

# CHAPTER ONE

## INTRODUCTION

### **1.1 Background of the Study**

Value Added Tax (VAT) is the most recent innovation in the field of Taxation. It is considered as one of the most powerful tool of the fiscal policy. From the long experience of VAT in several countries, many economists as well as policy makers have reached in the conclusion that VAT is probably the best in indirect tax. It has gain huge popularity within the short span of time.

VAT is as the name itself suggests, imposed on the value-added portion in different stage of sales. It is modern and scientific form of sales tax. Ultimately, the real and final burden of tax is shifted towards to the consumers who consumes goods and enjoys the services. As goods and services are shifted in the process of production and distribution, one after another stage the tax is also jointly shifted simultaneously.

Sales tax is commonly divided into three types: turnover tax, single stage tax and multiple stage tax. Turnover tax is imposed at all stages of production and distribution process. On the other hand, the stage tax is levied at only one stage of the production and distribution process. It may be imposed at either manufacturing level or at the wholesale level or at the retail level. According to the stage of its imposition it is called as manufacturing tax, wholesale tax or retail tax. Multiple taxes as a turnover are also levied at different stage of production and distribution process. VAT falls in the category of multiple stage tax. It is the good combination of turn over tax and retail level tax .It is turnover tax in the sense that it as other turnover tax is imposed at each stage in the production and distribution process. VAT ultimately differs from the turnover tax as the letter is imposed on total value while former is imposed only on value added portion particularly at the stage. Similarly, VAT is similar to manufacturing tax, wholesale tax or retail tax in the sense that as mentioned earlier. VAT follows all the stage in the process of sales. Value added Tax (VAT) is levied on the value added more than 120 developed and developing countries have introduced

VAT and others are in the process of introducing it. First of all it was introduced in France in 1990 A.D. By Dr. Wilhelm Von Seimon.

However, the concept of this tax in Nepal was introduced in early of 1990's. Nepalese government included the concept of introducing VAT in Nepal in its eight plan. Finance act 1992 and 1994. introduced two tier sales tax to make the base of implementing the VAT. VAT task force was formulated in 1993 in technical assistance of USAID which suggested the steps to be followed while implementing the VAT in Nepal.

It drafted the VAT law as well. High level tax system review task force suggested implementing VAT in Nepal in 1995 VAT related act and rules were enacted in 1996 respectively and implemented in the FY 1997. Nepal has adopted a consumption type, destination based VAT extended right through to the retail level with tax credit method, a single positive VAT rate of 13% together with the zero rate on exports, exemption some goods and services including agricultural product and maintain threshold level of Rs. 2 million for including tax payer in the tax system. In Nepal, VAT was brought to replace sales, hotel and contract and entertainment tax, contract tax and hotel tax the government of Nepal has introduced VAT. In 1997 especially it is supplementary of sales tax or improving sales tax. The goods are passed through different channel (i.e. producers-agent-wholesale-retailer-consumers) by adding the value in each channel. In this process government charges 13% on the added value which is called value added tax (VAT).

## **1.2 Statement of Problems**

Nepal's position in the world according to GNP, in terms of per capita income is 9th from the bottom. (World Development Report 2012) it shows that Nepal still remains at one of the tenth poorest country in the world. In spite of more 4 decades of the planned development the Nepalese economy is persistently suffering from general poverty and stagnation. It has led several economic and social disturbances in the country.

Therefore widespread poverty and illiteracy are the main causes of the effective implement action of VAT in Nepal. "VAT" regime is extremely challenging in a burgeoning economy like Nepal where with long open boarder, a large segment of the economy is to be monetized.

While introducing a new concept and system opposition's surfaces due to apprehension because of lack of information a hence confusion and ignorance regarding its effect. After this tax was implemented due to the absence of clarity regarding the tax, it was opposed by the businessmen, professional and other sectors. FNCCI the apex tax body of the private sector which is represented mainly by the industrialist has been advocating the introduction of VAT with full preparation. The business community particularly importance have been very hostile to VAT from very beginning and made strong voice against VAT some said is a regressive inflationary, it is complicated and will encourage corruption early application will bring disasters administration is inefficient many business on and tax collectors are ignorant about this Nepalese government has horridly introduced VAT without preparation and is now consulting the business community preparation are inadequate etc. various issues have resin and practical regarding VAT and its effect in Nepalese economy. The reason for the opposition against VAT in the initial stage was not due to its weakness or any difficulty arising out of it. It was because of the years of harassment from the tax administration particularly the tax income and custom administrations and the fear that the revenue employees would make decision of their own will and collect taxes. (Dahal, 1993:75)

So, Nepalese government considered various issues which were previously raised and most of them were solved before implementation of VAT. However "Resistance from the business community, ignorance of general people and the lack of full support and commitment from politicians and government officials forced the Authority responsible for the implementation VAT to make compromise in various aspects of VAT which has weakened the process of its implementation right from the beginning. The expensiveness of VAT implementation could be defective in Nepalese context because it requires more manpower, expensive computer difficult to work business

and only total population of 40% are educated among which nearly 25% retailers use to keep up their amount transactions properly. (Kandel 2007)

Due to high custom duty, administrative procedure and with the objective of evading tax, the imports under invoicing the goods and accordingly fornicates the invoices right up of the level of retail sale and this make it difficult to collect the actual tax. While several tax pays have been maintaining two set of amounts issuing two types of invoices collecting VAT from the buy but not depositing them to the treasury and collecting VAT without being registered seen as a major problem in current scenario similarly open border with neighboring country is major problem with VAT. Due to which goods are coming through illegal means and government loss of revenue.

Another problem in the principle of VAT due to political instability and frequent changes in the government VAT could not be fully implemented. Therefore, strong political commitment with political stability is required for the effective implementation of VAT. For the limited business and employees and the influential people backing them, including politician who have been taking undue advantage from the non-transparent tax system will never appeal to them. Since those who opposed VAT took advantage of this situation it proved even more difficult.

Additional problem have emerged owing to the lack of sufficient awareness among the tax payer regarding the importance of issuing invoice and the lack of Necessary initiation and effectiveness in the tax administration in making the issuance of invoice compulsory. The awareness amongst the Nepalese that this nation government and the people are our and therefore we need to conserve and develop is lacking: consumers to demand the invoice on the purchase and sellers to issue invoice on the sale of goods is key for the successful implementation of VAT in retail level is seen as major problem.

### **1.3 Objectives of the Study**

The general objective of the study is to examine effectiveness of VAT in Nepal and suggest and useful alternative solution to the wide range of problems. The specific objectives are:-

- ) To examine the historical background of VAT.
- ) To evaluate effectiveness of VAT.
- ) To find out the problem faced by government in effective implementation of VAT.
- ) To provide suggestions for making VAT effective and efficiently in Nepal.

### **1.4 Signification of the Study**

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

After a long discussion, interaction, preparation and debate VAT has finally been implemented from 1997 in Nepal. Implementation of VAT system itself will not be sufficient its performance is yet to be evaluated.

In the context of tax reform in Nepal, the adoption and implementation of VAT is a right step in the history of taxation as it checks tax evasion and avoidance, it creates board base of taxation and thereby generating more revenue. So significance of this study is to find out whether its implementation has enabled the government to achieve the above mentioned objectives or not.

Although a lot of attempts are made to focus the newly adopted tax system, but empirical study is hardly carried in Nepal. This study mainly concentrates on the analysis of its impact on different areas of so that suitable suggestions can be made for making VAT system more effective.

## **1.5 Limitations of the Study**

To examine the various issues of VAT in Nepal and their option the existing evidence facts and general requirement for a VAT have been examined in details and then the conclusion are made.

The main limitations of the study are:-

- (a) This study has been performed in limited time and resources.
- (b) It covers VAT aspect only
- (c) This study is mainly concentrated on the government efforts to make VAT effective.
- (d) The information and data only collect from Inland Revenue Department, Ministry of Finance and concerned aspect.
- (e) Only fifteen years data from fiscal year 1997/1998 to 2011/2012 are used for study.

## **1.6 Organization of the Study**

Keeping above objectives in mind, the present study has been organized in the following five chapters.

- Chapter I      Introduction: - Background, Statement of problems, Objectives of the study, Significance of the study, Methodology of this study and Organization of the study
- Chapter II     Review of Literature:- Concept of Value Added Tax, Historical Background of VAT, Types of VAT, Exemption and Zero rating, Operation, Review of Related Studies
- Chapter III    Research Methodology:- Types of Research, Population and Sample Source of Data Collection processing and analysis procedures
- Chapter IV    Presentation and Analysis of Data:- Secondary data, Primary data Major Finding
- Chapter V     Summary, Conclusion and Recommendations

## **CHAPTER -II**

### **REVIEW OF LITERATURE**

#### **2.1 Conceptual Frame Work**

##### **2.1.1 Tax Revenue**

Tax is the main source of government. Mainly there are two types of tax revenue, Direct tax revenue and Indirect tax revenue. Direct tax is that type of tax which is really paid by the tax payer. Direct tax is the sum of personal and corporate income tax, property tax, vehicle tax, interest tax and others. Indirect tax is that type of tax, which is levied on one person and paid by another person. Indirect tax is the sum of excise duty, goods and service based tax. Direct tax is important than indirect tax for the economy. Direct tax is more progressive than indirect tax. Social Justice can be established by direct tax. On the other hand both higher income group and lower income group are equally responsible to pay indirect tax.

In development economic like USA, UK etc, direct tax plays a leading role for the internal resource mobilization, where as in developing countries like Nepal indirect tax plays pioneering role by dominating direct tax. In general how much direct tax can mobilize the internal resource shows the magnitude of economic development but in the context of Nepal indirect taxation is the principle source of general review. So convert the economy in the channel of development, it is necessary to increase the show of direct tax.

Tax policy has various objectives among them.

- a) To increase growth rate in relatively short period to the maximum possible extent.
- b) Flexibility in tax structure and maximum revenue productivity.

- c) To have equitable distribution of income and property.
- d) To increase the employment saving and investment.
- e) To minimize regional disparity.

### **Direct tax revenue**

A direct tax is a tax paid by a person on whom it is legally imposed, the person paying and bearing tax is the same. Direct tax is a tax on income and property. The characteristics of a direct tax are equitable as per the property or income, certainty as per the process of payment, amount to be paid time of payment elastic in nature. The example of direct tax revenue are income tax, property tax, vehicle tax, interest tax, expenditure tax death tax, unite tax etc.

### **Merits**

- a) It is equitable as it is imposed on person as per the property or income.
- b) Time procedure and amount of tax to be paid is known with certainty.
- c) It is elastic, the government can change tax rate with the change in the level of property or income.
- d) It enhances the consciousness of the citizen tax payers feel burden of tax and so they can insist the government to spend their contributions for the welfare of the community.

### **Demerits**

- a) It gives mental pinch to the tax payers they have to curtail their income to pay to the government.
- b) Tax payers fell in convenience as the government imposes tax progressively.
- c) Tendency to evade tax may increase to avoid tax burden.



- d) It is expensive for the government to collect tax individually.

In Nepal, direct tax revenue is the sum of income tax, land tax, research tax, property tax, vehicle tax, tax on registration and other. Nepal is levying for different type of income tax namely individual income tax, corporate income tax, house rent and interest tax. In dividable tax included all forms of income and the government has given exemption. Corporate income tax is levied on the net profit of the corporation (company). House rent tax levied on the house rent received by the individual and housing company and the interest tax is levied on the interest received on deposit and investment (bond). Property tax levied on each real property at late rate. Wealth tax is levied on person's wealth in the progressive way. Registration tax is levied on the transfer of ownership or the rights of use of immovable property under the name of house show the structure of direct tax revenue in Nepal.

### **Indirect Tax Revenues**

An indirect tax is a tax imposed on one person but partly or wholly paid by another. It is that tax where the person pay the tax and the person bearing the tax are different. An indirect tax is a tax on goods and services. The main features of indirect tax are convenient to pay, mass participation, limited evasion shifting of incidence. The consumer pays the tax to the business person, not the government etc. The examples of indirect taxes are customs, excise value added tax and so on. The merits and demerits of indirect tax revenue are

### **Merits**

- a) It is convenient as the tax payer does not have to pay lump sum amount for tax.
- b) There is mass participation; each and every person getting goods or services has to pay tax.
- c) There is less chance of tax evasion as the tax payers pay the tax collected from consumers.

- d) The government can check on the consumption of harmful goods by imposing higher taxes.

### **Demerits**

1. It is uncertain, as demand fluctuates, tax will also fluctuate.
2. It is a regretful as the tax burdens to the rich and poor same.
3. It has bad effect on consumption, production and employment. Higher taxes will reduce all of them
4. Most of the taxes are included in the price of goods or services as a result; taxpayers do not know how much tax they are paying to the government.

Custom duties are composed of import duties, export duties and export service charges countervailing duties and Indian excise refund. Customs duty is one of the most ancient types of taxes. It is as old as the international trade itself. Customs duties is levied either on ad valorem (on the basis of value) or on specific basis (on the basis of quantity)

Custom duties can be divided in to two parts. Import duty and export duty. The customs imposed on imported goods is called import duty whereas the same imposed on exported goods are called export duty. In Nepal customs duty covers around on third of total tax revenue right now.

Excise duty is also important part of indirect tax revenue. Taxes levied on the manufacturing, sale or consumption of goods or service injurious to health or luxurious goods is called excise duty. It is narrow based indirect tax. Excise duty is also an ancient tax. In Nepal excise duty was introduced at the time of King Surendra Bikram Shah in 1870 A.D., excise duty provides around 9 % of total tax revenue in Nepal.

A major contributing item on indirect tax revenue of Nepal is sales or VAT. The basic objective of sales tax or VAT is to collect revenue. It is the tax that imposed on the value addition in each stage of production or deals. In Nepal, value added tax was introduced in 1997 replacing the sales tax, entertainment tax, hotel tax and contract tax. Right now the rates of value added tax in Nepal are 13 %. The contribution of this tax to Nepalese tax is around 30 percent. The following table shows the structure of indirect tax revenue.

### **2.1.2 Meaning of VAT**

Value added tax is the latest innovation in the field of indirect tax system. VAT is the youngest member of sales tax family. It is a broad based indirect tax. The term VAT exists, in English from value added tax. It is nearest from the French term added value tax. VAT is a sales tax in advanced form. It is imposed on different stages. It is the tax imposed on added value of good and service. Value added tax is one of the forms of indirect tax too. Encyclopedia of taxation and tax policy says "value added tax is a broad based tax on business designed to measure net value generated in a country" Being a broad based tax it is imposed on producer, wholesaler, retailer and consumers also. It is related to both the goods and services. It is levied on industry as well as commerce. Accordingly, It measures net value generated in a country i.e. GDP. (Kandel 2007)

According to Indian Tax institute, VAT is " a tax imposed on the seller of goods and services based on value added by their respective units." value added tax is also known as goods and services tax or added value tax it is a tax system that aims to minimize tax evasion and increase resource mobilization It is imposed on value added amount in each stage and therefore, is equivalent to multi-stage sales tax. In constrict to sales tax. VAT is imposed on added value of production and distribution. The value is added in the form of profit, rent, wages, salary etc. (Kandel 2007)

The following table shows simple process of calculation the VAT

**Table No. 2.1, Process of Calculating VAT**

<b>Stage of sales</b>	<b>Net purchase price (A)</b>	<b>Sales price (B)</b>	<b>Value added</b>	<b>VAT @ 13%</b>
Manufacture	100	200	100	13
Wholesaler	200	350	150	19.50
Retailer	350	500	150	19.50
<b>Total</b>	<b>650</b>	<b>1050</b>	<b>400</b>	<b>52</b>

*Source: Arbitrary figure estimated during the study.*

From this example, Researcher can say that the value added tax collected in varies steps of production as a placement on the basis of the value added in the process of doing business. Again  $VAT = \text{Value added tax rate} \times \text{Let value added}$  be 400 and tax rate is 13% then  $VAT = 13\% \text{ of } 400 = 52$ .

### **2.1.3 Evaluation of VAT**

VAT is the most recent innovation in the field of taxation. The concept of VAT was developed for the first time by Dr. Wilhelm V. Siemens in Germany in 1919 A.D. The concept of VAT was developed further in 1949 by a tax mission to Japan headed by Prof. Carl S. Shoup. The tax however, remained as only a topic of academic interest until 1953. In 1954 France introduced a VAT covering the industrial sector the tax was however, limited up to the wholesale level. By the end of 1960s only eight countries including France, Brazil Germany, the Netherlands, and Sweden etc. had introduced VAT (Bhattraï and Koirala 2007)

In Asia, Vietnam introduced VAT in 1973 but avoided in the same year and again used in 1999 A.D. Out of seven countries of the SAARC region, five countries have implemented VAT system. Republic of Pakistan introduced the system on

November 1, 1990, for the first time in the region. VAT in Pakistan is applicable in transactions up to wholesale stage only. Bangladesh introduced the system in 1991. But there, VAT is applicable in transactions of production and import stage only. The Nepal and Sri Lanka too introduced the system in 1997 and 1998 respectively. Nepal introduced VAT in 16 November 1997 with replacement sales tax, contract tax, hotel tax and entertainment tax. Unlike above Nepal has implemented full VAT system i.e. VAT is require in retail transactions also. India has introduced the system in some prescribed regions of the country on April 1<sup>st</sup>, 2005. (Shrestha 2008)

As the data provide by IMF the rapid and seemingly irresistible rise of the VAT is probably the most important tax development of latter twentieth century and certainly the most breathtaking. Forty five years ago the tax was a child in the revenue sectors. Value added tax is the most efficient tax system developed so far. The system operates in a way that it becomes beneficial to all concerned. Under the system tax authority can collect more government revenue in one hand on the other hand consumers can have relatively cheaper commodities as the systems helps government to reduce tax rates.

Now a day around 130 countries have introduced VAT system across the world. The system has been chief source of revenue of the governments of those countries. About 70% of people of the world live in VAT. IMF, UNIDO, WTO, WCO etc. organization are focusing on political, social policy. After liberalization of the decade of the 1970s, VAT started to spread world wise. Good result of VAT in the implemented countries attracted to apply VAT in the virgin countries. From this fact researcher find out some more countries are in process to adopt the system.

Nepal introduced VAT in November 1997. However the concept of this tax in Nepal was introduced in early years of 1990s. GON included the concept of

introducing VAT in Nepal in its 8th plan Finance act 1992 and 1994 introduced two tier sales tax to make the base of implementing VAT. VAT task force was formulated in 1993 in technical assistance of USAID which suggested the steps to be followed while implementing the VAT in Nepal. It drafted the VAT law as well high level tax system review task force headed by Prof. Madan Dahal suggested implementing VAT in Nepal in 1995. VAT related act and rules were enacted in 1995 and 1995 respectively.

1. In Nepal, VAT was implemented fully in 1968.
2. VAT was first introduced only in selected province and selected goods but since the achievement was not satisfactory it was implemented fully in 1994 in Nepal.
3. VAT was abolished after three month of its introduction in 1995 in Nepal.
4. VAT was introduced in 1995 and was abolished after a change in the government in 1997 and it was reintroduced in 1999 in Nepal.

(Khadka, 1998).

#### **2.1.4 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. Basically there are three types (i.e. consumption type, income type and Gross National product (GNP type) of VAT. They are described below.

##### **(a) Consumption type**

This is the popular types of VAT type Nepal also applies this type. Under this type VAT excludes all capital goods purchased from other firms. In the year of purchase, all are excluded from the tax base while depreciation is not deducted

from the tax base in subsequent years. The base of tax is consumption since investment is relieved from taxation under these types.

Consumption Type VAT = Gross domestic product - cost of intermediate goods  
cost of capital goods.

### **(b) Income Type VAT**

The income type VAT does not exclude capital goods purchased from other firms from the tax base in the year of purchase. This type however excludes depreciation from the tax base in subsequent years. Under this system the tax falls both on consumption and net investment and the conceptual tax base of this variant is the net national income.

Income type VAT = Gross receipt - cost of intermediate goods- depreciation

### **(c) Gross National Product (GNP Type)**

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

GDP type VAT= Gross receipts- cost of intermediate goods.

## **2.1.5 Method of Calculating VAT**

Consumption types of VAT system is popular and widely, adopted in the world. In this type the real taxpayer is consumer but the service follower are only the tax collector agent. They are registered on government revenue (tax) office. There are mainly three method of computing VAT liability. They are given below.

### **a) Addition Method**

In production or distribution, there are same process and involve the means of production under this method, tax base is obtained by adding the payments made

by the firm to the factors of production employed is production processes such as wages, rent, interest and profit. This method is suitable for income types of VAT. (Bhattraai and Koirala 2007)

#### **b) Subtraction Method**

One can assume that under this method tax base is determined through the means of subtraction by its name. Very simply value added is found out through purchase minus from the sales and rest of the amount regarded base for tax. Under this method value added is determined as net turnover the net turnover is obtained by subtracting the cost of materials from sale proceeds. This method is suitable for consumption type VAT.

$$T = f(\text{out puts}) - t(\text{in puts})$$

#### **c) Tax Credit Method**

The tax base to deposit to the government is calculated deducting the tax paid to purchase or receives the goods and services from the tax collected or charged in the sales. Under this system, tax is imposed on total value of sales and taxpayers are allowed to deduct from their gross tax liability the taxes already paid by their suppliers and pass on to them. As compared to subtraction method which deducts purchased from sales and levies tax on the difference, tax on purchase is subtracted from the tax on sales under this method. This method is also known as movece method or this method is also called indirect subtract method in that it calculates the value added indirectly while calculating the tax,

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

Out of three methods of computation VAT. Tax credit method is widely used.

### **2.1.6 VAT and International Trade**

When Nepal was entered in WTO at that time Government of Nepal has made major commitment to economic liberalization with the view to adopting



international trade. Globalization made the world in a small village. Foreign investment, trade, tourism are affected by the policies of nation. Fiscal policy, Monetary policy, commercial policy, revenue policy etc impact the trade and development. In the case of international trade, for applying VAT, there are two alternative. These two principles or alternative largely depends on the goods and the policies of nation. These two alternatives are found regarding international trade in the system.

**i) Origin Principle.**

Under this principle goods and services produced in a country are taxed at the place where they are produced or rendered irrespective of whether they are consumed there or not. A country applying this principle taxed all exports and free imports. VAT is charged in the country where goods are originated and goods imported are free of VAT under this principle. Export is taxable and import is received from tax liability under the origin principle. Addition, subtraction and tax credit there three method of consumptions of VAT can be applied equally under this system but tax credit method is not suitable because tax rate importing country needs to compute export is discouraged under the origin principle due to equal tax burden as domestic supply.

**ii) Destination principle**

Under this principle tax for import and tax free for exports, is known as destination principle of VAT. Under a destination principle of VAT all exports are allowed to free tax and all imports are tax paid. Under the basic destination rule, tax would be collected at importation and the firm would receive credit for this tax and a refund when the products are exported (Subedi, 1997)

**2.1.7 Freeing from VAT**

Some goods and services are left free from VAT or not taxable goods and services known as freely from VAT. Such provision makes the tax administration

simple and promotes equity among tax payers. There are mainly three provision of freeing from VAT they are,

- i) Exemption
- ii) Zero rating.
- iii) Threshold.

**i) Exemption**

The supply where the VAT is not imposed is exempt supply. This is not taken into account in determining whether a trader is a taxable person or not. Accordingly input tax attributable to it is not normally available for credit. The objective of the government is to make the vender free from the responsibility for registering and paying tax, but to keep some tax on the final purchaser exemption is a suitable measure.

In Nepal several goods and services are exempt from VAT. Exemption are generation particularly on administrative and social ground the list of goods and services which are tax exempt are given schedule-1 of the act, amended by finance act 2063 are as follows.

- ) Basic agricultural products.
- ) Goods of Basic needs like water fuel wood and coal, kerosene and salt.
- ) Live animal and animal products.
- ) Agricultural inputs such as seeds, fertilizer pesticides, agriculture equipment, pots to be used for poultry purpose birds and animal feeds etc.
- ) Medicine, Medical and similar health services.
- ) Education including the provision of research in a school or university the provision of professional or vocational training or refresher train and the

provision of education in a school or university and supply of goods made in connection with such service.

- ) Books newspapers etc including books, news papers, newsletters and periodicals and newsprint.
- ) Artistic and cultural goods and services carving services painting etc, cultural program, admission to libraries, museums etc.
- ) Passengers and goods transportation services covering air transport non - tourist passenger trains partition (except cable car) and goods.
- ) Personal or professional service including personal services rendered by artists. Sportsmen, authors, writers, designers, translators and interpreters, institutionally or individually.
- ) Other goods or services including postal related services, financial and insurance service, printing related services, ornaments electricity, raw wool, battery operated tempo, their chassis and battery, alternative energy related items, airplane related items, fire brigade and ambulance, jute goods, industrial machinery, woolen carpets and related items cotton items, goods of philanthropic purpose personal goods imported which it free of tariff due to personal belongings.
- ) Land and building
- ) Betting, Casinos, Lotteries. (Kandel, 2007)

## **ii) Zero Rating**

Zero Rating means taxing goods or services with zero rates. In this model the goods and services are taxable but the government defines the criteria of zero rating. The zero rate is a tax rate of nil. It is equivalent to complete exemption.

The zero rates are applied to goods supplied for export although no tax is charged on supply. The input tax paid on it is available for credit. It is opposite of exempt supply because the tax paid input in case of exemption is not credited. Zero rated items according to the value added Tax Act 2052 schedule 2 (revived in 2065) are:

1. Export of goods

) Goods exported outside the Nepal or,

) Goods shipped for use as stores on a flight to an eventual destination outside the Nepal or,

) Goods loaded for use as stores on aircraft to a destination outside the Nepal or as merchandise for sale by retail or supplied to persons in the cause of such a flight.

2. Export of Services:

) A supply of services by a person resident in the Nepal and having no business establishment, assent or legal representative acting on his behalf in the Nepal.

4. Imports of goods and services by accredited diplomats.

5. Medical industries can get zero rate facility if they intended.

6. Local purchase from those which were provided exemption from sales tax as per the agreement made previously. (IRD, 2069)

**iii) Threshold**

In most of the VAT system small suppliers having transactions of up to mention limit are not required to register. The amount determined for that purpose is

known as threshold. The main objective of threshold is to make easy to tax administrator to administer and to make easy to small supplier in doing his business. The threshold amount varies from country to country and time to time. It depends on number of factors like revenue requirement, administrative capacity, status of the recording system in the economy etc. (Kandel 2007) to make simplicity VAT Act 1995 and Rules 1996 have fixed the threshold in Nepal. The provisions are

- i) Provided that any person who imports in to the Nepal goods value at 10,000 rupees or more at one time for commercial purpose shall have to register is transaction.
- ii) In case any person has reason to presume that his transaction shall exceed twenty million rupees in the coming three months he shall submit an application setting out such conditions to the concerned tax officer in the format as set forth in schedule one for the registration of the transactions.
- iii) If the amount of transactions carried out by any person exceeds twenty million rupees in absence of conditions where presumption could not be made as set forth in sub rule (a.) The person carrying out such transaction shall submit an application to the concerned the officer in the format set forth in schedule for registration of the transactions with in thirty days of the date on which such excess occurs.
- iv) If the amount of transactions of any consultant Rs one hundred thousand or more yearly that consultant shall have to register in the concerned tax officer.
- v) The transaction of government purchase and construction more than thirty five thousand shall have to register in the VAT office.

### **2.1.8. Tax Rates**

Rates means positive rate excluded zero rate. Design of tax rate structure is chiefly influenced by revenue requirement, administrative, simplicity, efficiency types of products, tax burden etc. Without tax rate one cannot determine the tax liability of concern party. Before the application of VAT there were different rates in sales tax, hotel tax, entertainment tax and contract tax. Now according to VAT system, theoretically and practically, the rate of VAT may be diversified into two rates they are:-

#### **i) Single VAT Rate**

In simple single VAT rate means a VAT of which tax is fixed only at one number. The tax rate has direct impact on the tax compliance, consumption as well as investment. It has crucial role in the context of economic development of a country and requires to be levied in the ideal rate. About 90% VAT applier countries are following the single rate. It is simple to understand easier to calculate. For example, Let us suppose 13 percent is a VAT rate fixed for all level for VAT purpose. The fixed VAT rates is known as single VAT rate.

#### **ii) Multiple VAT Rate**

In concept, multiple VAT rate means more than two kinds of VAT rate which are fixed on the basis of the commodities and the services nature. The multiple tax rate system encourages the tendency of the tax evasion, difficulty to administer affect the equity etc. The multiple VAT rate system is economically inefficient as well multiple rates has to classify the goods and services into groups. For example suppose VAT rates are 1%, 2%,3% for first, second and third goods respectively for VAT purpose. Those fixed VAT rates are known as multiple VAT rate.

### **2.1.8 Tax Refund**

If the input tax is more than the output tax, the balance should be carry forward to tax payer it is known as tax refund. Income tax act, 2058 has deal with refund and set off the tax as per the provision of that section. If a person has paid the tax in excess of the tax liability IRD will recover the tax payable by the person at first. After recovering that amount it there is still the tax excess of the liability, the remaining amount will be refunded to the tax payer. The interest payable against the amount of tax, which is not payable, will also be refunded. However the IRD obliged to refund the amount of tax to a person interest at the standard rate for period filing the return and retuning the amount in case of tax deposited with retained filed. Tax credits related to medical and foreign tax for an income year may not be set off or retuned under this section. The tax payer should apply in department for refund of tax in specified form. He/She should also submit the documents related to excess payment of the tax (Income tax rule 2059)

## **2.2 Empirical Literature Review**

### **2.2.1 Review of Books and Articles**

Review of literature covers review of past studies conducted by other researcher such a review of books, thesis research articles and project reports are considered as relevant to right study are review here is.

Shoup (1988) analyzed the implementation of VAT in developing countries and suggested some advantages and disadvantages of VAT. According to his research, the advantages of VAT are follows:

- i) VAT reduces vertical integration because of its nature which is tax on the value added not turnover.
- ii) VAT is more revenue productive than other tax.

- iii) Its coverage is also more than other forms of sales tax.
- iv) It exempts exports well considering the problem of deducting the capital goods.
- v) It is self-enforcing.
- vi) If foods and necessities are to be zero rated regression may be reduced.

**The disadvantages Pointed out by the Author are:**

- i) Difficulty is the case of both compliance and administration and collection.
- ii) Inflationary in Nature.
- iii) It creates more and more problems in developing countries

**It is regressive.**

Comparing VAT with turnover tax and retail sales tax, he recommended VAT to be superior to them but it needs caution in implementation. Consumption type of VAT is superior to other forms. Tax credit method of VAT is universally practiced. A VAT is comprehensive it is covered all economic activities from the earlier stage of farming or mining right through to the retail.

His main findings in this study are:

- i) VAT is not dealt for all developing countries.
- ii) There is lack of basic accounting and efficient and empirical tax administration, which are the main obstacle to implement it.
- iii) The choice between turnover taxes and the VAT becomes a matter of weighting the pros and cons.



- iv) No generation seems justified on the suitability of the VAT for developing countries as a group. This means circumstance is important.
- v) VAT is now a principle source of revenue for many developing countries.

John F Due and Friedlander (1997), they evaluated the VAT that is addition to avoiding the adverse consequences of turnover tax and greater revenue raiser, a proper cross audit is possible. The possibility of cross checking is considered as a beauty of VAT. In their view tax reported as paid by the firm to its suppliers for which it takes credit against its own tax liability, should appear as the tax paid by the suppliers. This cross checking is not automatic but it can be made by auditors, ultimately by computers. So VAT is the most monotonous one, whose uses have extended rapidly.

John Due and friend lender also showed the tax principle that the VAT is somewhat more complex than the retail sales tax, particularly in its concept. The number of taxpaying firms is somewhat larger, since not only retailers but all manufactures and wholesale firms must also be registered and must file their return. According to them, the tax is somewhat less adaptable to exemptions than other sales taxes. Since the exemptions must be handled throughout production and distribution channels, former pose a serious problem. To register them all as taxpaying firms would greatly add to administrative and compliance tasks. If they are not registered they would not receive credit for the tax paid on purchase for firm use. Research accepted that “The administrative complexity” is the main visualized problem of VAT in developing countries. However they conclude that it is undoubtedly the ideal form of sales tax in many countries.

Nepal Chamber Of Commerce organized a national wide discussion programmed on VAT. On the discussion it gave the mixed arguments on the supporting side

and against side. In the discussion mainly the business community stood against the VAT. The main summary of the discussion are-

- ) Government machinery is not capable for implementing VAT.
- ) Business community has not confidence in the administrant because it has failed to implement many other taxes effectively and fulfill its own commitments even previously.
- ) Price will be high and hamper to domestic industry and difficult to exports in the competition markets.
- ) Illegal trade can prosper as of VAT collection on the custom offices. Import and re-export of imported goods will get a negative impact leading to define in government revenue.
- ) VAT will inhabit the growth of newly developing trade and an industrial activity is the country.
- ) VAT has to keep the accounting system but the Nepalese business community is not able to keep modern tax system so it increases costing.
- ) If a VAT is introduced it will increase consumer price Borden. Markets will dry up and transferred the consumers in the Indian markets.
- ) If a VAT is introduced it will increase consumer price and reduces the trade and on the other hand Nepalese border markets will dry up and transferred the consumer in the Indian markets.

Khadka (2000), in his book, *The Nepalese Tax system (2000)*, has pointed out the need to introduce VAT in Nepal. One of important reason was to develop a stable source of revenue by boarding the tax bare moreover; Nepal will have become

less dependent on international trade taxes for its revenue in the future. It will not be a position to levy import duties on trade that takes place within the South Asian Association for Regional Co-operation (SAARC) region after the implementation of the South Asia Free Trade Arrangement (SAFTA). Nepal is a member of the World Trade Organization (WTO) which would also have to be considered in this context. The base of the sales tax was narrow, as sales tax used to be collected at the political grounds and weak tax administration only aggravated the problems. This apart, it has been necessary to transfer some of the national level taxes. Such as land revenue, house and land tax and make them financially more autonomous. In such condition, Khadka stress that “there was no choice but to introduce VAT in Nepal to generate revenue required for improving its deteriorating more economic performance.”

Khadka (2005), in an article “Modernizing Tax administration in Nepal” concludes that VAT in Nepal was introduced as a major part of the overall tax reform program initiated in the early 1990s. A detailed preparation was made for the implementation encountered various obstacles issue mainly to the political instability and the opposition from the business community. Despite this the number of VAT registrant and the VAT revenue collection has been increasing gradually. The tax refund system is also becoming institutionalized. The tax has been accepted by the business community and others and is well established. The implementation of VAT will broaden the tax base and develop a stable and reliable source for future revenue generation

### **2.2.2 Review of Thesis**

Gurung (2002), in this study that many believed that the VAT would not service but the fact is that it did the outcome however was unexpected. Today Nepalese VAT system has a fairly comprehensive base including goods and service or consumption based and have a reasonable threshold that renders VAT administration practicable. The point that need to stressed VAT is a modern system of taxation that pre suppose the existence of a certain economic order comprising of business standers and ethics, documentation (technology) and simplified regulation that are simple, respected and complied with therefore, successful application of VAT will require assessment of their fundamental pillars. In our context with a view to gradually overcome inherent deficiencies in each sector with a positive approach, today every where there is an overall economic downturn VAT is flourishing. It is going to remind the mainstay of revenue.

Sharma, (1998) has presented a thesis to Tribhuvan University named 'Value Added Tax in Nepal, Issued and Options' (1998). In this study paper, he has provided the finding as Nepal has been under going through a several fiscal crisis due to limited sources of revenues and increasing government expenditure. Due to narrow tax base sales tax is not productive and elastic. Adoption of fully fledged VAT replacement would be helpful in removing the production distortions on other undue pressures economic activities caused by the interest defects of sales tax. The VAT would increase the competitiveness of Nepalese is greatest problem of implementing a VAT in Nepal. Underdeveloped business structure practices and distribution system is the second biggest problem for the applicability of a VAT in Nepal. Due to the existence of large proportion of small traders in trading activities unfavorable business structure and practices and weak administration there would be anarchy in the tax system. The existence of open boarder and a large amount of unauthorized trade from India to Nepal poses a great threat to

success for implement a VAT in Nepal. The existing under valuation of imports is another big obstacle for implementation a VAT. A VAT is bound to have poor result then expected due to the various applicability problems.

Dhakal (2006), in his thesis, he analyzes the different aspects of Nepalese VAT system being focused on revenue potentiality. The main objective of this research was to examine the historical background of the VAT. Analyze Nepalese tax structure and estimate the potential of revenue yield from VAT. The major findings of the studies are:-

- ) Nepal has adopted the destination based consumption type VAT operated through the tax credit method.
- ) Nepal has followed the destination principle to adjust the international trade.
- ) The primary reason for growing popularity of the VAT is its broad coverage without distorting economic efficiency.
- ) The stepwise collection of VAT discourages the evasion of VAT.
- ) VAT has somehow equity nature as compared to other kind of sales tax.
- ) Exemption and zero rating reduce the repressiveness of VAT however it makes the administration complex.
- ) VAT is more efficient tax to avoid the cascading and pyramiding effects.
- ) VAT is not immolating from the fault of regressive nature. Single positive rate creates repressiveness with respect to expenditure but not necessarily with respect to incomes.

- ) From the administrative point of view VAT cannot be attractive alternative to other kinds of sales tax.

Due to administrative complexity as well as maintain the equity norms exemption and zero rating are principally proposed out such provision makes the tax base limited.

The recommendation of the study was:

- ) Value added tax should be extended through retail level as a bulk of tax performance to generate more revenue.
- ) The important sectors of VAT offices like as tax refund, tax audit, tax payers service investigation return processing and registration should be separated for successful operation.
- ) The existing destination based consumption type of VAT operation through the tax credit method should remain continuous.
- ) Consumers should be creating awareness for taking invoice for every taxable purchase by comprehensive advertisement program.

Poudel (2004) has submitted a thesis to T.U. for degree of management entitled “Effectiveness of Value Added Tax in Nepal”. General objective of the study is to examine the major issued involved in the presses of implementation and effectives of value added tax in Nepal. The study was based on descriptive research design. He found that there may be varies key challenges persisting to effective implementation of VAT system.

The major findings of this study are following given:

- ) There may be weak owing to the lack of practice of issuing and receiving invoices. Similarly there may be problem of under invoicing at the customs has not been reduced.
- ) There may be misunderstanding between tax payer and tax administrator for refund of tax. One blame the VAT system has not been put in to proper practice while other complain that there is delay in refund owing to the fact that the tax payers don't even comply with simple formalities.
- ) There may be the lack of publicity and effective monitoring. In the implementation of VAT the main glitch has been in terms of the lack of public awareness. Until a time when a situation is created where the consumer himself/ herself, it will be an uphill road for VAT.
- ) The fragile political situation and economic slowdown may be the cause of implementation VAT effectively. There was a change in 15 times in the period of 17 years. (2046 up to 2065).
- ) Lack of proper book keeping has resulted in a discouraging status of returns, which can be seen from the excessive number of credit return.
- ) The difficulties to implement may be the merger of VAT and income tax administration in 2001. Merged entity was dominated by the management of the former tax administration.

Bhatta (2005), in his thesis entitled 'Value Added Tax System in Nepal.' The researcher found many numbers of positive and negative comment about value added tax system in Nepal. To fulfill his objective, he used descriptive types of analysis. The major findings of researcher are as follows.

1. Administrative capability is great important for the effective implementation of VAT in Nepal. Some aspects of private sector, organizational structure and

inspection system, reward and punishment, political intervention, selection of skilled and experienced man power are needed to improve for effective implementation of VAT.

2. The implementation of VAT in Nepal is a good case for other countries to study when considering the reform of their indirect tax system. But the cultures of doing business without maintaining multiple sets of book of account have made implementation of VAT difficult.
3. From the study about VAT system in Nepal “It is found that there are lots of problem in VAT existing now. Most of the freedoms, businessman and general public do not have obstacles idea about \VAT. They have been facing many problems, such as pricing problem maintaining accounting problem and more over billing problem business man and traders are not encouraged by the government and tax administration, however now the government has started to introduce special package programmers, but it is not enough.
4. The functional structure and comprised administration made it possible not only to monitor revenue but also each and every functional target. Enforcement become more effective and ever voluntary compliance increase during this period, however, the level of proper enforcement and staff attitude problems still had a negative influence on compliance and the program issuance of bills remained a major bottle neck.

Shrestha (2008) submitted the thesis on “A study on VAT implementation, problems and effectiveness in the Nepalese economy”

In his findings, there is no proper system of valuation of goods in custom and control mechanism is also not good. Beside the open boarder is one of the main problems for successful implementation of VAT. Despite the best effort, large numbers of potential tax payers are outside the boundaries of vat net due to which honest tax payers are have to face unfair competition. And his other findings were



business persons are not happy with the present increased VAT rate although the present VAT Act is very good for implementation, fine and penalty system is very strong rather than facilitative one, there is lack of education among customers and business sector and there is need of modern tools regarding registration of tax payer, investigation system, tax audit and systemic database.

Nepal (2008) submitted the thesis on “Revenue generated from VAT in Nepal”. The main objectives of the study were to analyse the status of VAT registrant, to analyse the composition of VAT revenue and to examine the helpfulness of VAT on economic growth.

Nepal cited the following findings:

1. Compulsory registrant is more voluntary registrant in Nepal.
2. Among the sources of revenue VAT has dominant all other sources of revenue collection i.e. income tax, excise duty and other.
3. People show positive response towards applicability of VAT.
4. VAT increase inflation.
5. VAT helps in economic growth.
6. VAT discourages illegal trade.

Pokherl, (2009) submitted the thesis on “Effectiveness of VAT in Nepal”

The study has covered a nine years period from FY 1998/99 to 2006/07. In this dissertation, found the following finding.

In this study, it is found that, there are lots of the traders; businessmen and general public do not have any clear idea about VAT and its aspects. They have been facing many problems such as pricing problem, main training account problem and more over billing problem. Businessmen and traders are not encouraged by the government and tax administration. No registration of business is any publicmatic most business

above the threshold level has now registered. The implementation of problem of registration, collection, tax refund and miscellaneous, there has been a notable increase in the number of registration. During the year 1999/00 the total number of registrants was 18204, while in the fiscal year the total number of registrants was 51483. Similarly the revenue is Rs 8765.9 million and 32145.41 respectively in the year 1998/99 and 2006/07. Through ten years have been already passed but record keeping and process of VAT system has still a great challenges and problems for taxpayer. Most of the tax payers are known about the record keeping and process of VAT system. About 37% respondents provided their views on registration difficulty, 29% on collection process and 30% opinioned on problem of tax refund system. Most of the tax payers are not conscious about VAT system. Tax payers are still unknown about its threshold, exemption, zero rating and related issues, which is essential criteria for VAT registration. It proves that government has no proper homework before its implementation. Smuggling business activities are increase due to weak administration proper operation/implementation. It is expected that VAT system help the government to control over these illegal activities. In the implementation of VAT in Nepal many problem arise which are challenges n application of VAT. Narrow tax base, weak public conscious level, improved tax administration, political instability, geographical barriers, open boarder and unauthorized trade exist as problems in the implementation of VAT in Nepal.

### **2.3 Research Gap**

In this way various books, papers, dissertations, reports, articles, journals and other reference materials have been reviewed while preparing the dissertation. But there are not sufficient study conducted in such particulars topic that “Value added tax in Nepal, Past and Present “in Nepal most of the studies were related

with theoretical aspect. The previous researchers were not able to explain the research gap but this study is focused to review the research gap in Nepal and it concluded that there is a huge research gap. Besides this the country is also facing the increasing burden of foreign loan. They have not shown the number of debit return filer, credit return filer and zero return filer. Besides this, the revenue performance of VAT is not properly studied. Only the limited challenges for VAT implementation are explained. In this study, the area of challenges for effective VAT implement in Nepal is studied. They are not explaining the VAT rules and regulation. Such special studies have not conducted yet so, this study is different from other related studies. VAT is being an important factor to government tax revenue so that its real situation and exact contribution n GDP, total revenue and tax revenue are also found out which made for effective VAT implementation in Nepal.

There are lots of researchers on VAT in abroad but very few of these are concerned about countries like Nepal. So, the study is mainly focus on the problems of VAT implementation in Nepal. Besides this, the study will be beneficial to the policy makers, revenue department, and students of tax, private sectors and researchers. It will provide the clear concept ideas as well as knowledge to those persons who are interested and want to gain knowledge of VAT system. Similarly, it will be equally helpful to the researchers who carry out their research work. The focus of the research work is on the problems of VAT implementation in Nepalese perspectives.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

This chapter is developed to the research methodology applied in the study for the achievement of desired objectives. Both primary as well s secondary sources of data are used to conduct this study. Opinions are described to know the fact of VAT. Questionnaires were distributed to the VAT Experts, VAT officers, businessman, consumers and students.

#### **3.1 Research Design**

This study includes three types of research as descriptive, analytical as well as empirical

- a) Descriptive research includes survey and fact finding inquiries of different kinds. The major purpose of descriptive research is the description of the state of affairs, as it exists at present.
- b) In analytical research has to use facts or information already available and analyze these to make a critical evaluation of the material.
- c) The empirical research relies on observation alone often without due regards for system and theory, it is data based research coming up with conclusion, which is capable of being verified by observation.

#### **3.2 Nature and Sources of Data**

In order to benefit this study, sample size from Kathmandu is selected persons included in the sample are carefully selected by consultation with tax experts, tax officers, businessman, consumers and students. The following table 3.1 shows the groups of respondents and the size of samples.

**Table No. 3.1**

**Group of Respondents and Size of Sample from Each Group**

<b>S.N.</b>	<b>Respondents</b>	<b>Number of respondents</b>
1	Tax Experts	15
2	Tax Officers	10
3	Businessman	10
4	Consumers	20
5	Students	15
	Total	70

### **3.3 Data Collection**

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

#### **(A) Primary Data**

The major tools used for the collection of primary data are the administration of a questionnaire to responsive of person a set of questionnaires was developed and distributed to the selected respondents in order to obtain accurate information. The questionnaire was distributed to different groups i.e. tax experts, tax officers, businessman, consumers and students.

#### **(B) Secondary Data**

The secondary sources of data are the information serviced from books, journals, newspapers reports and dissertations etc. The major sources of secondary data from economic survey and budget speeches, ministry of finance, Tribhuvan University Reports and records of department of taxation, ministry of finance, dissertations related to VAT available at central library, publications of VAT projects, publication of VAT department, economic review and indicators from Nepal Rastra bank, world

Development Report, published documents of Nepal Rastra Bank and National Planning Commission, Books related to VAT and websites etc.

### **3.4 Presentation and Data Analysis**

A total 70 sets of questionnaire were distributed to the selected respondents in order to get accurate information distribution work is done personally rather than sending by any means to get accurate and actual information in time.

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

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

## **CHAPTER FOUR**

### **DATA PRESENTATION AND DATA ANALYSIS**

For analysis of primary data, which are based on the questionnaire, almost 100 questionnaires were distributed. Among them only 70 questionnaire were collected. Some responses among them were not clear for the purpose of the analysis. Those questionnaires, with incomplete response, are not included in this study.

#### **4.1 Presentation and Analysis of Secondary Data**

##### **4.1.1 Registration and Canceling Registration of VAT**

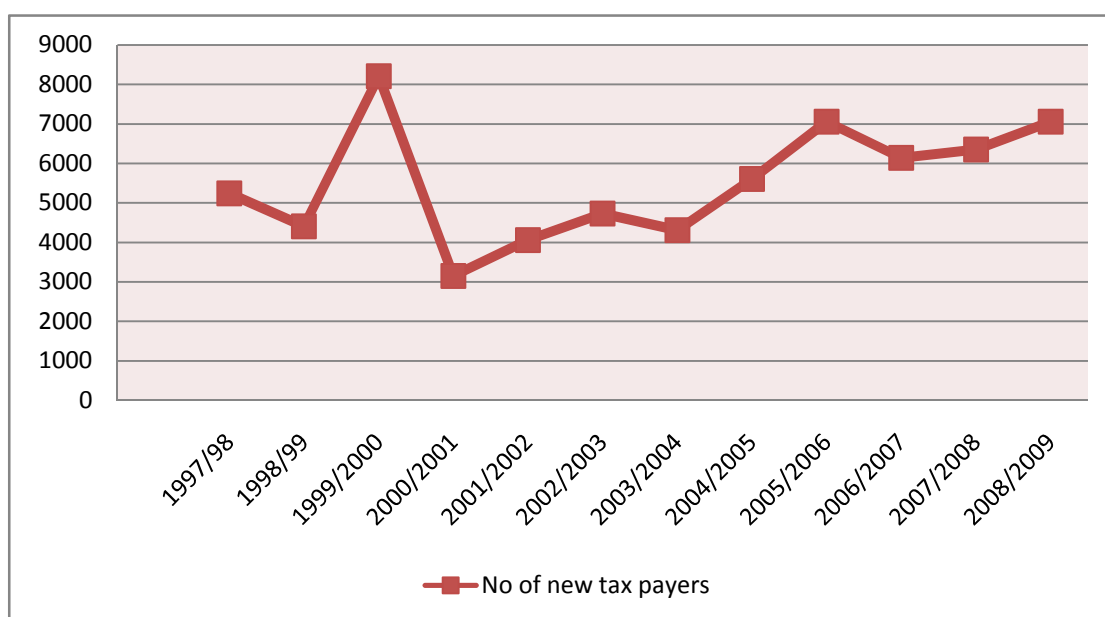
Registration and getting VAT certificate is the first function of both tax administration and business person. The numbers of sales tax registrant were 2045 at the time of introduction of VAT in 1997. Out of the threshold are registrants voluntary in VAT. Business community was opposition in the beginning and they discouraged to register in the VAT. Commitment of government, the registrants are increasing yearly and the private sector also favor of it. There are two departments in the introduction of VAT. VAT department and revenue department. In the past, some researchers registered in VAT department, to improve the revenue collection, refund, registration, audit, data management both revenues department and VAT department merged with the re-structurally inland Revenue department. Total registrants in PAN (Permanent Account Number) are 245550 and VAT are 54271 till 2008/09. The registration and registration cancellation can be seen from the following table

**Table No. 4.1, Trend for VAT Registration**

<b>Fiscal Year</b>	<b>No of new tax payers</b>	<b>Total no of tax payers</b>	<b>Increasing % of tax payers</b>
1997/98	5237	5237	
1998/99	4405	9642	84.11
1999/2000	8205	17947	86.13
2000/2001	3146	21093	17.53
2001/2002	4056	25149	19.23
2002/2003	4723	29872	18.23
2003/2004	4302	34174	14.4
2004/2005	5602	39776	16.39
2005/2006	7055	46831	17.73
2006/2007	6134	52965	13.1
2007/2008	6346	53958	11.99
2008/2009	7054	54271	13.07

Source: Inland Revenue Department (IRD) (2009/10)

**Figure No. 4.1, Trend for VAT Registration**



Source: Inland Revenue Department (IRD) (2009/10)



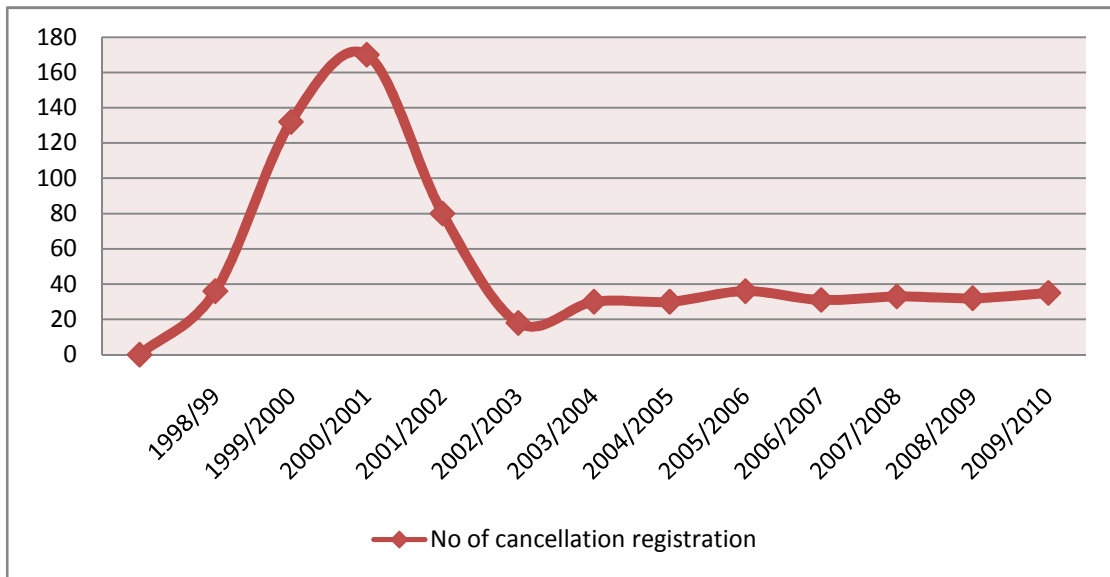
From the above table 4.1, researcher can say that the total no of tax payer is in increasing order because the total number of new tax payer or total no of tax payer is 5237 in the Fiscal year 1997/98 (i.e. VAT implementation period). After this, in 2008/09, the total number of new tax payer and total numbers of tax payers are 7054 and 54271 respectively.

**Table No. 4.2, Number of Tax Payer Canceling Registration.**

<b>Fiscal Year</b>	<b>No of cancellation registration</b>	<b>Total</b>	<b>Percentage</b>
1998/99	36	36	0.7
1999/2000	132	159	1.3
2000/2001	170	329	0.9
2001/2002	80	409	0.4
2002/2003	18	427	0.1
2003/2004	30	457	0.1
2004/2005	30	487	0.1
2005/2006	36	523	0.1
2006/2007	31	554	0.1
2007/2008	33	598	0.1
2008/2009	32	612	0.1
2009/2010	35	554	0.1

Source: Inland Revenue Department (IRD) (2009/10)

**Figure No. 4.2, Number of Tax Payer Canceling Registration**



Source: Inland Revenue Department (IRD) (2009/10)

Registration canceling is the regular process of VAT. There are many reasons to cancel the registration like it is the corporate organization closed, individual ownership being death, partnership, dissolved, nil trisection year, zero report, confusedly registered etc.

In the above table in the year 1998/99 the 36 registrants cancelled deregistration and it is in increasing and decreasing order. Mainly the canceling order is going in decreasing order. In the year 2006/07, the number of cancellation is only 35.

#### **4.1.2 Trend of VAT Collection**

Value added tax is the best form of sales tax, which is natural regarding method of production and helpful in generates more revenue collection. Because of its broad coverage, naturally, transparency and fairness, VAT will generate more revenue with less distortion. The revenue collection from VAT in different fiscal year is presented below.

**Table No. 4.3, Trend of Revenue Collection from VAT**

(Rs in Millions)

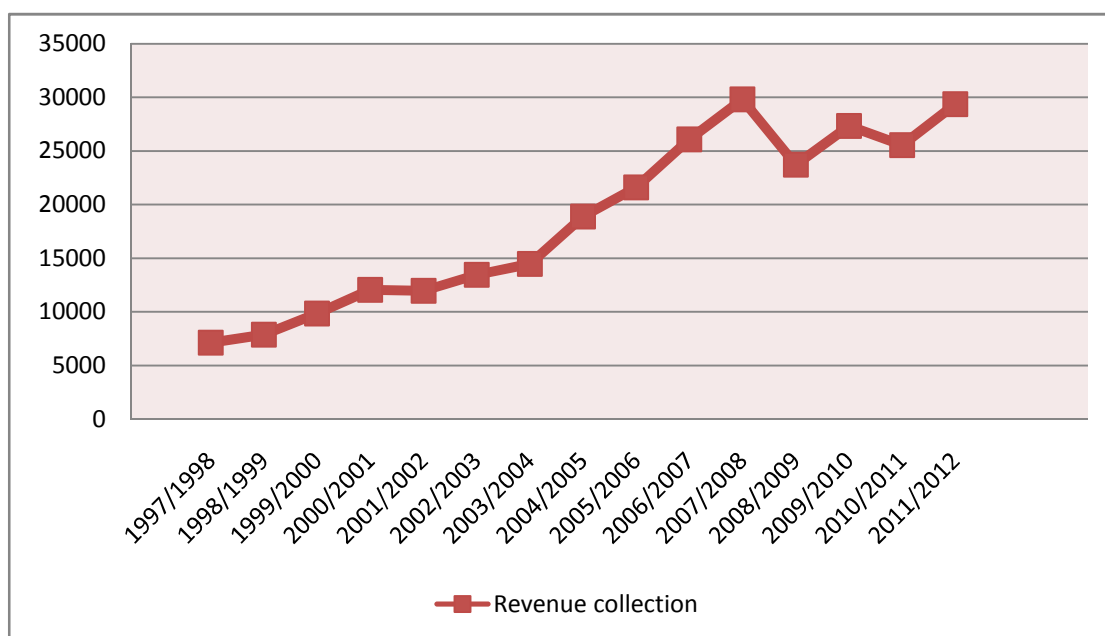
<b>Fiscal Year</b>	<b>Revenue collection</b>	<b>Percentage change</b>
<b>1997/1998</b>	<b>7132</b>	
1998/1999	7882	10.5
1999/2000	9855	25
2000/2001	12048	22.3
2001/2002	11964	-0.7
2002/2003	13460	12.5
2003/2004	14479	7.6
2004/2005	18885	30.4
2005/2006	21611	14.4
2006/2007	26096	20.8
2007/2008	29816	14.26
2008/2009	23741	-20.38
2009/2010	27331	11.5
2010/2011	25541	9.3
2011/2012	29371	11.4
Total	279212	168.88
Average	18614	12.06

Source: Economic Survey 2011/2012, MoF

From the above table 4.3, researchers can clear that the value added tax revenue is increasing year to year. VAT generated about 7132 million in the fiscal year 1997/98. In the year 1998/99, it reached up to 7882 million that is 10.5% more than previous year similarly it is increase year to year. In the year 2007/08, it is increased 14.26 % to previous year. Though, VAT collection has reached Rs. 29731 million in the fiscal year 2011/012. Despite the various difficulties in the implementation of VAT, the collection trend of revenue through VAT is not bad. Value added tax is increasing radically except fiscal year 2001/02. there are many facilities in value added tax i.e.

minimum rate, tax credit, tax refund, deregistration zero tax rate, threshold, exemption facilities in value added tax, now tax rate is 13 percent.

**Figure No. 4.3, Trend of Revenue Collection from VAT**



Source: Economic Survey 2011/2012, MoF.

It is expected that VAT will generate more and more revenue in the days to come when it is implemented effectively and effectively. Since VAT is broad based tax it will provided a stable base of revenue to the government.

#### **4.1.3 Contribution of VAT in Government Revenue**

The income of the government through all sources like taxes, fees, fines, donation, etc is called government revenue. Government revenue may be divided into two main headings: tax revenue and by non tax revenue. Tax revenue contributes about three quarters of total revenue while non-tax revenue respondents about one quarter of total revenue of the central level. The trend and composition of tax revenue and non-tax revenue in the recent year are given is following table.

#### 4.1.3.1 Contribution of Direct and Indirect Tax on Total Revenue

**Table No. 4.4, Composition of Total Revenue**

(Rs in millions)

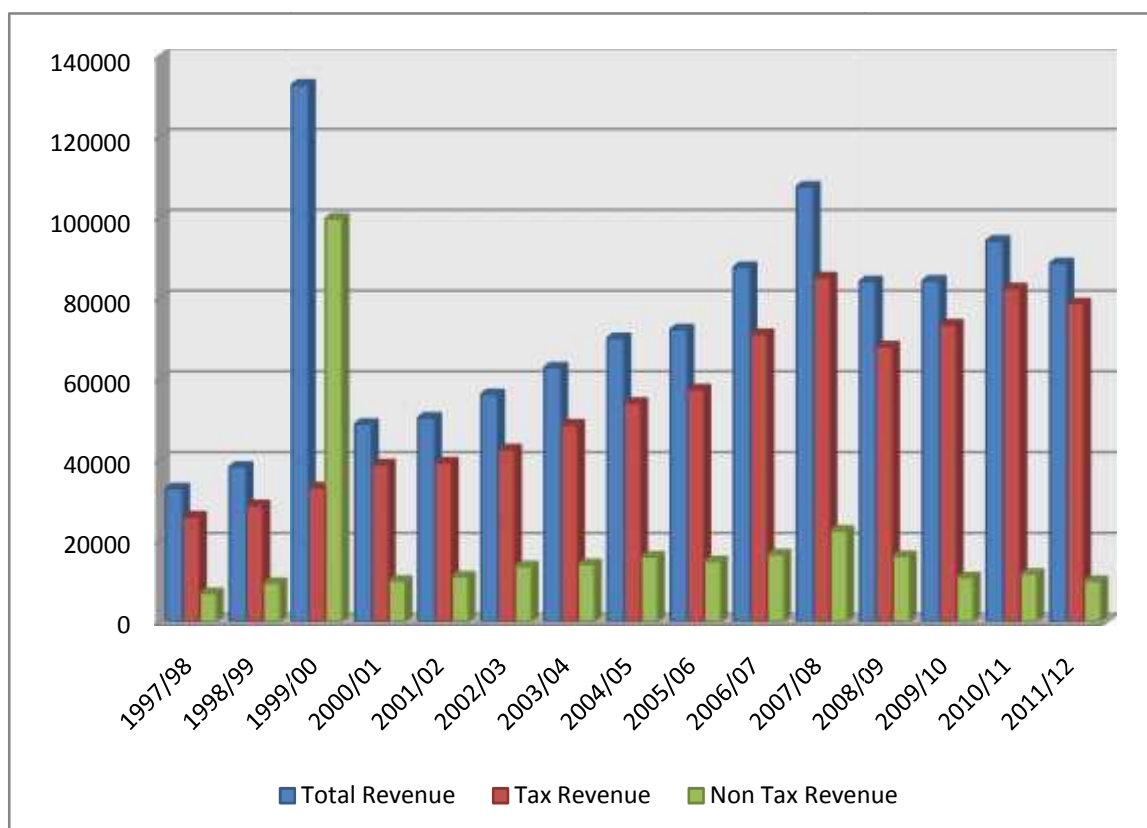
Fiscal Year	Total Revenue	Tax Revenue		Non Tax Revenue	
		Amount	%	Amount	%
1997/98	32937.9	25939.8	78.7	6998.1	21.3
1998/99	38251.3	28752.9	77.2	9498.4	22.8
1999/00	132866.7	33152.1	77.3	99714.6	22.7
2000/01	48893.9	38865.1	79.5	10028.8	20.5
2001/02	50445.6	39330.6	78	11115	22
2002/03	56229.8	42586.9	75.7	13642.9	24.3
2003/04	62871	48713	77.3	14158	22.7
2004/05	70122.7	54104.7	77.2	16018	22.8
2005/06	72282.1	57430.4	79.5	14851.7	20.5
2006/07	87712.2	71126.7	81.1	16585.5	18.9
2007/08	107622.5	85155.5	79.1	22467	20.9
2008/09	84203	68080	80.9	16123	19.1
2009/10	84371.2	73495.1	87.11	10876.1	12.89
2010/11	94235	82478.7	87.52	11756.3	12.48
2011/12	88672.4	78703.7	88.76	9968.7	11.24
Total	1111717	827915.2	1204.89	283802.1	295.11
Aggregate Average	74114.49	55194.35	80.33	18920.14	19.68

Source: Economic Survey 2011/12, MOF

The above table shows the composition of Nepal's total revenue, which constitutes tax and non-tax revenue from the fiscal year 1997/98 to 2011/2012. The share of tax revenue has always been greater than the share of non-tax revenue. This indicates that the role of tax revenue. This indicates that the role of tax revenue is very much important in revenue mobilization of Nepal and to meet the increasing government expenditure.

In the Fiscal year 1998/99, the total revenue collection was Rs. 32937.9 million in which the contribution of tax and non tax revenue was 78.7% and 21.3% respectively. In the fiscal year 2011/2012 the total revenue collection was Rs.88672.4 million in which the share of tax and non tax revenue was 88.76% and which indicates that the contribution of both tax and non tax revenue total revenue seem to be growing simultaneously.

**Figure 4.4, Composition of Total Revenue**



Source: Economic Survey 2011/2012, MOF

#### 4.1.3.2 Contribution of VAT in total revenue

VAT plays a vital role for revenue generation. The share of VAT in the total revenue is shown in the following table 4.5.

**Table No. 4.5, Contribution of VAT in total Revenue**

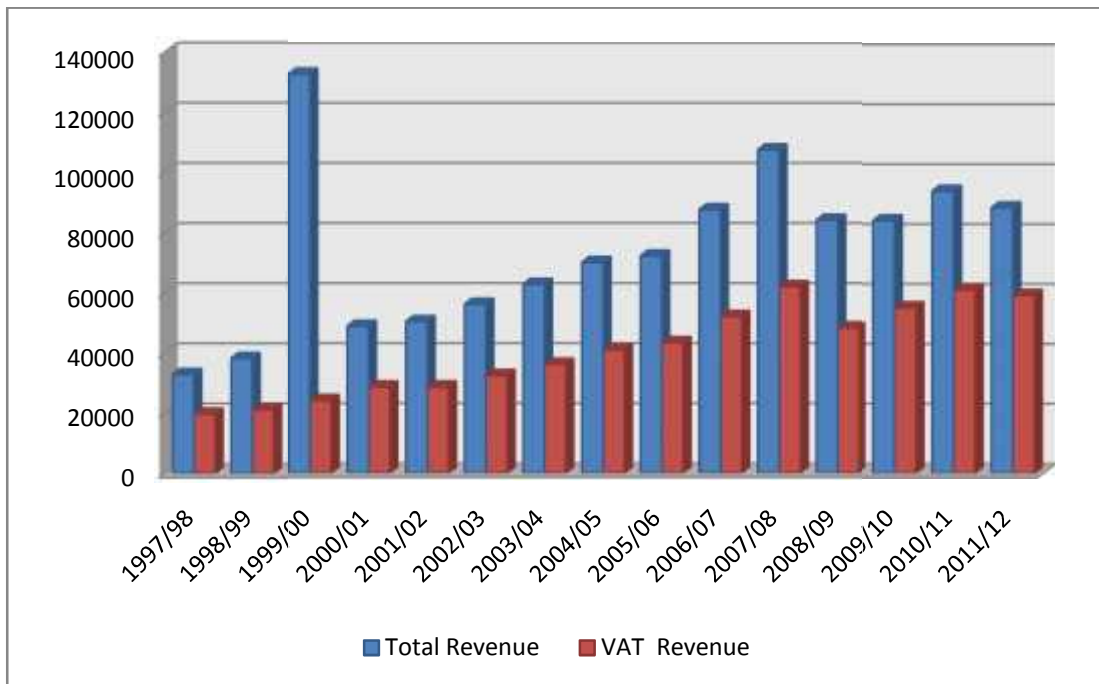
Year	Total Revenue	VAT Revenue	% of TR
1997/98	32937.9	19751.9	59.97
1998/99	38251.3	21236.8	55.52
1999/00	132866.7	24200.7	18.2
2000/01	48893.9	28705.7	58.71
2001/02	50445.6	28733	56.96
2002/03	56229.8	32481.2	57.76
2003/04	62871	36260.4	57.67
2004/05	70122.7	41032.9	58.5
2005/06	72282.1	43462.3	60.12
2006/07	87712.2	52146.4	59.45
2007/08	107622.5	62067.8	57.67
2008/09	84203	48365.8	57.45
2009/10	84371.2	55351.9	65.6
2010/11	94235	61243.3	64.99
2011/12	88672.4	59456.1	67.05

Source: Economic Survey 2011/2012, MOF

The above table 4.5 shows the contribution of VAT in total revenue. In fiscal year 1997/1998 contribution of VAT in total revenue was 59.97. In fiscal year 1999/00, contribution of VAT was decreased dramatically and reached at 18%. After that the trend of contribution of VAT in total revenue was in increasing trend with slight fluctuation and in the fiscal year 2011/2012 it reached at 67.06, which indicates that the contribution of VAT in total revenue seems to be growing simultaneously.

The contribution of VAT in total revenue from fiscal year 1997/98 to 2011/2012 is also presents in figure below.

**Figure No. 4.5, Contribution of VAT in Total Revenue**



Source: Economic Survey 2011/2012, MOF

## **4.2 Empirical Study of VAT**

There have been various empirical studies conducted before and after the VAT implementation of VAT system in Nepal. It is viewed that this system has not been implemented effectively as expected. There was a strong opposition from the business community during the earlier period of VAT implementation. In that time, there was a negotiation between private sector and government on the different aspects and provisions of VAT. After that, VAT was extended through the retail level and thus implemented in its full-fledged form. In the beginning period of VAT implementation, there was lack of skilled and trained manpower and setup properly. But currently different informative programmes, seminars and meeting were held to make the businessmen. Consumers and people know to the VAT currently business community is also in favor of VAT and further demanding to identify and include into the tax net. In such situation an empirical study is done to know the views of person



of different field on different aspects of VAT. For the purpose of survey, different questionnaire were prepared to know the opinion of the various persons of different field (i.e. tax experts, tax officers, businessman, consumer and student). The responses received from various respondents have been arranged tabulated and analyzed in order to facilitate the descriptive analysis of the study.

#### 4.2.1 View of Billing System

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

**Table No. 4.6, View of Billing System**

Respondent	Possible		Impossible		I don't know		Total
	No.	%	No.	%	No.	%	
Tax experts	15	100					15
Tax officers	10	100					10
Businessman	5	50	3	30	2	20	10
Consumer	5	25	10	50	5	25	20
Student	9	60	6	40			15
Total	44	63	19	27	7	10	70

Source: Field Survey 2012

From the field survey, it is found that all tax experts and officers advocate for the possible of billing system in VAT system. 50% businessman claimed that billing system is possible at the same time 30% argue that it is impossible and 20% are unknown about it. 25% consumers say that there is possibility, 50% say impossible and 25% say I don't know. Similarly 60% students say possible and 40% says impossible about it.

#### 4.2.2 Demanding of VAT bill

As while introducing VAT there is fear amount the consumer and organization that it will raise the price of goods and services. So that consumer, businessman and organization always make excuses to demand bill due to lack of education that VAT bill does not allow the increment of price. Government has provided limitations for payment of VAT but consumer always went to stay below the level to escape from the VAT. This trend seems in the context of Nepal. It is necessary to key the revenue of the nation transparent.

**Table No. 4.7, Percentage of Customers Demanding VAT bill**

Respondent	Around 10%		Up to 20%		20 to 60%		Above 60%		Total
	No.	%	No.	%	No.	%	No.	%	
Tax experts	12	80	3	20					15
Tax officers	10	100							10
Businessman	6	60	4	40					10
Consumer	12	60	8	40					20
Student	8	53	7	47					15
Total	48	69	22	31					70

Source: Field Survey 2012

According to the VAT bill demanding by consumer is it too low in practice. Out of 70 respondents 69% agreed around 10% consumer demand VAT bill where as 31% respondent around 20% ask for VAT bill. They also mention that the governmental

and other clients, who are forced to need VAT bills by their rules and regulation only demand VAT bills.

### 4.2.3 Problems in the Process of VAT Implementation

The tax payer and the tax collectors both have to be well known and conscious about the record keeping and process of VAT system. Through 10 years have been already passed, but still it has a great challenge in this aspect. The respondents were asked for their views to explore the problems that implementation aspect is facing. The study shows registration collection, tax refunds are main problems for the implementation.

**Table No. 4.8, View on Problem in the Process of VAT**

Respondent	Registration		Collection		Tax refund		I don't know		Total
	No.	%	No.	%	No.	%	No.	%	
Tax experts	9	60	3	20	3	20			15
Tax officers	4	40	4	40	2	20			10
Businessman	2	20	3	30	5	50			10
Consumer	6	30	4	20	8	40	2	10	20
Student	5	33.33	6	40	3	20	1	6.67	15
Total	26	37	20	29	21	30	3	4	70

Source: Field Survey 2012

60% tax experts, 40% tax officer, 20% businessman, 30% consumer and 33.33% student agreed around 37% in total showed registration as the problem while for 20% tax expert, 40% tax officer, 30% businessman, 20% consumers and 40% students in total 29 collections in problem. Similarly for 20% tax expert and tax officers, 50% businessman, 40% consumer and 20% students in total 30% refund in problem, 10% consumers and 6.67 students unknown about it.

#### 4.2.4 Major weakness of VAT implementation

The VAT should be introduced after a considerable level of the preparation creating infrastructure organizing a proper and the efficient administration and providing minimum required level of taxpayer education in Nepal. If the VAT is implemented hurriedly on presumptive basis without making the full presumptive basis without making the full and adequate preparation the VAT system could be distractive and counterproductive in least developed country like Nepal.

In order to know the major weakness of VAT implementation, respondents were requested to rank their responses on the given choice. The question was "What is the major weakness of VAT implementation?"

**Table No. 4.9, Major Weakness of VAT Implementation**

S.N.	Weakness of VAT	No. of Respondents	%	Rank
a.	Costly system in management	18	26	2
b.	lack of consciousness of tax payers	20	29	1
c.	Administration corruption	10	14	4
d.	Government has do proper home work	15	21	3
e.	Lack of canalized impact export system	7	10	5

Source: Field Survey 2012

The major weakness of VAT implementation ranked in the order of preference of the respondents is as follows.

1. Lack of consciousness of tax payers.
2. Costly system in management
3. Government has to do proper home work.
4. Administration corruption
5. Lack of canalized import export system.

#### 4.2.5 Responsible for Tax Evasion in Nepal

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

**Table No. 4.10, Responsible for Tax Evasion**

Respondent	Business Enterprises		Tax Administration		Consumers		All		Total
	No.	%	No.	%	No.	%	No.	%	
Tax experts	15	100							15
Tax officers	3	30	2	20	5	50			10
Businessman	2	20	5	50			3	30	10
Consumer	7	35	4	20	3	15	6	30	20
Student	7	47	2	13	6	15			15
Total	34	49	13	18	14	20	9	13	70

Source: Field Survey 2012

From the above outcomes 100% tax experts, 30% tax officers, 20% businessmen, 35% consumers and 47% students supported that the most responsible group for tax evasion is business enterprises. Similarly 20% tax officers, 50% businessman, 20% consumers and 13% students viewed due to tax administration. Likewise 50% tax officers, 15% consumers and students claim that consumers are responsible for tax evasion, 30% business and consumers greed due to the all responsible group. Out of

total respondents 49% opinioned due to business enterprises, followed by 18% tax administration 20% consumers and 13% by all groups.

#### **4.2.6 Most Important Factor for Effectiveness of VAT**

Although it has been fifteen years from the implementation of VAT. However it has not yet secured the expected results. There are many problems existing in the implementation of VAT. It is necessary to identify the existing problems and solve them successively to make the VAT more successfully. Hence, there are so many factors for the effectiveness of VAT. These are proper implementation, broad coverage, tax education, effective and efficient administration and clear VAT laws and regulation. In order to know the most important factor for effectiveness of VAT in Nepal respondents were ranked their responses on the given choice. The question was "what is the most important factor for effective of VAT in revenue collection. The opinion survey on this context is summarized in the table.

**Table No. 4.11, Important Factor for Effectiveness of VAT in Revenue Collection**

<b>S.N.</b>	<b>Factor</b>	<b>No. of respondents</b>	<b>%</b>	<b>Rank</b>
1	Proper implementation	13	19	3
2	Broad coverage	6	9	5
3	Tax education	20	29	1
4	Effective and efficient administration	12	17	4
5	Clear VAT laws and regulation	15	21	2
6	If other	4	5	6

Source: Field Survey 2012

The important factor for effectiveness of VAT ranked in the order of preference of the respondents is as follows.

1. Tax education

2. Clear VAT laws and regulations
3. Proper implementation
4. Effective and efficient administration
5. Broad coverage
6. Other specify

Other important factors for effectiveness of VAT specified by some of the respondents are as follows:

- (a) Most professional people are required in tax department as well as in tax offices.
- (b) Reduction in the discretionary power of tax officers.

It can be conclude that clear rules and regulations and tax education to the public are the most important factors for the effectiveness of VAT in revenue collection.

#### **4.2.7 Major Problem of VAT in Nepal**

The questions of problem of VAT in Nepal were asked and given to rank from 1 to 10. The response has been received out of 70 respondents. The outcomes of the field survey in this aspect are given below.

**Table No. 4.12, View on Problem of VAT in Nepal**

<b>S.N.</b>	<b>Problem of VAT</b>	<b>No. of respondents</b>	<b>%</b>	<b>Rank</b>
1	Problem on billing system	10	14	2
2	Problem on open boarder with India	3	4	9
3	Problem on tax refund	6	9	6
4	Weak and traditional economic policy	5	7	7
5	Weakness in government economic policy	4	6	8
6	lack of awareness in public	15	21	1
7	Shortage of taxpayer participation	8	11	4

8	Lack of mutual understanding between taxpayer and tax administration	7	10	5
9	Lack of Launching enough special programmes	9	13	3
10	Difficult account system	3	4	10

Source: Field Survey 2012

The major problems of VAT in Nepal ranked in the order of preference of the respondents are as follows.

1. Lack of awareness in public
2. Problem on billing system
3. Lack of Launching enough special programmes
4. Shortage of taxpayer participation
5. Lack of mutual understanding between taxpayer and tax administration.
6. Problem on tax refund.
7. Weak and traditional economic policy
8. Weakness in government economic policy
9. Problem on open boarder with India.
10. Difficult account system.

#### **4.2.8 View on Rising in Price Due to VAT System**

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



**Table No. 4.13, View on Rising in Price Due to VAT system**

Respondent	Yes		No		i don't know		Total
	No.	%	No.	%	No.	%	
Tax experts	6	40	9	60			15
Tax officers	5	50	5	50			10
Businessman	6	60	3	30	1	10	10
Consumer	12	60	5	25	3	15	20
Student	6	40	5	33.33	4	26.67	15
Total	35	50	27	39	8	11	70

Source: Field Survey 2012

#### 4.2.9 Views of Single VAT Rate

Because of multiple rates, tax reform become much more complicated to both tax payer and tax officers. Despite this reasons different countries already implemented various tax rate according to their economic condition but all tax administrators prefer to use single rate of VAT to effective implementation. Likewise, Nepal has preferred a single VAT rate be effective or not. The outcomes are presented in the table below.

**Table No. 4.14, View of Single VAT Rate**

Respondent	Effective		No Effective		i don't know		Total
	No.	%	No.	%	No.	%	
Tax experts	12	80	3	20			15
Tax officers	6	60	4	40			10
Businessman	5	50	3	30	2	20	10
Consumer	6	30	12	60	2	10	20
Student	4	26.67	6	40	5	33.33	15
Total	33	47	28	40	9	13	70

Source: Field Survey 2012

According to the survey 47 % of the total respondents were concluded that the single VAT rate is effective. In contrast 40% of total respondents disagree with current single VAT rate. Remaining 13% of total respondents seemed to be unknown about it.

#### 4.2.10 Effective of VAT in Future

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

**Table No. 4.15, Effectiveness of VAT in Future**

Respondent	Yes		No		Total
	No.	%	No.	%	
Tax experts	15	100			15
Tax officers	10	100			10
Businessman	6	60	4	40	10
Consumer	6	30	14	70	20
Student	9	60	6	40	15
Total	46	66	24	34	70

Source: Field Survey 2012

According to the field survey 66% of the total respondents were totally optimistic that VAT will be effective in future but 34% of total respondents were pessimistic that VAT will be effective in future.

### 4.2.11 Knowledge About VAT

The questions were "From which media you know about VAT" the opinion survey on this context is summarized in the table.

**Table No. 4.16, Knowledge About VAT**

Respondents	Radio/FM		TV		Hording Board		Pamphlets		Daily Newspaper		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	
Tax experts	4	26.67	5	33.33					6	40	15
Tax officers	3	30	2	20					5	50	10
Businessman	2	20	3	30	1	15	1	10	3	30	10
Consumers	8	40	6	30	1	5	2	10	3	15	20
Student	4	26.67	3	20	1	6.67	1	6.67	6	40	15
Total	21	30	19	27	3	4	4	6	23	33	70

Source: Field Survey 2012

According to the survey 30% of the total respondents were known about it from Radio/FM. Similarly 27%, 4%, 6% and 33% of the total respondents get idea about VAT from TV, Hording Board, Pamphlets and Daily Newspapers respectively.

### 4.3 Problem Faced By the Government in Effective Implementation of VAT

Theoretically, VAT is considered to the best fiscal tool through partially, it has many problems. VAT system entered in both year of its implementation in Nepal but implementation of VAT is not proceeding a desired pace. It is facing many problems and challenging in effective implementation. In spite of the most popular fiscal tool, Nepal is still facing number of challenges poor administration, political instability, mal practices, corruption etc. These existing challenges in the implementation of VAT in Nepal are explained below.

### **(1) Problem of Political Instability**

The government of Nepal has been facing the problem of political instability since the introduction of VAT in this country. Changing of government frequently creates many problems on VAT collection as well. Because different government have different attitudes and their own views that directly affect VAT collection, regulation and implementation. (The Kathmandu Post, 2002)

### **(2) Problem of Non-Cooperation between the Government and Private Sector**

Government policies in Nepal are often formed and implemented without a due consideration and preparation with regard to VAT the government never taxes the private sector into confidence. Private sector is not much involved in designing the VAT structure rules, regulation and solving the wide range of issue on one hand, the private sector is actively opposing the implementation of VAT, at least at present on the other hand, the government is firm to implement the new tax such a divergence would lead to many undesirable consequences which would make the VAT and unsuccessful.

The VAT structure, rules and regulation formed without consulting and discussing with the private sector are likely to become unpractical and non-operational. International experience also shows that the VAT is less likely to be effective or successful where the private sector does not fully co-operate the government. (Crow, 1993)

### **(3) Public Consciousness level**

Public consciousness is a basic element that should be at higher level in the people so that the government policy and programme can be guided at the right direction for achieving objectives of any government policies and programmes. In the context of Nepal it has a poor public consciousness level relating to VAT, the business community has been misinterpreting and also misguiding VAT to the people by saying that VAT certainly raises the price level of goods. But there is no voice against

such misguidance and miss-interpretation. The consumers, who are really interested to make the VAT effectively successful, want to get VAT bills on their purchases but they are not getting such bill from business community. Most of the consumers do not demand VAT bills when they are asked by the businessman to pay a 10% more amount to get VAT bill. But they don't know the fact that businessmen are covering the VAT amount into the price of the product indirectly. Thus by non-issuing proper bills, businessmen are cheating revenue to the government as they are collecting VAT amount from consumers indirectly.(Neupane, 2004) So far as the consumers remain unfamiliar with the different theoretical aspect and existing rules and regulations of the VAT, the problem will remain is existence. Thus very weak public consciousness level about VAT is being one of most significant problem for the proper implementation of Nepalese VAT system.

#### **(4) Geographical Barriers**

Geographical situation of our country has created an important issue about the applicability of VAT in Nepal. Land distribution seen to be extremely unequal. Such geographical condition has arisen several problems in the path of application of VAT in Nepal. In the remote areas where the people must bear the burden of higher prices of commodities due to service rendered by porters, animals and air transport. Because of these, the burden of VAT is higher in the remote areas than in other accessible areas which are clearly inequitable and unjustifiable. So the higher price level of commodities discouraged completely the VAT. In spite of that, there are small scale business activities in the remote areas. The revenue collection in such areas would be negligible amount as compared to collection cost. Therefore, the high collection cost does not permit VAT to be the applicable in some of the districts in Nepal. Similarly controlling and mentoring system of VAT in far and remote areas is not easy due to the lack of transport, communication etc. It is difficult to control the many functions of VAT like inspection, audit, tax refund, penalty, appeals in the remote areas due to the lack of adequate tax officers.

### **(5) Tax Evasion**

The large amount of illegal trade and other established tax evading practices pose a great challenge to a VAT in Nepal. Most of the tax evasion occurs at the import level. The existence of long open boarder, weak and easily corruptible tax administration are the major factors to facilitating tax evasion. There are several possible ways and forms of tax evasions in VAT in Nepal. These are:

- (a) Non registration
- (b) Seller doesn't report their sale to the tax authority.
- (c) Un-recorded trade
- (d) Dummy business
- (e) Smuggled goods supply by the channel of exempted business.

### **(6) Narrow Tax Base**

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

### **(7) Problems of Registration**

Some businessmen, especially small traders, who are liable to register, may not register themselves as tax payers. It is administratively very difficult to discover all the legal tax payers under the VAT system because of the threshold limit. Tax evaders may take a good advantage of this difficulty. Further non-compliance of the tax from the registered taxpayers may also occur due to administrative weaknesses. (Adhikari, 2005)

### **(8) Weak Tax Administration**

An effective and efficient administration is crucial for the proper implementation of VAT but in Nepal. VAT administration is still in traditional nature and corruption is being a major problem. Transparency is being only a nice slogan but lacking in real field. Tax officials are not given specialized training on various aspects of taxation. Some of the tax officers are still not familiar with the basic and essential concepts of VAT and even new entrance to the tax administration are directly posted to field to field officers without being given and basic training for their jobs. There is lack of adequate auditors, treaty negotiators and trained personnel on various aspects of taxation. There is also no system of performance based evaluation of the tax official for promotion to higher levels. Due to the weak tax administration, there is a big gap between legal system and its actual operation. Besides that administrative inefficiency is another most serious problem for implementing VAT. For effective implementation, qualified, intelligent, well-trained manpower are necessary effective even from the traditional period and system has not been still improved. Also there is not motivation for consumers to get bills on their purchases.

Under the VAT system whenever invoice is not issued corresponding to each sale, a part of revenue is lost to the government. Each invoice issued by a VAT registrant is just like a NRB cheque to the government. In current status of Nepalese economy bills are not issued or they are not properly issued once the invoices are not issued properly in the initial stage, it encourages issuing invoices accordingly in the successive stages of production and distribution, so that a significantly high volume of

revenue is lost to the government. Thus, smuggling and under valuation that takes place in the earlier stages encourages the traders of successive stage to issue face invoices and thus both the problems are highly interrelated.

#### **(9) Smuggling, Under Valuation and Unauthorized Trade**

Nepal has long border with both neighboring countries India and China. However the border with China is not being a serious problem due to the geographical inconveniences caused by mountain area. There is no easy way to pass through the Chinese border and hence level of illegal trade is negligible. But the open border with India is being most challenging issue and problem is still alarming. People of the India and Nepal may easily enter one another's country and buy goods not paying customs duties for personal use. However, major problem is due to the large volume of smuggling and under valuation transaction by business enterprises, rather than consumers. Once the goods are entered into the country by an undervalued billing, VAT revenue along with customs duties is lost and that can't be catch up in successive stage of distribution. Similarly the goods, which are entered through the illegal route, remain completely beyond the VAT net. Thus volume of smuggling and under valuation while importing goods from India. Besides that, there is not any measurement of unauthorized trade between Nepal and India. Many businessmen have claimed that only a little amount of goods from India come through customs. So it seems, unauthorized trade is very much organized and systematic in the border area. (Sharma, 1998:94)

#### **(10) Fine, Penalties and Prosecution.**

For any non compliance, penal provision has been made in the section 29 of the VAT act. Penalty may be imposed in the following circumstances.

- (a) In case of non-registration with VAT offices Rs. 10000 and the due tax amount for each tax period.
- (b) In case of failure to issue invoice or invoice not being in the prescribed format Rs. 2000 and the amount of tax collection.



- (c) In case the registered tax payers do not use the registration number in all the transaction related to VAT does not display the registration certificate Rs. 1000.
- (d) In case of collecting VAT without registration in VAT, amount of tax and 100 percent of such amount.
- (e) In case of not maintaining accounts as prescribed by act Rs. 10000 and now allowing tax officer for verification of accounts and other documents Rs. 500 for each default.
- (f) In case not mentioning date and price of transaction, VAT number of parties and other matters as prescribed Rs. 5000.
- (g) In case of Failure to submit prescribed format the statements of tax amount to be paid within 25 days after expire of the months irrespective of volume at transaction or nil transaction 0.05 percent per day or Rs. 1000 is more.
- (h) In case of under invoicing, Rs. 2000 for each invoices or doubles at tax amount penalties whichever is more as per Finance Act, 2001.

## CHAPTER FIVE

### SUMMARY, CONCLUSION AND RECOMMENDATION

#### 5.1 Summary

Undoubtedly, taxation and economic development are two closely interrelated concepts. Taxation has an important role in country's economic development. In recent decades, many developing countries around the world have begun to focus their poorly designed tax structures as an integral part of their development efforts. Such reform has established some new trends. One of such trends is the increasing acceptance of VAT as an important part of their tax reform program.

VAT is the latest innovation in the field of taxation for 21<sup>st</sup> century. It was first implemented in 1954 by the French government. Then after more than 135 countries of the world are being attracted towards this system. In Nepal, VAT was seriously considered during the first half of 1990 and came into practice since 1997. Some studies held in that period concluded that VAT was applicable to Nepal but its effective implementation through efficient administration was identified as a serious challenge. Adequate preparation suggested for its success in future.

The VAT is collected from sellers on the basis of their "value added" at each of the stage of business process. Thus the same value is never taxed twice and never produces cumulative effects. The types of VAT are three. They are; gross national product type, income type and consumption type.

Registration of the business vendors having taxable transaction and capacity is the first step of VAT operation in any economy. Each and every registered vendor should receive and give the bill while purchasing and selling the goods respectively. Every VAT registered person should keep book of record. Then tax return should be prepared and submitted to concerned tax office and pay the tax. Other important

aspects that are required for the successful operation of VAT are enforcement, auditing computerization, penalties etc.

VAT is superior to other types of sales tax because it has many attributes. These attributes are : Economic efficiency, Revenue productivity, Supporting economic growth, No excess burden, Equity norms, Simplicity of administration, Price stability, Accounting base, Self -policing, Catch up effect if VAT can be implemented effectively along with its different provision like exemptions, threshold, zero rating, it will be more equitable. Avoidance of pyramiding and cascading effects and providing cross auditing self policing and catch up effects are the most favorable feature of VAT which makes it superior then RST.

Rate structure plays major role in efficiency and the success and failure of a tax. There is remaining discussion about single or multiple rate of VAT. In single rate, administration is simple and easy to all business entity. In contrast, it reduced tax base or can't expand the tax base. In equity concern, Single rate doesn't support the social equity because of equal rate for all goods and services that consumed rich or poor people. Multiple rate system seems quite complex but it has so many positive attributes. Such as; It broads the tax base, It Increases revenue, It accepts the social equity.

Implementing VAT in Nepal is not only an easy task but also a highly challenging job. The main obstacles for successful implementing of VAT are: type of business structure and their malpractice, unclear distributional channel, credit sales system, seasonal market. This aspect should be improved as the time of demand. Special problems came up due to the existence of small trades in large portion. As many of small traders cannot fully comply with the requirement of a VAT due to their low scale of operation, lack up accounting records, illiteracy and high compliance cost. A problem arises on small treads them without no substation revenue loss and extra

burden on small traders. Fixing threshold limit to exempt the truly smaller traders is only the appropriate option of this problem.

The existence of open boarder and large number of unauthorized trade from India to Nepal poses a great threat to the success of VAT in Nepal. The illegal import from India and china would help to from a channel of unrecorded trade or black market channel resulting in a large-scale tax evasion. Because the tax administration is not strong enough to check or control the situation, the scope for illegal trade and tax evasion would not decrease even after the adoption of a VAT. The implication of unrecorded trade is that the genuine traders would be adversely affected and illegal trade would ultimately repeal the legal trade.

Due to the lack of experts a skilled manpower in the VAT administration, the auditing system, which is one of the most importance part of VAT operation, is not effective. Refund system is not easy task, process oriented and delaying .So that, the businessman are getting trouble to get the refundable amount. A public consciousness level is very low. Businessmen are cheating consumers by charging high price to them in the name of VAT. They are also cheating government by not issuing proper bills in their sales and hence do not pay real VAT amount.

The geographical condition of the country and difficulties would create several problems for the effectiveness of VAT in Nepal. In this condition, the applicability of VAT may be regressive. It adds additional burden to the remote area's people because miserable in equitable and unjustifiable. So the higher price level of commodities discourages completely the VAT.

Strong administration, educational, registration program, extensive training program, technical data base system, Co-ordination of various departments (i.e. IRD, CD, RID), High level VAT implementation team, co-operation between government and private Sector, etc are essential pre-requisites for success of VAT.

We cannot easily forecast the effects of VAT on various areas. In general considerations of various effects have been made extant by using some of the existing evidences. VAT would have a favorable impact on saving, investment and production activities of the country. VAT would also increase the competitiveness of Nepalese products. The business activities of country would get certain impact from the VAT business activities would get certain re-adjustment and business structure and practices would also change. The VAT would be helpful in promoting countries exports. But import would decline due to the raise in the prices of imported goods. VAT would have positive impact on the collection of income tax and import duties. Because VAT would disclose the trading records of businessmen making them more transparent, collection of income tax would certainly increase with VAT. The VAT would put the revenue at risk. Tax liability would be distributed among more unsophisticated taxpayers like trader; there is more danger of revenue leakage.

One of the best features of VAT is its catch up effect, which makes tax evasion impossible. But this effect is difficult to achieve in practical ground because of existing channel of illegal trade and undervalued transaction and lack of administrative capability to catch and destroy the illegal channel and regulate system fairly.

## **5.2 Major Findings**

On the basis of previous chapter and data presentation and analysis some important findings can be drawn. The major findings are viewed below.

- a) VAT is an advance form of sales tax. It has been spread all over the world within a short span of time. It has gain huge popularity that any tax had gained earlier in the history of taxation in such a short period.
- b) From the study it is found that there are lots of the traders, businessmen and general public do not have any clear idea about VAT and its aspects. They have been facing many problems such as pricing problems, main training

account problem and more over billing problem. Businessmen and traders are not encouraged by the government and tax administration.

- c) Non-registration of business is no problematic most businessmen above the threshold level have now registered. The implementation of problem of registration, collection, tax refund and miscellaneous.
- d) There has been a notable increase in the number of registration. During the year 1999/00 the total number of registrants was 17947 while in the fiscal year 1997/98 the total number of registrants was 5237. Similarly the revenue is Rs. 7882 million and 29371 million respectively in the year 1998/99 and 2011/12.
- e) 66% of the total respondents were totally optimistic that VAT will be effective in future but 34% of total respondents were pessimistic that VAT will be effective in future.
- f) 50% of the total respondents reached to conclusion that VAT will raise price of the commodities but 39% claimed not rise in price due to VAT system.
- g) 47% of the total respondent argued that current VAT rate is effective and 40% claimed that it has to be improved.
- h) Through ten years have been already passed but record keeping and process of VAT system has still a great challenges and problems for taxpayer. Most of the tax payers are unknown about the record keeping and process of VAT system. About 37% respondents provided their views on registration difficulty, 29% on collection process and 30% opinioned on problem of tax refund system.
- i) Out of total 49% respondents supported that the most responsible group for tax evasion is business enterprises, 18% respondents viewed due to tax administration and 20% respondents claims that consumers is responsible for tax evasion.
- j) Billing system is one of the major aspect of the effective implement of VAT but businessmen hardly issue bill to consumers, consumers too are not much interested in taking bills due to miss-concept of increase in the price of goods such practice has discouraged the consumers to demand VAT bill and is the

root cause of the failure of the billing system. 63% respondents claimed it is possible and 27% respondents claimed it is not possible in VAT system.

- k) Most of the taxpayers are not conscious about VAT system. Taxpayers are still unknown about its threshold, exemption, zero rating and related issues, which is essential criteria for VAT registration. It proves that government has no proper homework before its implementation.
- l) Smuggling business activities are increasing due to weak administration proper operation/ implementation. It is expected that VAT system help the government to control over these illegal activities.
- m) In the implementation of VAT in Nepal many problems arise which are as challenges in application of VAT. Narrow tax base, weak public conscious level, improved tax administration, political instability, geographical barriers, open boarder and unauthorized trade exist as problems in the implementation of VAT in Nepal.

### **5.3 Conclusion**

It is clear that, the tax is most essential source of the government revenue. Tax can be classified as two categories; direct tax and Indirect tax. 3/4 portion of total is occupied by Indirect tax. VAT is a major source of national revenue. It covers almost 1/3 share of total revenue. Thus the conclusion is that the prospects of VAT entirely depend on its implementation aspect. VAT has bright prospect in Nepal only when it can be implemented in a successful way further, the successful featuring depends up on the strong, fair, capable, honesty, taxpayer friendly and efficient administration.

Trend of VAT collection is increasing from the past. Government also adopted VAT as a foundation of revenue. This fact is shown in 10th plan, budget speech and strategies of Inland Revenue department. Nepal adopted open and liberal economy. Income level of Nepalese people is low, lack of industrialization. So, at present income tax can't contribute to national revenue because of above reason. High income

rate discourage saving and investment. Contribution of excise duty is not sufficient because lack of industrialization. Besides this, VAT is broad-based tax system. It has many attributes that increase the potentiality of VAT in Nepal. Strong political commitment, co-operation between customs offices and revenue offices, Co-operation between private sector and the government bodies, systemization of the open border, high public consciousness level, transparency and improvement of rules and regulation accordingly overtime. Thus VAT can be entrenched as an integral part of the Nepalese tax structure in the long run if the issues mentioned above are taken seriously.

There is no doubt about suitability of VAT for nation building. At present, Consumer awareness is gradually increasing, no one in opposition of VAT, All business communities accepted, Administrative capacity is strengthened, computerization system is applied are promote the implementation of VAT. Effective implementation of VAT helps other tax, Such as income tax, import duties. So many beauty aspect of VAT makes it popular. Thus, VAT has great potentialities for fulfillment of revenue scarcity.

#### **5.4 Recommendations**

- (a) Tax related information should be published regularly through journals, magazines. Newspapers, pamphlets, radios, television and cinema, interview programs with professors' researcher, tax experts, economists. It should be conducted and published through media. Similarly, the students at school as well as campus level should be given the knowledge about VAT. The school as well as campus level curriculum should include tax education and social obligation of paying tax.
- (c) The existing long open border is the main cause of smuggling trade under evaluation system. So border should be effectively controlled to prevent the illegal trade. There should be a effective checking system to prevent any kind of illegal trade in border side.



- (d) The billing should be made compulsory in business system should be developed in VAT system. The use of cash machines should be encouraged in the shops and departmental stores. Monitoring system of the VAT administration is not so effective. Because of this, taxpayers are still encouraged for tax evading practices. Many businessmen don't issue invoice for their selling and even do, follow the other improper invoices. So, an effective and efficient auditing investigation and monitoring system should be developed.
- (f) Strong political commitment is necessary for modernization and effective implementation of the VAT system. Separate VAT department should be established so that the specialization should be achieved in the matter of VAT and the burden of tax official could be reduced.
- (h) There should be a close co-operation between the private sector and government sector for the successful implementation of VAT. A proper co-operation between both sectors should be established confidently.
- i) An efficient, strong and fair administration is the most crucial for the proper implementation of VAT. VAT administration is still weak, traditional, corrupted in nature. In spite of these, there is lack of expertise, well trained and skilled officers in the VAT administration. So, informative programmes such as seminars,, training, discussion should be organized to make the tax officers skilled and capable in their field of job and service minded attitude needs to be developed in the mind of tax officers.
- j) Efficiency of Nepalese VAT system mainly depends upon its three major subsystems i.e. VAT policies VAT laws and VAT administration. So for the success of Nepalese VAT system in concerned, the emphasis should be given highly to these subsystems. Finally the effective and efficient implementation and development of VAT is only possible when there is fair understanding between the government tax administration, tax payers and other concerned parties. So they must have commitment, dedication and self-motivation to implement VAT in the future prospect. Apparently VAT cannot deliver the intended results unless these problems are addressed seriously.

## APPENDIX -1

### Value Added Tax in the world years Countries

S.N.	Name of country	Year
1.	France	1954 A.D.
2.	Ivory Coast	1960 A.D.
3.	Senegal	1961 A.D.
4.	Brazil & Denmark	1967 A.D.
5.	Germany	1968 A.D.
6.	Nether land & Sweden	1969 A.D.
7.	Ecuador, Luxembourg & Norway	1970 A.D.
8.	Belgium	1971 A.D.
9.	Ireland & Uruguay	1972 A.D.
10.	Australia, Bolivia, Italy, Vietnam & UK	1973 A.D.
11.	Costa Rica, Nicaragua, Chile, Argentina & Colombia	1975 A.D.
12.	Honduras, Israel & Peru	1976 A.D.
13.	South Korea & Panama	1977 A.D.
14.	Mexico	1980 A.D.
15.	Haiti	1982 A.D.
16.	Guatemala	1983 A.D.
17.	China	1984 A.D.
18.	Indonesia & Turkey	1985 A.D.
19.	Morocco, New Zealand, Niger, Portugal, Spain & Taiwan	1986 A.D.
20.	Grenada & Greece	1987 A.D.
21.	Hungary, Philippines & Tunisia	1988 A.D.

22.	Japan and Malawi	1989 A.D.
23.	Iceland, Kenya, Pakistan, Trinidad & Tobago	1990 A.D.
24.	Bangladesh, Benin, Canada, Jamaica, Mali, South, Africa & Estonia	1991 A.D.
25.	Tajikistan, Paraguay, Belorussia, Algeria, Fiji, Thailand, Ukraine, Cyprus, El-Salvador, Moldova, Kazakhstan, Kyrgyzstan, Russia, Dominican Republic, Uzbekistan	1992 A.D.
26.	Burkina Faso, Poland, Romania, Czech Republic, Slovakia, Venezuela, Turkmenistan, Azerbaijan, Armenia Georgia	1993 A.D.
27.	Bulgaria, Finland, Lithuania, Singapore, West Samoa, Congo Niger & Madagascar	1994 A.D.
28.	Gabon, Ghana, Switzerland, Malta, Latvia, Liechtenstein Mauritania, Togo & Zambia	1995 A.D.
29.	Albania, Belize, Uganda & Guinea	1996 A.D.
30.	Barbados & Nepal	1997 A.D.
31.	Croatia, Surinam, Mauritius, Tanzania, French, Polynesia Vanuatu, Sri Lanka, Mongolia	1998 A.D.
32.	Slovenia, Namibia, Mozambique, Papua New Guinea	1999 A.D.
33.	Macedonia, Dominica Botswana, Rwanda, Australia	2000 A.D.
34.	India	2005A.D.

Sources: Rup B. Khadka “*Preparation and Implementation of VAT in Nepal*”(1998)

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**APPENDIX -3**  
**QUESTIONNAIRE**

Dear Sir/ Madam,

I would like to introduce myself as a student of Central Department of Economics, Faculty of Humanities and Social Sciences, Tribhuvan University. As per the partial fulfillment of the Master Degree of Tribhuvan University it is compulsory to submit thesis so I am preparing this entitled "ISSUES AND EFFECTIVENESS OF VALUE ADDED TAX IN NEPAL ". I would like to share your valuable comment to make my study meaningful.

I assure you that this is only as academic research and your comment and suggestion will be kept confidential.

Sincerely

**Uttam Pathak**

Full Name: .....

Address: .....

Occupation: .....

(1) From which media you know about VAT?

- (a) Radio/F.M.  (b) T.V.   
(c) Hording Board  (d) Pamphlets   
(e) Daily Newspapers  (f) If other .....

(2) What is your view about billing system?

- (a) Possible  (b) Impossible  (c) I don't Know

(3) Could you please tell in percentage of the total customers demanding the VAT bills?

- (a) Around 10%  (b) Up to 20%   
(c) 20% to 60%  (d) above 60%

(4) What is the problem in the process of VAT implementation?

- (a) Registration  (b) Collection  (c) Tax refund   
(d) Miscellaneous  (e) I don't know

(5) What are the major weakness of VAT implementation (Tick any one)

- (a) Costly system in management   
(b) Lack of consciousness of tax payers   
(c) Administration Corruption   
(d) Government has do proper homework   
(e) Lack of canalized import export system

(6) Who is the most responsible group of the tax evasion?

- (a) Business enterprises  (b) Tax Administration   
(c) Consumer  (d) All

(7) What is the most important factor for the effective of VAT in revenue collection (Tick any one)

- (a) Proper implementation  (b) Broad coverage   
(c) Tax education  (d) Effective and efficient administration



(e) Clear VAT law and regulation  (f) in others .....

(8) What is the major problem of VAT in Nepal (Tick any one)

(a) Problem on billing system

(b) Problem on open boarder with India

(c) Problem on tax refund

(d) Weak and traditional economic policy

(e) Weakness government economy policy

(f) Lack of awareness in public

(g) Shortage of tax payer participation

(h) Lack of mutual understand between tax payers and tax administration

(i) Lack of lending enough special programme

(j) Difficult account system

(9) Will price rise due to VAT system?

(a) Yes  (b) No  (c) I don't know

(10) Do you think the single rate of VAT (13%) is effective?

(a) Efficient  (b) No efficient  (c) I don't know

(11) Will the VAT be effective in future?

(a) Yes  (b) No

*Thanks for your co-operation*