

CHAPTER-I

INTRODUCTION

1.1 Background of the Study

Least developing countries including Nepal has been depend upon indirect tax for internal revenue generation. One of the best options regarding with revenue collection through internal sources is Tax. Taxes are emphasized in all countries developed as well as developing countries cause they have the potential for the yield of the tax system and achieving a system of taxation that satisfy the demand for equity and social justice.

Tax is a simple terminology is financial changes imposed on individual or legal entity by government. Therefore, it's a liability to pay to the government. Tax consists of direct and indirect taxes. Direct taxes refer to those taxes that are collected from the people and organization that are responsible for it, whereas indirect taxes are collected from those who are not directly responsible for paying taxes. In this contest, Value Added Tax (VAT) import export duties, excise duty, Custom duties are example of indirect tax. Value Added Tax (VAT) is the latest innovation in the field of taxation, which is broad based. It is consider as the reform tax system of the 21st century has already been implemented in popularity in more than 135 countries in the world VAT is multistage commodity and service based tax, which is levied on the value added business at different stages of production and distribution. It is impose on value of goods and services. So, the VAT is indirect tax depend upon customer.

The value added tax is broad based indirect tax. The term value added tax is not word wise. The term exist in English form value added tax. It is the nearest from the French word added value tax. In some states, the VAT is preferred to say as goods and services tax. VAT is general consumption tax assessed on the value

added to goods and services. It was first introduced in Germany in 1919 A.D. by Dr. William Von Siemens to replace the multistage sales tax in order to avoid the undesirable effects particularly cascading and pyramiding. The first country introduced VAT in Asia is Vietnam. Vietnam introduced VAT in 1973 but avoided in the same year and again raised in 1999 AD. Our neighboring country China introduced VAT in 1984. India also has used for full VAT from 2003. Nepal introduced VAT in 16 November 1997. However, the concept of this tax in Nepal was introduced in early years of 1990's. Government of Nepal 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 taskforce 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 tax force headed by professor Madan Dahal suggested implementing VAT in Nepal 1995. VAT related act and rules were enacted in 1995 and 1996 respectively. (*Kandel 2007*)

The current threshold for VAT registration is Rs. 2 million, these vendors whose annual turnover is below the threshold can, however, register voluntarily. Government has also announced compulsory Permanent Account Number (PAN) taking program to all business holder. It leads to create a mass campaign and awareness at public level regarding tax revenue system. There is persistent increase in the number of VAT registrations. It has crossed the 80,000 mark almost 82,433 business firms are registered in all over the Nepal up to Ashadh 2067. As the taxpayers are increasing the amount of revenue collection and the level of tax compliance are improving today. [*Sources: Annual Report FY 2066/067, IRD*]

According to Rup Bahadur Khakda, "Value Added Tax is not an additional tax, but has replaced taxes such as sales tax, hotel tax, contract tax and

entertainment tax that used to levied on the sale of goods and services. [Sources: *Khadka, 2004*]

According to Economy watch website “Value added tax properly known as VAT is a special type of indirect tax in which a sum of money is levied at a particular stage in the sale of a product or service.” [Sources: www.economywatch.com]

From above definitions, it is obvious that VAT is an indirect tax which is the newest and significant experiment done on the modern tax system. Like its predecessor ie. the sales tax, VAT is levied on the sales of goods and Services (GST). VAT is broad based tax as it also covers the value added into each commodity by a firm during all stages of production and distribution channels. It is a modern scientific tax system to improve the collection of taxes, to increase efficiency and to listen tax evasion. It is covering the value added to each commodity by a firm during all stage of production and distribution channels. It referred as the backbone of income tax system in Nepal. It makes transparency in all kinds of economic transaction has to make the wide area of economy.

VAT system has always been an important instrument for augmenting revenue, especially in developing countries, where it is the major sources of domestic income. It is also an important instrument for attaining a proper pattern of resource allocation, income distribution and economic stability, to conclude, VAT has been the most essential factor for the most developing country like Nepal and it is the revised form of sales tax.

Likewise still many problems are there for optimum level of output from VAT system of Nepal. Moreover, to make it one of the major contributions on revenue of the nation for self sustain, government must be able to generate sufficient revenue that is most important sources of financing. Through the proper administrative strategy, the national objective can be achieved.

Following are the some characteristics of VAT system in Nepal:

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

1.2 Statement of the Problem

Tax system plays a vital role for the development of the country Nepal has introduced comprehensive tax reform program after the restoration of the multi party democracy system in 2046 B.S. The implementation of VAT has been taken as an important part of this process. It is envisaged that through the implementation of this tax, the base of tax will become economically efficient and increase transparency in our entire tax system. In order to create conducting policy environment to implement. Value Added Tax more efficiently government made several changes in the customs and income tax system prior to the introduction of VAT on 16th Nov 1997 efforts were made to establish a legal and institutional basis for this and through taxpayers educational and awareness program regarding various aspect of this tax was imported to potential tax payers as well as different section of the society. When a situation is created where the customer him/herself is self-motivated to ask for an invoice, it will be an uphill to climb for VAT.

In the beginning stage of implementation of VAT, government had to defend to the market. VAT was as subject of strict opposition from the business community in the period of introduction. There was eleven-day strike in the main city of the country - Kathmandu based. The administration had to struggle to get tax payers registered. The businesspersons and industrialist, who directly or indirectly benefited from the VAT, were motivated to spread negative publicity.

Despite their hurdles, the VAT was implemented in 1997 but the factors such as custom valuation not being based on actual price, lack of tendency to execute fair business amongst the businessmen, tax payers not used to paying taxes inability of the revenue administration to make the audit system systematic and reliable, instability and insincerity of the government may be the main reason for this system not being as successful as in other countries. Nevertheless, the lack of awareness regarding this system amongst the taxpayers, tax administration (those who have knowledge are also motivated to cheat or evade the tax) and the public is also one of the main reasons for VAT's ineffectiveness.

On the other hand, government made VAT the main sources of revenue collection but the mainstream of VAT, billing system is very weak, still the consumers could not get genuine bills. Businesspersons try not to issue that bill and if issued, they ask for high value added price. So, the consumers have tendency of not taking the VAT bills.

Therefore, the general expenditure only could not cover by internal sources of revenue. Now the revenue saving is zero. This discourages the foreign assistance and only one way to the government is to broaden the tax base. To increase the VAT rate, where per capita income is low, then giving financial burden to the public. To be more specific to the problem, the study tries to find out the answers of following basic problems:

1. How much amount of VAT collected by government at different stage of sales for DELL computer?
2. What is the contribution of VAT in total tax revenue structure in Nepal?
3. What is the trend of registration and cancellation of VAT?
4. What is the impact of VAT on government revenue?
5. How much amount will be collected from VAT for coming 5 years?

1.3. Objectives of the Study

The basic objective of this study is to examine the present situation of Value Added Tax system of Nepal. The study aims to achieve the main system on effective implementation of VAT and will find out some solution for them. VAT is the most important segment of government revenue; Nepalese government could as compared to expected. It being a new growing concept to Nepal its effectiveness is still doubtful. There may be various reasons for not gaining the effective result from VAT as well as from total tax scenario. Therefore, the study tried to recommend a package of suggestions and solution for effective implementation and to help program makers for strategy formulation.

The study has been focus as detail investigation, analysis and evaluation of various aspects of value added tax. The basic objective of this study is to identify the VAT system in Nepal and provide suggestions to the government be as follows:

- To find out the amount of VAT collected by government at different stage of sales of DELL computer.
- To examine the contribution of VAT in total tax revenue structure in Nepal.

- To examine the trend of registration and cancellation of VAT.
- To find out the impact of VAT on government revenue.
- To forecast the amount of VAT collection for coming 5 years.

1.4. Significance of the study

In the present business competition, there is a global trend of the tax reform. There were as many as 25 tax reform program during 1984 to 1990 in major Asian developing countries and Latin America, east Europe and Asia from 1990 to 1995. Concerning those global trend of tax reform of Nepal could not be independent of such changes but will certainly influenced from such global changes. Government of Nepal decided to introduce VAT in the first quarter of the decade 1990. Due to the mid-term election and regular changes in government disturbs the smooth functioning similarly business community claims that VAT is not appropriate in Nepalese economy as it increase unnecessary tax burden to the tax payers and it is difficult to administrator too. However, the government claims that VAT is a modern and scientific tax system. It does not increase the tax burden but carry all the tax payers in a roadmap of tax brackets. So, it is possible to collect substantial amount of revenue. Tax being one of the major sources it helps the government to implement development activities. Therefore, the topic VAT and overall tax system are the integral part of our country's economy it is essential to improve its efficiently by minimizing problems and facilities the positive aspects.

This thesis will somehow illustrate its importance and suggest the government to make new strategy and implement the current program smoothly. The concept of VAT is slowly introducing in the Nepalese business environment. Now it is necessary to undertake research to find out the effectiveness of VAT

system. It was introduced in Nepal the business community was in favor of old tax system. Limited study is carried out in this issue and those already studied materials could not access the critical path for the future review and effective implementation of the VAT system. Therefore, it is necessary to undertake research activities to search out the key areas where certain change and corrections is necessary.

This study would be beneficial for the policy makers, private sector and other stakeholders. Policy makers would be able to identify the areas needed for improvement and for the proper implementation of VAT. Private sector would be able to identify the impact of VAT before and after the implementation. Similarly, it would help the researcher to carry out their research a step ahead about VAT.

In the content of availability of limited studies in this areas findings of this study would be helpful to the government for formulating strategies and making the tax administration more transparent as well as public oriented. Besides this, the study will largely be benefited in terms of refining the current issues, revising the plans and policies and targets the criteria and improving the overall impact of tax system to the national government, social community and other beneficiary groups.

1.5 Limitation of the Study

Each study has its own limitation and boundaries. This study also has various limitations, some of which are as follows:

1. This study is base on the availability of valuable and sufficient literature.

2. Major sources of data was secondary type thus the error consisted in those sources may perceive in this research.
3. The person selected for interview may not be sufficient to represent the universe.
4. Lack of availability of necessary secondary data related to VAT.
5. Due to time and resource, constraint data and information that were collected might not be sufficient for the study.
6. By nature of a research all the factors of VAT could not be explored in details.
7. The study is confined to Nepalese laws, acts, rules, ordinance, regulation and circular to income tax.
8. This research has been conducted to fulfill the requirement of MBS course with a prescribed time.

Although, findings of the study will be helpful to all concerned stockholders throughout the country.

1.6 Organization of the Study

The study has been organized into five different chapters, they are as follows:

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|-------------|---|---|
| Chapter I | : | Introduction |
| Chapter II | : | Conceptual framework and review of literature |
| Chapter III | : | Research Methodology |
| Chapter IV | : | Presentation and analysis of data |
| Chapter V | : | Summary, Conclusion and Suggestion. |

Chapter I provides an introduction of the study. It includes general background, introduction of VAT, Statement of the problem, objectives of the study, significance of the study, research methodology, limitations and organization of the study.

Chapter II is related to review of literature, which includes conceptual framework and review of related studies and research gap.

Chapter III contains rational of the selection of the study area, research design, universe and sampling, nature and sources of data collection, data processing and analysis, limitations of the study and availability of study.

Chapter IV is related with data analysis and presentation.

Chapter V states the summary, conclusion and suggestion of the study.

Then references, questionnaire used in data collection and calculation of trend and correlation are placed there after in annexes.

CHAPTER- II

CONCEPTUAL FRAMEWOK AND REVIEW OF LITERATURE

2.1. Conceptual Framework

2.1.1. Meaning of Taxation

While Benjamin Frenklin may have been right that death and taxes are the only certain things in life, (Franklin, 1979) this certainty definitely does not extend to the way taxes are levied tax system are continuously changing as countries align their tax system with involving economic political and administrative conditions.

In simple terminology, tax is a liability to pay an amount to the government. Tax is not voluntary, so it is compulsory contribution to the national revenue from nation's citizens. Everyone is subject to the tax law; we are all obligated to pay for a share of the cost of public goods. Of course, through our democratic process, as citizens we impose taxes on ourselves and all of us have a rightly to use our share of public goods provided by the government. As this way, government sets the rules of road, levies taxes and tools to pay for collective activities and construct/ buy public goods like highways.

According to professor Seligman "Tax is a compulsory contribution from a person to the government to defray the expense incurred in the common interest of all without reference to special benefit conferred" (Source: *Bhattarai & koirala 2009*)

In the words of plehn "Taxes are general contribution of wealth levied upon persons, natural or corporate to defray expenses incurred in common benefits upon the residents of the states." (Source: *Bhattarai & koirala, 2009*)

Finally, tax is a liability to pay an amount to the government. It is a contribution to the domestic revenue from taxpayers according to law, where, a taxpayer is not benefit directly.

2.1.2. Canons or Principles of Taxation:

A good tax system should have certain principles or canons. Different writers have their own opinion regarding the principle of taxation, some major principles are as follow:-

Adam Smith

-) Canon of Equity: This canon emphasizes paying the tax based on ability to pay. Tax should be levied on equal ground to all the taxpayers having equal incomes.
-) Canon of Certainty: As per canon of certainty, the time method manner and quality of the tax should be specific.
-) Canon of Convenience: The time, place and manner of tax payment should be convenient and the language of tax laws should not be complex.
-) Canon of Economy: The cost of the collection of tax should not be higher. There should be minimum difference between the amount that people are ready to pay tax and the amount that actually goes to the state treasury.

Bastable

- Canon of Productivity: Every tax system should be revenue productive, which means it should be taxed in that do not provide adequate revenue should be withdrawn.
- Canon of Simplicity: Every tax system should be simple to understand and applicable in public life. Complexity in tax system creates unnecessary hassles. Simple tax system with higher tax rate induces the taxpayer to compliance whereas complex tax system having lower tax rate may not be complied.
- Canon of Flexibility: Tax system should be flexible enough as per the requirement of the economy of the country. Higher the economy higher will be the revenue and vice versa. Similarly, higher the requirement of the revenue higher rate should be changed and tax rate should be minimum to the industries of necessity.
- Canon of Diversity: Tax system should not depend on limited income sources. It should cover wide range of income sources. This principle says that tax should be levied on various stages and various sources.
- Canon of Neutrality: The canon says that the tax should not affect the economic sector of country. Tax system should not only focus on collecting more revenue but also consider the offer in the economy.

In addition to these canons the other canon can be:

Canon of Co-ordination: In a democratic country central as well as local government have right to raise revenue. Therefore, coordination between central and local level government is necessary.

2.1.3. Types of Tax

Tax may be of various types. The rate and nature of tax may be different, as an economist has classified the tax from different angles. They have given a very long list of the types of tax. But on the basis of impact and incidence the tax may be classified into two types:

-) Direct Tax
- o Indirect Tax

A direct tax is really paid by the person on whom it is legally imposed. Direct taxes are levied on the income and property. The direct taxes have been used to bridge the gap of income and wealth inequality in the society. For example: Income tax, property tax, interest tax etc. An indirect tax is imposed on one person but paid partly or wholly by another. Indirect taxes are generally imposed on consumption of goods and services. The taxes on such goods and services are integrated with their price, selling those goods and services on higher price, the taxpayers easily transfer the burden on general consumers. For examples: excise duty, import and export duty and value added tax etc. (*Kandel 2007*)

2.1.4 Meaning of VAT

Generally, value added is sale value minus cost of purchase inputs in connection with the transaction. Then, value added tax (VAT) is an indirect tax that is imposed on different goods and services based on added value in different stages of production and distribution channels.

VAT 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 the 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 goods and services. VAT is on of the form 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 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 multistage 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 calculating VAT

Table 2.1
Process of Calculating VAT

Stage of Sales	Net purchase Price (Rs.)	Sales Price(Rs)	Value Added (Rs)	VAT @13% (Rs)
Manufacturer	100	200	100	13.00
Wholesaler	200	350	150	19.50
Retailer	350	500	150	19.50
Total	650	1050	400	52.00

Source: Arbitrary figure estimated during the study.

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

2.1.4.1 History and Evolution of VAT

Tax is collect by government to meet the need of budget. Among the various types of tax, the sales tax is one of the major sources. VAT is the most scientific system of sales tax. In the early days, the tax from the consumption and production is collected as sales tax. Now, it is completely replaced by the VAT. The concept of VAT was introduced in 1919 A.D. by Dr. Willhem Von Sieman in Germany this concept was brought to replace the “Usnatzsteuer” (multi stage sales tax) due to this undesirable effects, particularly cascading and vertical integration of the latter tax (MST) for the first time. The Germany knew the administrative complication of the VAT system. So, it has the fear to implement. Therefore the rate of unsatzsteuer is reduced instead of the implementation of VAT. In 1921 A.D., the America was implementing the corporate income tax. Professor Thomas Adams suggested the tax for the united state of America to replace the existing tax system until early 50s the development of VAT remained limited only in the theory. *[Sources: Bhattarai and Koirala 2009]*

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

In late 60s, VAT started to become popular countries like Denmark and Brazil adopted this system of tax in 1967. Germany also adopted VAT in the same year. In 1969 the countries like Netherland and Sweden also adopted VAT in their

countries, in 1970, 1971 and 1973 Luxemburg, Belgium and Ireland introduced the VAT respectively.

In Asia, Vietnam was the first country to adopt this most scientific tax system. The country adopted VAT in 1973. The trend being VAT popular was increasing all over the world. In 1977, 1984, 1985, 1986, South Korea, China, Indonesia and Taiwan adopted VAT respectively. Similarly VAT was adopted by Philippine in 1988. Japan in 1989, Thailand in 1992 and Singapore in 1994. In SAARC region Pakistan was the first adaptor of VAT and it implemented VAT in 1990. [*Sources: Bhattarai and Koirala 2009*]

Similarly, India introduced VAT first as modified Value Added Tax (Mod VAT) in 1996. But, actually in India, VAT replaced Sales tax on 4th January 2005. Through some state did not opt for VAT (for political reasons), majority of the state embraced VAT, states like Andhra Pradesh and Maharastra taking the lead. The empowered committee, constituted by government of India, provided the basic framework for uniform VAT laws in the states but due to the federal. Nature of Indian constitution, states do have a liberty to set their own valuations for the VAT levied in their own territory. (*Sources: System of Value Added Tax in Nepal*), ALDERLS:- Alliance of lawyers for research and development of legal sector in Nepal.

The following table shows that the evolution of VAT in the world:

Table 2.1.4.1
History and Evolution of Vat

VAT Adopting Year	Countries
1954	France
1960	Ivory Coast
1961	Senegal
1967	Brazil, Denmark
1968	Germany, Uruguay
1969	Netherland, Sweden
1970	Equator, Luxemburg, Norway
1971	Belgium
1972	Ireland
1973	Austria, Bolivia, Italy, United Kingdom
1974	Argentina, Chile, Colombia, Costa Rica, Nicaragua
1976	Honduras, Isrel, Peru
1977	Korea, Panama
1980	Mexico
1982	Haiti
1983	Domineer, Republic Guatemala.
1984	China
1985	Indonesia, Turkey
1986	Morocco, New Zealand, Niger, Portugal, Spain, Taiwan
1987	Grenada, Greece
1988	Hungary, Philippines, Tunisia
1989	Japan, Malawi
1990	Iceland, Kenya, Pakistan, Trinidad and Tobago

1992	Algeria, Armenia, Azerbaijan, Cyprus, Estonia, Kazakhstan, Russia, Tajikistan, Thailand, Turkmenistan, Uzbekistan, Moldova
1993	Burkina Faso, Czech Republic, Poland, Rumania, Georgia, Slovak Replica, Venezuela.
1994	Bulgaria, Finland, Lithuania, Singapore, Researchers Samara, Madagascar, Nigeria
1995	Gabon, Ghana, Switzerland, Zambia, Mala, Mauritania, Togo, Latvia.
1996	Albania, Guinea, Uganda
1997	Nepal, Barbados, Congo Republic
1998	Croatia, Mongolia, Sri Lanka, Tanzania, Vanuatu
1999	Cambodia, Cameron, Mozambique, Antis Netherlands, Papua New Guinea, Slovenia
2000	Australia, Macedonia, Namibia Swean
2001	Rwanda
2002	Lebanon
2003	India

[Source VAT four Year of Implementation, Khadka 2004]

In Nepal Value Added Tax act was enacted by 1995 and started to implement only at 16 Nov. 1997. It replaced the old sales tax, contract tax, hotel tax and entertainment tax.

2.1.4.2 Value Added Tax in Nepal

Nepalese ancient tax system was based on Vedas, smritis and purans. Directives propounded by yagyabalka, chanakya were main sources of taxation system in Nepal.

Value Added Tax replaced four different tax act such as sales tax act, Hotel tax act, contract tax act and entertainment tax act. It is believe that successful implementation of VAT will helps to generate custom duties and income tax also. It is expected to enhance the revenue collection and it is closely associated with the GDP. This act classifies into goods and services under three categories they are VAT able goods and services, exempted goods and services and zero rated goods and services. It is applied at a single rate (presently 13% and initially 10%) based on addition of value of the goods and services at each stage in the process of supply and delivery of goods and services.

Since, then second amendment have already been made on value added tax act 1995 and 8th amendment have been made in the value added tax rules, 1997AD. Various directives have been issued by the concerned authority to implement the VAT in Nepal. (Sources: System of Value Added Tax in Nepal, ALDERLS- Nepal)

Nepal cannot successfully and properly tear a curtain built from massive poverty, hunger, unemployment and social, political and geographical constraints over 50 years of planned development. Nepal cannot succeed to score much better than the 2.4% growth rate of GNP, where as the country like Indonesia and South Korea can achieve satisfactory growth rate of 6% and 7.7% respectively. [*Khadka Rup Bahadur, 2004*]

There is a global trend of tax reform. In this way there were as many tax reform. In this way there were as many tax reform program in major Asian developing countries and this trend continued on Latin American, East Europe and Asia. Relating the global trend of tax reforms, Nepal could not be independent of such changes but will certainly be influenced from such global changes.

To reduce the economy's dependency on foreign assistance for development expenditures, the government needs to continue its efforts to

mobilize domestic resources. While full implementation of the Value Added Tax is one area, they may have an immediate pay off. More broad based tax reforms are necessary to integrate the VAT with income and customs tax administration to produce more buoyant and responsive tax system.

At the early stage of VAT implementation, government has made a great effort to make VAT more effective and produce the business community in the period of introduction. Later there were some correction in VAT rules and regulation, they slowly business community accepted the system and further demanded it to extend through the retail level. It has been expected that VAT will help the government to collect more revenue than previous sales tax. However, VAT is not a hen that lays golden eggs but it could be turned into a Wels where we can trap the tax leakages.

It was introduced in 16th November, 1997 (1st Mangsir 2054) but still many businessmen in Nepal are not very clear on how this system works. Moreover this system requires proper recording of business transaction, which many firms lack, existence of small traders in large proportion and their inability to comply with the requirement of VAT due to their slow scale of operation, lack of accounting records, literacy and high compliance cost. The existence of open boarder and large amount of unauthorized trade from India to Nepal is a challenge for implementing VAT. [*Khadka Rup Bahadur, 2004*]

The current threshold for VAT registration is Rs. 2 million. Those vendors whose annual turnover is below the threshold can however register voluntarily. In these days, Nepal government has proposed a wide reform on VAT administration through the budget of FY 2066/067 and has aimed high revenue mobilization. Government has also announced compulsory PAN number taking program to all income-earning individual, which will also help to create a mass campaign and awareness at public level regarding tax and revenue system in Nepal.

Therefore, VAT is more scientific, it enhances the potentiality of tax by broadening tax base and minimizing tax leakage. It reduces smuggling, unofficial trade and corruption through transparency. If the government operates the VAT administration effectively and efficiently outcomes of VAT are to be positive and favorable on all sectors of business.

2.1.5 Types of VAT

VAT may be of various types. Basically they are categorized on several classifications. The most important of them is on the basis of its treatment to capital goods. So, the VAT has been classified into three types.

a) Consumption Type VAT

Under the consumption type VAT all capital goods purchased from other firms, in the year of purchase are excluded from the tax base, while depreciation is not deducted from the tax base in the subsequent years. Since investment is relieved from taxation under this variant of tax is known as the consumption. That is why this variant of VAT is known as the consumption type VAT. As exports are relieved from tax while imports are taxed the base of this tax becomes identical to the base of retail sales tax on consumer goods and services.

Nepal has adopted a consumption type multistage VAT system. Through this system, tax is levied on value added at each stage in the process of production and distribution practically speaking Value Added is never calculated directly but the same result is obtained indirectly by the input tax credit mechanism. ie VAT is levied on output and credit is allowed for the full amount of tax paid on the input including capital goods at previous stages. The end result is that each and every registrant pays VAT on its value added only.

Consumption Type VAT = Gross domestic produc

Cost of intermediate goods.

b) Income Type VAT

This type of vat does not exclude capital goods purchased from other firms from the tax base in the year of purchase. The variant however does include depreciation from the tax base in the subsequent years. Moreover, under this system an excess of years- end inventory over starting inventory is included. The tax falls both on consumption and net investment and the conceptual tax base of this variant is the net national income. This type of VAT has the difficulty in calculating income for a particular period. As a result only few countries practice this type of VAT.

Income Type VAT = Gross receipt – Cost of intermediate goods- Depreciation.

c) Gross National Product Type VAT

Under this variant capital goods purchased by firms are not deductible from the tax base in the years of purchase. Similarly, this variant does not allow the deduction of depreciation from the tax base in subsequent years. Thus the tax is levied both on consumption and gross investment and the conceptual tax base of this variant is gross domestic product.

So, GNP type VAT = Gross receipt- Cost of intermediate goods.

2.1.6 Features of Nepalese VAT system

The type of VAT adopted by Nepal is conventional similar to that implemented over 135 countries (Wikipedia, the free Encyclopedia) around the world, it has injected some special features into the VAT system to make it uniquely Nepalese. The following are the main features of the Nepalese VAT system:

-) Input tax credit
-) Tax exemption
-) Self- assessment
-) Threshold limit
-) Tax refund
-) Zero rating

Input Tax Credit

Registered businessmen are obliged to collect and remit VAT on their taxable transactions. These registrants are entitled to recover the tax paid on their purchase. This recovery or refund is known as an input tax credit (ITC). It is the total of the tax paid or payable on taxable goods and services purchased in Nepal and the tax paid on taxable goods imported into Nepal.

Where VAT is paid or payable by a registrant on a purchase or on imports the registrant is allowed to claim an input tax credit for those purchase used in the registrant's commercial activity.

However, the purchase of goods or services may relate in part to a commercial activity, in certain circumstances the purchase may not generate an input tax credit entitlement. When he/she sells goods or services these are tax most registrants are entitled to claim input credits for the tax paid on acquisitions of capital goods for use primary in commercial activities. Unlike the income tax deduction rules, the input tax credit for any VAT paid on capital goods in not amortized over the life of the asset. It can be claimed in full in the period in which it is acquired. If the capital goods are later put to a non commercial use, special change of use rules will apply. Taxpayers whose export is more than 50% of total

sales or those who are continuously on 6 months credit may claim for refund. Refund shall be paid back within 30 days from the receipt of refund claim. [

Source: www.ird.gov.np]

Tax exemption

The purchaser will not pay VAT on tax-exempt goods and services and the supplier is not allow input tax credit on purchase related to the following items [goods and services]:

1. These goods which is related with basic needs like rice, pulses, flour, fresh fish, meat, eggs, fruits, edible or piped water, wood fuel, kerosene etc.
2. Basic agricultural products are also tax- exempt for example; paddy, wheat, maize, millet, vegetable etc.
3. Social welfare services including medicine, medical services, veterinary services and educational services.
4. Goods made for the use of disabled persons.
5. Educational, cultural goods and services such as; books and other printed materials, radio and television transmissions artistic goods etc.
6. Personal services which is relate with services oriented activities, are also tax exempt, as for example, by professionals, by actors and other entertainment, people charging for academic and technical research and computer services.
7. Exemption from tax is also extend to the purchase and rent of land and buildings.

8. Financial and insurance services.
9. Postage and revenue stamps, bank notes, cheque books etc.

[Sources: <http://www.ird.gov.np> and book of bhattarai and koirala]

Self Assessment

Section 18 of the VAT act has required the tax payers to submit tax return on self assessment basis. VAT is levied on the basis of actual transaction. The businessmen him/herself knows best what transaction has taken place and what cost. Since the taxpayer has to maintain his/her sales record by themselves on the basis on invoices issued at the time of sales and purchase of goods and services, the VAT accounting is referred to as a self-accounting system.

Threshold Limit

Nepal's VAT regime seeks to keep small vendors outside the tax net, who are defined using a "turnover" threshold as the criteria. The threshold is currently set at Rs. 2 million. The VAT registration threshold has been unnecessarily controversial. If the threshold level is too high a majority of the businessmen may not come under the VAT net and such circumstances it will simply not be possible to implement VAT effectively. Therefore it is common to keep the threshold is fixed based on the administrative capacity, the capability to maintain accounts in the industry and commerce sector the need for revenue etc.

[Source: <http://www.ird.gov.np/information.php?c=vat>]

Tax Refund

It is a very important aspect of VAT which must be made simple easy and systematic. In the connection to export tax refund is grant after verifying the

export declaration forms, letter of credit or bill of entry and proof of payment to authenticate the export and the import declaration forms or purchase invoices to authenticate the tax paid on inputs. The inland revenue department has adopted an internal policy to provide refunds within 30 days of the receipt of the refund claim although the huge limit fixed under the law is 60 days. In the case of none exporter, there is a possibility of a future adjustment to the excess input tax credit. The carry forward system is there is no need for taxpayers to prepare refund claims and tax administration does not have to process refund claim.

[Source: <http://www.ird.gov.np/information.php?c=vat>]

Zero Rating

In addition to the positive rate of 13%, a zero rate was also prescribed under the Nepalese VAT. Zero rates were recommended for exports in order to maintain the competitiveness of Nepalese products in the international market. This is because VAT would not apply to the exports but exporters would receive input tax credit that means exports would be free from VAT.

[Source: <http://www.ird.gov.np/information.php?c=vat>]

2.1.7 Objectives of introducing VAT

VAT payers great role in the revenue mobilization in Nepal. Revenue is the blood of nation which is necessary to do any activities. So, the reason behind VAT system, it makes transparency in all kinds of transaction, helps to make the wide area of tax and discourages tax evasion. The main reasons or objectives of introducing VAT are as follows:

-) To make tax system neutral and efficient.

-) To increase revenue mobilization by broadening the tax base.
-) To minimize the cost of taxation.
-) To establish a transaction based transparent tax system.
-) To examine the contribution of VAT in total revenue GDP and tax revenue.
-) To examine the number of tax payers registered under VAT and cancelled the registration under VAT.
-) For economic development in the nation.

2.1.8 Method of Computing VAT

Consumption types of VAT system is popular and widely adopted in the world. In this type the real taxpayers is consumer but the service follower are only the tax collector agent and they are register on government revenue office. There are mainly three method of computing VAT liability. These are mention 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 process such as wages, rent, interest and profit. This method is suitable for income type of VAT
[Sources: Bhattarai and Koirala 2009]

B. Subtraction Method

We can assume that under this method tax base is determined through the means of subtraction by the name very simply value added is found out through purchase minus from the sales and rest of the amount regarded base net turnover.

And the net turnover is obtained by subtracting the cost of materials from sale proceeds. This method is suitable for consumption type VAT. $T = F \text{ (output)} - t \text{ (input)}$.

C. Tax Credit Method

The tax base to deposit to the government is calculated deducting the tax paid to purchase or receive the goods and services from the tax collected or changed in the sales. Under this system tax is imposed on total value of sales and tax payers 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 indirect subtract method in that it calculates the value added indirectly while calculating the tax.

$$T = F \text{ (Outputs)} - t \text{ (Inputs)}$$

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

2.1.9 Principles of VAT with regarding International trade

That period when Nepal was entered into WTO, the 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 of the trade and development. In the content of international trade, for applying VAT, there are two alternatives or principles. These two principles are largely depends upon the

goods and the policies of the nation. So, these two type of principles are found regarding international trade in the system such as maintained below:

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. Export is taxable and import is received from tax liability. Addition, subtraction and tax credit these three methods of consumption of VAT can be applied equally under this system but tax credit method is not suitable tax rate importing country needs to compute export is discouraged due to equal tax burden as domestic supply.

II. Destination Principle

Goods or services are taxed not at the place where they are produced but the place where they are consumed. VAT is levied on domestic consumption, meaning that VAT is levied on all imports while exports are relieved from VAT by means of zero rating. (ie. The tax payer gets refund of VAT earlier paid in purchasing raw materials and interrelated goods but he should not pay tax on added value). Many countries largely adopt this method. The main advantage of this principle is non-discrimination between import and internal production. This principle is favorable for promoting export. Many countries follow this principle because they are eager to boost export. Nepal's VAT system is also characterized by the principle of destination.

2.1.10 Registrant of VAT

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

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

2.1.10.1 Cancellation of the Registration

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

2.1.10.2 Obligation of the VAT Registrant

1. Submit VAT return and pay the collected VAT amount within the 25th day of the following month.
2. Provide tax invoice to their customer.
3. Maintain purchase and sales book separately for the VAT purpose.
4. Keep their VAT records for a period of 6 years.
5. Inform the Inland Revenue office of changes to the business including new address, telephone number or a reorganization of a partnership within 15 days.
6. Put their certificate of registration in the premises where customers may easily see and read it.

7. Allow tax officers to enter the business to examine the business records and the stock on hand.

[Source: Bhattarai and Koirala 2009]

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

1. The amount of VAT paid on purchases.
2. The amount of VAT collected on sales.
3. Method of distinguishing between taxable and exempt sales.
4. The time the goods and services were supplied.
5. Evidences that goods were exported. If any.

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

1. The invoice number
2. The invoice date
3. The supplier's name and PAN number in the purchase book.
4. The customer's name and PAN number in the sales book .
5. The taxable value and
6. The amount of VAT.

2.1.11. VAT Accounting

The effectiveness of VAT depends upon the VAT accounting system. It should not contain unnecessary details. So that, it cannot provide appropriate and useful information. The VAT accounting should be information based as well as less costly. The accounting in VAT is the process of mainly purchase, sales, VAT account and stock. Thus purchase and sales book are the main part of VAT accounting. Registrants should record all the purchase during the full period all the goods and services either trading or non trading appearing in separate columns. Likewise, the sales book is another main part of VAT accounting. It should be posted on the basis of sales invoice in chronological order.

The VAT according is monthly summary showing sources of the figures used in the VAT return. In order to complete the VAT return, a taxpayer need to ensure that the amount of VAT collected on sales, the time of goods and services supplied and provided that.

2.1.12. Tax Invoices

Every registrant is required to issue a tax invoice to the recipient in supplying any goods and services. It is necessary to mention sales amount, PAN of buyer' and self whether it is registered in VAT or not, address of seller, buyer, date of transaction, date of invoice issued etc. the invoice should be in sequential order for the fiscal year. Minimum copy of three must be raised.

2.1.13 Return filling

VAT is based on self assessment. Tax payer himself/herself calculates all taxes. Every registered taxpayer requires submitting the return to a tax officer within 25 days after the close of tax period.

2.0.14 VAT Collection

The producer and supplier are the agents for tax collection on behalf of the department on VAT administration. Usually they collect VAT on sales and deposit the collected amount after crediting the tax in prescribed public account. Tax should be collected in selling price that comprises the costs related to transportation and distribution expenses as well as profit. Excise duty, custom and other tax except income tax are also included under selling price. In Nepal if the taxpayers fails to deposit collected tax by regular system then tax officer may implement various methods and measures to collect the tax arrears.

2.1.15. Appeal

Taxpayer may file an appeal to revenue tribunal within 35 days against tax assessment on penalty charged by a tax officer. A provision of appeal to director general had been included in first amendment of VAT act as a choice of taxpayer.

2.1.16 Management Information System

Tax system should be backed up by good and effective information technology, which must be taxpayer friendly. Providing taxpayer adequate information at right time is very important. So, to meet this very purpose, a separate department has been set up.

2.1.17 Electronic System

Inland Revenue department has started computerized system which is internet based. It accepts electronic filling of TDS, installment Returns of income tax, VAT and electronic registration of PAN [E-PAN]. Its main purpose is to operate easily make data bank of tax related data. It records all the data according to the PAN number of the taxpayers.

2.1.18 Administrative Review

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

2.1.19 Offences

Following acts are considered with offence and fine and penalties will be imposed:

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

Source : Bhattraai and Koirala 2009

2.1.20. Reward

If a person provides information which is solid showing that a tax payer has evaded or attempted to evade all or some person of tax, he/she will be awarded with the amount equal to 20% of the amount of tax collected on that basis of such information.

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

[Source :Bhattarai and Koirala 2009]

2.2. Review of Related Activities

2.2.1. Theoretical Review

VAT is more scientific, so it enhances the potentiality of tax by broadening tax base and minimizing tax leakages. It reduces smuggling, unofficial trade and corruption through transparency. If government operates the VAT administration effectively and efficiently, outcomes of VAT are to be positive and favorable to all related sectors.

Nepal cannot successfully and properly tear a curtain built from massive poverty, hunger, unemployment, socio-political and geographical constraints over

45 years of planned development. The country cannot succeed to score much better than 2.4% growth rate of GNP, where as the country like Indonesia and South Korea can achieve satisfactory growth rate of 6% and 7.7% respectively.

There is a global trend of tax reform. In this way there were as many as 25 tax reform program between 1984 to 1990 in major Asian developing countries and this trend continued on Latin American, East Europe and Asia from 1990 to 1995. Relating the global trend of tax reforms, Nepal could not be independent of such changes but will certainly be influenced from such global changes. Considering this reality GON decided to introduce VAT in Nepal.

To reduce the economy's dependency on foreign assistance for development expenditures, the government needs to continue its efforts to mobilize domestic resources. While full implementation of the value added tax is one area that may have an immediate pay off. More broad based tax reforms are necessary to integrate the VAT with income and customs tax administration to produce a more buoyant and responsive tax system.

At the early stage of VAT implementation, government has made a great effort to make VAT more effective and productive. However, VAT was subject of a strict opposition from the business community in the period of introduction later there were some correction in VAT rules and regulation, then slowly business community accepted the system and further demanded it to extend through the retail level. It has been expected that VAT will help the government to collect more revenue than previous sales tax.

It was introduced in 1997 but still many businessmen here in Nepal are not very clear on working system of VAT. Moreover this system requires proper recording of business transactions, which many firms lack. Existence of small traders in large proportion and their inability to comply with the requirement of VAT due to their low scale of operation, lack of accounting records, illiteracy and

high compliance cost. The existence of open boarder and large amount of unauthorized trade from India to Nepal is a challenge for implementing VAT.

In this content, this topic was proposed for the research work. It is one of the important sides that require in depth study for the effectiveness of VAT system in Nepal.

The review of theoretical background of VAT is made with the coordination of the topic selected. Negative aspect that Nepal faced possible remedies that were previously recommended and positive aspects that in future Nepal can grab are analyzed based on the past data.

2.2.2. Critical Aspect

The government is facing to generate enough revenue through VAT for the national coffer due to ambiguous tax policies and discretionary tax administration. The government/s efforts are only focused at collecting more tax and raising tax rates rather than reforming the tax administration and simplifying tax procedures. (The contribution of VAT to national revenue is not anticipated although it has been eight years since its implementation)

The tax administration is yet to be taxpayer friendly while resolving 'practical difficulties' of entrepreneurs and traders. Frequent changes in policies and unrestricted reassessment system have created a lot of confusion, which in turn has been an impediment during implementation. (The VAT act has been amended seven times in the course of eight years.) but there are still a number of clauses and sub-clauses which need modifications. The government effort has remained at only paying lip service and it has failed to implement its commitments too.

Further Nepal's taxation system and administration is not conducive to business. There is no need to improve attitude and treatment of taxed officials, which is a major reason that people hesitate to go to tax offices. The diverse interpretation of laws and regulations have added extra legal burden on the business community. As a result, the share of tax in national revenue generation has not been able to pick up compared to the contribution of non-tax revenue sources.

The taxpayers are also equally responsible for making the taxation system dynamic and vibrant. Taxpayers tend to avoid segregated information to reduce tax liabilities and evasion is abundant. This is to see in future, how far the government programmers of campaign and tax-helper could n do in this matter.

A country with a high income tax can be well off, if it has zero tax tariffs. Scandinavian countries are prosperous despite taxes on income exceeding 50%, since they all maintain minimum duties, how tariffs enable people to become wealthy, even through income taxes may take always a substantial chunk of their money high tariffs prevent people from becoming rich.

Due to tariffs, resources be it manpower or raw materials automatically move to their most valued use in a free market. This increase efficiency and leads to wealth generation. Some industries will close, but those who can sustain could do much better. Those venders who undisclosed their business will quickly find other things to do. As one door closes, they will find another two opening. In India, many industries were crippled by lowering of tariffs, but many more came into existence that could now be competitive because their inputs could be obtained at much cheaper rates from abroad, the result was an explosion of manufacturing and retail activities India has never witnessed before. The Indian economy took off. It went from no growth to a rate of six to nine percent in the last 15 years a rate exceed only by china amongst the world's major economies.

Even now in India, the important tariffs are too high. Productivity gains are possible in India and in Nepal by eliminating import restrictions and duties altogether. In the meanwhile, we should cheer each and every reduction in duties, through never losing sight of our ultimate goal a duty free country.

By reduction in custom which businessmen loose and which businessmen gain is irrelevant. What is important and relevant is that the people of our country (Nepal). You and I as consumers stand to gain, that gain is a big goods of quality will costs less and employment opportunities will skyrocket as Indians, Chinese, Bangladeshis and people of other countries flock to Nepal to pick up duty free gods.

The government has been able to collect value added tax (VAT) more than the target but it has failed to meet the mark set for income tax until mid June 2011. This scenario contrasts the earlier trend of not meeting the vat target while meeting that of the income tax in the last few years.

Internal value added tax has also over's not target after a gap of few years. The internal Vat collection rose to Rs. 20.38 billion. The government has plan to collect Rs. 25 billions as internal VAT.

So, the VAT collected at customs points is at par with the target but the over hooting of target in the internal front contributed to surpass overall VAT collection.

2.3 Literature in the Content of Nepal

2.3.1 Review of Relevant Books

Dhakal Arjun (2001)

“VAT and its Revenue Potential in Nepal” The major findings of this studies are:

1. Nepal has adopted the destination based consumption type VAT operated through the tax credit method.
2. Nepal has followed the destination principle to adjust the international trade.
3. The primary reason for growing popularity of the VAT is its broad coverage with out distorting economic efficiency.
4. The stepwise collection of VAT discourages the evasion of VAT.
5. VAT has somehow equity nature as compared to other kind of sales tax.
6. Exemption and zero rating reduce the respective of VAT, however it makes the administration complex.
7. VAT is more efficient tax to avoid the cascading and pyramiding effects.
8. VAT is not immolate from the fault of regressive nature. Single positive rate creates repressiveness with respect to expenditure but not necessarily with respect to income.
9. 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 recommendations of the study are

1. VAT should be extended through retail level as a bulk of tax performance to generate more revenue.

2. The important sector of VAT offices like as tax refund tax audit, tax payers, service investigation return processing and registration should be separated for successful operation.
3. The existing destination based consumption type of VAT operation through the tax credit method should remain continuous.
4. Consumers should be create awareness for taking invoice for every taxable purchase by comprehensive advertisement program.

Adhikari Chandra mani (2003)

“Value Added Tax in Nepal: Theory and Practice” deals with the theoretical concept of VAT which includes historical background, objectives, merits and demerits of VAT introduction of VAT system in Nepal, different terminologies associated with VAT. Tax administration system and legal provision made for the VAT implementation in Nepal and Value Added Tax rule 1997 and Value Added Tax act 1996.

Khadka Rup Bahadur (2004)

“Overview of VAT in Nepal” conclude that VAT in Nepal was introduced as a major part of the overall tax refund program initiated in the early 1990s. A detailed preparation was made for the implementation encountered various obstacles reduce mainly to the political instability and the opposition from the business community. Despite 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 sources for future revenue generation.

Amatya Surendra Keshar, Pokhrel Bihari Binod and Dahal Rewanta Kumar (2004) “

Taxation in Nepal (Income Tax, Property Tax and Value Added Tax)” This book makes in depth approach to the study of income tax, property tax and VAT in Nepal in order to meet the specific requirements of the students studying taxation. This book includes legal provisions of Income Tax Act 2058 and VAT Act 2052. Not only theoretical but also numerical problems of income tax and Value Added Tax are shrewdly presented in this book.

Kandel Pushpa Raj (2007)

“Tax Laws and Tax planning in Nepal” The book was designed to fulfill the needs of MBS level under Tribhuvan University. This book was very useful to the students and teachers to know the legal provision of the income tax act 2058. The book has attached acts, rules related to Value Added Tax and income tax.

Bhattarai and Koirala (2009)

“Tax Laws and Tax Planning” Describes the Income Tax system in depth. This book includes the separate chapter of Value Added Tax. It describes VAT practice in Nepal with several theoretical as well as with examples. This book specifically designed for the study of MBS 2nd year under Tribhuvan University.

2.3.2 Review of Relevant Thesis

In Nepal VAT was introduced on 16th November 1997. It was levied in place of the import manufacturing level sales tax, hotel tax, contract tax and entertainment tax. The time of the introduction of VAT a total of 2045 firms were registered under the sales tax. In this period there are so many obstacles and hindrances in the path of its development. During the course of its development various experts and researchers express their view regarding the problems and future prospects of VAT. So, this chapter includes the summary of many thesis given by the students:

Dhakal, Bishnu Hari (2000)

“Nepalese Tax Structure” has analyzed the Nepalese tax structure along with the basis emphasis and historical background and potential revenue of VAT in Nepal. The increasing trend of the resources gap of Nepal is forcing the country to debt-trap situation. Domestic resource mobilization through the property designed tax system is the best way to uplift the situation. In this process, Nepal has adopted the destination based, consumption type VAT operated by the tax credit methods. VAT encourages investment, supports economic growth and keeps price stable. Exceptions and zero rating reduced the regressively of VAT however it makes the complex. The study found that VAT is unable to complete the existing sales tax mainly due to the minimum use of invoices by sellers and as well having no interest to obtain invoices by purchasers. Elasticity and buoyancy Nepalese tax system are very low. Further, they are decreasing in recent years. VAT more attractive from the theoretical as well as empirical aspects. Hence, the introduction of the VAT is not the fulfillment of the requirement and VAT system itself has a great need of reforming in the Nepalese context.

Laudari, Raju (2001)

“Analysis the problems and prospects of VAT in Nepal” concludes that major problems associated with the VAT system to business houses are account keeping and billing weakness of VAT administration are lack of motivation service minded attitude and dishonesty in VAT officers. VAT system is the best and advanced fiscal tool in theoretical sense could not yielding the expected returns in Nepal because of lack of strong and honest tax administration, lack of coordination between tax collectors and tax payers and lack of strong political commitment etcetera. The VAT was well received and also welcomed by the business community. One-year experiment showed that the operation was reasonably satisfactory for its success, there were several reasons to meet such as careful planning of tax structure and administration, close co operation between.

The government and business sector, sector, extensive publishing program, coordinated reform in purchased tax and income tax and selection of competent reasons in the key positions. There were several things that can be taken as suggestion from Trinidad and Tobago for the introducing and operation of VAT in other developing countries as well.

Karki, Baburam 2008

“Revenue mobilization through Value Added Tax in Nepal” explained that the strong commitment from grassroots level to the top level is prerequisite to make VAT success, which seems lack in Nepalese tax environment. An efficient, strong and fair administration is the most initial for the proper implementation of VAT. But the VAT administration is still weak, traditional, corrupted and even physical infrastructures are available properly. Even if the VAT system is bad on the computerized, the data arrangement is not so good. It is necessary to develop and expand the networking of data box and information system at all levels. Therefore, it is necessary to promote it in tax system. So that the existing problems such as under invoicing, none issuance of bills and enforcement of law would be automatically solved.

Gyawali, Sanjaya (2007)

“Value Added Tax contribution to government revenue: An analysis in the context of Nepal” that the revenue collection through VAT is not satisfactory in Nepal. VAT system which was attempt to establish as a main sources of revenue is problematic due to the weak billing system, under invoicing has remain as another major problem. The number of Vat exempted goods and services and its impact in revenue is still large. An administrative competency seems to be weakening slowly.

Pandak, Prabin (2006)

“An overview of Tax system in Nepal: A study of VAT” has described that existing threshold of Rs. 2 million and provision of tax refund are two possible way of tax evasion. It seems that existing exemption has a broad coverage. However some exemptions are unavoidable due to administrative complexity and equity aspect. So, exemptions should be minimized gradually.

Joshi, Asistha (2009)

“Current practical issues on VAT system” has explained that the ultimate goal of every country of the world including Nepal is to get better economic development and to ensure the rapid rate of economic growth. To get the pace of economic development, it is essential to have sufficient revenue generation, particularly revenue collection through taxation is a primary source and it plays the great role for development of national economy. In which the indirect tax has occupied two third place of total tax revenue. After the implementation of VAT System, contact tax, hotel tax, Sales tax and entertainment taxes have been replaced by it. It was not easy for government to implement VAT: there were lots of debates, discussion and interaction on VAT. But at the present context, looking at the contribution of these replaced tax in tax revenue and gross domestic product of the contribution, it’s generally increasing before, the implementation of VAT.

Wagle, Mahesh (2010)

“A study on contemporary issues on VAT system of Nepal” has described that the after implementation of VAT in Nepal and promulgate the VAT act, there has been legal changes made rates were increased for the effectiveness of VAT but still there are many problems, hurdles ahead to simply the whole system. He also carried but out on to review the some new changes {ie. Tax plate, E-TDS and compulsory sales register} made on business sector by the revenue administration. According to his field survey, level of awareness of the account, businesspersons

paying VAT is at low level on some provision of VAT act. He recommended that VAT areas should be increased, proper co-ordination between IRD and MOF. Taxpayer customers who are ignoring the VAT system should be given proper knowledge about VAT and its benefits. Revenue administration may draft a policy to collect the arrear of VAT may be like tax settlement committee and should be implemented with honesty for improving billing condition, regular supervision, audits and investigation applied. Threshold of VAT should be decreased substantially.

2.3.3 Review of Relevant Articles and Journal

Nepal chamber of commerce also made a study to analyze the possible effects of VAT in Nepalese economy in 1997. Dr. Pushpa Raj karnikar heading the team. The main findings of the study report was as follows:

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

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

{Source: Nepal Chamber of Commerce, 2007}

Dr. Roop Jyoti (Former Finance Minister)

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

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

- Lack of invoicing or invoicing with the correct value.
- Lack of effective implementation of the VAT threshold.

Source: Khada Rup Bahadur(2001)

Bendix Lane (Chief Technical Acheson)

“Four years of Value Added Tax”conclude that, there were a lot of constraints and difficulties in introducing and implementing VAT in Nepal. The first two years of VAT were very turbulent. Despite this, VAT was introduced and survived because of the efforts of a small group of extremely dedicated, motivated and hard working people. Since its establishment in 1997, the VAT administration had been improving gradually until the early summer of 2001. The merger between the former VAT department and the former department of taxation into

the inland revenue department took place in April 2001. This made it very difficult to keep focus on various important activities and decision that needed to be carried out and to continue the VAT implementation process by the new Inland Revenue Department (IRD). Some difficulties were expected after the merger and some of the problems have already been solved still lots of challenges are left to be resolved.

Source:Khadka Rup Bahadur(2001)

Acharya Mahesh (Former Finance Minister)

“Four years of implementation of VAT” conclude that, for Nepal’s development through modern tax system, successful and extensive implementation of VAT is compulsorily needed. VAT is a self policy system that records business transaction from the level of manufactures to the consumers. The smuggling and revenue leakage from the border areas will be controlled. For the success of VAT, employees of the internal revenue administration to be alert towards showing trustworthiness and skill in the tax assessment and in collection process. Revenue can be mobilize better through skill and simplicity rather than by punishment.

Source:Khadka Rup Bahadur(2001)

J.B.R. Pashupati Shamsher (Member of Constitution Assembly)

In his views published on ‘Four years of implementation of VAT’ conclude that, revenue plays an important role in the country’s development and tax is the primary source of revenue mobilization. Finding new source of revenue as a VAT was a timely action. This tax reduces the possibility of leakage by maintaining two accounts and also creates an environment of fair competition amongst the industrialists and businessmen. There are complaints from industrialist and businessmen such type of weakness must be corrected in order to make VAT effective. To support the economic development and to make this tax effective. It

is necessary to solicit the co operation of industrialists and businessmen. Similarly to make VAT successful, it is necessary to raise the level of awareness of the consumers.

[Sources : Khadka Rup Bahadur 2001]

2.3.4 A study of Taxpayer's Satisfaction Level in Nepal- August 2010

A study of taxpayer's satisfaction level in Nepal was carried out jointly by the Inland Revenue Department (ministry of finance) and the German Technical Co-operation (GTZ) on august 2010. The suncey's purpose was to determine the satisfaction level of Nepalese taxpayers regarding existing tax policy, the quality of service and tax documents, tax procedures and administrative mechanism and the overall performance of the tax administration.

The majority of the sampled taxpayers stated that people should pay taxes and deseed to be penalize if they fail to do so. Only one third of the respondents were satisfied with the delivery of public services in the fields of the security, electricity, supply, drinking water and social benefits, where as about 50 percent of the respondents were satisfied with the services in the telecommunication, transportation and education sectors. Less than 40 percent were satisfied with the quality of the services of IRDs (Except for Location and Accessibility) in spite of the perception that services during the post seven years have improved.

The majority of the respondents were reasonably satisfied with the tax procedures and administrative mechanisms, except with tax refunds. Four out of five respondents have observed important in this respect in the past several years.

The most important sources of information on tax issues are newspapers. Regarding the availability of information and the comprehensibility of the printed documents, three out of four were satisfied for income and other taxes and four out

of five for VAT. With reference to the contents and coverage of the documents, over 83 percent were satisfied.

An overwhelming majority of the interview partner noted the importance of knowledge and information about the tax system and tax policy. Four out of five respondents observed improvement in the tax policy and tax system during the past three years. However, over two thirds of the respondents felt that the tax money has not been utilized properly by the government.

Based on the major findings of the study one can draw the conclusion that the tax administration in Nepal has been improving over the past seven years. As contributing factors for the improvement, the GTZ-ITAC and RAS, DANIDA VAT and RAS projects, which have been implemented in the IRD for over a decade should be mentioned. It is very encouraging to note that the overwhelming majority of the respondents see paying taxes to the government as their duty. When taxpayers are not satisfied, the tax authorities have to identify the reasons for their dissatisfaction and take corrective measures.

Although, the performance of the Nepalese tax administration has been improving over the past years in the perception of taxpayers, it still remains on a comparatively low level. A better reputation of the public administration is critical in order to encourage most taxpayers to comply with tax laws. This would lead to more tax generated income for the public sector and if world provide additional budgetary room in the long run. However, better reputation can only be achieved if citizens feel significant improvements in the services delivery. Apart from that, the tax administration needs to establish an effective system of penalization for citizens who fail to fulfill their tax duty.

General comments and suggestions of Taxpayers

- Use the tax money properly for development of the nation and not for the interest of ruling political parties.
- Provide basic services to the people in proportion to the tax collected.
- Make the tax payment process very simple and practical that encourages more people to pay tax regularly.
- There is poor documentation of the papers submitted by the taxpayers. These must be filed systematically and kept in alphabetical/chronological order. Locating the files in the IRDs is always a problem for taxpayers.
- There should be no audit after completion of full audit.
- The government must set aside some funds from the tax collected for taxpayer service activities.
- The government should consider lowering the tax rates and to expand the tax base.
- There should be no tax for the organizations, which don not make profit, tax on interest earned in particular.
- The government is dependent on donors to develop tax policies. Don't depend on them, be practical and make your own judgment.
- Don't put the entire burden on registered taxpayers. Those, who are not registered as yet, should also be brought into the net.
- Provide relief to the taxpayers from visiting the IRDs frequently.

- Officials in the taxpayer section need to be very competent and informative.
- Staff members in IRDs should always understand taxpayers as their customers and not as milking cows.
- Put PAN numbers of all registered taxpayers in the website of the department.
- Why do all large taxpayers need to go to Kathmandu? Can't this be arranged locally?
- An effective complaint logging system should be established.
- There is no major complaint regarding the tax policy and tax acts of the government, but there are problems in their implementation practices.
- There is no problem for officials of chamber of commerce and industries in dealing with IRD officials, but for ordinary people it is not easy.
- Tax rates should be progressive.
- There should be one and the same tax policy for all and there should not be any discrimination.
- Tax rate for small business stalls is high compared to big business houses, so reduce the rates for the small business enterprises.
- Communication on tax policy and practices need to be increased.
- The staff members should behave impartially.

- There are some loopholes for corruption, correct those staff effective monitoring immediately particularly in the case of audit and investigations.
- Make the tax procedures simpler and shorter.
- Develop better/effective incentive system for regular taxpayers and give due respect to them.

[Source : A study on taxpayers satisfaction level in Nepal 2010, RAS]

2.4 Research Gap

Lots of studies have been conducted in different aspect of taxes either in worldwide coverage or in particular case of study of any country. But most of them are based on previous provision. This research has tried to analysis the current and contemporary issues on practice of VAT like trend of registration, refund and collection of taxation in the process of tax implementation, provision regarding the VAT act and has also incorporated the matter about the electronic submission of VAT returns. Likewise, this study also aims to know the attitude and knowledge of the all stakeholders of VAT system on various aspect with it.

Due to the lack of seriousness in the research work, (especially in case of thesis) output could not address the objective of study. The researcher was flabbergasted that research work is used only for formal completion of final year thesis. Most of these are based on secondary data only, which makes the errors repeated and no more contribution. This research work is based (not completely but major part) on primary data, which is updated to recently changed situations. The data collected is diversified to major three category of the society ie. Businessmen, consumers and experts. This is done with objective to find out the problem from different years. Secondly, the analysis of data presented is done with

consideration of conditional state of respondents. Ex-among 30 consumers, some were bachelor or degree level educated, some SLC or less than that, some from highly sophisticated family who enters only to departmental stores and some were street buyers. This diversity could not be analyzed only from the statistical data collected from questionnaire.

This study has focused about the VAT system in Nepal and its impact on government revenue. No study has been made previously at this aspect. So, this study will be fruitful to those interested persons, parties, students, teachers, businessmen and government for academically as well as policy perspectives.

CHAPTER – III

RESEARCH METHODOLOGY

3.1. Introduction

Research methodology states the method in which data have extracted and discoursed the tools that have used in interpretation of such data to fulfill the objectives. It is the process of arriving at the solution of problems through a planned and systematic dealing with the connection, analysis and interpretation of the facts figure. This study is undertaken to examine the condition of Value Added Tax system in Nepal. It is based on both primary and secondary data. For the primary data, opinion survey technique was adopted to find out the views of respondents representing different group related to VAT. The empirical investigation was inducted to find out the practical aspect to VAT system. Similarly, secondary data have been collected from the Inland Revenue Department, Budget speech of Government of Nepal (GON), Newsletters and publications of different authorities and so on. Other necessary data and information have been collected from related books, expert's articles, websites etc. Various statistical and mathematical tools are used to analyze the collected data such as, bar diagram, simple average, trend line, percentage, correlation, pie chart etc.

3.2 Research Design

A research design is a plan for the collection and analysis of data. It is not possible for a researcher to conduct a research present without research design. Normally research design becomes either primary data or secondary data or both. Most of the data and information of the study are concerned with past phenomena of the performance either they are numerical or opinions, the studies have made the base of past rules of VAT and to analyze it after collection of past data and

experience. This study uses its own procedures of data analysis. So that, this study can be regarded as historical research design and it also followed analytical as well as descriptive research design which has been presented below:

- Historical and descriptive analysis with tabulation
- Data analysis, statistical and mathematical tools
- Interact with resource persons.

3.3 Population and Sample Size

The population for this study was specifically those persons who come in touch with various provisions of VAT system being implementation in Nepal. For example, all the tax experts and the taxpayers available in Nepal are considered as population and the tax experts and taxpayers available in Bharatpur Municipality are considered as the target population. Out of the targeted population, sample of 60 people have been taken into consideration. The number and type of the samples are given below:

Table 3.1

Group of respondents and sample size:

S.No.	Respondents	Sample Size
1	Tax experts	30
2	Tax payers	30
	Total	60

Source: Opinion survey

3.4. Nature and Sources of Data

3.4.1. Review of Primary Data

In order to achieve good result of this research, the researcher collected primary as well as secondary data from different sources. In the primary data, the major tools use for collection is through the questionnaires for the concern people, field visit in IRD, interview schedule, Focus Group Discussion (FGD), and according to necessary other places. A set of questionnaires are developed and distributed to different groups of people like students, tax-experts, accountants, businessmen, teachers and so on to find out their views on various issues and provisions of VAT act and regulation and regulation as well as some practical aspect of VAT system.

3.4.2. Review of Secondary Data

The secondary sources of data and information derived from Inland Revenue Department, different budget speech of government ministry of finance, newspapers and magazines, pubic and un public books , articles etc.

- Publication of inland revenue department.
- Publication of VAT projects.
- Publication of VAT department.
- Publication of different types of books, reports and seminar paper of FNCCI and NCC.
- Public documents of national planning commission and Nepal Rastra Bank.
- Budget speech of government of Nepal and economic survey.

- Publication of central bureau of statistics.
- Daily, weekly and monthly newspaper and magazines which are related to research.
- Published and unpublished report, article and dissertation on the concerned subjects.
- Various books written by tax officers, scholars and website of different institutions.

3.5. Data processing and Analysis

Data collected through questionnaire was tabulated and analyzed. Relevant data from secondary sources, observation and focused group discussion were processed and used to complete the findings from interview. Data collected from primary and secondary sources are analyzed using tools like percentage, bar diagram, correlation and regression, trend analysis and so on. The regression equation $Y = a + bt$ (where, a = constant variable, b = sloping size and t = time period) is used to find out the future trend analysis.

3.6. Reliability and Validity of the Data

Since both the quantitative and qualitative tools are applied, there are high possibilities of getting reliable data. Besides this triangulation of information collected through questionnaire also helps to make the data more reliable and valid. On the other hand percentage, correlation, regression and trend analysis are used as analytical tools which may be incomplete for data presentation. Limitations may arise, as it could not represent the whole part of our country. So, there is possibility of getting fictitious data which could not access the real objectives of the research activity. This is due to the lack of financial assistance and time required for the research analysis.

CHAPTER – IV

PRESENTATION AND ANALYSIS OF DATA

This chapter is one of the most important stages of the study. In the context of presentation and analysis of data, all information are collected from primary sources (i.e. interview, questionnaire etc) as well as secondary sources (i.e. economic survey, internet search, annual reports etc.) are arranged, tabulated, presented in figure and analyzed.

4.1 Presentation and analysis of VAT at different Stages

As we know that, VAT is not a genuinely new form of taxation but merely a sales tax administered in different stage of production and distribution channel. The prices to be charged under VAT and sales tax do not differ. Under the VAT system, consumers know the amount they are paying in form of VAT but under sales tax system, it was not shown separately in the bill.

So, above both taxes are collected finally from the consumers. VAT is more transparent than sales tax. It is levied at each stage from production to sales but sales tax is levied only on certain stage of sales. Therefore, VAT is levied not on the total cost of sales on the amount of value added in each stage of distribution.

As for example, a computer manufacturing company ‘DELL’ supplies new branded computers to own related supplier. Where, following presentation will clarify that VAT collected through government at different stage of sales by computer supplier.

A customer purchased a computer from a manufacturing company ‘DELL’ is Rs. 28,000. Company has not any VAT on its inputs but the company sold it to wholesaler at a profit of 20% on cost price. The wholesaler and retailer sold the

computer at profit of 15% each on cost to final consumer. What is the cost price to final consumer and VAT charged by government @ 13% on successive stage of sales?

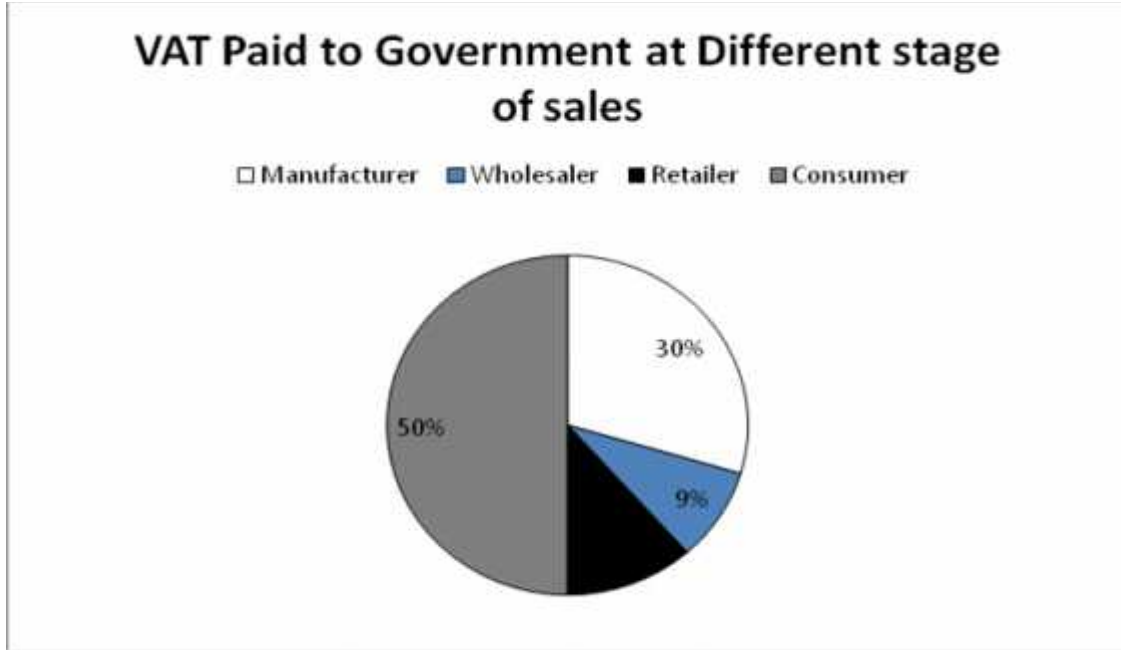
Table 4.1
Computation of VAT

Channels	Cost Price	Added Value	Selling price exclusive VAT	VAT @ 13%	Selling price After VAT	VAT payable to govt. in each stage
Manufacturer to Wholesaler	28,000	5,600	33,600	4,368	37,968	4,368
Wholesaler to Retailer	37,968	5,697.90	43,665.90	5,676.57	49,342.47	1,308.57
Retailer to Customer	49,342.47	7,401.37	56,743.84	7,376.70	64,120.54	1,700.13
Total VAT						7,376.70

Source: Apendix - III

From the above table, we found that VAT collected though Government at different stage of sales by the computer supplier. Where, manufacturing cost of the computer is Rs. 28,000 and added value is shown Rs. 5,600 @ 20% profit margin in manufacturing level. In which level, VAT payable to government by wholesaler is Rs. 4,368 @ 13% of Rs. 33,600. Similarly, the cost price of Wholesaler to Retailer is Rs. 49,342.47 and Retailer to Final consumer is Rs. 64,120.54. Total VAT charged by government on successive stage of sales is Rs. 7,376.70.

Figure 4.1



Source : Table 4.1

From the above figure, we can show that the percentage of VAT paid to Government at different stage of sales. Where, 11% paid by the retailer, 9% by wholesaler, 30% by manufacturer and total 50% by the final consumer.

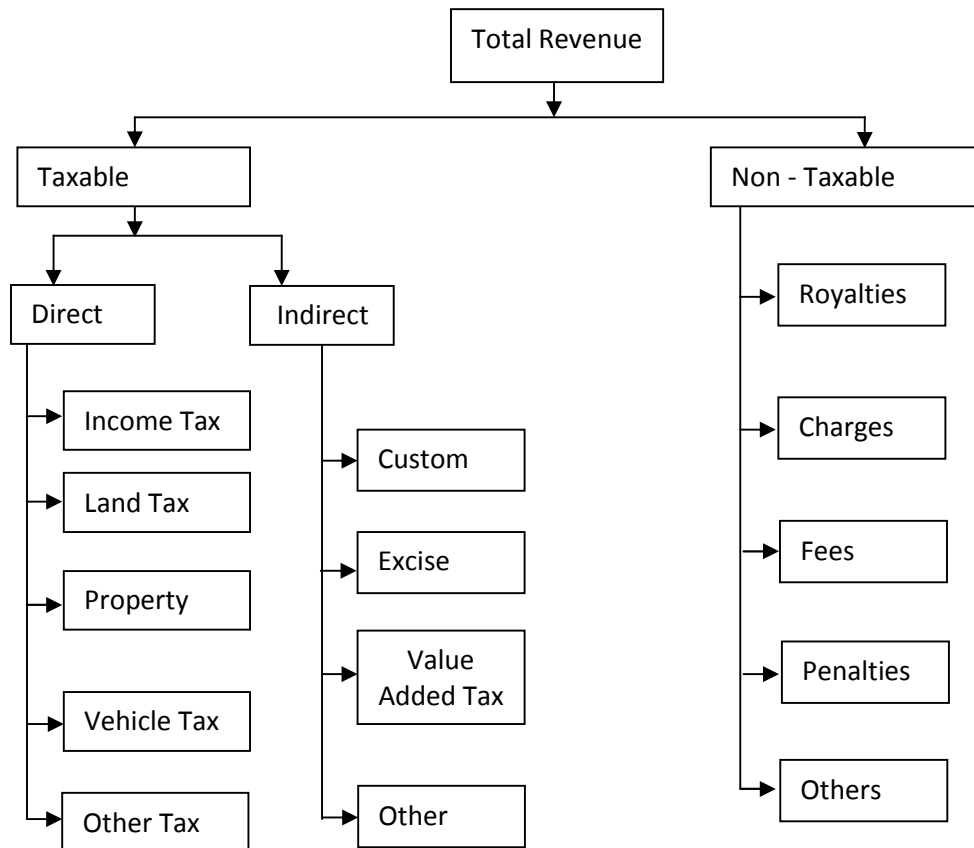
4.2 Nepalese tax Structure

4.2.1 Total Tax revenue structure of Nepal

Government requires sufficient revenue to carry out development plans to maintain peace and security to day to day administration function and other public welfare activities. A modern democratic government has to perform different social welfare programs, for this purpose government collects revenue from different sources such as tax revenue, from public enterprise, fees, fines, grants etc. or tax revenue is the sum of custom duty, excise duty, value added tax, corporate and personal income tax, property tax interest tax and other non tax

revenue. Some non taxable income are royalties telephone change, water change tickets etc.

For this, we can say that revenue are divided into two parts taxable and nontaxable. Which are given below:



Both tax revenue and non tax revenue are equally important for the government. The structure of tax revenue and non tax revenue is mostly determined by the type of economy that the government adopts. In capitalist economy amount of tax revenue is generally higher than non tax revenue and socialist economy the amount of non tax revenue is generally high.

In Nepalese economy amount of tax revenue is generally higher than that non tax revenue. Tax is compulsorily contribution by the tax payers to the government. Taxation is main source of income of the government excluding foreign aid. In the fiscal trend of Nepal, tax revenue structure is a combination of

two tax elite. They are namely direct tax and indirect tax. The table below shows that the trend of tax revenue has been increasing.

Table 4.2.1

Total Tax Revenue Structure of Nepal

Rs. In '000'

Fiscal Year	Total Tax Revenue	Direct Tax		Indirect Tax	
		Amount	% as Total Revenue	Amount	% as Total Revenue
2062/063	57,426,935	13,961,476	24.31	43,465,510	75.69
2063/064	71,126,728	18,980,298	26.69	52,146,430	73.31
2064/065	85,155,457	23,087,759	27.11	62,067,698	72.89
2065/066	117,051,907	34,320,739	29.32	82,731,168	70.65
2066/067	156,294,932	41,750,183	26.71	114,544,749	73.29

Source: Annual report IRD 2066/067

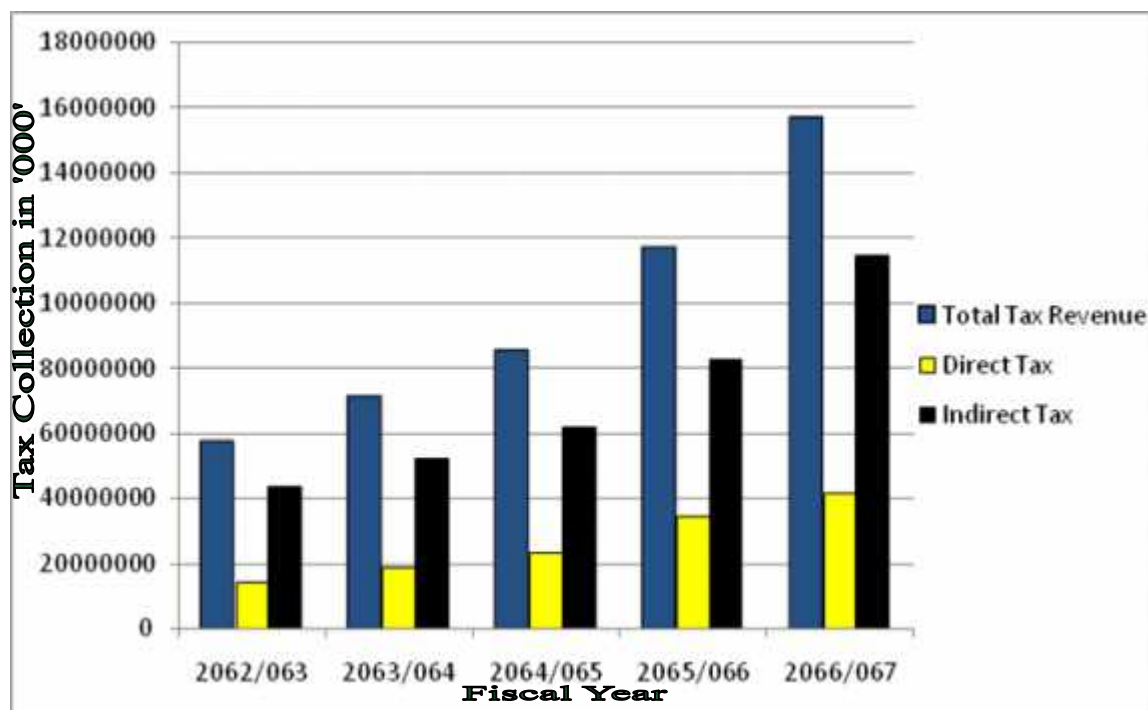
In above table, tax revenue increased by 33.53 in FY 2066/067 compared to that of the previous fiscal year. Such revenue has increased by 37.46% in FY 2065/066 to compared to its preceding fiscal year. Similarly, tax revenue in FY 2064/065 and 2063/064 by 19.73% and 23.86% increased respectively.

Here, structure of total tax revenue is going on increasing trend. Where tax revenue grew in FY 2063/064, 2064/065, 2065/066 and 2066/067 by 23.86%, 19.72%, 37.46% and 33.53% respectively. On the total tax revenue, direct and indirect tax both are increasing trend. Where share of direct tax in FY 2062/063, 2063/064, 2064/065, 2065/066 and 2066/067 are 24.31%, 26.69%, 27.11%, 29.32%, and 26.71% respectively. On the other hand, Share of indirect tax in FY

2063/064, 2064/065, 2065/066 and 2066/067 are 75.69%, 73.31%, 72.89%, 70.65%, and 73.29% respectively.

Figure: 4.2.1

Total Tax Revenue Structure of Nepal



Source : Table 4.2.1

In above figure shows that structure of total tax revenue, Direct tax and indirect tax for the FY 2062/063 to 2066/067. Where, X-axis shows that fiscal year and Y-axis represents tax collection in ‘000’. Direct and indirect tax revenue both are going on increasing trend so total tax revenue also going on increasing trend.

4.2.2. Share of VAT Revenue Structure

In the above analysis ‘Structure of total tax revenue’ showed an increasing trend on revenue mobilization. This increase in income tax may be attributed by VAT law forced the reluctant businessmen to registered their name and file the return of

the income. Although, there was no substantial increase in VAT itself. It helped to increase the collection of income tax.

As aforementioned there are two types of tax, one is direct and other is indirect tax, this study is based on VAT a sources of indirect tax. So, here we are focusing on the direct tax. It is imposed to person but paid wholly or partially by another person. Indirect tax has been dominant role in tax revenue. Similarly, sales and value added tax has dominant position in indirect tax. For the comparison purpose taxes from contact, hotel tax and entertainment have been included in sales/value added tax because after the adoption of VAT all these taxes were replaced. The example of indirect taxes are custom duty, VAT, Excise duty, Indirect tax etc. the merits and demerits of indirect tax revenue are follows:

Merits

- Indirect tax revenue is convenient as the tax payer does not have to pay lump sum amount for tax.
- There is mass participation each and every person getting goods or services has to pay tax.
- There is less chance of tax evasion as the taxpayers pay the tax collected from consumers.
- The government can check on the consumption of harmful goods by imposing higher taxes.

Demerits

- It is uncertain, as demand fluctuates, tax will also fluctuate.
- It is a regretful as the tax burden to the rich and poor same.

- It has bad effect on consumption, production and employment. Higher taxes will reduce all of them.
- 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 charge 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 liquid either on adore (on the basis of value) or on specific basis (on the basis of quantity)

Custom duties can be divided into two parts: import duty and export duty. The customers 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. Tax levied on the manufacturing, sale or consumption of goods and services 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 Shaha. It provide around 9% of total tax revenue.

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

Table 4.2.2**Share of VAT revenue***Rs. In '000'*

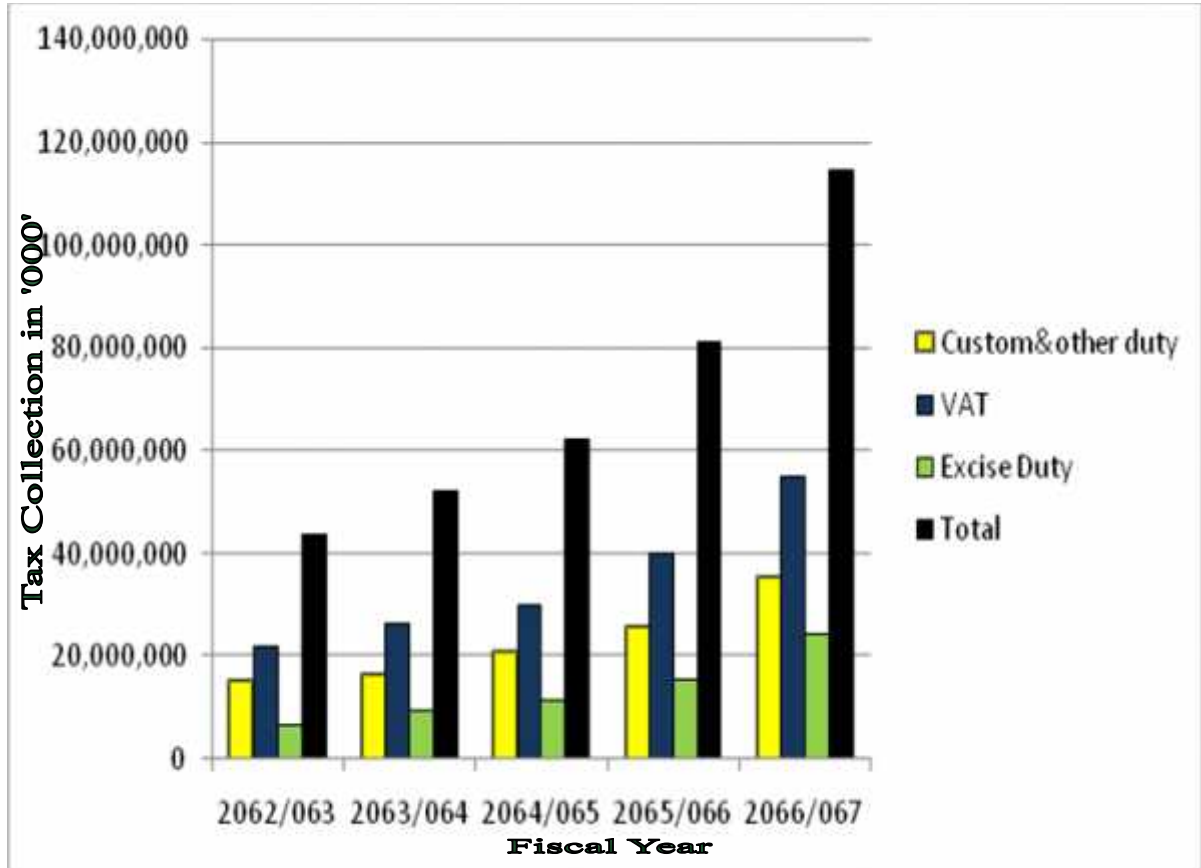
Fiscal Year	Indirect Tax				As % of Indirect Tax		
	Custom and Other	VAT	Excise Duty	Total	% of Custom Duty	% Of VAT	% of Excise Duty
2062/063	15,343,676	21,613,043	6,506,940	43,463,659	35.30	49.73	14.97
2063/064	16,707,644	26,095,599	9,343,187	52,146,430	32.04	50.04	17.92
2064/065	21,062,421	29,815,703	11,189,575	62,067,699	33.93	48.04	18.03
2065/066	25,829,493	39,947,480	15,416,958	81,193,931	31.81	49.20	18.99
2066/067	35,317,786	54,920,856	24,306,107	114,544,749	30.83	47.95	21.22

Source: Annual Report IRD 2066/067

In the above table, total tax revenue increased by 41.08% in FY 2066/067 compared to that of the previous Fiscal year. Such revenue has increased by 19.98%, 19.30% and 30.82% in fiscal year 2063/064, 2064/065 and 2065/066 respectively compared to its preceding fiscal year. The share of VAT is 49.73%, 50.04%, 48.04%, 49.20%, 47.95% in fiscal year 2062/063, 2063/064, 2064/065, 2065/066 and 2066/067 respectively. Likewise, the share of custom duty 35.30%, 32.04%, 33.93%, 31.81%, 30.83% in fiscal year 2062/063, 2063/064, 2064/065, 2065/066 and 2066/067 respectively. And the share of excise duty is 14.97%, 17.92%, 18.03%, 18.99% 21.22% in fiscal year 2062/063, 2063/064, 2064/065, 2065/066 and 2066/067 respectively.

Figure 4.2.2

Share of VAT Revenue Structure



Source : Table 4.2.2

Here, the above figure shows that structure of total tax revenue for the Fiscal Year 2066/067 is in increasing trend. Where, X-axis shows that fiscal year and Y-axis represents tax collection in '000'. Custom and other duty, VAT and excise duty all are going in increasing trend. So, the figure of total indirect tax revenue also going on increasing trend.

4.2.3 Internal Revenue Collection by Trend Analysis

Table 4.2.3

Internal Revenue Collection

Rs.In '000'

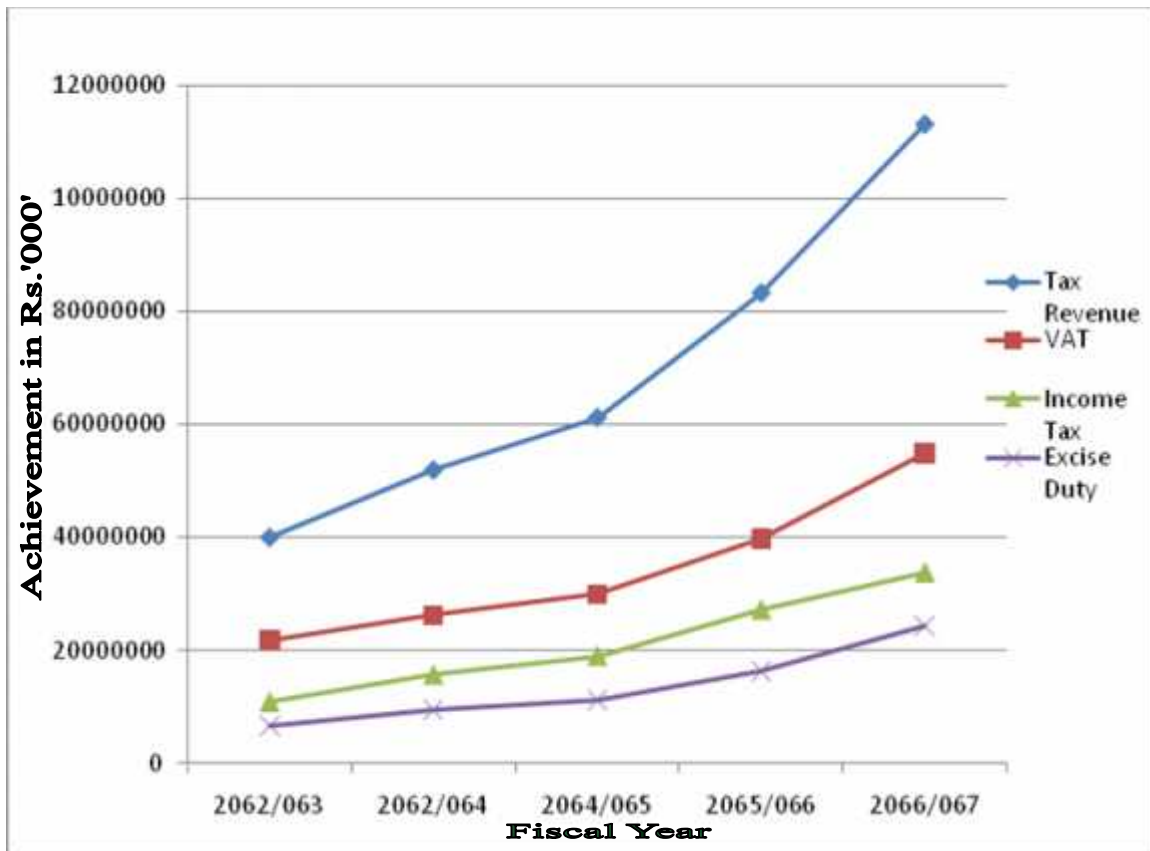
Budgeted					
FY	2062/063	2063/064	2064/065	2065/066	2066/067
Tax Revenue	44,300,000	48,817,000	58,126,800	85,660,000	106,499,900
VAT	23,650,000	26,463,000	29,651,900	41,000,000	51,560,000
Income Tax	11,800,000	12,710,500	16,869,200	27,087,000	36,298,000
Excise Duty	7,950,000	8,637,500	10,523,200	14,073,000	18,641,900
Actual					
FY	2062/063	2063/064	2064/065	2065/066	2066/067
Tax Revenue	39,901,151	51,852,586	61,152,297	83,185,706	113,048,290
VAT	21,613,043	26,095,599	29,815,702	39,700,921	54,920,856
Income Tax	10,933,520	15,731,804	19,077,813	27,247,386	33,821,327
Excise Duty	6,506,940	9,343,187	11,189,575	16,237,398	24,306,,107
Increment %	9.16	30%	18.64%	39%	36%

Source: Annual Report IRD 2066/067

In above table 4.2.3 shows about internal revenue collection from fiscal year 2062/063 to fiscal year 2066/067. In FY 2066/067 Rs. 113 billion collected which is greater than last year of Rs. 83 billion. Where increment is 36%. So, inland revenue department contribution to the total revenue of the government. On the basis of above internal revenue collection table, we can present the data separately in the following figure.

Figure 4.2.3

Internal Revenue Collection Trend Analysis



Source: Table 4.2.3

From the above trend analysis we found that three different types of tax (VAT, Income tax, Excise Duty). Where VAT contributes the highest value and followed by income tax and excise duty. The VAT is going on increasing trend so the VAT line also showing in increasing figure. Similarly other two types of tax – Income tax and Excise duty both are going on increasing trend. All three types of tax going on increasing trend then the total tax revenue figure also presented on increasing trend.

As above trend line of tax revenue collection by inland revenue department is increasing trend when all segment of revenue (Income tax, VAT and excise

duty) are also going on increasing trend. Among these three types of tax, VAT is presented separately in the following table:

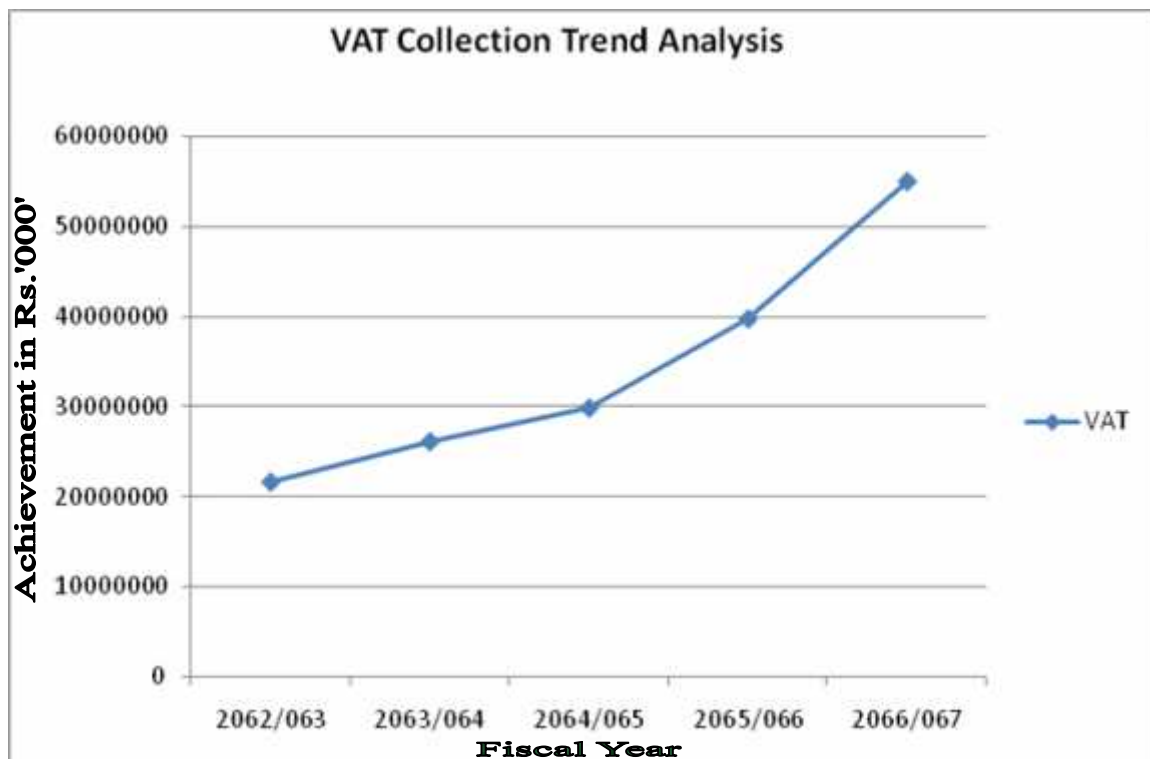
Table 4.2.3 'A'
VAT Collection Trend Analysis

Rs. In '000'

Fiscal Year	2062/063	2063/064	2064/065	2065/066	2066/067
VAT	21613043	26095599	29815702	39700921	54920856

Source: Annual Report IRD 2066/067

Figure 4.2.3 'A'



Source: Table 4.2.3 'A'

Above figure 4.2.3 'A' shows VAT collection increasing trend from fiscal year 2062/063 to FY 2066/067. It is increased from Rs. 21.6 billion in FY

2062/063 to Rs. 54.92 billion in FY 2066/067. Which is going on increasing trend. It indicates the improvement in total tax collection by IRD.

4.3 Analysis of Different Aspect of VAT

Value added tax is general consumption tax, assessed on the value added to goods and services. In some countries including Australia, Canada, New Zealand and Singapore this tax is known as “goods and services tax” and Japan it is known as “consumption tax”. It is a general tax that applies in principle, to all commercial activities involving the production and distribution of goods and the provision of services. It is a consumption tax because it is borne ultimately by the final consumer. It is not charge on companies. It is charge as a percentage of price which means the actual tax burden is visible at each stage in the production and distribution channel. It is an indirect tax in that the tax is collected from someone other than the person who actually bears the cost of the tax. (*Bhattarai and Koirala 2009*)

The concept of VAT is still new in Nepalese community. This year (2066/067BS) is the 12th - 13th year of introduction of VAT. It was introduced in Nepal with replacement of sales tax, hotel tax, entertainment tax and contract tax. Now we can say that VAT has been proved ultimately in developed and developing countries successfully introduced and applied get the good performance.

4.3.1 Replacement of sales, entertainment, hotel and contract tax by VAT

VAT is an improved form of sales tax. A tax based on the sales of goods and services imposed for generating revenue is sales tax, entertainment tax, hotel tax and contract tax separately. So, VAT was introduced with replacement of existing sales tax, entertainment tax, hotel tax and contract tax. Mainly sales tax converted into value added tax and others are subsidiary. Generally these are three types of sales tax; namely multiple stage sales tax, single stage sales tax and value added tax. The tax imposed on each stage of sales is multi stage sales tax, where as the tax imposed on only one stage is single stage sales tax. In other words if tax imposed on manufacturer, wholesaler and retailer, it is multistage sales tax. In contrast, where the tax is imposed either on manufacturer, wholesaler or retailer, it is single stage sales tax. The nature of sales tax is that the tax incase of sales is levied on total amount of cost of sales and the tax amount of earlier stage becomes the cost of the goods and services for next stage. Value added tax in opposite which is levied not on the total amount of cost of sales but on the amount of value added in stage. (*Kandel 2007*)

In Nepal sales tax was introduced in 2022 BS. At first sales tax is in Nepal was levied on retail stage only. However, in 2025 BS it was levied on whole sales tax. Similarly in 2031 BS, the system was again changed and the sales tax was imposed on manufacturing stage. Since mangsir 1st 2054 BS sales tax was replaced by value added tax. Before implementation of VAT, the rate of sales tax was 15%. Whereas after implementation of VAT the rate is fixed at 10%. Now, the tax rate is 13%. (*Bhattarai and Koirala 2009*)

Sales tax is completely replaced by VAT but hotel, entertainment and contract tax have not been replaced in such way. A small amount of revenue used to be collected under the name of entertainment, hotel and contract tax but, theirs

contribution on total is remarkable reduce after the implementation of VAT in Nepal. Now, all the above taxes are being completely replaced by value added tax. In the year 2054/055 the sales tax, contract tax, hotel tax and entertainment tax was 713.4, 61.6, 30.1, 11.4 million respectively. When VAT was introduced, the sales tax was completely replaced by it. After VAT contribution of contract tax, hotel tax and entertainment tax on total of four is decreasing year after year. Their contribution is zero. Which shows that value added tax completely replaced to these four taxes. Now, VAT is able to replace sales tax, entertainment tax, hotel tax and contract tax completely.

4.3.2 VAT collection on the basis of internal and import

Table 4.3.2
VAT Collection: Internal and Import

Rs. '000'

Fiscal Year	2062/063	2063/064	2064/065	2065/066	2066/067
VAT Collection	21613043	26095599	29815703	39700921	54920856
Internal	8150502	9631330	10808241	13918493	20379831
Import	13462541	16464269	19007462	25782428	34541025
Internal/Import Ratio	38:62	37:63	36:64	36:64	37:63
Increment %	33	21	17	34	38

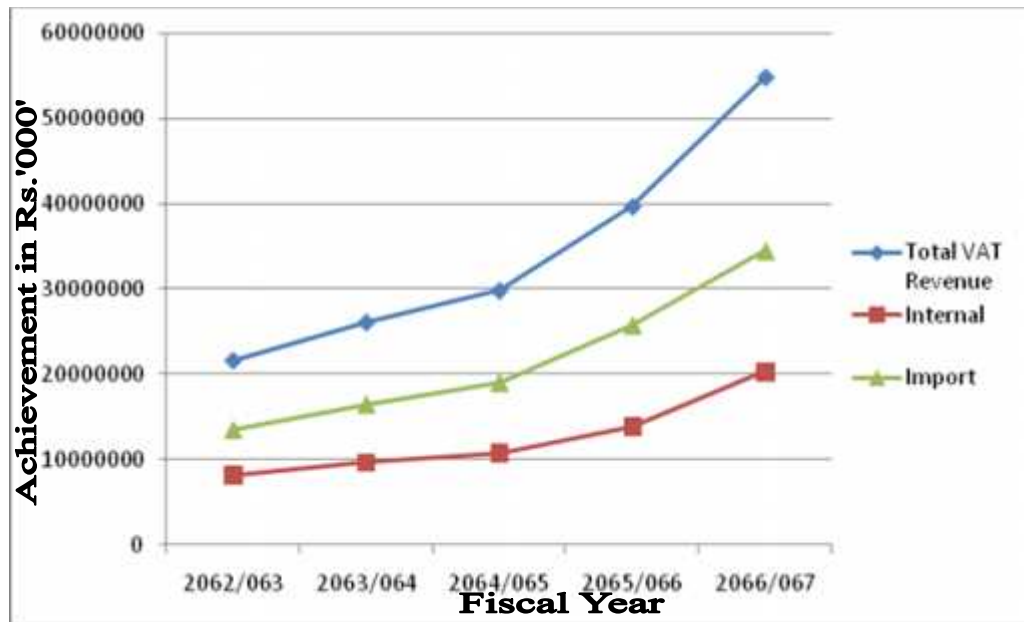
Source: Annual Report IRD 2066/067

Above table 4.3.2 shows the data of VAT collection from internal trade and import of goods and services from abroad. VAT collection from import is more than the collection from internal sources. Which shown on above table. The ratio

of collection from internal sources and import is 38:62, 37:63, 36:64,36:64 and 37:63 in FY 2062/063, 2063/064, 2064/065, 2065/066 and 2066/067 respectively.

Figure 4.3.2

VAT collection trend analysis: Internal and Import



Source : Table 4.3.2

Here, X – axis represent the fiscal year and Y – axis represent the achievement in ‘000’. The trend of VAT collection from internal and import both are in increasing trend. It shows VAT achievement trend also going on increasing way.

4.3.3 VAT registrants, Information filler, Non fillers and Cancellation

Table 4.3.3

Year	2062/063	2063/064	2064/065	2065/066	2066/067
	Ashadh	Ashadh	Ashadh	Ashadh	Ashadh
• No. of Tax Payers	46,831	52,965	59,707	69,653	82,433
No. of Tax Payer's Growth rate %	17.74	13.10	12.73	16.66	32.53
• Information Fillers	33,633	36,457	40,139	45,085	47,919
%	71.82	68.83	67.23	64.73	58.13
Dr. Information	10,449	11,457	12,052	13,491	14,311
%	31.07	31.43	30.03	29.92	29.86
Cr. Information	12882	13,594	15,050	16,952	18,005
%	38.30	37.29	37.49	37.60	37.57
Zero Information	10,139	11,044	12,779	14,371	15,325
%	30.15	30.29	31.84	31.88	31.98
Suspended Information	163	362	258	271	278
%	0.48	0.99	0.64	0.61	0.58

Source: Annual Report IRD 2066/067

The above table represents the data from various aspect. The data mainly focused on the trend analysis of VAT registrants, information fillers and non fillers, cancellation and suspended are presented separately in the following table and figures:

Table 4.3.3 'A'

Number of VAT Registrants

Rs. In '000'

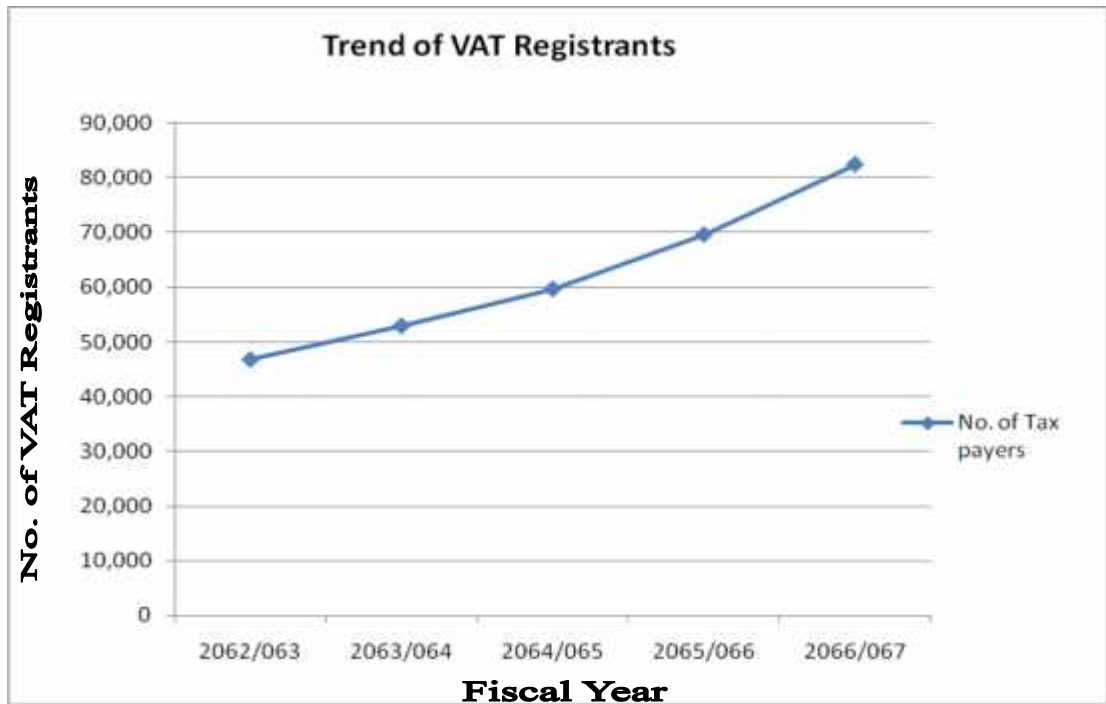
Year	2062/063	2063/064	2064/065	2065/066	2066/067
	Ashadh	Ashadh	Ashadh	Ashadh	Ashadh
No. of VAT Payers	46,831	52,965	59,707	69,653	82,433

Source: Annual Report IRD 2066/067

Number of VAT Registrants

Figure 4.3.3 'A'

Source : Table 4.3.3. 'A'



The trend of VAT registration is continuously increasing from fiscal year 2062/063 to FY 2066/067. At the end of ashadh 2062 it was 46,831 and reached to 82,433 at the end of ashadh 2067. But the growth percentage is fluctuating between 13% to 33%. Though, the total number of tax payers is increasing but, it is not sufficient meet the government's need. We know that to increase the VAT collection, the number of tax payers should be increase faster than in the previous year.

Table 4.3.3 'B'

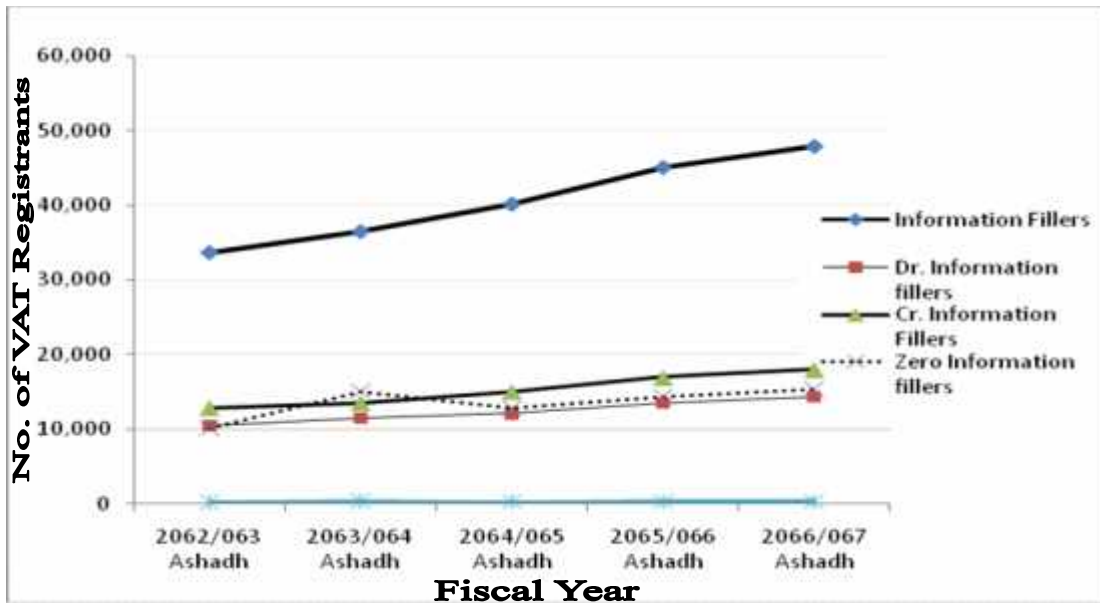
Trend of Information Fillers

Year	2062/063	2063/064	2064/065	2065/066	2066/067
	Ashadh	Ashadh	Ashadh	Ashadh	Ashadh
Information Fillers	33,633	36,457	40,139	45,085	47,919
Dr. Information	10,449	11,457	12,052	13,491	14,311
Cr. Information	12882	13,594	15,050	16,952	18,005
Zero Information	10,139	11,044	12,779	14,371	15,325
Suspended Information	163	362	258	271	278

Source: Annual Report IRD 2066/067

Figure 4.3.3 'B1'

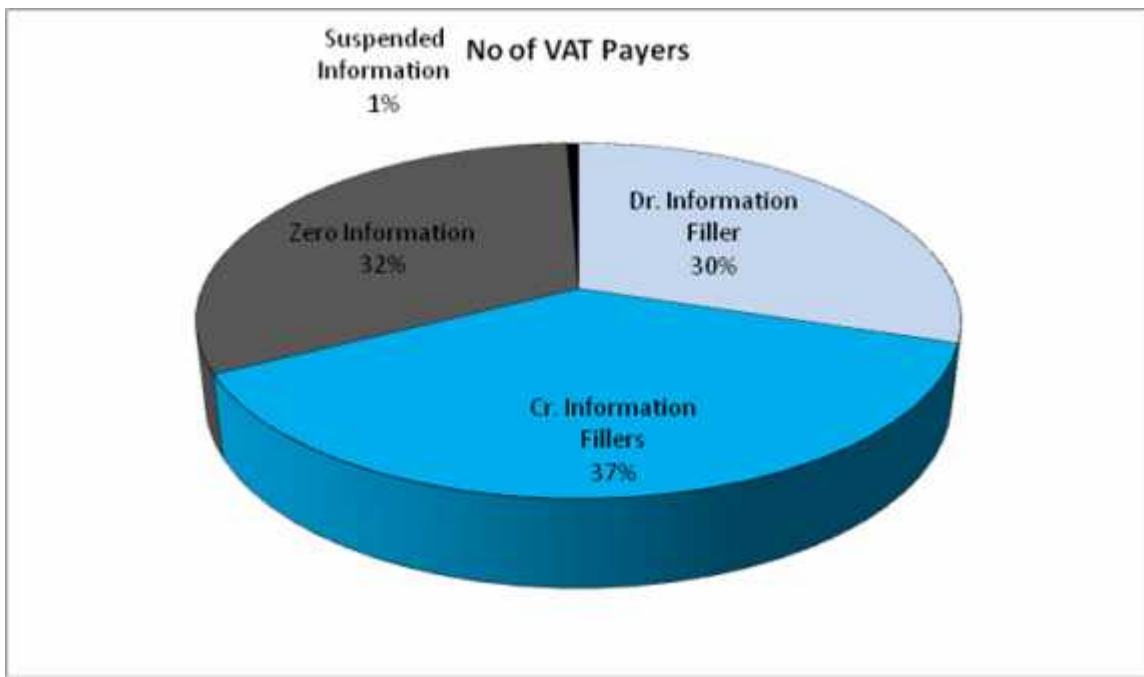
Trend of Information fillers



Source : Table 4.3.3 'B1'

From the above table and figure the trend of information filler shows that positive sign. Where, in debit, credit information and zero information fillers are increasing. But suspended information fillers are fluctuating. The Dr. and Cr. Information filler, zero information filler all are increasing trend so total information fillers is going on increasing way. The trend of information fillers also shown in pie chart which is follow.

Figure 4.3.3 'B2'



Source : Table 4.3.3 'B2'

From above pie chart we can show that the percentage of debit information fillers are 30%, credit information fillers are 37%, zero information fillers are 32% and suspend information is 1%

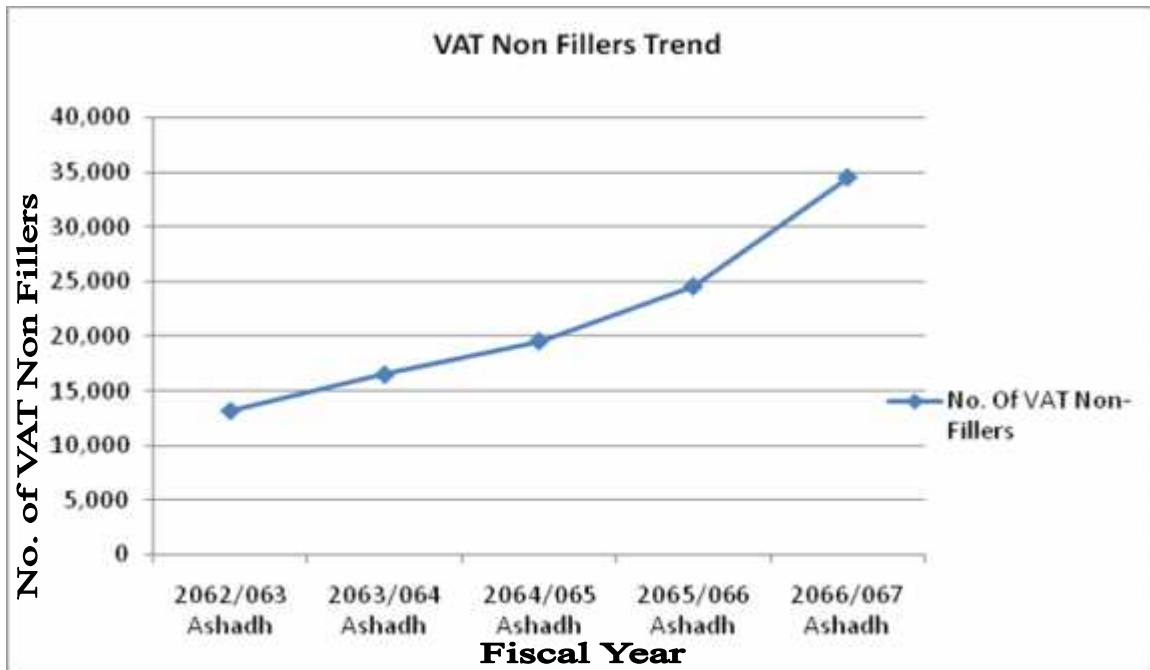
Table 4.3.3 ‘C’

Trend of Information Non-Fillers

Year	2062/063	2063/064	2064/065	2065/066	2066/067
	Ashadh	Ashadh	Ashadh	Ashadh	Ashadh
Information Non-Fillers	13,198	16,508	19,568	24,568	34,514

Source: Annual Report IRD 2066/067

Figure 4.3.3 ‘C’



Source : Table 4.3.3 'C'

From the above figure the trend of information non fillers are going on increasing trend. Which is 13,198 in fiscal year 2062/063 and 34,514 in FY 2066/067. It is not good for the government to increase the information non fillers. It is a sign of business recession. So, the government of Nepal should be very sincere in the improvement of political situation and conflict management to make the economic depression recovered.

4.3.4 Office wise Registration Status

Table 4.3.4

Office Wise Registration Status of VAT as on Ashadh End 2067

Office Code	Inland Revenue Office	Total Registration
11	Bhadrapur	2,393
12	Biratnagar	3,599
13	Dharan	2,099
14	Janakpur	2,131
15	Lahan	1,887
16	Simara	1,393
17	Birgunj	3,871
18	Hetauda	1,895
19	Bharatpur	2,331
20	Dhangadhi	2,234
21	Mahendranagar	1,327
22	Pokhara	4,139
23	Lalitpur	5,060
24	Bhairahawa	2,269
25	Kathmandu - 3	12,336
26	Nepalgunj	3,511
27	Kathmandu – 1	14,442
28	Kathmandu – 2	7,571
29	Bhaktapur	3,251
30	Krishnanagar	810
33	Butwal	1,625
51	Dang	1,636
52	LTO	343
Total Tax Payers		82,154

Source: Annual report IRD 2066/067

The above table 4.3.4 represent the VAT registrants in different location with in the country. Kathmandu is divided in three parts i.e. Kathmandu 1, Kathmandu 2 and Kathmandu 3 and VAT registrations in this region are greater than any other region of the country. 58% of the total registrants are in this region only. Other major regions are Lalitpur, Pokhara, Bhairahawa, Birgunj, Biratnagar, Bhaktapur and Nepalgunj.

4.3.5 VAT Revenue Collection

Value Added Tax is the best form of sales tax which is regarding on the basis of production and distribution channel. The revenue collection of the government from indirect tax “VAT” in different fiscal year is presented below:

Table 4.3.5
Total Revenue and VAT Collectio

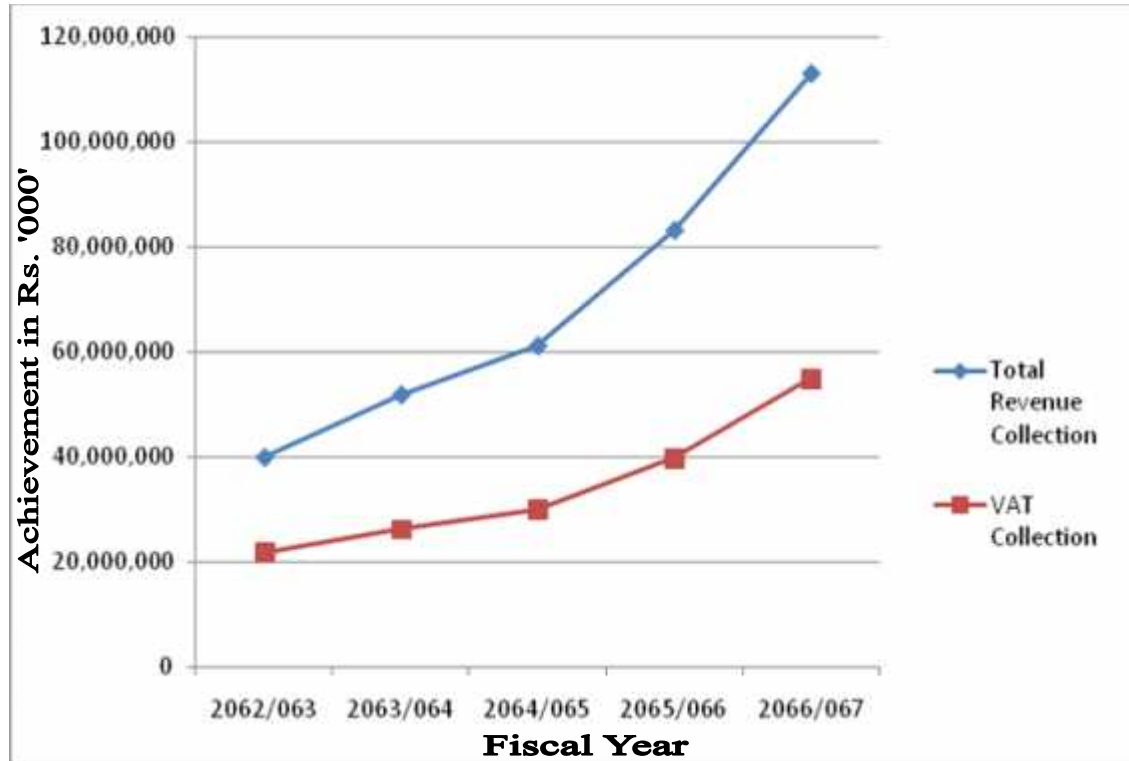
Rs: '000'

Fiscal Year	Total Revenue Collection	VAT Collection
2062/063	39,901,151	21,613,043
2063/064	51,852,586	26,095,599
2064/065	61,152,297	29,815,702
2065/066	83,185,706	39,700,921
2066/067	113,048,290	54,920,856

Source: Annual Report IRD 2066/067

Figure 4.3.5

Total Revenue and VAT Collection Trend



Source : Table 4.3.5

The above table and figure show that value added tax revenue is increasing by year to year. VAT generated about Rs. 21.61 billion in the fiscal year 2062/063 it increased up to Rs. 54.92 billion in FY 2066/067. This trend shows that total revenue to the government also increasing on the basis of VAT collection. It increased up to Rs. 113 billion in FY 2066/067 into Rs. 39.9 billion in fiscal year 2062/063. So, the total revenue collection and VAT collection both are going on rising trend with each other.

4.3.6 Impact of VAT on government revenue: Correlation Analysis

VAT being a major sources of government revenue, its contribution to total revenue should be highly associated. Unless and until VAT collection increases total revenue could not increased. Therefore government revenue and VAT are correlated things and it is very important to analyze the degree of association between these two variables (Government revenue and VAT). This correlation analysis results out the impact of VAT on Government revenue. In this analysis VAT is independent variable and government revenue is dependent variable, as government revenue tends to increase or decrease due to change in VAT collection.

Table 4.3.6

Impact of VAT on government revenue: Correlation Analysis

Rs:'000'

Fiscal Year	Total Revenue Collection	VAT Collection
2062/063	39,901,151	21,613,043
2063/064	51,852,586	26,095,599
2064/065	61,152,297	29,815,702
2065/066	83,185,706	39,700,921
2066/067	113,048,290	54,920,856

Source: Annual Report IRD 2066/067

Correlation Coefficient (r) = +0.9989

The correlation between these two series of data is +0.9989 which shows positive correlation between two variables i.e. total revenue and VAT. Therefore, the increase of total revenue will increase the value added tax and vice versa. The

positive correlation means increase in government revenue is effect on increase in VAT and vice versa.

Now, it is very important to understand that VAT which comprises 51% in government revenue and having highly positive correlation (+0.9989) is a backbone of current revenue collection portfolio. Its development and improvement will surely be beneficial for the whole nation, no doubt. Therefore, the previously concluded problems from field survey should be seriously thought and applied to improve the VAT collection system.

4.3.7 Estimation of VAT for next 5 years

As we know that revenue collection of government is affected by many variables. If these variables are in favor of the nation more revenue is collected otherwise not. The forecast of VAT collection is depend upon on previous five years data for coming five years. The forecast does not consider the effect of environmental statistical tool time series is used.

Estimation of VAT for next five years:

Let, the straight line trend be represented by:

$$Y = a+bx..... I$$

Where,

Y = Dependent Variable

X = Independent variable

a, b = Regression parameters

Fitting the trend line

Calculation of VAT for next 5 years

(Y= Vat collection in Rs. '000000')

Year (X)	VAT (Y)	x= (X-2064/065)	x 2	xy
2062/063	2161	-2	4	-4322
2063/064	2610	-1	1	-2610
2064/065	2986	0	0	0
2065/066	3970	1	1	3970
2066/067	5492	2	4	10984
Total	Y=17219	x=0	x2=10	xy=8022

Let, the base year = 2064/065

$$a = \frac{y}{n} \quad (17219/5) = 3443.8 \quad 3444$$

$$b = \frac{xy}{x^2} \quad (8022/10) = 802.20 \quad 802$$

Substituting the values of a and b in equation i and now, Trend line

$$Y = a + bx$$

$$= 3444 + 802x \dots \dots \dots \text{II}$$

For the estimating of VAT for coming 5 year

For FY 2067/068, X =3, Y = 3444+ 802X 3 = 5,850

For FY 2068/069 X = 4, Y = 3444 + 802X 4 = 6,652

For FY 2069/070 X = 5, Y =3444+ 802X 5 =7,454

For FY 2070/071 X = 6, Y = 3444+ 802X 6 = 8,256

For FY 2071/072 X = 7, Y = 3444 + 802X 7 = 9,058

Table 4.3.7
Estimation of VAT for next five years

Rs'.00000'

Fiscal Year	Estimated VAT
2067/068	5,850
2068/069	6,652
2069/070	7,454
2070/071	8,256
2071/072	9,058

From the above table 4.3.7 shows that the revenue collection estimation of coming 5 years. In fiscal year 2067/068 the revenue collection will be Rs. 5,850 million. This shows the increasing trend VAT revenue collection. Where, the revenue collection forecasting in 2071/072 is Rs. 9,058 million.

4.4. Empirical study

An empirical investigation was conducted in order to find out the varies aspects of Value Added tax from the experience of the real world. In this empirical study, the analysis has been done about value added tax based on information collected from the tax experts, tax administrators (tax officer) and tax payers. The major tool used for this purpose is questionnaire.

In this study, the questions are asked to 50 different individuals related to field i.e. tax experts, tax administrators (tax officers) and tax- payers. The questionnaire has covered varies aspects of VAT in Nepal. (See the questionnaire in appendix). Information received from the respondent's are tabulated and analyzed in the proper way. The following table shows the groups and no. of respondents.

Table 4.4

Group of Respondents and Number

S.N.	Group of Respondents	Number
1	Value added tax experts	10
2	Value added tax administrators (officer)	20
3.	Tax- payers	20
	Total	50

Source: Opinion survey

4.4.1 Result for Empirical Investigation

A. Soundness of value added Tax administration in Nepal

To know the opinion about the soundness of VAT administration in Nepal, question was asked with respondents “Do you know about the VAT administration in Nepal is sound?” Then, such responses received from the respondents are tabulated as follows:

Table 4.4.1.A

Soundness of VAT Administration in Nepal

Responses Respondents	Yes		No		Total	
	No	%	No	%	No	%
Tax experts	4	40	6	40	10	100
Tax administrators	7	35	13	65	20	100
Tax payers	9	45	11	55	20	100
Total	20	40	30	60	50	100

Source: Opinion survey

From the above table 4.4.1.A, we found that cent-percent responses of the question are received. Sixty percent respondents are disagree about the soundness of value added tax administration of Nepal where as forty percent are agreed that the VAT administration. In the conclusion, we can say that training must be providing to tax experts and administrators.

B. Opinion about Current Vat Rate

To know the opinion about the present Vat rate in Nepal, I'm requested to Respondents to select one among the three alternatives (High, Medium and Low). The question was asked "what is your opinion about the current VAT rate? The responses received from the respondents are tabulated as follows:

Table 4.4.1.B

Opinion about Current Vat Rate

Responses Respondents	High		Medium		Low		Total	
	No	%	No	%	No	%	No	%
Tax experts	1	10	7	70	2	20	10	100
Tax administrators	2	10	13	65	5	25	20	100
Tax payers	12	60	6	30	2	10	20	100
Total	15	30	26	52	9	18	50	100

Source: Opinion Survey

From the above table 4.4.1.B, I found that cent-percent responses of the questions are received. Where, 52% respondents are agreed that the present Vat rate is medium, 30% respondents are agreed on the high range and 18% respondents are agreed on the low tax rate. It concluded that the current VAT Rate is medium.

C. Has the VAT been leaking in Nepal?

To know the opinion about VAT has been leaking in Nepal, the question was asked with respondents, “Has the VAT been leaking in Nepal?” Then the responses received from respondents are tabulated as follows:

Table 4.4.1.C
Has the VAT been leaking in Nepal?

Responses Respondents	Yes		No		Total	
	No	%	No	%	No	%
Tax experts	3	30	7	70	10	100
Tax Administrators	10	50	10	50	20	100
Tax payers	12	60	8	40	20	100
Total	25	50	25	50	50	100

Source: opinion survey

From the above table 4.4.1.C, we found that cent-percent responses of the questions are received. Where, 50 percent respondents are agreed with the leaking of VAT. VAT provides more chances of direct contact between the tax- payers and tax personnel. Since direct contacts and dealing facilities collusion malpractice and misuse of power, tax evasion would be easier under the VAT.

D. whether VAT helps to economic growth or not?

To know that VAT helps to economic growth or not the question was asked with respondents “whether VAT helps to economic growth or not?” Then, the responses received from respondents are as follows:

Table 4.4.1.D

Whether VAT helps to economic growth or not?

Responses Respondents	Yes		No		Total	
	No	%	No	%	No	%
Tax experts	10	100	0	0	10	100
Tax administrators	15	75	5	25	20	100
Tax payers	12	60	8	40	20	100
Total	37	74	13	26	50	100

Source: Opinion survey

From the above table 4.4.1.D, I found that the cent-percent responses of the question are received. Where, 74 percent respondents believed that VAT helps to economic growth of Nepal. On the other hand, 26 percent of respondents are argued that VAT only does not help to economic growth in Nepal.

4.5 Major Findings

After the presentation and analysis of data, we find that some findings from the study which are concerned with the Value Added Tax system in Nepal. The major findings of the study has been presented as follows which are correspondences to the objectives of the study:

- The amount of VAT through DELL computer is contributing a lot in total revenue of the government. So, the total Vat paid by this computer is Rs 7,376.70. where, manufacturer to wholesaler is Rs. 4,368, wholesaler to retailer is Rs.1,308.57 and retailer to customer is Rs. 1,700.13.
- In Nepalese tax structure, internal revenue collection is more important factor of revenue generation. Internal revenue collection is Rs.113 billion in fiscal year 2066/067 is greater than last year of Rs.83 billion. Where, increment is 36%.Indirect tax in Nepal mainly includes custom duties, VAT and excise duty. Share of VAT revenue among these three is highest in F/Y 2066/067, 47.95% has contributed from VAT only. Similarly, there is 30.83% of custom duty and 21.22% of excise duty.
- No. of VAT registrants have been increasing day by day. It has reached to 82,433 at the end of Ashadh 2067. Which was 46,831 at the end of FY 2062. The growth percentage is fluctuating between 13% to 33% in last five years. However, the total no. of taxpayers is going on increasing trend but it is not sufficient meet the government's need.
- The trend of Value Added Tax and Total Revenue Collection is the most related with each other. So, the total revenue of the government is increasing on the basis of VAT collection. When VAT generated about Rs.21.61 billion in FY2062/063 then total revenue was Rs.39.90 billion and VAT Rs.54.92 billion in FY 2066/067 then total revenue increased up to Rs. 113 billion.
- Projection of Vat coming 5 years shows the value added tax revenue for the year 2071/072 has estimated as Rs.9058 million.
- Indirect tax is contributing a lot in total revenue of the country. The main portion of the indirect tax is value added tax.
- Value added tax system has been implementing in Nepal has completed twelve year so, the study has focused into finding the VAT payable to

government in each stage of distribution channel by different types of consumer at the rate of 13%.

- Contribution of indirect tax revenue is large in government found where the show of indirect tax revenue on total tax revenue is more than 70 percent in each year on last five years from fiscal year 2062/063 to 2066/067. Where, 73.29% in F/Y 2066/067.
- Major problems associated with VAT system to business sectors are account keeping and billing. In this context weaknesses of VAT administration are lack of motivation, service minded attitude, dishonesty in VAT officers etc.
- It is found from the study that the major problems of VAT's leakages are an unofficial trade from the southern and northern borders. Under valuation of goods is rampant which cause problems from the initial stage of the VAT. Once the problems started in the chain of Vat, it affects the whole system. According to Vat system, if less tax is paid the tax credit latter will also be less and taxpayers are discouraged from indulging in under invoicing.
- One of the reasons why Vat is not successful in Nepal is due to formal interest in different layer of administration system of VAT. As for example, during the survey I was asked time to time that only the staffs having good connection with political parties is posted in revenue department but also in many case he/she pay a large sum of money to go to that department and moreover, the businessmen pay a large donation during election.
- Contribution of VAT in Inland Revenue Collection is Rs.54.92 billion in fiscal year 2066/067, which is greater than last year Rs. 39.70 billion. It shows that the improvement in total tax collection by IRD.
- Before implementations of VAT there are different types of tax based on the sales of goods and services imposed for generating revenue is sales

tax, entertainment tax, hotel tax and contract tax having different tax rates. Either, the tax rate was less or more than VAT. Hotel tax was between 10 to 14 percent, sales tax was 15 percent. Whereas after implementation of VAT the rate was fixed at 10%. Now, the tax rate is 13%.

- VAT collection from internal trade or domestic trade and import of goods and services from abroad is the important factor for revenue generation. Where, collection from import is more than the collection from domestic trade. The ratio of collection from internal or domestic sources and import is 38.62, 37.63, 36.64, 36.64 and 37.63 in FY 2062/063, 2063/064, 2064/065, 2065/066 and 2066/067 respectively. Total VAT revenue has increased by 38% in FY2066/067.
- Existence of small traders in large proportion, lack of accounting records, illiteracy and high compliance cost, open border with Indian market etc which create a question for successful implementation of VAT. Very large number of small tax-payers with no record keeping and issuing invoices are major problems facing by Nepalese Tax System.
- The trend of information fillers shows a positive sign. Where, total no. of information fillers is 47,919 in FY 2066/067, which were 33,633 in FY 2062/063. Debit, Credit and Zero information fillers is increasing trend and Suspended information fillers is zigzag.
- Office wise registration status of VAT shows the VAT registrants in different locations in the country. Kathmandu is divided into three parts i.e. Kathmandu1, Kathmandu2 and Kathmandu3 and Vat registrations in this region are greater than any other region like Biratnagar, Pokhara, Butwal etc. of the country. 58% of the total registrants are in this region only.
- It is very important to understand that VAT which comprises 51% in government revenue and having highly positive correlation (+0.9989). It is a backbone of current revenue collection portfolio will surely be beneficial for the whole nation.

CHAPTER-V

SUMMARY, CONCLUSION AND SUGGESTION

5.1 SUMMARY

The main objective of the study is to find the value added Tax system in an overview of Nepal. The study carried out under the topic of "An Overview of Value Added Tax System In Nepal" is divided into five different chapters. In this context, chapter one deals with an introduction of the study. It includes background of the study, introduction of VAT, statement of the problem, objectives of the study, significance of the study, limitations and organization of the study. Chapter two, deals with the review of literature. It includes conceptual framework and review of related studies and research gap. chapter three, explains the research methodology used to evaluate of research design, data processing and analysis, population and sample size, nature and sources data, reliability and validity of data. Chapter four is the main part of study which presents and analysis the data collected from secondary and primary sources. Chapter five states the summary, conclusion and suggestion of the study.

Taxation has played an important role in the economic development of each country. Value added tax is a modern and scientific Tax system. It is a kind of indirect tax imposed on value added on goods and services by business firm at the successive stage of production and distribution. Value added tax brought to replace sales tax, contract tax, hotel tax and entertainment tax. VAT is scientific system of taxation. The types of value added tax are classified in three forms such as consumption types as invoice/ Tax credit method, Income type as a subtraction method in connection with deducting facility in subsequent then otherwise addition method and next one is Gross national production of addition method. VAT has regarded as one of most of important innovation in the field of taxation. The evaluation of Vat is the most significant event in the history of commodity tax. German scholar Dr. William Von Siemens, father of VAT, was the founder of Value Added Tax. He developed the concept of VAT in 1919 AD. A

tax mission to Japan led by Earls S, soup, and developed the concept of VAT further in 1949. Any country did not introduce VAT until 1953. In 1954, VAT was first introduced by France to cover the industrial sector alone limiting the tax up to the wholesale level. In 1960, this tax was adopted by Ivory Coast. In 1967, Brazil and Denmark adopted this tax system there after many other countries started adopting this tax. Now, more than 130 countries of the world have been implementing VAT in their economy up to now.

In Nepal 1996/97 budget announced that VAT would be implementing from Mansir 1st 2054. However, full-fielded VAT was effective from Bhadra 1st 2056. Value added tax Act has already enacted in 1996 to regulate actual practice of VAT. According to value added tax Act 1996 the tax rate is 10 percent and export are subject to a rate of zero percent. There is provision of threshold and exception in VAT Act 1996. Single positive rate of 10 percent now, this rate is change into 13 percent from Magh 1st 2061.

VAT is introducing not only important in the economy but also the other related portion may be easier then replaced tax system. The methods are available to compute of VAT. There are addition method, subtraction method and tax credit method. Addition Method includes salary/wages, interest, profit etc. under the Subtraction Method value is determined as not turn over, which is obtain by subtracting the cost of material from sales proceeds. Tax credit method is popular in there method in practices invoice is the important document in tax credit method. Comparatively, easier and simplicity tax credit method is adopting for computing VAT in Nepal.

There are two principle of VAT origin principle and destination principle. Origin Principle advocates the theme that “Tax all goods and services where they are Originated or produced that relieved those goods from taxes which are mported imports subject to tax. Nepal has been adopting destination principle of VAT. from abroad.” Under a destination principle of VAT, all exports are allowed to free tax and In coming days, the government should balance this expenditure through ceiling on general expenditure and especially on security expenditure. To increase security expenditure on unplanned way is to decrease the development

expenditure. The cycle of income of general public revenue, collection and poverty alleviation also need continuation to development activities. Government by reducing taxes on various commodities has tried to promote import and at the same time has tried to curb the smuggling also. Though at present, it is difficult to deal with the large number of people wanting to be registered into VAT, the government is appointing 'tax helpers' urging the businessman to support the government by 'taking and giving' bills of right value.

The problem is not so much in manufacturing but in trading. The government should aware of it. Unless illegal trading through the open boarder with India is address, we cannot adopt a magical solution. The government should have two -tier VAT system. For items with custom duty of more than 5%, VAT should be less. This will allow the tax department to enforce proper declaration of valuation at the customs points. Alternatively, the duty rate should be brought to 5% allowing VAT to remain the same. This will ensure transparency in transaction. All types of businesses whether small or big should be brought under tax not to increase revenue but for better performance.

The government should understand that people's income does not keep on increasing on a constant rate during economic recessions. That may generate less revenue which tax official failed to understand. Leakage is one of the serious problems inflicting the tax system. The government needs to introduce strong measures for stemming the rot and make sure they are implemented. It is better to broaden the net than to put addition taxes on existing customers. Due to falling revenues from exports, VAT has become more important. The government, however, should not raise the VAT rate, but concentrate on efficiently implementing it.

5.2 CONCLUSION

Public finance has two sources of revenue, one is tax revenue and other non- tax revenue. The revenue of Nepal also two sources; Import custom and VAT. Tax revenue is classified into two types: Direct Tax and Indirect Tax. Direct tax is a tax paid by the person on whom it is legally imposed. Tax payer paid the tax other and that collects the tax from different persons paid to government or tax payer and tax imposed are separate.

In developed country, direct tax contribution become more than indirect tax. An indirect tax is a tax imposed on one person but partly or wholly paid by another under developed country like Nepal has the more contribution of indirect tax. The share of direct tax is 26.71% and indirect tax is 73.29%. Custom duty, VAT and Exercise duty are main source of indirect tax. Value Added Tax contributed about 48% of total indirect tax revenue. Thus value added tax has regarded as one of the important source of government revenue. Import is the main base of value added tax in Nepal around 62% of VAT has contributed by import in Nepal.

The term 'Value Added' refers to the value added to goods and services by a step in the chain of original purchase, manufacturing or other enhancement and retail. Thus, Value Added Tax means the liability to be levied on the Value Added by an organization at each stage of its producing goods and rendering services. Generally, the tax base is broad, having with exemptions on goods and services is the simply the reason of popularity of VAT in the world. Other facility of VAT is neutrality role on the methods of production and distribution as well as consumer choice. It is justice able for the neither consumer to pay the tax to government neither transparency of nor producer. By the transparency of invoice controls the price and increase the competition.

Further, the stepwise collection of VAT does not encourage tax evasion. VAT is considered vertically neutral because changing the methods of production and distribution cannot reduce the tax liability. This is the unsuitable for under developing countries. Where, the gap of poor and rich is very large and

treat the same measure of consumption rate. A poor farmer should pay tax as well as rich people in the clothe are an example.

5.3 SUGGESTION

After analyzing and presenting the data, we got various findings. These findings are directly and indirectly related with an overview of Value Added Tax System in Nepal. Based on such findings, the following suggestions can be presented for successful implementation of VAT and to get the desired result:

- It is necessary to lunch a comprehensive tax- payer education program in order to give ideas about varies aspects of value added tax to the existing and potential tax- payers and others.
- The contribution of indirect tax revenue (VAT) is 73.29% and other direct tax is 26.71%. Increasing rate is not high of VAT revenue. In the last five years it is going on increase trend. In this situation mainly the VAT revenue collection is unsatisfactory. Therefore, the Inland Revenue Department should celebrate “Registration Month” as like as “PAN Saptaha.”
- Both direct and indirect tax is increasing in very low percentage in recent years. Therefore, government tax authority should identify the reason believed it and take corrective action.
- Value Added Tax is implementing for the replacement of sales tax, entertainment tax, hotel tax and contract tax. Therefore, the rate of VAT should be 15 percent to make the balance of tax and to increase the VAT revenue. In this way, the ratio of VAT will be increase.
- The increasing rate of registrant tax- payers is not satisfactory because it is in decreasing order. Therefore, the tax authority should pay attention toward it.
- VAT collection on import is remarkably higher than domestic production such high dependency on import is not the good signal for the government

therefore authority should take an effective step to encourage domestic production.

- Thresholds, zero rating and exemption provision make limiting the scope of VAT. Our economy is not so large while the large economy of India has IC Rs. 1000000 (ten million) threshold. Furthermore zero rating and exemption provision are large which are not suitable for Nepalese context. These provisions are also the course of tax evasion. Therefore, tax authority should properly monitor over these provision to increase the revenue collection through VAT. Government should facilities to small business -person to registration under the VAT. The exempted list should be limited and it helps to increase the registration and collection.
- The administration should be watchful to discourage any kind of malpractice, fraud evasion and avoidance of tax. Similarly, the reward and punishment system should be followed according to performance of VAT.
- The government should apply the “Rasan Card” for the people who are living under the poverty line. By this precision make easier reduction or minimization of tax exemption goods and services. Most essential goods and services have to exempt. In this situation, VAT will cover the broad base and increasing the revenue collection.
- The boundary of value added tax should be increase instead of increasing the rate of VAT in order to increasing amount of revenue collection from VAT. Unfortunately, the government increased the rate of VAT from 10 percent to 13 percent in Magh 2061 after seven years of VAT implementation.
- Facilitate to the small business- person to register under the VAT. They have to get credit facilities and yearly reporting systems. This kind of provision the coverage of VAT has been increased.

- It is known that double and multiple rate of VAT is difficult to administer but it is better to introduce double and multiple rate of VAT instead of increasing single rate. High rate in luxuries and imported goods and low rate essential goods should and low rate an essential goods should be levied.
 - An effective computer program for invoicing and record keeping to need of value added tax should be developed by the Inland Department and should provided particularly to retailers at nominal cost.
 - The existing destination based consumption types of VAT operation through the tax credit method should remain continuous.
 - This is the age of public private partnership (PPP) for the development of nation. When the co-partners are away from their objectives problems are arises. Without any coordination of private sector with government, the mission cannot be achieving. In this way, coordination is the compulsory function of government and private sector.
-) The VAT administrator and tax payers/businessmen must be accountable towards proper implementation of VAT. They have to perform their duties honestly to achieve the positive result from VAT.
- Awareness campaign to general consumers to pay tax and awarding the conscious consumers like schemes may bring positive message at the general level of our Nepalese market.
 - Standards like those that Nepal accounting standards, Nepal standard on auditing should be strictly implemented and then book- keeping system of all people get standardized.

To make VAT a backbone of our revenue and to get prosperous and happy Nepal using this revenue, a strong commitment and cooperation from all the stakeholders of the system is required. We hope that, everybody work genuinely and honestly to solve the existing problem of our VAT system and explore the future prospects of this sector and it helps to increase revenue collection in Nepal.

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ANNEXES

Annex - I

Dear Sir,

I am a student of Birendra Multiple Campus Bharatupr Chitwan, studying in the final year of MBS.

As you know, the students of this level have to write a dissertation on the subject of their specialization. Being a student of accountancy stream, I have determined to present a dissertation on VAT. The topic approved for me by Tribhuvan University is “An overview of VAT system in Nepal”.

I have enclosed a questionnaire with this cover letter. I request you to fill up the questionnaire as per the instruction given on the top of the questionnaire. It would be a matter of great pleasure for me if you kindly respond me back in spite of your busy and valuable time schedule. Your responses will be great important to my study.

I assure you that your responses will be kept confidential.

I am looking forward to your kind cooperation and support in this study.

Thank You,

Yours Sincerely

.....

Saraswati Bhattarai

Birendra Multiple Campus Bharatpur Chitwan

Tribhuvan University

T. U. Regd. No. 7-1-240-498-2000

Annex – II

QUESTIONNAIRE

Name of the Respondent

Office/Organization

Position

Department

Age

Please answer the following questions with tick mark () in appropriate space and as required by the questions. I humbly request you to fill it up with the best of your knowledge.

1) Do you consider that VAT administration in Nepal is sound?

a) Yes b) No

2) Is present VAT rate appropriate?

a) Yes b. No c. I don't Know

3) What are the major problem and weakness in VAT system?

- a) Voluntary compliance
- b) Relatively high tax rate
- c) Difficult to maintain the account for tax purpose
- d) Lack of Previsions under the Nepalese VAT law
- e) Other (If any, specify)

4) In your opinion, are the provision made under the Nepalese VAT act sufficient in all respect?

a) Yes b) . No

5) If any, in which aspect the improvement are needed? Please specify in following numbers.

- a)
- b)
- c)

6) Do you issue VAT invoices in every sales?

a)Yes b) No

7) Did you receive VAT invoices in every purchase?

a)Yes b) No

8) What are the books of account to be prepared for VAT?

- a) Sales book and purchase book.
- b) Sales book, purchase book, debtors' and creditors' book.
- c) Debtors' book and Creditors' book.
- d) Sales book, purchase book, debtors' and creditors' book and stock book.

9) Did you maintain all the required books?

a) Yes b) No

10) Has VAT been lacking in Nepal?

a) Yes b) No

11) Has Vat been discouraging the Nepalese business?

a) Yes b) No

12) Whether VAT helps to economic growth or not?

a) Yes b) No

13) Is VAT inflationary in Nepal?

a) Yes b) No

14) Do you have any comment of the VAT system of Nepal?

a)

b)

c)

Thank you for your valuable time.

Annex – III

Cost prices of different parts of the DELL Computer are as follows:

Computer Parts:	Cost of Manufacturer Rs.
18.5” LCD Monitor	8,800.00
Mother Board	4,000.00
Dual Core CPU	4,500.00
RAM	2,000.00
Hard Disk Drive	3,500.00
Casing Box	2,500.00
DVD Drive	1,500.00
Mouse	625.00
Key Board	575.00
Total	28000.00

Source: Annual Report of relative computer 2067.