knowledge of VAT is the most important question for businessman and consumers as if they don't know about the VAT system; the implementation of VAT would be supposed to be weak. So I tried to know about the peoples view. The following table shows the awareness gain by consumers and businessman in the present situation. Here the response given by the consumers and businessman on the question asked "**Have you ever heard about the VAT system?**"

Table 4.7
Knowledge about VAT system

S.N	Group of respondents	Sample size	Yes	No	Only by listening
1	Businessman	10	8	0	2
2	Consumers	15	7	3	5
Total		25	15	3	7
Percentage		100%	60%	12%	28%

Source: field survey 2012

The table shows that the most of the respondents (60%) do have the knowledge about VAT system. Among them (28%) have only a little knowledge about VAT where as 12% of them do not know about it. This show that the government authorities are not successful to lunch the better public awareness programme of VAT system to the general public.

4.2.2 Registration of business on VAT

We asked the respondent's businessman as they had their business got registered on VAT or not. The table below shows the answer of respondents on the question being asked "Have you get your business registered on VAT?"

Table 4.8
Business registration on VAT

Respondent type	Response	No.of respondent	%
Businessman N= 10	Yes	7	70%
	No	3	30%

Source: field survey 2012

The above table shows that the bigger % (70%) of the businessmen have got their business registered on VAT whereas only 30% do not have their business on VAT registration.

4.2.3. Purpose of business registration on VAT

This question is asked to find out the reason why businesses should be registered on VAT of among the various reasons which force the businesspersons to go to the tax office. This would help the planner to find out the best and easy way for the businesspersons to register on VAT. On question asked to businessman "What is the purpose of registering your business on VAT?"

Table 4.9**Purpose of business registration on VAT**

Respondent type	Response	No. of respondent	%
Businessman N= 10	Because of threshold limit	3	30%
	Because of compulsion nature	6	60%
	To help government in revenue collection	1	10%

Source: filed survey 2012

The data in the table shows that 60% businessman register their venture under VAT net due to legal compulsion as 60% businessman marked on legal compulsion. Since the need of the VAT registration should be self-initiated, the trend should be developed for self-motivation for registration. The sad news is that only 10% (only 1 businessman among 10) want to help the government. And 30% get their business registration because of threshold limit as the threshold limit for Nepal is Rs. 2 million for VAT registration.

4.2.4. Problems on VAT registration

It is very crucial that the process of VAT registration should be easy and encouraging. Despite that, there are so many obstacles and problems during registration process and after registration too. To solve the problems of business persons is a main responsibility of government for the smooth functioning of the system.

Table 4.10**Problem on VAT registration**

Respondent type	Response	No.of respondent	%
Businessman N= 10	Don't have sufficient knowledge about VAT system	2	20
	The office personnel do not provide the required assistance and guideline	5	50
	The laws and rules are not clear	2	20
	Difficulties in maintaining the specified accounts	1	10

Source: field survey 2012

The table above shows the problems to be faced while getting registration on VAT by the businessmen. The findings in the above table shows that the Tax office couldn't provide the required guidelines and assistance so that the business person wills to get their ventures get registered. On the question asked “**What are the major problems of registration process?**” to 10 businessmen 50% (5 businessmen) said that the tax offices do not provide

the required guidelines while 20% thinks that they don't have sufficient knowledge about VAT system and 20% thinks that the laws and rules are not clear. Therefore, government should correct the system wherever is possible and give training as well as incentive for the tax officers. Government should also punish hard to those who are abusing their authority for vested interest.

4.2.5. Is present VAT rate appropriate?

Government increased VAT rate from 10% to 13%. This is done to increase the tax revenue in the national coffer. But the impact is not good enough as compared to expected. Therefore, government revised some provisions in the recent financial ordinance 2006. So, it is important to know whether the current rate Ok or not. If not what should be done? So the question is being asked “**Is present VAT rate is appropriate?**” and the obtained result is shown in the table below:

Table 4.11
Appropriation of Present VAT rate

S.N.	Group of Respondents	Sample size	Yes	No
1	Tax Experts	5	5	0
2	Tax Officials	10	10	0
3	Businessmen	10	8	2
4	Consumers	15	9	6
Total		40	32	8
Percentage		100%	80%	20%

Source: Field survey, 2012

The above table shows the result that among the total respondent's 80% (32 respondents) answers that the present VAT rate is appropriate while 20% (8 respondents) says it is not appropriate. Though the Tax experts and Tax officials says that it is appropriate rate but the government should be very much serious while deciding the VAT rate as it should be convenience to the businessmen and consumers.

4.2.6. Books and records

After registering the business on VAT the businessmen must follow the rules and regulations prescribed as per the rule and law. This rule and law also includes recording the transaction in the books of accounts in a prescribed manner. The books of accounts must be maintained after registering it by tax officers. For this, a question is asked to the businessmen **“What books & records must be maintained for recording the transactions?”** and the result obtained is presented in the following table:

Table 4.12
Books of accounts

Respondent type	Response	No. of respondent	%
Businessman N= 10	Purchase book	0	0
	Sales book	0	0
	VAT account	2	20
	All of above	8	80

Source: Field Survey, 2012

From the above data, it shows that for recording the business transaction of VAT registrants, the businessmen must maintain purchase book and sales book along with VAT account as prescribed by the laws and rules as 80% of our respondent businessmen answered according to it while 20% replied for VAT account.

4.2.7. What should be included in purchase and sales book?

While maintaining the purchase and sales book, certain procedure must be fulfilled i.e. Transactions must be recorded in a prescribed manner. For to know more about this, a question **“What should be included in purchase and sales book?”** is asked to our respondent businessmen and the obtained result is presented in the following table:

Table 4.13**What should be included in purchase and sales book?**

Respondent type	Response	No. of respondent	%
Businessman N= 10	Invoice number	2	20
	Invoice date	2	20
	Taxable value	1	10
	Customer and Supplier name with PAN no.	5	50

Source: filed survey, 2012

The data presented in the above table discloses that 50% respondents answered that while maintaining the books of accounts the name of customer and supplier with their PAN no is the must concern while 20% of them replied with invoice number and 20% of them with invoice date as 10% of them have a view point of taxable value.

4.2.8. VAT plays as a means to increase government revenue

Many people don't have sufficient knowledge about the VAT and they don't know how VAT affects the price of the commodity. Here, I've tried to find out the personal thought of the persons so that the appropriate result is determined. In the question asked **“Do you think VAT plays as a means to increase government revenue?”** the answer obtained is showed in the table below:

Table 4.14**VAT as a means to increase government revenue**

S.N.	Group of Respondents	Sample size	Yes	No	I don't know
1	Tax Experts	5	5	0	0
2	Tax Officials	10	10	0	0
3	Businessmen	10	7	3	0
4	Consumers	15	7	5	3
Total		40	29	8	3
Percentage		100	72.5	20	7.5

Source: Field survey, 2012

The table displays that 72.5% of the respondents are of the opinion that VAT plays an important means to increase government revenue while 20% believes that it is not a mean of revenue collection and 7.5% of them do not know about it.

4.2.9. Does VAT increase the price of commodity?

It is found in the previous research also that consumers do not ask for invoices while making purchase due to afraid of increase in the price of goods and services. Every one wants to play less which is the nature of consumers worldwide. By not taking invoice if the goods is found cheaper then why to take bill is a common thought. In the question asked “does VAT increase the price of commodity?” the given table shows the obtained answer.

Table 4.15
VAT increase the price of commodity

S.N.	Group of Respondents	Sample size	Yes	No	I don't know
1	Tax Experts	5	0	5	0
2	Tax Officials	10	0	10	0
3	Businessmen	10	2	8	0
4	Consumers	15	5	8	2
Total		40	7	31	2
Percentage		100	17.5	77.5	5

Source: field survey 2012

Above table shows that 77.5% of the total respondents have negative opinion towards raising the price of commodity due to VAT where 17.5% of them says that price raises due to the VAT of the commodity and among them 5% replied they do not know about it.

4.2.10. Do you ask to issue VAT bill on purchase?

The main backbone of VAT system is billing system. The main problem identified by various previous studies is fall under weak billing system. Most of the sales and purchases are not billed that are in low price-called low invoicing. Therefore this affects the whole system of taxation. Here also effort is made to identify the current situation of perfect invoicing.

An analysis of the result of the past showed that the ration of revenue to the GDP was 9 to 11% before the implementation of VAT has not gone beyond 15%. Even the tendency of tax evasion has not declined after the implementation of VAT. There is feeling that tax evasion has increased because VAT and income tax can both be evaded if a vendor is able to issue false invoices during sales and hence the tendency to issue invoices has further declined. The inability to get purchase invoices from the businessmen and consumers while purchasing goods from the market proves this point. On the question asked “**Do you ask to issue VAT bill on purchase?**” the following result is found:

Table 4.16
Issue of VAT bill on purchase

S.N.	Group of Respondents	Sample size	Yes	No
1	Businessmen	10	8	2
2	Consumers	15	5	10
Total		25	13	12
Percentage		100	52	48

Source: Field survey, 2012

From the above table, it is obtained that 80% (8 businessmen) ask to issue Vat bill on their purchase and only 20% don't ask whereas from the consumers it is only 33% ask to issue bill and 67% don't ask to issue to. So this shows that businessmen are more alert to have ask of bill while consumers are not aware of it.

4.2.11. Issuing of VAT bill on every sales

From the above data, we found that businessmen ask issuing of bill on their every purchase made but here we also want to know about the issuing of bill on their every sales so that consumers right can be protected. So we asked the respondent business person a question “**Do you issue VAT bill on every sales?**” The result obtained is showed below in the following table:

Table 4.17
Issue of VAT bill on every Sales

Respondent type	Response	No. of respondent	%
Businessman N= 10	Yes	3	30%
	No	3	30%
	Yes if only consumers ask	4	40%

Source: Field survey, 2012

From the above table, it is found that 30% of the businessmen issue bill and 30% of them don't issue while 40% of them issue only if consumer ask them to issue bill. This shows that though the businessmen are aware of billing system but they are ignoring it to issue to the consumers. So the government should make the consumers i.e. public aware of billing system so that VAT can be implemented successfully and can achieve the targeted objective.

4.2.12. Obligations that must be followed after registration on VAT

After getting any business registration on VAT they must follow the prescribed rules, act, laws & regulations related to VAT under the VAT act. So, to know more about VAT rules a question “ **What are the obligations that must be followed after registering business on VAT?**” has been asked to the tax experts and officials and the result obtain is presented below:

Table 4.18
Obligations that must be followed after registration on VAT

S.N.	Group of Respondents	Sample size	Must file VAT return on or before 25 th day following the end of each month	Issue VAT invoice on sales	Maintain books of account	Keep VAT records for a period of 6 years
1	Tax Experts	5	2	1	1	1
2	Tax Officials	10	5	3	1	1
Total		15	7	4	2	2
Percentage		100	46.67	26.67	13.33	13.33

Source: Field survey, 2012

From the data presented in the above table it can be concluded that after getting business registration on VAT the mainly obligation that must be followed by tax payers is to file VAT return on or before 25th day following the end of each month as 46.67% respondents viewed it. Similarly, 26.67% respondents have conclusion that one must issue VAT invoice after registration while 13.33% respondent equally replied for maintaining books of account and keeping VAT records for a period of six years simultaneously.

4.2.13. Government utilizing the collected revenue

VAT was introduced in Nepal to get revenue mobilization and to avoid the problems of existence tax system. As Vat is the best system to get greater revenue productivity due to the many problems relating to the implementation of the revenue collection from VAT is not satisfying as it has been expected. But it has generating refundable amount of revenue

since it was implemented in the country. On the question asked to the respondents **“What do you think, government is utilizing the collected revenue in a proper way?”** the following result is obtained:

Table 4.19
Government utilizing the collected revenue

S.N.	Group of Respondents	Sample size	Yes	No	I don't know
1	Tax Experts	5	5	0	0
2	Tax Officials	10	10	0	0
3	Businessmen	10	4	6	0
4	Consumers	15	4	7	4
Total		40	23	13	4
Percentage		100	57.5	32.5	10

Source: Field survey, 2012

Table shows that most of the respondents (57.5%) argue that revenue collection from VAT has been utilizing in a proper way while 32.5% believe that it has not been utilizing in a satisfactory way and 10% of them are unknown about the fact. Though 100% of Tax experts and 100% of Tax officials say that it has been utilizing in a best possible way but only 40% of businessmen and 27% (round figure) of consumers believe that but 60% of businessmen and 47% (round figure) of consumers do not believe it as 26% of consumers are unaware about the fact.

4.2.14. Implementation scenario of VAT

VAT was introduced on 16 Nov 1997 in Nepal. Though it is pledged that VAT has been implemented successfully in Nepal in the present context but it can't be fully considered. So, to know the present scenario of VAT implementation we have asked our respondents in a question **“What is the present implementation scenario of VAT in your opinion?”** and the findings are computed in the table below:

Table 4.20**Implementation scenario of VAT**

S.N.	Group of Respondents	Sample size	Sound	Unsound	Medium	Low
1	Tax Experts	5	4	0	1	0
2	Tax Officials	10	7	0	3	0
3	Businessmen	10	3	2	4	1
4	Consumers	15	2	7	4	2
Total		40	16	9	12	3
Percentage		100	40	22.5	30	7.5

Source: Field survey, 2012

From the above table, it is found that 40% of the respondents think that VAT has been successfully implemented (whose data is 90% of tax experts, 70% of tax officials, 30% of businessmen and 13% of consumers) while 22.5% of them think it has unsound scenario (whose data is 0% of tax experts, 0% of tax officials, 2% of businessmen and 47% of consumers). Similarly, 30% of respondents believes it is a medium level of implementation scenario in the present context (data is 10% of tax experts, 30% of tax officials, 40% of businessmen and 27% of consumers) where 7.5% of them answers it is in a low level of implementation in the present situation (data is 0% of tax experts, 0% of tax officials, 10% of businessmen and 14% of consumers) thinks so. So we can say that VAT is in its good position of implementation scenario.

4.2.15. Current legal provisions and rules of VAT

To know the opinion of respondents about its current provisions, rules and regulations we have asked a question “**Do you think that current legal provisions & rules of VAT is sufficient in Nepal?**” we found the below mentioned result relating to it.

Table 4.21**Current legal provisions and rules of VAT**

S.N.	Group of Respondents	Sample size	Yes	No	Moderate	I don't know
1	Tax Experts	5	3	0	2	0
2	Tax Officials	10	7	0	3	0
3	Businessmen	10	1	6	3	0
4	Consumers	15	3	5	4	3
Total		40	14	11	12	3
Percentage		100	35	27.5	30	7.5

Source: Field survey, 2012

The above table displays that out of 25% of total respondents, 60% of businessmen are strongly opposing the present legal provision. It is a pathetic that out of 37.5% of respondents, 20% of the consumers do not know about the legal provisions of tax. 27.5% of the total respondents are of the opinion that present VAT system is not sufficient and thus should better be improved.

4.2.16. Major problems of present VAT system

Though it has been trying for the successful implementation of VAT, it has to tackle the various difficulties and problems are to be faced. So here, we have tried to find out some of the major problems in the effective implementation of VAT system in Nepal so a question “**What are the major problems of present VAT system?**” is asked to tax experts and tax officials and the finding is presented below:

Table 4.22
Major problems of present VAT system

S.N.	Group of Respondents	Sample size	Unawareness of computer system to the normal persons	Registration process	Billing system	Tax refund process
1	Tax Experts	5	1	0	3	1
2	Tax Officials	10	3	0	6	1
Total		15	4	0	9	2
Percentage		100	26.67	0	60	13.33

Source: Field survey, 2012

The table shows that 60% respondents think that billing system is the main problem of VAT implementation system in business sector. Out of 60% of the respondents, 60% of tax experts and tax officials focused on billing system. Similarly, 20% of tax experts and 30% of tax officials believe that it is due to the lack of awareness of sound computer system to the public while 20% of tax experts and 10% of tax officials says it is due to the refund process.

Billing is the main problem of present vat system because the seller has various products including VAT and non-VAT. Consumers also don't know the items which is vatable and which is not. Customers will buy all the items, so in this case billing will be the problem. Again, for the seller they have to keep all the gray market products and real market

products where grey market products will not make any impact on VAT and real market goods will impact on VAT and stock. So in this case, billing is the problem and main problem is grey market.

4.2.17. Major weaknesses of VAT implementation

To know the exact position of VAT in Nepal, a research with legal provisions, rules and regulations, registration, different problems, weakness and so on other is being held relating to the VAT implementation. So to find out the major weakness on VAT implementation a question “**What are the major weakness of VAT implementation?**” is been asked to the tax experts and officials and their answers relating to it is presented below in the following table:

Table 4.23

Major weakness of VAT implementation

S.N.	Group of Respondents	Sample size	Lack of trained manpower	Weak administration	Unconscious taxpayer	Weak economy
1	Tax Experts	5	2	0	2	1
2	Tax Officials	10	3	1	5	1
	Total	15	5	1	7	2
	Percentage	100	33.33	6.67	46.67	13.33

Source: Field survey, 2012

Table shows that unconscious taxpayer is the major weakness having for the effective implementation of VAT i.e. 46.67% respondents. Similarly, 33.33% of them believes it is due to lack of trained manpower in the organization while 6.67 says it is due to weak administration and 13.33 thinks of weak economy.

4.2.18. Steps to be taken to make VAT effective

In order to know the most important factor for effectiveness of VAT in revenue collection in Nepal, respondents were requested to express their view about the most important factor for effective of VAT in Nepal. So a question “**In your opinion what steps are to be taken to make VAT effective?**” has been raised to the respondents to express their view. The view of the respondents is shown in the following table:

Table 4.24
Steps to be taken to make VAT effective

S.N.	Group of Respondents	Sample size	Increase Public awareness	Develop information technology	Develop skilled manpower	Improve in threshold limit	Effective reward and punishment system
1	Tax Experts	5	3	1	1	0	0
2	Tax Officials	10	4	3	2	0	1
Total		15	7	4	3	0	1
Percentage		100	46.67	26.67	20	0	6.66

Source: Field survey, 2012

The above table shows that a 46.67% respondent wants to increase public awareness programme so that VAT can be effectively adopted while 26.67 believe that it can be effectively implemented by developing information technology where 20% of respondents says it can be fulfilled by developing skilled manpower by providing different trainings to the tax officials and persons. Similarly, 6.66% says it can be done by providing effective reward system to the businesspersons so that they are motivated in the system while punishment should be given to the persons who are in the evasion of VAT where 0% believe it can't be made effective with the improvement in threshold limit.

4.3 Major Findings

- ❖ In fiscal year 2067/68, the total revenue collection is Rs.171806676000 where direct tax contribution 24.28% and indirect tax contributes 75.72%.
- ❖ The revenue collection of fiscal year 2067/68 is in increasing trend.
- ❖ VAT has contributed 47.50% to total tax revenue in fiscal year 2067/68 in increasing trend.
- ❖ In VAT collection, internal collection and Import has a ration of 36:64 for fiscal year 2067/68 which increases VAT collection of 12.33% in comparison to previous year. This shows import contributes higher than internal collection.
- ❖ Nowadays, people are more aware of VAT so many of business are getting registration on VAT. The business registration on VAT is in an increasing trend.

- ❖ From the above presented data we can conclude that 80% of businessmen but only 47% of consumers have the knowledge about VAT system. This shows that general persons should be made more aware of VAT system.
- ❖ Most of the businessmen got their business registered on VAT due to the compulsory nature. This shows even to the present context people don't want to be in VAT system willingly.
- ❖ According to the businessmen, most of them say the major problem in VAT registration process is lack of sufficient assistance and guidelines by office personnel. Tax office should regulate their staff's in accordance to it.
- ❖ In the question asked "Do you ask to issue VAT bill on purchase?" It is observed most of the consumers i.e. (67%) do not ask to issue invoice. Public awareness program should be launched thoroughly.
- ❖ By observing the present scenario of VAT, it can be concluded that VAT has been implemented successfully and effectively in Nepal though the current legal provision and rules of VAT is not sufficient.
- ❖ It is found from the study that the main problem of VAT system is in its billing system though there is somehow problem in refund process too. Weakness of VAT implementation is unconscious tax payer according to tax experts and tax officials.
- ❖ According to the tax experts and officials, for the effective implementation of VAT system, public awareness program should be increased along with the development of information technology.
- ❖ A question has been asked to the businessmen regarding the reforms to be made for better effectiveness of VAT. Here, the businessmen has a view point that at this time all the goods and services are rated on a flat rate of VAT i.e 13% which increases the value of goods. So, the government should consider conducting the multi rated VAT system so that goods and services can be equally rated.

CHAPTER V

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1. SUMMARY

VAT is a broad-based tax as it covers the value added to each commodity by an entity during all stages of production and distribution. It is a modern tax system to improve the collection of taxes, to increase efficiency and to lessen tax evasion. It is also regarded as the backbone of income tax system in Nepal.

Value added tax (VAT) is a type of indirect tax that is imposed on goods and services. Sometimes, when government operates on a budget surplus or wants to increase its revenue in order to finance its budget deficit. Around 136 countries in Asia have recognized the importance of value added tax. The tax is levied not only on goods but also on service provided which is the source of revenue for the government to plan development activities in the country. Since, Nepal is a developing country, the main source for revenue is generated through tax levied on the individual on the purchase of goods or services. The government imposes taxes and duty charges on the fellow people for fulfilling the infrastructural, technological, entrepreneurial demand of the country.

Value Added Tax ('VAT') was first introduced in France in 1954 and today, it has been implemented worldwide with tremendous success. In Nepal, after intense debate and deliberation, it was implemented first in 1997. However, it is felt that its positive impacts are yet to be fully realized even after almost 14 years of implementation. The main problem that the government is facing each year is lack of compliance by all taxpayers due to various reasons. It is presently adopted by over 120 countries all over the world.

The concept of VAT in Nepal was introduced in early 1990s. Nepal government indicated its intention to introduce VAT in the eight plan. Subsequently, the finance minister declared to introduce a two-tier sales tax system to make the base of implementing VAT from the fiscal year 1992/93. A VAT task force was created in 1993, under the financial assistance of USAID in order to make necessary preparation for the introduction of VAT. The VAT task force prepared the draft of VAT legislation. Finally, VAT was introduced in Nepal in 16 November, 1997 with single rate of 10% formally and it was fully implemented.

For years, nations have used the VAT to raise an incredible amount of money to finance the federal deficits. However, the VAT in Nepal has not really been for deficit reduction

purposes. The government seems to have favored it simply because of its huge revenue generating capability. And, that is the major problem with VAT in Nepal. It has been implemented not for deficit reduction and economic growth but as a cash-cow for the government.

Nepal got the idea to implement the VAT by observing its success in many European nations. The main reason why developed economies in Europe favored the VAT was because of improved compliance and lesser evasion when compared to a sales tax. Our Inland Revenue Department claims the low evasion to be the prime reasoning behind implementation of VAT in Nepal. And, their reasoning is quite sound given the general consensus among VAT implementing nations that VAT is not as easy to evade as the sales tax.

Another major problem with the VAT is the stage-wise levying of the tax. In simple terms, VAT is a multi-layered tax, and it is levied in each stage of manufacturing. This multi-layered levying of VAT provides increased opportunities of evasion and fraud in each stage. In addition, the multi-layered tax does result in higher cost of the final product, although policymakers claim that it doesn't.

Nepal introduced VAT system for several reasons. It was necessary to introduce such a tax to develop a stable source of revenue, to broaden the tax base, to promote economic growth, to generate a revenue required for improving its deteriorating macro economic performance, to establish an account based modern transparent system, to make the tax system more scientific, to gain the confidence of donors & to make the Nepalese tax system effective.

In the empirical study, the analysis has been done about VAT on the basis of information collected from experts, tax officials, businessmen and consumers. The tool basically used is questionnaire. The questions were asked to 40 different individuals related to this field. Empirical as well as theoretical analysis shows that VAT is superior to other types of Sales tax. Not only that, most of the respondents have also viewed in VAT as best instrument for research mobilization, bright future and discouraging illegal business. Similarly, most of the respondents (Tax Experts & Officials), argued that billing problem, open boarder, administrative incapability as hunting problem. They also discussed about legal provisions, choice between single or multi rated VAT, behavior of tax personnel, rate of VAT, need of public awareness programs etc.

VAT is collected mainly in the city areas. The institutional set ups and the aims of revenue also imply that it has targeted the city areas most. Hence, it appears appropriate to prepare and increase publicity campaign based on radio, TV, FM programs that are popular in the cities as well as in the whole country. Though the main business centers are located in the city areas, consumers come to a particular shop from the 75 districts of the country. Similarly, immediate campaigns should be undertaken to place attractive hoarding boards in strategic locations of the cities with messages regarding VAT invoices and by placing inspiring messages in the popular newspapers and magazines. Public awareness campaign should be undertaken in such a way that whether a consumer goes, whether at home or market place, they encounter with VAT messages and remind them to take invoices. The campaign should as much effective as it could stamp on consumers mind that they should not purchase anything without an invoice.

5.2 Conclusion

Value Added Tax (VAT) is a scientific system of indirect taxation in which tax is charged on selling price so that the ultimate burden of tax is passed on to customers. It is basically tax on consumption and collected at each stage of production and distribution. VAT applies to each commodity as it passes through the production and distribution channels but only to the 'value additions' to each stage in the production and distribution process. In Nepal VAT was introduced on 16 Nov. 1997. VAT replaces the old Sales Tax, the Contract Tax, the Hotel Tax and the Entertainment Tax. VAT is a tax imposed on the value added to goods and services consumed in Nepal. The tax is based on the principle that each producer or distributor adds value, in some way, to the materials they have purchased and it is this added value that is taxed at each stage of the production and distribution chain. There is the presumption that VAT is shifted forward completely to the consumer. VAT is a broad-based tax as it covers the value added to each commodity by a entity during all stages of production and distribution. It is a modern tax system to improve the collection of taxes, to increase efficiency and to lessen tax evasion. It is also regarded as the backbone of income tax system in Nepal.

The effectiveness of VAT depends on its implementation. There must be sound surrounding. But being a developing country, Nepal has to face too many difficulties in implementation of VAT properly. These problems and challenges are now laminating the effectiveness of VAT. To get positive effectiveness from VAT implementation, first of all

problems relating to the implementation of VAT must be administered and tried to be minimized. Implementation of VAT in our country till now has not secured the expected outcome because of many challenges/problems in implementation like open borders, ignorance of people, lack of full support and commitment from the politicians and forces of government officials, instability of political condition etc. Likewise, the culture of doing business without maintaining multiple sets of books of accounts, lack of culture of issuing and receiving bills at the point of sale or purchase, negative behavior of tax officials and lack of sense of accountability in government and political parties has greatly affected the successful implementation of VAT.

There is a popular misconception that VAT is a simple method to generate huge revenue for the government. Leading economists and policymakers in Nepal are not immune to this misconception. If anything, VAT is an immensely complicated system requiring different taxation policies for different types of goods and services.

The VAT in Nepal, at 13 percent today, is already one of the highest VAT rates among the developing countries. In the thirst for quick revenue, government policymakers in Nepal seem to be forgetting the evidence from previous research that an implementation of VAT always results in higher prices in the market for consumers. This result has been shown to hold by numerous researches. Studies have shown that VAT seems good in the short-run, but it tends to slow the long-term economic growth.

Can a poor country like Nepal really afford to have higher consumer prices as a result of the VAT? We are a growing economy. The VAT is not helping our economy if consumers end up paying higher prices for all products. Anyone with the most basic knowledge of economics can tell you that higher consumer prices always slow down the economic activities. VAT in Nepal is really a bad policy if it has in any way hampered the long-term growth of our economy. Being a developing nation that we are, we do not really want anything to slow our economy. Therefore, in today's context, VAT seems to be more of a problem than a solution in Nepal.

In today's Nepal, the manufacturing industry is struggling to survive. Therefore, it seems to be the wrong time to implement the VAT in Nepal. Maybe it can be implemented in the future when we have solid economic growth and our manufacturing industry is booming. But, given today's economic scenario, VAT is not the best tax alternative for us to pursue.

All Imports are taxed and exports are zero-rated to support export of domestically produced goods and services through tax credits and tax refund mechanisms. VAT has completed its 15 years. During that time it has witnessed many ups and downs. It has become the backbone of internal revenue as it surpassed customs duties from fiscal year 2002/03 and now stands as the largest contributor to state coffer. At the time of its introduction, only 2,045 taxpayers converted from the old sales tax regime to VAT, but by the end of FY 2067/68, the number of VAT registrations had reached 97,733.

IRD has been pursuing a two-pronged strategy, namely enhancing service delivery to lure taxpayers towards tax administration and administering stringent legal actions against tax dodgers. Establishment of Taxpayers Service Offices (TSOs) at the doorstep of the taxpayers will focus on registration, taxpayer education, tax collection, market survey and monitoring to enhance service quality.

It is shown that, in a developing country, tax policies that might seem very realistic and politically non-controversial are likely to yield a very narrow VAT tax base. In the case of Nepal, the VAT tax base becomes less than 20 percent of gross domestic expenditure. It is further reduced if compliance is less than 100 percent. Hence, if a government of a developing country wants to rely more on the VAT over time, it must move aggressively to broaden the base and enhance compliance. Such policies may require harder political choices than is usually required from governments of most industrialized countries. Resources also will have to be spent to enhance the effectiveness of the tax administration. Registration is required for any business having annual taxable turnover of more than the limit prescribed or belonging to an associated group, which has aggregate annual taxable turnover exceeding the limit prescribed as per Vat Regulation, 2053. Small taxpayer having taxable turnover less than prescribed limit may apply for registration. VAT registered person is required to submit VAT.

VAT registered person is required to submit VAT returns under self assessment system on monthly/ Bi-monthly/ tri-semester basis to the IRD within 25th day of the end of the month/ bi-month/ quarter. Such returns must be submitted to the tax officer or “through post office registry”. Such return must be furnished whether or not taxable transactions are carried out during the period.

The VAT is the largest contributor in the revenue followed by income tax in the current fiscal year, according to the Finance Ministry. Lawmakers have stressed for taking stern action against those Industrial institutions and companies, who encourage duplicate bills to evade Value Added Tax (VAT).

5.3 Recommendations

After a long preparation, planning VAT was introduced in our country and has already become a decade. Even though, it has made great jump by implementing of VAT, in such circumstances or the basis of major finding and conclusion following recommendation has been made to make VAT more effective revenue collection in Nepal:

- ❖ First, to start with the positive impact that VAT laws brings is taxation at every stage of supply chain and credit to taxes paid on inputs and on input services. Therefore, the foremost good factor that VAT laws bring is the removal of cascading effects. The term cascading effects refer to ‘tax on tax’. Therefore, VAT shuts door for multiple taxation, thereby removing cascading effects in supply chain as every buyer and seller will be entitled to avail input tax credits and adjust its credit with its output tax liability. In principle, we have understood VAT laws to be so.
- ❖ However, in practice, not necessarily the implementation of VAT laws always removes cascading effects. Therefore, we need to have an effective and good VAT law that alone brings the intended consequences to the tax payers. In practice, what has been observed is the concept called ‘exemption of taxes’ on ‘exempted goods and services’ which act as a barrier to smooth supply chain. Mainly, the essential goods and services, for example rice, pulses, flour, fresh fish, kerosene, salt, health services, contraceptives, medicine etc. are exempted from payment of VAT on a simple rationale that these commodities and services are essential for human survival and imposition of taxes will increase the price of these products thereby making it inaccessible and expensive for poor citizen of our poor country. Morally and ethically too, this sounds a great welfare measure taken by the state. But, in practice and in a world which is full of profit making enterprises, this rationale does not work so greatly as think it to be. We can understand the tax exemption behind the agricultural products like wheat, paddy, flour etc. and agricultural tools, shovels, etc. But, Nepalese VAT law even exempts taxes on air travel, gold and silver,

mobile phone set etc. which is beyond anyone's understanding and these types of exemptions have only accentuated the obstacles to smooth supply chain.

- ❖ VAT administration should be strong and committed towards to effective implementation of VAT.
- ❖ The time consuming process in registration and other activities should be changed and punctuality with time should be developed.
- ❖ Making all traders compulsory to register on VAT net. So that the vendor could not misuse the facility given by threshold limit.
- ❖ Vat returns submitted by the taxpayer must be complying with the existing laws & regulations.
- ❖ A business whose turnover is above the threshold limit and should be complying in VAT registration can operate business without registering. So, the tax office must examine such businesses in a reasonable ground believe that a taxpayer required to be registered nude this act has been involved in a taxable transaction without being registered.
- ❖ Providing various facilities to VAT registrants can increase VAT compliance. The tax administration can select genuine businessmen and reward them.
- ❖ The businessmen can claim credit for the non-taxable transaction. So, the administrator should constitute deemed sales and tax should be collected accordingly.
- ❖ In the computer billing system, tax invoice may not reflect true transaction value. So, IRD has direct access to the software installed at the tax payer business place and review such instances
- ❖ Training programs must be provided tax offices for development of skill manpower administration with current information technology.
- ❖ Publicity and educational program must be made more effective.
- ❖ Tax helper program should be monitored properly as there is a bad smell even in that young blood too. They should be guided properly. To decrease corruption, strong measures of carrot and stick should be applied.
- ❖ The proper co-ordination among various government departments involved in revenue collection must be maintained. Computer networking system should be established in all the custom points with department. It is necessary to simplify tax procedure and reform tax administration.

- ❖ For proper billing system consumers should be made will informed and strict warning should be given to business that issue false bills for every taxable sees must be made compulsory.
- ❖ The government should apply the multi rated VAT system for different goods and services so that goods and services can be equally rated.
- ❖ Government should be able to ensure the people that the revenue from VAT is used in transparent manner to uplift the economy of country.
- ❖ Under valuation should be effectively implement timely revision should be made on unpractical acts, rules and regulation on the basis of experience gained.
- ❖ In the present Nepalese environment there exists instability of political situation, so government should create an environment of strong political commitment for effective revenue collection on VAT.
- ❖ Account keeping is also one of the problems in the successful implementation of VAT. Most of the businessmen are still in the old mind-set and run their business in the traditional way in Nepal. Especially small traders apparently don't want to keep the transparent and clean record of their transactions. so, government should make strong plan and policy to keep sound account in every organization.
- ❖ The tax administration should be very watchful to prevent any kind of malpractice, fraud and tax evasion. Utmost care should be taken to prevent any kind of bribing and corruption. Tax officials should effectively be monitored.
- ❖ The success of VAT system is not only the success of the IRD, but also the success of nation as a whole. The role of general media, radio, TV, newspaper plays an important one. Emphasis should be given on mass media. Awareness towards VAT system should be created among general public, non-governmental and government organization.
- ❖ Border should be effectively controlled to prevent the illegal trade. Warehouse and highways checking should be done effectively to prevent any kind of illegal trade.
- ❖ Most of the taxpayers are not satisfied with VAT administrators. They always have complaints against the administrators who do their jobs rather slowly, harassing the customers unnecessarily. The work that is to be finished today is postponed for the next day. This is their habit. Therefore it is suggested that tax administrators should be consumer-focused and result oriented
- ❖ Another possible remedy that can be injected to streamline the credit mechanism would be rather than making these products exempt, a small VAT should be

imposed on them. In Nepal, currently, there are only two VAT rates – 0% and 13%. In this context, a middle path can be found making majority of currently exempt products taxable, say at the rate of 1%-3%. Though imposition of tax may make these products little more expensive and may not go well with ‘people – centric!’ political class but we must understand that imposition of tax at small rate will not be so burdensome on us- the public and on the other, and helps not to snap the supply chain.

- ❖ One of the major challenges of implementation of VAT in Nepal is to discourage the general public in dealing with no-billing and under billing practices.
- ❖ Improvements and changes should be brought about in the whole system of implementation of VAT. Improvement in key areas such as audit coverage, selection methods, staff training and monitoring is needed to bring about effective implementation of VAT.
- ❖ Small firm and business should be encouraged to record every transaction they undertake. So as to bring about an accurate amount of tax to be imposed on.
- ❖ Investments on software and technologies should be made to track the non-filers and also to make the transparency on transaction.
- ❖ The lack of strong political commitment, administrative capability and recording system are the major problems in the implementation of VAT system in Nepal. Furthermore, lack of proper accounting and auditing, indifferent attitude among tax officials and weak appeal system have also been hindrances for the proper functioning of the Nepalese VAT system. So, the government of Nepal should be more concentrated on rules and regulation of VAT system and it should be practically applied. Then only our government can run the country smoothly with the good financial condition and can get the proper revenue as predicted.
- ❖ The trend of under-invoicing, attempt to avoid VAT and producing fake VAT bills by creating fictitious transactions have been found in investigations. Such activities should be discouraged by imposing high penalty fees and fair auditing.

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Annexes

Annex 1

Questionnaire for consumers

Dear Sir,

I would like to introduce myself as a student of Shankar Dev Campus, Master In Business Studies MBS, endeavoring to prepare a research report on “*Value Added Tax (VAT) And Its Implememtation, Problems And Effectiveness in Nepalese Economy*”. I kindly request you to fill the questionnaire below with your valuable time, views, information and suggestions. Moreover, the information you provide will be kept confidential and will be use just for the research purpose only.

1. Do you know about VAT system?

- a) Yes
- b) No
- c) Only by listening

If yes, please specify.....

2. Do you think VAT plays as a means to increase government revenue?

- a) Yes
- b) No
- c) Don't know

3. Is present VAT rate is appropriate?

- a) Yes
- b) No
- c) Don't know

4. Do you ask to issue VAT bill on purchase?

- a) Yes
- b) No

5. Does VAT increase the price of the commodity?
- a) Yes
 - b) No
 - c) Don't know
6. What do you think; government is utilizing the collected revenue in a proper way?
- a) Yes
 - b) No
7. What is the present implementation scenario of VAT in your opinion?
- a) Sound
 - b) Unsound
 - c) Medium
 - d) Low
8. Do you think that current legal provisions and rules of VAT is sufficient in Nepal?
- a) Yes
 - b) No
 - c) Moderate
 - d) I don't know
9. What is your suggestion for to make VAT effective?

.....

Annex 2

Questionnaire for Businessmen

Dear Sir,

I would like to introduce myself as a student of Shankar Dev Campus, Master In Business Studies MBS, endeavoring to prepare a research report on “*Value Added Tax (VAT) And Its Implementation, Problems And Effectiveness in Nepalese Economy*”. I kindly request you to fill the questionnaire below with your valuable time, views, information and suggestions. Moreover, the information you provide will be kept confidential and will be use just for the research purpose only.

1. Do you know about VAT system?

- a) Yes
- b) No
- c) Only by listening

If yes, please specify.....

2. Have you get your business registered on VAT?

- a) Yes
- b) No

If yes, please specify date.....

3 What is the purpose of registering your business on VAT?

- a) Because of threshold limit
- b) Because of compulsion nature
- c) To help government in revenue collection
- d) If others, please specify.....

4. What are the major problems of registration process?

- a) Don't have sufficient knowledge of VAT system
- b) The office personnel do not provide the required assistance and guidelines
- c) Difficulties in maintaining the specified accounts
- d) If others, please specify.....

5. Is present VAT rate appropriate?
- a) Yes
 - b) No
 - c) Don't know
6. What books & records must be maintained for recording the transactions?
- a) Purchase book
 - b) Sales book
 - c) VAT account
 - d) All of above
7. What should be included in purchase and sales book?
- a) Invoice number
 - b) Invoice date
 - c) Taxable value
 - d) Customer & supplier name with PAN number
8. Do you think VAT increases the price of the commodity?
- a) Yes
 - b) No
 - c) Don't know
9. Do you think VAT plays as a means to increase government revenue?
- a) Yes
 - b) No
 - c) Don't know
10. Do you ask to issue VAT bill on every purchase?
- a) Yes
 - b) No
11. Do you issue VAT bill on your every sale?
- a) Yes
 - b) No

12. What do you think; government is utilizing the collected revenue in a proper way?

- a) Yes
- b) No

13. What is the present implementation scenario of VAT in your opinion?

- a) Sound
- b) Unsound
- c) Medium
- d) Low

14. Do you think that current legal provisions and rules of VAT is sufficient in Nepal?

- a) Yes
- b) No
- c) Moderate
- d) I don't know

15. What are your suggestions for effectiveness of VAT?

.....

Annex 3

Questionnaire for Tax experts and Tax officials

Dear sir,

I would like to introduce myself as a student of Shankar Dev Campus, Master In Business Studies MBS, endeavoring to prepare a research report on “*Value Added Tax (VAT) And Its Implementation, Problems And Effectiveness in Nepalese Economy*”. I kindly request you to fill the questionnaire below with your valuable time, views, information and suggestions. Moreover, the information you provide will be kept confidential and will be use just for the research purpose only.

1. Could you please explain the present system of VAT in Nepal?

2. Do you think VAT plays as a means to increase government revenue?
 - a) Yes
 - b) No
 - c) Don't know
3. Is the present VAT rate appropriate?
 - a) Yes
 - b) No
 - c) Don't know
4. Does VAT increase the price of the commodity?
 - a) Yes
 - b) No
 - c) Don't know
5. What are the obligations that must be followed after registering business on VAT?
 - a) Must file VAT returns on or before 25th day following the end of each month
 - b) Issue VAT invoice on Sales
 - c) Maintain books of accounts
 - d) Keep VAT records for a period of 6 years.
6. What do you think; government is utilizing the collected revenue in a proper way?
 - a) Yes
 - b) No

7. What is the present implementation scenario of VAT in your opinion?
 - a) Sound
 - b) Unsound
 - c) Medium
 - d) Low
8. Do you think that current legal provisions and rules of VAT is sufficient in Nepal?
 - a) Yes
 - b) No
 - c) Moderate
 - d) Don't know
9. What are the major problems of present VAT system?
 - a) Unawareness of computer system to normal person
 - b) Registration process
 - c) Billing system
 - d) Tax refund process
 - e) Others, if any.....
10. What are the major weaknesses of VAT implementation?
 - a) Manpower (lack of trained)
 - b) Weak administration
 - c) Unconscious tax payer
 - d) Weak economy
 - e) Others, if any.....
11. In your opinion, what steps are to be taken to make VAT effectiveness?
 - a) Increase public awareness
 - b) Develop Information technology
 - c) Improve in threshold limit
 - d) Effective reward and punishment system
 - e) Need of training programme
 - f) Others, if any.....
12. What reform should be made in present context so that the burden of VAT is equally distributed for all kinds of goods and services?

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