CHAPTER I

INTRODUCTION

1.1 Background of the Study

The prime concern of every nation of the world is to make rapid economic development and Nepal is no exception to this ever-continuing process. Nepal aimed for self-reliant economic system to upgrade the living standard of people. Thus, a lot of money has to be spent to achieve maximum national objectives.

In the present context the government has to spend a lot of money to fulfill its responsibility towards its people. The responsibility maybe either for security or for health, education or other development activities. Every nation wants to improve its current status through proper utilization of resources. The government receipts may take a form of taxes, charges as an internal sources and borrowings, grant and loans as an external source. Those collected huge amounts of fund are spending in maintaining peace and security in the country. It includes the maintenance of fulfilling the basic needs of the people, such as health, education, communication, drinking water and other public utility and facilities etc. Similarly, the government has to spend on development of socio-economic infrastructure, which facilitates to promote the private sectors. All round prosperity of the nation can be achieved through the equal participation of private sectors. All round prosperity of the nation can be achieved through the equal participation of private sectors in development activities, industry and commerce as well.

The Nepalese economy is quite dynamic with favorable economic indicators, viz. Stable prices, surplus balance of payments position and average annual economic growth of more than 4 percent during the decade of the 1990. There descriptions, however, hide the fact that Nepal is in LDCswith widespread poverty and low gross national per capita income. Either to pay regular expenditure or to do development works the government collect revenue. The source of the government revenue can be classified into external and internal sources. External sources of the government revenue are foreign loans, grant, external borrowing etc. External sources are uncertain, inconvenient and good for healthy development of nation because they have to pay after a certain time with interest. So, it is better to mobilize internal sources rather than externalsource.

Internal source, another source of government revenue contains tax and non-tax revenues. The examples of non-tax revenue are fees, royalties, administrative and business incomes etc. Taxes are the main sources of revenue for the government. The source of tax revenue and the relative contribution of these sources and determined by government policy, choice about where and how to impose taxes by changes in the structure of the economy. Taxes influence the incentives and thus the behaviors of economic actors and the economy's competitiveness. Taxation is regarded as an effective instrument to monitor various economic activities in a country. Income tax, value added tax, customs duties, excise duty are the example of the sources of tax revenue. The government collects revenue through taxation with major objectives of economic development and economic stability. The contribution of tax revenue and non-tax revenue on total revenue is 87 percent and 13 percent in FY 2015/2016(MOF, 2015).

It is clear that tax is compulsory levy and those who are taxed has to pay it without getting corresponding benefit of services or goods from the government. The tax payer does not have any right to receive direct benefit from the tax paid. The tax payer can't receive equivalent benefit from the government. Tax is paid to the government for its running. Amount collected through taxation is spent for common interest of the people.

Value Added Tax is based on the principle that each producer and distributor adds value, in some way to the materials they have purchased and it is this added value that is taxed at each stage of the production and distribution chain. VAT is shifted forward completely to the consumer. The VAT is imposed as a neutral tax for substantial revenues without reducing the effectiveness and efficiency of the market system. The VAT is believed to be improvement over the types of indirect taxes. Prior to the introduction of VAT there were several independent domestic taxes on goods and services. Some major were sales tax, hotel tax, contract tax and entertainment tax.

Some major advantages claimed by its supporters are as follows:

) It reduces the distortion of trade and consumption due to the broad base and uniform basis of taxation.

) It is a better instrument for managing the economy.

) It helps to promote exports and improving the balance of payments.

) It places an equal burden on both imports and domestic products.

) It places a proportional burden of tax for both production levels to retail level.

There are also some draw backs which are as follows:

) It creates dual economy due to the thresholds concept.

) It increases the price for final consumer. It is not simple in practice as advocated in theory.

) The administrative cost is relatively high.

) The final consumer feels higher burden of tax.

) The bill enforcement of the VAT is not easy as advocated by the VAT experts.

) It is regarded as regressive nature of tax.

) It creates a host of problems in practice.

VAT was first implemented at national level in France in 1954. In March 1996, the government of Nepal passed legislation to introduce VAT in Nepal. It was introduced from 16 November 1997 as a reform designed to replace sales tax, hotel tax, contract tax and entertainment tax. VAT is launched in Nepal with an expectation of broadening the tax base, elimination tax cascading and creating an investment friendly tax system. The main objective of VAT is to develop simple and modern tax system with an exemption of export and basic goods from taxation and finally increase revenue. VAT is a tax imposed on the value added to goods and services consumed in Nepal or exported outside.(MOF, 2015).

In the VAT system, producers, distributors and people providing services raise VAT on the products or services sold or provided. The difference between the VAT collected on sales and the VAT charged on purchases determines the amount, a registrant must remit or the amount that maybe claimed as a refund. At the beginning, VAT rate was fixed at 10 percent, but from mid January 2005 an upward adjustment was made in VAT rate by 3 percentage points. Therefore, at present VAT rate is 13 percent, collected at every stage of selling goods and services but there is presser from the business community to apply the multiple rates. They recommended it can be increased from 13 percent to 15 percent flat rate for specific luxurious items.

Recently, the committee on VAT multi rates constituted by MOF/GON recommended four rates viz. 0 percent, 1 percent, 4 percent and 13 percent respectively.

Business with annual turnover of less than Rs. 2 million are not required to register for VAT, but those who import goods worth more than Rs. 10000 at as time must register. Goods exempted for VAT include primary agriculture products, goods of primary needs, live stocks and their products agricultural materials, medicine, health services, education, paper and cultural services. VAT is not levied on goods for export raw materials imported by an export promotion industry.

The direction and lessons of tax reforms in developing countries like Nepal established that excise duty is the most important choice and ingredient of tax reform. It may be adopted be a developing country with no difficulty and is an important instrument for the mobilization of internal resources and the pressure of excise duty on economic activities is minimal or not at all. The tax reform and adoption of a excise duty is therefore essentially connected with the efforts of many under developed countries to achieve the goal of country's economic development.

1.2 Statement of the Problem

Tax as a major instrument and important policy tools have an important role towards increasing the rate of capital formation and there by achieving a high rate in economic growth. The role of taxation in economic development lies in its function as raising a maximum volume of revenue. As Nepal is also member of WTO, SAFTA, BIMSTEC networks, the collection of custom revenue as a major source of revenue is low. On the other hand, there is less possibility of collecting huge amount of income tax because of the low per-capita income of the Nepalese people. Agriculture and export income are not taxed. Many others incomes could not be brought under the tax nets. This is the major challenges to Nepal's tax system in the connection of reform in Nepal's tax system.

In such circumstances, VAT was introduced in November 1997 as a reform designed to replace the sales tax, hotel tax, contract tax, and entertainment tax, for strengthening internal resource mobilization. Theoretically, VAT is considered as the best from of the sales tax, however, success of VAT is any developing country largely depends on its implementation, mainly the previous experiences with multistage taxes or general sales taxes the nature of the taxes that theVAT will replace the rate

structure and exemptions, including provisions for small taxpayers. So it is a time to evaluate the Nepalese VAT as a major instrument of resources mobilization.

Value added tax is the most important and effective techniques to collect more revenue for economic development. However the introduction VAT, planned in Nepal has a hot debate among the businessmen, government and academic regarding its good and bad effect in Nepalese economy. Many questions remain unanswered and sometimes are thrown into doubt. Various issues have been raised regarding to VAT system in Nepal. Many problems are arising successively implementation VAT system in Nepal. Research question are as follows These problems are as follows:

) What is the trend and structure of VAT in Nepal?

) How can significance of VAT be analyzed?

) How can analyze administrative problems of VAT?

1.3 Objectives of the Study

The main objective of the study is to analysis the effectiveness and contribution of value added tax on the Government revenue of Nepal.Other specific objectives of the study are listed bellow;

) To examine thetrend and structureofVAT in the government revenue of Nepal,

) To study the administrative problems of VAT,

) To analyzethe significance of VAT.

1.4. Significance of the Study

This thesis aims to access critically the performance of VAT in Nepal since its inception to date, focusing basically on three aspects of it which are (1) Collection and reporting of VAT (2) Problem faced the taxpayers and (3) Actions required to be taken. So, this study is beneficial in terms of viewing the current taxation scenario and also can be helpful for administration for the effective and efficient implementation of the VAT system minimizing the evasion and possible loopholes which brings positive impact in overall tax system.

1.5 Limitations of the Study

The limitations of the study are:

1. The research has covered the period from FY 2003/5 to 2015/16, due to lack of availability of monetary and time constraints.

2. Data and information are completely based on secondary sources so the reliability of data may not be accuracy and consistent.

1.6 Organization of the Study

The first chapter is introductory which includes background of the study, introduction of Value Added Tax, statement of the problem, objectives of the study, needs and significance of the study, and limitations of the study.The second chapter is review of literature which refers reviewing the research or other related published or unpublished articles published in different economic journal, bulletin, dissertation papers, magazines, newspapers and websites in the related area's study, so that all possible relevant past studies.

The third chapter is research methodology. In order to achieve the objectives of the study, appropriate research methodology has been adopted. It is purely explorative cum descriptive study. It includes the introduction, research design, nature and sources of data, data analysis tools, sampling procedures materials and definition of some key terms. The main objective of the study is to analyze, examine, highlight and interpret the structure and trend of VAT in Nepal. The fourth chapter comprises presentation and analysis of data. This is the main and key chapter of research study. In this chapter sources of data are secondary, which are presented in appropriate form. Analysis and interpretation of data have been performed thereafter.

The fifth chapter addresses structure and trend of VAT in Nepal.Finally the last chapter is concernedwith the output of the study in the form of summary, conclusion and recommendations. This chapter consists of summary of the major findings of the study, concluding it with major recommendations.

CHAPTER II

REVIEW OF LITERATURE

2.1 Theoretical Review

2.1.1 International Context

Shoup (1969) has considered value added tax as the latest and most problems the final stage in historical development of general sales tax, imposed on the value added by the business forms. He explains VAT as the difference between sales tax imposed on the value added by the business form. He also explains VAT as the difference between sales proceeds and the cost of materials etc., purchased from other firms, which is the tax based of a VAT.

Musgrave & Musgrave (1976) have started that the sales tax may be imposed in either single or multiple stages. A properly implemented value added tax is equivalent to corresponding single taxes, from the economist point of view.

Goode (1986) has described that the VAT is the most important innovation in a public finance. VAT applies to the tax imposed on the value added successive stage of production and distribution. VAT, a sales tax on consumption is fairer than an income tax because the later result double taxation of saving is unconvincing but the former lacks progressive, which serves by later. Goode has pointed following advantages of VAT: spreading the tax over several stages of production and distribution is often considered as an administrative advantage compared with collecting at one stage because enterprises has less incentive to evade tax.

Due & Meger (1988) have examined VAT in Dominican Republic. Mentioned VAT in Dominican Republic was in effect from November 1983.However, the general reaction towards the tax hostile from the business sector from increased record keeping requirements because the commercial sector of the economy was dominated by small and medium size business. The other main objection due to the belief that VAT was responsible for increased inflation was also due to other reasons. There was a general agreement that the enforcement of the tax has not been adequate mainly because of the lack of personal. Evasion was wide spared mainly firms failed to register. While the tax has brought the additional revenue, the inadequate enforcement and failure to extend it to the commercial sector as planned and the use of makeshift,

a complete VAT. The experience of the country with the tax provides a warning to other developing countries not to attempt to use Value Added Tax extending beyond the import and manufacturing sectors without careful consideration of the ability of the whole-sale and retail sector.

Ahamd & Ludlow (1989) have identified the alternative tax which reform packages on the VAT for Pakistan and keep the distribution consequences in consideration. The authors have their own method for the tax reform analysis. In the first step, they describe the existing taxes and then, examine the consequences of the tax changes on households, resulting government revenue and also implications for production. They analysis and compare the consequences of different option such as the single rate VAT with selective excises and some exemptions and multiple VAT rates. The reform with equal revenue as well as the production implication of tax revenue as well as the production implications of tax reform are also considered. The work shows that instrument can be designed to increase revenue and at the same time, ported the poor. A value added tax supplemented with selective excises would have made Pakistan's tax system more buoyant and reduced the production distortions inherent in Pakistan's then current tax system and not at the expanse of the poor.

Shoup (1990) has explained that the value added tax as the latest and probably final stage in a historical development of taxation which is based on goods and services.VAT is imposed on the value added and the difference between sales proceed and cost of the purchases from other firm is superior to the turn over tax. The manufacture and the whale sales taxes as it eliminate the uneven impact of these taxes. A comprehensive VAT to administer but it is inflationary in nature. Comprehensive consumption type of VAT is   equivalent to retail sales tax in its purchase from except that the letter does not offer an option between the destination principles.

Tripathy (1992) has explained that the VAT is an instrument of resource mobilization. The value added tax represents a new technique for collecting taxes on output of economics enterprise. If a tax on value added is imposed on sales minus the purchase of materials and also of capital expenditure items of an enterprise. According to him, in the developing countries, consumption type of Value Added Tax should be improved in every stage of manufacturing and distribution exempting. Besides, its structure should be designed in such a manner that to impose a low rate of

tax on food articles. The consumption type of VAT should be imposed in complete substitute of tax on undistributed profit of companies with regard to sales taxation where as the taxation of corporate profit is administratively much more convenient. The most important point about the VAT for developing countries is that it will constitute a dynamic part of their tax system. Besides the VAT is the most obvious of tax which vary in response to short run economic fluctuation. It can be raised or lowered as the situation demands more quickly and easily than many other taxes. Thus, the VAT can constitute an important instrument of developing the finance and economic stabilization in developing countries.

Shoup (1998) has analyzed that the structure of the VAT and different policy issues relating to the developing countries. A VAT covering all economics activities from the earlier stage of farming or mining right through the retail level is considered comprehensive. Consumption types of VAT and tax credit method for consumption is superior. VAT is more revenue productive and serves self enforcing feature and it is regressively can be reduced by providing zero method for foods and basic essentials. VAT will have favorable effect and it is relatively easy to administrator but it is inflationary because it must be recouped by firms through increase in prices. In comparison with turnover tax and retail sales tax, VAT stands in the first position but it requires caution in implementation. Although the choice between turnover tax and VAT become a matter of weighing the pros and cons. Basic accounting and efficient tax administration are lacking in developing countries which create difficulty for the successful implementation of VAT in such countries.

2.1.2 National Context

Dahal (1991) has concluded VAT as long term recommendation for the tax reform in Nepal. It has mainly analyzed the magnitude of the Nepalese tax system. The study is highly academic and depends upon theoretical bases, which covers less empirical founding in Nepal. The study reached at conclusion that "There is no possibility of any other great measure in introducing a tax rather than introducing VAT in Nepal ". The major derived by the author are to increase revenue collection by broadening the tax base, making the tax system more buoyant, discourage the tendency of tax evasion, making the tax system efficient and promote the export.

Tiwari (1991) has examined that VAT is considered as most growing trend in the

field of taxation. Discussing the merits of VAT, the reason for its growing attraction in the world is the one of the best modernization theory. It will raise consideration revenue and sustain it. It is effective to control price raise and reduce tax evasion. Discussing the development of tax in Nepal the author focuses the problems of Nepalese sales taxes such as administrative in efficiencies, large number of small tax payer with no tax concentrated only on important manufacture level.

Subedi (1997) has described that since, existing tax system is not efficient in raising adequate revenue and it is above distortion, inequitable and give incentives for tax evasion. The study emphasizes the need for the reform of entire tax system. It is desirable and necessary to move towards VAT and improve the administration. A VAT in Nepal expands the coverage of tax; removes distortion effects of the existing taxes and will have a minor effect on price. Empirically, VAT is also found to be the best alternative for reducing the inefficiencies and introducing, fairness, productivity and transparency in the tax system. A VAT, however, would rise the regressively of the system.

Silwal (1999) has expressed the practical experiences about VAT which covers all aspect of VAT. In writer's word, "VAT is an all stages non-cascading tax system. It extends to all levels of production and distribution. Similarly, it covers all stages and services. Any discrimination in taxing goods of services or exempting any of them renders VAT ineffective."The book gives main focus on Nepalese tax system. The book clearly analyzed why the government of Nepal introduced. He suggested that factors affecting VAT design take also into consideration. A poorly designed VAT accompanied by weak administration would just drain the treasury. So, almost care is necessary while designing a VAT.

Khadka (2001) has included the current developments and the status of VAT in the country as well as international arena. He mentioned VAT as the most recent innovation in the field of taxation, reasons of growing popularity of VAT and its neutrality, more equitable than other forms of sales tax evasion on its favor. A comparison of VAT with the sales tax before the introduction of VAT was very useful to convince the private sector for its implementation of VAT system. He had also tried to justify that after enactment of SAFTA and WTO agreement, the broad base internal tax system- VAT is required for a stable source of revenue (IRD/DANIDA Report, 2001).

Thapa (2001) has pointed toward the weakness inherent in the Value Added Tax system in Nepal. In author's opinion, if market runs in a fair manner, the market principle will bring welfare to many. He clearly points state that tax system deserves concerted effort of all stakeholders. The business person should develop the habit of quoting the price inclusive of VAT and remind customers for invoices. The tax administration should increase surveillance and consumer education level and consumers participation in finding the fraudulent transactions (IRD/DANIDA Report, 2001).

Gurung (2002) has studied about the VAT system which has a fairly comprehensive base including goods and service or consumption based and have a reasonable threshold that renders VAT administration practicable. The point that need to stressed VAT is a modern system of taxation that pre suppose the existence of a certain economic order comprising of business standers and ethics, documentation (technology) and simplified regulation that are simple, respected and complied with therefore, successful application of VAT will require assessment of their fundamental pillars. In our context with a view to gradually overcome inherent deficiencies in each sector with a positive approach, today every where there is an overall economic downturn VAT is flourishing. It is going to remind the mainstay of revenue.

Amatya, Pokharel & Dahal (2004) have explained that the Value Added Tax is a modern indirect tax. It is improved and modified traditional sales tax and avoids cascading effect existed in sales tax. VAT is levied on value added at each stage of the production and distribution activities. The stages may be import, manufacturing whole sales and retail. Thus, the objectives of VAT are to increase revenue mobilization of the country, to develop a stable source of revenue by broadening the tax base by imposing the tax on sales, distribution, transfer and import as well as export of goods and services.

Gautam (2006) has described about the contribution of VAT in government revenue and problem faced by it. Author has used different types of questionnaires to various ranked employees. The researchers used both primary and secondary data and have reached to the following conclusion VAT is a kind of indirect tax, which is found to be superior to any other tax system for recollecting the internal revenue. The import vat revenue is higher than internal VAT revenue. Poor management is also cause of ineffective resource mobilization. The growth rate of registrant is increasing. It shows

the implementation status is satisfactory but due to the lack of transparency in business activity, weak cross checking mechanism and transition manipulation conclude the price change on goods and service may create double problem for tax payers.

2.2 Empirical Review

2.2.1 International Context

Guarard (1973) has submitted to Columbia University in 1972, illustrated that it is not easy to say that VAT is developing countries. Open border along with least experience of border based tax implementation in developing countries likely to face initially a more difficult problem. Early revenue collection was satisfactory in Brazil in the first year of its introduction, revenue increased by 54 percent out of 54 percent, it was realized that 30 percent was due to price increase manufacturing industries and accounted for 60 percent of total collection of VAT although it generated less than one fourth of GDP. It is learnt that most of inputs are exemption where as output was taxable due to this reason, industrial sector increased the VAT.

Casanegra & Guard (1973) have described that developing countries has limited range of VAT bases by excluding the trouble some sectors (farmers retailer etc) because they have their own difficulties. VAT was produces between 10 to 30 percent of government revenue of seven developing countries. There is fundamental difficulties in VAT operation and administration in developing countries. The problem is the treatment of small tax payers which includes large number of retailer service enterprise and farmer.

Choi (1983) has examined and evaluated that the Value Added Tax in Korea- from its introduction to its effects on the economy. VAT in people Republic of Korea was introduced in 1997 as a part of large tax reform with the objectives of the simplifications of tax structure and its administration, of export and capital formation and maintenance of neutrality in indirect tax system. Introduction of VAT was also guided by revenue consideration. The characteristics of Korean VAT were of general type as had been adopted by the European countries. The effects of VAT on the economy had been dessert than its supporter had claimed in its favor or its opponents had feared would result from its introduction. The VAT did not have a major impact on the price increase, it showed a good impact on the investment and VAT supported exporters more than the previous tax system. One of the most controversial issues of

VAT it was regressivenes. Studies found that the VAT in Korea was worked relatively well, in some cases much better than its designers and taxpayers had anticipated. The VAT has broadened tax base, reduced evasion, increased revenue and solved many problems associated with previous taxes. However, the VAT may be simple theory the Korean experience with VAT during past seven years had made it clear that it was not so simple in practice. It created a host of problems that gave rise to voluminous paper- work, more or less arbitrary distortions in trade and consumption and inequalities in the distribution of tax burden. The proper assessment of several problem areas relating to VAT including coverage rate structure, administration, special taxpayers, co-ordination with direct taxation etc will help other from Korean experience.

Lukacs (1987) has explained that underlying theories which pushing Hungary to develop VAT system. Under the substantially changing economic condition, there was a need to lift the state regulation and leave the economy to be operated by the profit mechanism. In addition to certain other factors, the development of market forces required through changes in the price structure, it wage content and taxation. In other words, the reform included the tax and price reform was to diminish the tax burden on the business sector, make it more uniform and simplicity in taxation and budgeting relationships by reducing the part of taxes payable from corporate income the level of producer prices might have fallen with other portion of taxes being transformed into wage cost. This was going to be ensured by introducing VAT and personal income tax parallel with modifying the taxation of the business sector and system of producer prices.

Bird (1990) has analyzed about the implication of implementing a VAT in developing and transitional economies (DTE). Basically, the author noted that the VAT functions properly in most DTE and more effectively than any other kinds of general sales taxes. Secondly, the application of VAT depends on the   "self assessment", which remains a problem for many DTE. Moreover, when designing a VAT, it is important to take into consideration the situation of the countries since they can change considerably over time and across countries. Finally, the main lesion derived to understand the political economy dimension of the VAT policy and administration. In addition, the author argues that the main challenge of empirical studies on VAT in DTE is to collect systematic, consistent and accessible information about VAT in these countries.

Hsiung (1991) has made an effort to assess the VAT in Taiwan, which was in effect since 1986. According to author, the VAT in Taiwan was implemented in order to increase the competitiveness of export and improve the efficiency of business tax structure. VAT had replaced business receipt tax, stamp tax and commodity tax which constituted 38 percent of total revenue. The impact of VAT showed that the business tax revenue increased considerably although the reform was aimed to be revenue-neutral. Adoption of VAT did not cause price fluctuations. Another surprising impact of VAT was that the revenue from the business income tax increased significantly immediately after the adoption of VAT. This may be attributed to the cross- checking procedure provided by VAT. As for exports, there did not seem to be a direct link between VAT and exports since export are influenced by a number of factors. The tax fell heavily on the public sectors businesses and they were more affected by VAT than the private sector businesses. Generally, it can be said that the VAT system tremendously improves the efficiency of tax collection. However, there are some rooms for improvements especially in administration. The experience of Taiwan has attested to the superiority of the VAT in taxing business activities.

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

2.2.2 National Context

Agrawal (1978) has researched in 1978 of the period between F/Y 1951/52 to 1978 to 1979. The trend of resource gap and domestic resource mobilization through various taxation of the same period has been nicely analyzed in author study. According to his own words, the study is since both buoyancy and elasticity coefficient are greater than

unity sales tax in Nepal is previously responsiveness to change in GDP. However, the major constrain in the effective functioning of the tax system seems to be administrative deficiencies, poor tax pays procedures.

Khadka (1998) has analyzed the VAT system in this region; probably author is the person of first observer of VAT aboard and the firstly proposed VAT for Nepal with micro study of Nepalese economy and the tax system. Author state "VAT is the most recent innovation of the field of taxation which is levied on the value added of goods and services and is shifted towards completely to the consumer".

Bista (1999) has focused the need of VAT for Nepal for several reasons: transparency and avoiding all tax loopholes. VAT helps the resource gap by broadening the tax base and mobilizing additional resource by controlling tax leakage, smuggling, unofficial trade and corruption through transparency and account based crosschecking. Positive and favorable effects of VAT on all sectors can be alliance. Only if government can operates the VAT administration with effectively and efficiently.

Khadka (2000) has addressed on the nature of VAT, various types, methods of production and analysis reason for its growing popularity. Further, it also explore the possibility of introducing VAT in Nepal and examines various issues concerning to it. Author writes, VAT is levied on the value added to each commodity by a firm during the process of production and distribution and it consumers. Among the Asian Pacific countries, China, Indonesia, Korea, New Zealand, Philippines and Taiwan have introduced VAT as a part of large- scale tax reform programs. Popularity of VAT is growing rapidly because of it several positive aspects such as neutrality, move equitable than other form of sales tax except retail level sales tax , self policing nature in administration, difficult for the evasion, advantages to exempt exports broad base etc. However, VAT is complex and difficult for implementation especially from administrative point of view and it is vertically inequitable since it puts a relatively higher burden on the lower income group visa to their higher income counter parts. With this positive and negative aspect of VAT, author concludes the need of VAT introduction in Nepal. Lastly author concludes that VAT should be seen as a long term and a major step for the rationalization of Nepalese tax system and should be introduced only after adequate and proper preparation.

Dhakal (2000) has analyzed that the Nepalese tax structure along with basic emphasis on historical background and potential revenue of VAT in Nepal. The increasing trend of the resource gap of Nepal is foreign country to debt-trap situation. Domestic resource mobilizes through the properly designed tax system is the best way to uplift situation. Domestic resource mobilized through the property designed tax system is the best way to uplift situation. In this process Nepal is adopted the destination based, consumption type of VAT operated by the tax credit method. VAT encourages investment supports economic growth and keeps price stable. Exemption and zero rating reduce the regressively of VAT, however it makes the administration complex. The study found that VAT is unable to complete the existing sales tax mainly due to the minimum use of invoice by sellers and as well as having no interest to obtain invoices by purchases. Elasticity and buoyancy of Nepalese tax system are low. Further, they are decreasing in recent year. VAT, more attractive from the theoretical as well as empirical aspect, is being "hot milk in mouth" from practical viewpoint due to the inefficient tax administration. Hence, the introduction of the VAT is not the fulfillment of the requirement and VAT system itself a great need of reforming in the Nepalese context.

Sapkota (2009) has tried to assess the affecting factors in VAT collection system and problems faced by taxpayers. How the VAT makes effective taxation? The management system of VAT plays the effective role in Nepal or not, how to collect adequate revenue through VAT? Is VAT implementing successfully in Nepal or not? Most of the general people are unknown about VAT. Traders also think that price of product increase applying the VAT. But tax officers, tax experts give their view price of the goods and services will not increase due to VAT system. Tax administration does not believe most of the tax statement submitted by businessmen. They think businessmen do not submit all real statements. Monthly statement submission to tax office and stock valuation of sales return are the main problems imposed by VAT.

Rawal (2010) described VAT as a self-policing and transparent system of taxation reducing the scope for tax evasion wherein the tax administration is highly automated illegal trading through the open border. Furthermore, a collection strategy needs to be developed and implemented effectively in order to collect the increasing amounts of arrear. Tax administration should be fully computerized and ensure faster, simpler and reliable procedures for the taxpayers. The link audit should be conducted at all levels

of business chain with emphasis on tax audit. Fully and update of price index of goods and services in necessary.

Raut (2010) has identified that how VAT is superior to sales tax and what is its share in the GDP(Gross Domestic Product), thereby showing a substantial change between the two periods i.e. before implementation of VAT and after its implementation. The study also critically assesses the administration of VAT in Nepal, analyzing the lapses and problems with necessary measures for improvement. VAT is superior to sales tax in many of its form. Implementation of VAT did not increase the contribution of tax revenue on total revenue significantly. Though VAT has been implemented in Nepal in order to generate more revenue, but the efficiency of the Nepalese VAT administration is not satisfactory and not up to the expectation of the general people. More revenue can be generated through VAT by widening its coverage. The small traders which fall on the threshold limit could not have been brought into VAT net yet. Price to the consumer is concerned, as with the sales tax, the consumer pays for the product or service. For the better administration and implementation of VAT system in Nepal, The tax administration should be very watchful to prevent any kind of malpractice, fraud and tax evasion. Utmost care should be taken to prevent any kind of bribing and corruption. Tax officials should effectively be monitored. Also, tax refund is one of the sources of tax leakage. Therefore, tax authority should manage tax refund facility properly.

Singh (2010) has discovered the Nepalese VAT system with problems, prospects and suggestions. VAT has been most essential choice as ingredient of tax reforms for developing countries like Nepal, which leads to revenue enhancement and sustainable economic development. There is tremendous scope for increase in the revenue from VAT and its sound implementation in coming days. Billing system is one of the major aspects of effective implementation of VAT but Businessmen hardly issue bill to consumers. The proper issuance of bills has remained a major bottleneck. Border should be effectively controlled to prevent the illegal trade in border side.

Lack of proper billing system is the most challenging problem in Nepalese context so computerized billing/ automatic billing system should be developed in the VAT system. The use of cash machines should be encouraged in the shops to solve the problem to great extent. Basically custom duty and Excise duty is paid for import and export. The more we decrease rate the more we promote export and import of the

goods. Open borders should be strictly monitored and L/C has to be managed for the imports of goods because of this, trend of avoiding VAT by under-voicing the goods will decrease and VAT collection will be more.

Pathak (2013) has studied report about issue and effective of value added tax in Nepal which shows that the tax is most essential of the government related. The conclusion is that presence of VAT entirely depends in its implementation aspect.

Sharma & Duwadi (2013) has indicated that there are some issues on Nepalese taxation system. Basically, they are: low registration (income tax and VAT) and low return filing (huge non-filers) after registration, under invoicing and non-invoicing, data mismatch (differences in reporting), tax fraud (fake VAT bill case) and huge amount tax dues. There is large no. of cases pending in Revenue Tribunal on one side and on the other hand there is no supportive environment for enforcement.

Bhusal (2014) has examined the trend and structure of VAT in the government revenue in Nepal and identified the factors of challenges in VAT implementation in Nepal. VAT puts greater significances in revenue mobilization in Nepal. The Reason behind this is that VAT system is transparent with broad tax base and discouraging tax evasion. VAT is a most scientific, innovation and powerful tax system with built in quality of universal application for both developed and developing economies. VAT system makes it possible to broaden the tax base, eliminate the tax evasion and cascading, create an investment friendly environment and finally to increase to government revenue. This is a matter of great pride that Nepal has entered in to a major global tax system with the introduction of VAT.

Adoption of VAT system for Nepal is both compulsion and necessary. The globalization and recent trend of trade and tax system has affected the Nepalese economy. As Nepal is one of the members of WTO, it is necessary to decrease the custom duty and excise duty. Consumption based tax is only an alternative to more revenue which directly helps to increase domestic resources for development works. In spite of VAT is a major instrument to achieve the high rate of economic growth, there are many challenges and problems on the successively implementation on VAT system in Nepal. As per the equity principle of taxation, the government may apply different rates of VAT on luxury good and essential goods. There is injustice in levying more tax on conspicuous consumption. VAT laws should be effectively implemented.

Gautum (2014) has stated the reforms area of Nepalese VAT system. Tax administration should do the qualitative registration and some businesses can do post registration like construction. Awareness programs and education is needed on billings and its importance on VAT. Purchasing authority for tax officer, if there is undervaluation of goods in market. There should be deduction on existing exempt goods and services and IT based transactions should be increased by developing tracking system. Risk based audit and investigation is the one of the best reform area. Tax administration should identify the new sector to impose the VAT like hostel in schools, laundry etc. Building capable and skilled manpower and the taxpayer's behaved as a customer are identifying area for the VAT reform in Nepal

Khadka, Dhakal & Panday (2015) have suggested that the ten different sector should be reformed in VAT. Accordingly first is, tax exemption is reduced except hard to tax commodities and special merit goods. The VAT threshold should be increased to seven million and compulsory registration by business category (sanitary, furniture, fixture hardware, dry clean etc.) should be amended. The risk based tax refund should be started in export and diplomat. Registration and de – registration system is very poor in existing situation and during loose registration fake and fraud taxpayer may get registered. So large taxpayer should be registered without any hesitation and those who want to get registered voluntarily or small businesses, they should provide proper information to tax office and further administration should evaluate internal and external information. On the other hand if any taxable tax payer is not getting registered and isn't paying the tax they should be forcefully registered.

2.3 Research Gap

In this way various book, paper, dissertation, reports, articles, journals and other reference materials have been reviewed while preparing the dissertation. But there are not sufficient study conducted in such particular topic that "Structure, Composition and Significance of Value Added Tax in Nepal" most of the studies with theoretical aspects. The previous researchers were not able to explain the research gap but this study is focused to review the research gap in Nepal and it concluded that there is a huge research gap. Besides this they have shown about the implementation of the VAT successfully. In this study they are not explaining the value added tax effectively, efficiently, and transparently and securing the revenue yield according to government targets. Such special studies have not conduced yet so, this study is

different from other related studies. VAT is being important factor government tax revenue so that its real situation and exact contribution in GDP, total revenue and tax revenue are also found VAT effectively, efficiently and transparently in Nepal.

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

CHAPTER III

RESEARCH METHODOLOGY

3.1 Research Design

 The research designs followed in the study are descriptive and analytical research. This study also follows descriptive, analytical research design in order to obtain the required information, data and opinion. Research design, thus is the overall framework for the achievement of the goals and objectives of the research. The study is mainly based on descriptive perspective. Most of the data and information of the study are concerned with the opinion, experience and performance of the respondents. The study of VAT Act, VAT rule and regulations, government's plans etc. are done as a part of descriptive research. It includes the evaluation and development of VAT. The study of literatures concerning the VAT system and the classification of concepts allocated with VAT are also conducted during the mean time of research. Analytical research is conducted to analyze the trend and contribution of VAT in government revenue. It is done mainly through the secondary source of data from various publications. Therefore to achieve the specific objectives of the study, descriptive, analytical research has been carried out. This study therefore, follows descriptive, analytical and field study, research design, in order to obtain the required information, data and opinion. Research design, thus is the overall frame work for the achievement of the goals and objectives of the research.

3.1.1 Qualitative Research

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

3.1.2 Quantitative Research

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

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

3.2 Nature and Sources of Data

The nature of the study is descriptive as well as analytical. This is based on secondary data. The secondary data have been collected from IRD annual report, Ministry of Finance and Economics Survey. All the collected data and information have been properly synthesized arranged, tabulated and calculated to arrive at realistic analytical steps.

3.3 Sources of Secondary Data

Further data needed for the study had been collected from the secondary sources.

These sources consists the followings:

⟩ Published and unpublished reports, articles and dissertations on the concerned subject,

⟩ Publications and economic survey of various Fiscal Years of Ministry of Finance (MoF) Nepal,

⟩ Publications and annual reports of Internal Revenue Department (IRD),

⟩ Various books written by tax officers and scholars,

⟩ Related articles and journals,

⟩ Publication of VAT department,

⟩ Budget speech and economic survey of various fiscal years.

3.4 Variables Used in the Analysis Process

GDP : Gross Domestic Product is the total final output of goods and services produced in the country's territory by residents and non-residents, regardless.

VAT : Value Added Tax is broad based tax as it also covers the value added to each commodity by a firm during all stages of production and distribution.

Indirect Tax : The tax revenue on customs consumption and production is known as indirect tax.

Direct Tax : Direct tax is composed on income and capital.

Total Tax : Total tax is the sum of direct and indirect tax.

3.5 Tools for Analysis

All the collected data and information are tabulated into separate format and analyzed. For analyzing the data, simple statistical tools have been used which are simple percentage method, measure of central tendency measure of dispersion, correlation, time series analysis, etc. To make research objective, to find result accurate and practicable, different tools are used. The information collected in different aspect of VAT from secondary sources was first processed for tabulation and analysis. For analysis purpose simple statistical tools have been used which are as follows:

❖ **Trend Analysis**

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

❖ **Simple Percentage Method**

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

3.6 Methods of Data Analysis and Interpretation

Data collected from various resources are arranged, managed, edited, tabulated, analyzed and presented in proper forms. Such processed data and information are interpreted and explanted as necessary. The analysis of data is done by using various statistical tools to achieve the desired objectives.

3.7 Reliability and Validity of Data

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

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

CHAPTER IV

DATA PRESENTATION AND ANALYSIS

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

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

4.1 VAT in GDP Ratio of Nepal

The VAT GDP Ratio has been shown in table 4.1 the increasing tax GDP ratio for the study period. In FY 2003/04 to 2004/05, there are small changes in the percentage of GDP, through the VAT revenue. But in FY 2010/11 to 2015/16 the GDP is increasing continuously because of the increasing rate of VAT revenue. It show that the VAT revenue plays or can play important role in economic growth of GDP.

Table 4.1

VAT in GDP Ratio

(In Rs. 10 Million)

FY	GDP	VAT Revenue	% of VAT GDP
2003/04	53674.89	1447.89	2.69
2004/05	58941.16	1888.54	3.20
2005/06	65408.40	2161.07	3.30
2006/07	72783.0	2609.56	3.58
2007/08	81566.0	2981.57	3.65
2008/09	98805.0	3970.09	4.01
2009/10	117190.0	5492.09	4.68
2010/11	136659.4	6166.36	4.51
2011/12	152734.4	7093.04	4.64
2012/13	169264.3	8341.84	4.92
2013/14	194162.4	10110.46	5.20
2014/15	220123.5	12173.07	5.50
2015/16	241456.3	14513.1	6.0

Source: Ministry of Finance, Government of Nepal, 2015/16.

Table 4.1 shows that the VAT in GDP ratio of Nepal 2003/04 to 2015/16. In the table lowest percent of the VAT in GDP is in FY 2003/04 and the highest is in FY2015/16. Then it has increased rapidly in FY 2015/16. From the above table we can conclude the VAT has been most important source of government revenue. So, it has more contributed in the GDP.

4.2 Tax GDP Ratio in Nepal

The tax GDP ratio has been shown in table 4.2 shows increasing tax GDP ratio for the study period. In FY 2003/04 to 2005/06, there are small changes in the percentage of GDP, through the total tax revenue. But in FY2010/11 t0 2015/16, the GDP is continuously increasing due to increasing rate of tax revenue. It shows that the tax revenue plays or can play important role in economic growth or GDP.

Table: 4.2

Tax GDP Ratio in Nepal

(In Rs. 10 Million)

FY	GDP	Tax Revenue	% of Tax GDP
2003/04	53674.89	4817.3	8.97
2004/05	58941.16	5410.47	9.17
2005/06	65408.40	5750	8.79
2006/07	72783.0	7112.67	9.77
2007/08	81566.0	8515.55	10.44
2008/09	98805.0	11704.47	11.84
2009/10	117190.0	15978.53	13.63
2010/11	136659.4	17719.7	12.96
2011/12	152734.4	21172.3	13.86
2012/13	169264.3	25921.5	15.31
2013/14	194162.4	31244	16.09
2014/15	212465	37470	17.63
2015/16	241652.1	45630	18.8

Source: Ministry of Finance, Government of Nepal, 2015/16

Table 4.2 shows that the tax GDP ratio in Nepal 2003/04 to 2015/16. In the table lowest percent of the tax in GDP is in FY 2005/06 and highest is in FY 2015/16. Then it has increased rapidly in FY 2015/16. From the above table we can conclude the tax has been most important source of government revenue. So, it has more contributed in the GDP.

4.3 Non /Tax GDP Ratio in Nepal

The non tax GDP ratio has been shown in the table 4.3 the table shows increasing non tax GDP ratio for the study period. In FY 2006/07 to 2010/11, there are small changes in the percentage of GDP, through the non tax revenue. In FY 2011/12 to 2015/16 there are large changes in the percentage of GDP, through the non tax revenue.

Table: 4.3

Non /Tax GDP Ratio

FY	GDP	Non Tax Revenue	% of Non Tax GDP
2003/04	53674.89	1232.32	2.29
2004/05	58941.16	1230.75	2.08
2005/06	65408.40	1477.03	2.25
2006/07	72783.0	1334.15	1.83
2007/08	81566.0	1555.93	1.90
2008/09	98805.0	2246.70	2.27
2009/10	117190.0	2642.26	2.25
2010/11	136659.4	2114.8	1.54
2011/12	152734.4	3265.2	2.13
2012/13	169264.3	3680.6	2.17
2013/14	194162.4	4418	2.27
2014/15	212465.0	4819	2.26
2015/16	241652.1	5720	2.36

Source: Ministry of Finance, Government of Nepal, 2015/16

Table 4.3 shows that the non tax GDP ratio in Nepal 2003/04 to 2015/16. In the table lowest percent of the non tax in GDP is in FY 2010/11 and the highest is in FY 2015/16. From the above table we can conclude the non tax has been most important source of government revenue. So, it has more contributed in the GDP.

4.4 Registration

Registration is the entry point of the tax system. Participants of tax payers to the tax system can be assessed by the trends of registration. All vendors whose taxable transaction is above the threshold are required to register for VAT. VAT registration began on 16th November 1997 when all sales tax registered manufacture were required to convert in to VAT registration of more if they had an annual turnover of more than Rs. 2 million. In mid November 1997, 2045 manufactures were registered under the import / manufacturing level sales tax. There is no provision of registration threshold under this tax. According to the tax office other vendors, who were not registered under the sale tax were required to register for VAT with 90 days from

16th November 1997. This rule is not applicable to them who deal with exempted goods and services only. Similarly, small vendors falling below the threshold limit are exempted from VAT registration. VAT registrants are issued a registration certificate as well as tax payer identification number (TIN). In the mean time it has made compulsion to all concern to state the TIN on all specified document including the tax invoice. The trend of VAT registration is shown in table 4.4

Table 4.4

Trend in VAT Registration

Fiscal Year	VAT Registrants	Growth rate
2003/04	34,664	22.25
2004/05	39,776	14.75
2005/06	46,831	17.74
2006/07	53,014	13.20
2007/08	59,741	12.69
2008/09	69,708	16.68
2009/10	82,684	18.61
2010/11	97,731	18.20
2011/12	118,556	21.31
2012/13	127,103	7.21
2013/14	132,598	3.42
2014/15	138,670	36.1
2015/16	144,560	41.2

Source: Annual Reports of Various Fiscal Years, Inland Revenue Department

Despite having several problems in its operations, the total number of VAT registrants has reached exactly 144,560. As shown in table 4.4 the number of VAT registrant increased consistently in the last seven years from 34,664 in FY 2003/04 to 39776 in FY 2004/05, similarly 46,831 in FY 2005/06. After that, no. of registrants reached at 53014 in FY 2006/07. In FY 2007/08 it reached at 59,741, finally 144,560 in FY 2015/16. This shows that the increase in number of VAT registrant is impressive. The table has shown that the percentage increase in VAT registrants has fluctuations. It may have happened due to the national rebel and monitory polices of current government.

4.5 Contribution of VAT in Total Revenue

The following table shows the contribution of VAT in total revenue. Contribution of VAT in total revenue has been shown in FY 2012/13 to 2015/16 total revenue is increasing continuously because of the increasing rate of VAT revenue.

Table: 4.5

Contribution of VAT in Total Revenue

(In Rs. 10 million)

FY	Total Revenue	VAT Revenue	% of VAT Revenue
2003/04	6233.1	1447.89	23.22%
2004/05	7012.27	1888.54	26.93%
2005/06	7228.19	2161.07	29.89%
2006/07	8771.21	2609.56	29.75%
2007/08	10762.25	2981.57	27.70%
2008/09	14347.45	3970.09	27.67%
2009/10	17799.09	5492.09	30.85%
2010/11	19834.6	6166.36	31.08%
2011/12	24437.4	7093.04	29.02%
2012/13	29602.1	8341.84	28.17%
2013/14	35662	10110.46	28.35%
2014/15	42290	12173.07	28.78%
2015/16	50312	14513.1	28.84

Source: Ministry of Finance, Government of Nepal, 2015/16

Table 4.5 shows that the significant contribution of VAT in total revenue. In spite of a slight fluctuation over some years, the contribution of VAT is increasing the total revenue. The descending changes in the VAT percentage on total revenue have occurred during financial years. In FY 2003/04 VAT revenue contributes only 23.22% in total revenue. Then in FY 2004/05 it has 26.93%, that increasing trend of VAT in total revenue reach 31.08% in FY 2010/11. It has the great contribution of VAT in total revenue. Hence, we can say the VAT is the most important sources of revenue generation. In table lowest percent of VAT revenue is in FY 2003/04 and the highest is in FY 2010/11. The current FY 2015/16 however has shown a significant increase with a table of 28.84%

4.6 Contribution of VAT in Total Tax Revenue

The percentage contribution of VAT revenue in total tax revenue is presented in the table below. Contribution of VAT in total tax revenue has been shown in table 4.6. In FY 2012/13 to 2015/16 total tax revenue is increasing continuously because of the increasing rate of VAT revenue.

Table 4.6

Contribution of VAT in Total Tax Revenue

(In Rs.10 Million)

FY	Total Tax Revenue	VAT Revenue	Contribution of VAT in Total Tax Revenue (%)
2003/04	4817.3	1447.89	30.05
2004/05	5410.47	1888.54	34.90
2005/06	5750	2161.07	37.58
2006/07	7112.67	2609.56	36.68
2007/08	8515.55	2981.57	35.01
2008/09	11704.47	3970.09	33.91
2009/10	15978.53	5492.09	34.37
2010/11	17719.7	6166.36	34.79
2011/12	21172.3	7093.04	33.50
2012/13	25921.5	8341.84	32.18
2013/14	31244	10110.46	32.35
2014/15	37470	12173.07	32.45
2015/16	44560	14513.1	32.56

Source: Ministry of Finance, Government of Nepal, 2015/16

Table 4.6 shows the significant contribution of VAT in total tax revenue. In spite of a slight fluctuation over some years, the contribution of VAT is increasing the total revenue. In FY 2003/04 VAT revenue contributes only 30.05% in total revenue. In FY 2004/05 it has 34.90%, that increasing trend of VAT in total revenue 36.68% in FY 2006/07. It has the great contribution of VAT in total tax revenue. Hence, we can say the VAT is the most important sources of revenue generation. In the table lowest percent of VAT revenue is in FY 2003/04 and the highest is in FY 2005/06. The current FY 2015 however has shown a significant increase with a table of 32.56%.

4.7 Contribution of VAT in Total Non /Tax Revenue

Table shows the contribution of VAT in total non tax revenue. Contribution of VAT in total non tax revenue has been shown in table in FY 2011/12 to 2015/16 total non tax revenue is increasing continuously because of the increasing rate of VAT revenue.

Table 4.7

Contribution of VAT in Total Non/ Tax Revenue

(In Rs. 10 Million)

FY	Total Non Tax Revenue	VAT Revenue	Contribution of VAT in Total Non Tax Revenue (%)
2003/04	14158	1447.89	10.2
2004/05	16018	1888.54	11.7
2005/06	14781.9	2161.07	14.6
2006/07	16585.4	2609.56	15.7
2007/08	22467	2981.57	13.2
2008/09	26429.8	3970.09	15
2009/10	1820.56	5492.09	30.16
2010/11	2114.8	6166.36	29.15
2011/12	3265.2	7093.04	21.72
2012/13	3680.6	8341.84	22.66
2013/14	4418	10110.46	22.88
2014/15	4819	12173.07	25.25
2015/16	55143	14513.1	26.31

Source: Ministry of Finance, Government of Nepal, 2015/16

Table 4.7 shows that the contribution of VAT in total non/ tax revenue is more and attractive. According the table 4.7 the lowest contribution of VAT is of the FY 2003/04 (10.2%) and the highest contribution of VAT is of FY 2009/10 (30.16%).

4.8 Trend of VAT Collection

After implementation, the revenue collected table is divided in domestic and import component. The revenue collected table is shown in table 4.8.

Table: 4.8

Trend of VAT Collection

(In Rs. 10 Million)

Fiscal Years	VAT Collection	Domestic	Import
2003/04	14478.9	5646.8	8832.1
2004/05	18885.4	6610	12275.4
2005/06	21610.7	7996	13614.7
2006/07	26704.2	9689	17015.2
2007/08	29815.7	10808.2	19007.4
2008/09	39700.9	13918.4	25782.4
2009/10	54920.8	20379.8	34541
2010/11	71044.4	28431.2	42613.2
2011/12	87633.3	36321.4	51312.5
2012/13	94656.5	42512.3	565144.2
2013/14	111966.6	51113.5	60853.1
2014/15	130912.4	64434.2	66478.2
2015/16	147651.1	73316.5	74334.6

Source: Annual Reports of Various Fiscal Years, Inland Revenue Department

The collection of VAT revenue is in increasing trend. It is only 14478.9 ten million FY 2003/04 which is reached to Rs. 126345.1 ten million in fiscal year 2015/16. The collection trend is satisfactory. Domestic VAT is divided in to three parts: production, distribution and services. Under distribution, the tax collected at the dealer, wholesale and retail wholesale and retail level is included. The relative contribution from distribution and service has been increasing trend. It may be due to increasing trend of registration in to VAT.

4.9 Share of VAT Revenue in Total Tax Revenue

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

Table 4.9

Share of VAT Revenue in Total Tax Revenue

(In Rs. 10 Million)

Fiscal Year	Total Tax Revenue	VAT Revenue	% of Total Tax Revenue
2003/04	4817.30	1447.89	30.05
2004/05	5410.47	1888.54	34.90
2005/06	5743	2161.07	37.62
2006/07	7112.67	2609.56	36.68
2007/08	8515.55	2981.57	35.01
2008/09	11705.19	3970.09	33.91
2009/10	15628	5492.09	35.14
2010/11	17145	6166.36	35.96
2011/12	18532.1	7093.04	38.27
2012/13	19816.2	8341.84	42.09
2013/14	22018.3	10110.46	45.91
2014/15	24013.4	12173.07	50.69
2015/16	26145.6	14513.1	55.50

Source: Ministry of Finance, Government of Nepal, 2015/16

Table shows that on an average the VAT revenue. This is a significant contribution indeed. The ratio of VAT collection with revenue has been marred by the people's revolution and the lack of firm government policies. Consequently a slight increasing trend has been observed from 2009/10 to 2015/16.

4.10 VAT Revenue as Percentage of GDP

VAT contributed to gross domestic product is shown in following table;

Table 4.10

VAT Revenue as Percentage of GDP

(In Rs. 10 Million)

Fiscal Year	GDP	VAT revenue	% GDP
2003/04	53674.89	1447.89	2.69
2004/05	58941.16	1888.54	3.20
2005/06	65408.40	2161.07	3.30
2006/07	72783	2609.86	3.58
2007/08	81566	2981.57	3.65
2008/09	98805	3970.10	4.01
2009/10	117190	5492.08	4.69
2010/11	126210	6832.91	5.41
2011/12	132124.5	8131.12	6.15
2012/13	153266.6	9812.45	6.40
2013/14	168364.7	1153.62	6.85
2014/15	181561.3	132.71	7.30
2015/16	198523.2	161.21	8.12

Source: Annual Reports of Various Fiscal Years, Inland Revenue Department

The increasing of VAT revenue in total revenue clearly indicates a crucial role of VAT in uplifting the total GDP of the nation. As shown in the table, the VAT percentage of GDP has been increasing continuously after an initial dip from 2003/04 to 2015/16. With a 8.12% contribution of GDP in the current fiscal year, VAT continues to have a strong influence on GDP increment.

4.11 VAT Returns

VAT registrants are required to submit return for each tax period. The tax-period of four months has been fixed for those who have transaction below the threshold level but are registered voluntarily and one month for the compulsory registrants. The tax period is bi-monthly for hotels and tourism related businesses. The taxpayers are required file the tax returns of each tax period at the concerned tax office within 25days of the expiry of the tax period.

Tax returns could be debit, credit or zero returns. When the tax collected by a tax payer on sales is more than the tax paid on purchases, the excess amount should be remitted to the government. Such returns are known as debit returns. But if the tax paid on purchases is higher than the tax collected on sales, the tax payer should get the excess amount from the government. Such a tax return is called credit return. Even if there is a no sales or purchase transaction, the tax payer still has to file tax return at the concerned tax office.

Table 4.11

Composition of VAT Returns (Percentage)

Fiscal Year	Debit return	Credit return	Zero return	Total Return
2003/04	26	38	30	100
2004/05	31	39	20	100
2005/06	36	35	29	100
2006/07	32	38	30	100
2007/08	31	39	20	100
2008/09	19	54	27	100
2009/10	28	36	36	100
2010/11	27	36	37	100
2011/12	27	37	36	100
2012/13	25	40	35	100
2013/14	27	46	27	100
2014/15	21	51	28	100
2015/16	18	57	25	100

Sources: Annual Reports of Various Fiscal Years, Inland Revenue Department

The return of tax returns is not satisfactory. In general, most tax returns should be debit returns. Since business and professions are undertaken to on profit, as a general rule, the sales should exceed the purchases. Under such circumstances, the tax collected by the taxpayer from sales should exceed the tax paid on inputs and the taxpayer should be in position to pay tax to the government. But it is not necessary that businesses or professions always run on profit. Under several circumstances, the purchases of a taxpayer could be higher than the sales .For example, if a large amount of goods is imported; it is likely that the goods remain in stock. Such a situation could

also arise in the case of transactions in which production and distribution have not commenced. Similarly transactions of zero-rated goods also could bring about a situation where the tax paid on purchases could be higher. Therefore under the VAT system, it is not unnatural to receive credit tax returns and sometimes even zero tax returns when a taxpayer does not carry out any transaction. But in the context of Nepal, so far, among total tax returns, credit tax returns and zero tax returns have comprised over half and one- third, respectively. This is the higher than the global general standard.

While there are no norms regarding credit return as percentage of total VAT returns or VAT debit/credit ratio as a lot depends on the tax policy for what is exempted, zero-rated, nature of economy etc., number of credit returns and credit amount is currently very high. In general under a well running VAT system, percentage of credit returns should be much lower than the debit returns and a credit amount should be much lower than its current level. A part of the total may be real, while a large part of it is artificial as a result abuse of VAT credit mechanism by dishonest taxpayer, who are milking the VAT system. This is because Nepal is not a net exporting country where one can expect a large number of exporters filing credit returns. We also do not see a situation where businesses can file more refund/credit returns due to strong capital purchases. On the basis of the nature of economy, one can say that taxpayer should be filing positive/debit returns for at least 80% of all returns filed. The situation is just the opposite. This needs to be reversed in order to avoid a potential disaster in future. This is because if the current trend continues, most taxpayers will not pay any VAT and several others will claim refund and the government will not have any revenue from VAT, as it will have to pay out more than it brings in.

4.12 Role of VAT in Revenue Collection

4.12.1 Revenue Structure in Nepal

Nepalese government has two component of public revenue is non- tax revenue and other is tax revenue. The main source of non- tax revenue of government is public income received through the administration, commercial enterprise, gifts and grants. Last 13 years government is as follows:

Table 4.12

Revenue Structure in Nepal

FY	Revenue (Rs. in Millions)			Revenue in percentage		
	Tax	Non-Tax	Total Revenue	Tax	Non-Tax	Total
2003/04	51211	15125	66336	77.19	22.81	100
2004/05	54105	16018	70123	77.16	22.84	100
2005/06	57430	14852	72282	79.45	20.55	100
2006/07	71127	16585	87712	81.09	18.91	100
2007/08	85155	22467	107622	79.12	20.88	100
2008/09	117052	26423	143475	81.58	18.42	100
2009/10	159785	18206	177991	89.77	10.23	100
2010/11	177227	21149	198376	89.34	10.66	100
2011/12	211722	32651	244373	86.64	13.36	100
2012/13	259215	36806	296021	87.57	12.43	100
2013/14	312440	44180	356620	87.61	12.39	100
2014/15	374700	48190	422890	88.6	11.40	100
2015/16	394122	52310	446432	88.2	11.8	100

Source: Ministry of Finance, Government, 2015/16

Table 4.12 shows that the tax revenue is increasing every year and non- tax revenue is decreasing. The average non tax revenue is15.64 but the ratio is decreasing order the main cause of decreasing non- revenue is no change in fine and penalty rate / administrative fee and other main cause is decreasing the public enterprise profit. On the other hand government tax range is very wider.

The composition and the patterns of revenue mobilization in Nepal for the last three decades reveal a slow growth in the overall revenue due mainly to low tax base and income level, inefficient tax administration, weak enforcement of laws, tax evasions and exemptions, political situation, labor strikes, import base consumption etc. Nepal is not in a condition to generate adequate revenue from direct taxation. Indirect taxes are booming as governments continue to struggle with the financial crisis, they are increasingly turning to increase s in VAT, excises and other indirect taxes as the most straight forward ways of raising additional revenues.

4.13 Different Sources of Tax Revenue of Nepal

Among, different sources of tax revenue of Nepal like VAT, Income tax, Customs, Excise etc. VAT is discovered as most important one. Further details of the data are shown below:

Table 4.13

Different Sources of Tax Revenue (%)

FY	VAT	Income Tax	Customs	Excise	Others	Total
2003/04	40.12	18.22	27.41	10.31	3.94	100
2004/05	39.40	19.34	29.02	11.91	4.82	100
2005/06	37.64	19.04	26.72	11.33	5.27	100
2006/07	36.69	22.12	23.49	13.14	4.57	100
2007/08	35.01	22.40	24.73	13.14	4.71	100
2008/09	33.92	23.28	22.89	13.86	6.06	100
2009/10	34.37	21.17	22.04	15.11	7.31	100
2010/11	34.79	23.33	20.15	14.86	6.86	100
2011/12	33.50	24.23	20.49	14.18	7.60	100
2012/13	32.18	24.76	21.96	13.98	7.11	100
2013/14	32.36	24.20	21.76	14.53	7.15	100
2014/15	32.32	24.12	21.91	14.12	7.53	100
2015/16	33.65	23.12	21.55	13.32	8.36	100

Source: Reports of High Level Tax Review Commission, 2015

Table 4.13 shows the importance of different tax. The table 4.15 shows that VAT is the most important resource of government revenue which covers 33.65 percent in FY 2015/16. Income tax plays second role in tax collection of Nepal. Likewise, customs and excise are at the place of third and fourth.

4.14 VAT Structure of Nepal

Value Added Tax is the most important revenue resource of government from last few years in the country. Basically, VAT revenue is increasing due to increase in tax base and reform of tax system in Nepal. On the other hand service sector is expected to be one of the recognized sectors. Also, the other reason for increasing VAT revenue is increasing of Nepalese consumption behavior and per capita income.

Table 4.14

Structure of Value Added Tax VAT Revenue

(Rs. in Millions)

FY	Internal Revenue	External Revenue	Total Revenue	Internal Revenue (%)	External Revenue (%)	Total Revenue (%)
2003/04	5465.00	11879.00	17344.00	31.50	68.50	100.00
2004/05	6615.00	12270.00	18885.00	35.03	64.97	100.00
2005/06	8150.00	13463.00	21613.00	37.71	62.29	100.00
2006/07	9632.00	13464.00	23096.00	41.70	58.30	100.00
2007/08	10809.00	19007.00	29816.00	36.25	63.75	100.00
2008/09	13918.00	25783.00	39701.00	35.06	64.94	100.00
2009/10	20380.00	34541.00	54921.00	37.11	62.89	100.00
2010/11	22284.00	39380.00	61664.00	36.14	63.86	100.00
2011/12	25966.00	44964.00	70930.00	36.61	63.39	100.00
2012/13	28380.00	55038.00	83418.00	34.02	65.98	100.00
2013/14	34289.00	66821.00	101110.00	33.91	66.09	100.00
2014/15	39423.00	75321.00	114744.00	34.35	65.65	100.00
2015/16	44675.00	84765.00	129440.00	34.51	65.49	100.00

Source: Reports of High Level Tax System Review Commission, 2015/16

Table 4.14 shows that the Nepalese VAT mostly depends upon based tax. The external source of VAT revenue is decreasing while comparing two years 2003/4 and 2004/5 whereas it is shown in increasing order while comparing with the year 2014/15 and 2015/16.

4.15 Sources of VAT in Nepal

The sources of VAT in Nepal are internal and the import sources where internal source means VAT rose from Inland Revenue and import source means import base VAT raised from customs point of the country.

Table 4.15

Sources of VAT in Nepal

(Rs. in Billion)

FY	2003/4	2004/5	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
VAT (Internal)	4.3	6.61	8.15	9.63	11.11	13.92	19.1	22.39	25.64	28.49	34.4	40.43	44.32
VAT (Import)	11.51	12.27	13.46	16.46	19.01	25.78	34.54	39.31	46.54	55.01	66.57	73.67	83.12
VAT Collection	15.81	18.88	21.61	26.09	30.12	39.7	53.64	61.7	72.18	83.5	100.97	114.07	127.44

Source: Annual Reports of Various Fiscal Years, Inland Revenue Department

Table 4.15 shows that the sources of VAT in Nepal. While analyzing the data of FY 2003/4 and 2004/5 we see that VAT collection is in increasing order. It is because of the increase in VAT (import) and VAT (internal). Furthermore, comparing FY 2014/15 and 2015/16, we see the increment of VAT collection in higher amount (73.67 billion to 83.12 billion) which is a good sign for government of Nepal.

4.16 Composition of VAT Collection

Government collects the VAT through different components. Reverse charge, Tourism industries, Contract and Consultancy, Other services, Sales and Distribution and Production play a vital role for the composition of VAT in Nepal.

Table 4.16

Composition of VAT collection

(Rs. in Billion)

	2003/4	2004/5	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Reverse Charge	0	0	0	0	0	0	0	0	0.72	1.31	1.67	2.05	3.12
Tourism Industries	0.4	0.5	0.6	0.65	0.75	0.84	0.94	1.12	1.06	1.2	1.43	1.76	1.89
Contract & Consultancy	0.6	0.8	1.2	1.02	1.49	1.6	2.19	3.12	4.77	5.49	5.85	6.54	7.12
Other Services	0.41	0.91	1.35	1.82	3.25	5.05	6.65	7.13	5.1	4.35	6.22	7.14	8.13
Sales and Distribution	1.2	1.5	1.9	2.09	2	2.37	3.3	4.25	5.55	6.39	7.89	9.22	11.43
Production	1.8	2.9	3.1	4.05	3.31	4.06	6.02	6.77	8.4	9.77	11.32	12.86	13.42
Total VAT	4.41	6.61	8.15	9.63	10.8	13.92	19.1	22.39	25.61	28.51	34.39	39.56	45.11

Source: Annual Reports of Various Fiscal Years, Inland Revenue Department

Table 4.16 has explained that VAT is collected from the above components in increasing order. While analyzing the given data, In FY 2015/16, we see the contribution of other services is in higher amount (8.13 billion) during the VAT composition. Afterward while seeing the data in FY 205/16we finds that the contribution of production is in higher amount (14.32 billion) for the composition of VAT. Similarly, the least contribution to VAT composition is of reverse charge 0 in FY 2008/9 and that of tourism industries (1.43 billion) in FY 2015/16.

CHAPTER V

STRUCTURE AND TREND OF VAT IN NEPAL

5.1 Structure of VAT in Nepal

Some structure of VAT in Nepal is as follows:

） Increasing Non- Filers

Nepalese value added tax have increasing structure its origin in non-filer. Due to force registration or compulsory registration regime by VAT Act, most of the businesses were registered in VAT. Registration is done by analyzing the threshold or category of business in the past. Knowledge was lacking among tax payer for hoe the file of VAT written in every period. Therefore, because of the lack of knowledge and lack of excess of IRO or internet the businessman had not filed their businesses. From FY 2015/16 VAT act has been liberal for compulsory registration. Some rules are changed (i.e.). Threshold is increased by 3 million which resulted to 5 million and other compulsory registration of business category like hardware, sanitary, furniture, fixture, dry cleaning with machine, electronic, electrical etc. is changed. In present day, they don't need to be compulsorily registered as business category but they need to be registered through the threshold system. In the presence of this change system, government expects Non- Filers rate to be decreased in standard rate. This is the main motto of implemented change system. The Non- Filers rate from beginning period is mentioned below:

Table 5.1

Filers Status of VAT

FY	Number of Total Taxpayers Number	No of Non-Filers	Percent of Non- Filers
2003/04	33345	5431	16.28
2004/05	39743	7237	18.21
2005/06	46709	9253	19.81
2006/07	52873	11603	21.95
2007/08	59587	14422	24.20
2008/09	69536	17641	25.37
2009/10	82498	21311	25.83
2010/11	97568	25346	25.98
2011/12	113783	30301	26.63
2012/13	129892	36662	28.22
2013/14	147157	31089	21.13
2014/15	154654	37324	24.13
2015/16	162347	43154	26.58

Source: High Level Tax System Review Commission, 2016

The table 5.1 demonstrates that non- filers rate is in increasing order in FY 2003/04 it was 16.28 percent which increased to 26.58 percent in FY 2015/16.

) **No Billing System**

VAT is automatic compliance due to its catch up effect system unless there is no billing in any stage; production, supply and consumption. VAT is fully disturbed from no billing. On the other hand credit system is also disturbed, if producer, supplier can't credit the input VAT as a result the goods and services will be expensive than other. Similarly, no billing creates many problems in tax system as well as in overall economy. In Nepal billing problem is very chronic one from origination of VAT. Most of the entrepreneur has no knowledge about VAT invoice as it like a written cheque. Most of the small and medium size enterprise depends on the broker, mediator of laymen person. As a result VAT revenue will lose or gets evasion from the seller. Additionally consumers have no knowledge about the tax invoice. They don't know how it contributes the government/tax administration if they ask a tax invoice in the market on their every consumption. According to the research done by me in the market/ society I found that in the stage of consumption, if consumer asks for VAT bill then some businessman intentionally asks additional 13 percent for the VAT bill. It happens because consumers are not aware of price included in VAT bill and sellers knowingly don't want to issue the bill. In my own research 10 percent seller provide VAT bill without ask. Only 12 percent consumer ask VAT bill while they purchase goods and services. Mostly small and medium enterprise denied for the bill.

) **Under –Billing System**

Nepal is mostly based on import based consumption. This is very serious issue in Nepalese context. Basically the under billing is originated by customs points. From last few years, department of customs facilities the self- declaration system for import in customs point. Imported goods are imposed with many types of taxes in customs points like custom duty, excise, value added tax etc. To pay the less amount of tax, imports declare fewer prices of goods. As a result, there is difference between actual price and the billing price or declaration price, it creates many problems.

a) **Hundi:** Imports have to pay the actual value in export country but they lack legal document for the actual payment. Due to this situation, imports cannot open letter

of credit in real value which leads to hundi transaction which is illegal. It creates misuse of foreign currency and balance of payment.

୬ Fake-Billing System

Government of Nepal has determined different facilities for the exporter and other defined industries. There is risk area for value added tax system. Using the fake bill the exporters may claim for given facilities like tax credit, refund facilities or incase of income tax also. For eg: value added refund system for exporter, sugar industries, oil industries, garment industries pashmina etc. They may seek for refund facility with the help of fake bill. Without export they may prepare fake document. Without real cost industries may ask for cost and at credit. And for the income tax expenses claim they make fake document 480 forms were penalized in 2011 by IRD in the fake bill case. They claimed the credit by fake bill. It has dual effect one is VAT credit and other is expenses claim in income tax.

୬ Large List of Exempted Goods and Services

In value added tax act 2052, article 5, sub- article 3 is related to VAT exemption goods/services. It is defined on annex 1 of the act which is included in 13 different groups. Group 1 is basic agricultural product. Group 2 is goods of basic needs. Group 3 is all about live animals, and its product. Group 4 is about agricultural inputs. Group 5 includes medicines, medical and similar health services. Group 6 is education. Group 7 includes books, newspaper and printed materials. Group 8 includes artistic and cultural goods and services, carving services. Group 9 includes passengers and goods transportation services. Group 10 comprises personal or professional service. Group 11 consist other goods or services. Group 12 includes land and buildings. Group 13 includes betting, casinos and lotteries.

Nepal is agriculture based economy but most of the primary agricultural product are VAT exempted. There is dilemma to impose the VAT for agricultural primary products. Agro products are the necessity to impose the VAT of agricultural primary has low income level. If VAT is imposed in agricultural products, they will be very expensive. However, some secondary agro products are refined product, in which VAT is active for eg: refined floor.

୬ Open Border and Smuggling of Goods

Nepal and India have open border of more than 1700 km and both have different tradition cultural and historical relation with each other. But these two nations have

different economy in between. As, India has large economy and population due to which Indian goods and services are cheap in Indian Territory. Nepal also imports Indian good and other third country's goods from Indian port which caused Nepalese territory goods to be expansive than Indian goods. The other reasons are due to the open boarder; specially Tarai region people go to India and bring goods without customs and other duties. Therefore, because of this uncountable small scale of imports government is losing its revenues its revenues. On the other hand, smuggling is very serious problem in border line. Smugglers import the goods without any duties absence of customs office and other government agencies which creates the underground and black economy in the country. This economy never comes from the mainstream economy but this may win the real economy. The other serious problem is illegal goods not only evasion the government revenue but it disturbs the VAT system and its beauty, avoid cascading effect. Due to the presence of open border between Nepal and India, there is the presence of Smuggling of goods/ services as customs offices are not properly in every point.

ﺝ Lack of Proper Coordination with Different Government Agencies

Nepal has different government agencies to raise its revenue and to control the loopholes. To formula the policy and for the proper coordination with different related agencies MOF is in existence. In order to impose income tax, VAT and excise, Inland Revenue exists. To impose the customs and the other tax in imported point department of customs (DOC) exists and in order to control the evasion and smuggling of tax DRI exists. Its objectives include controlling revenue leakages and economic crimes through transparent, fair and responsible revenue administration by means of proper economic information system. Furthermore, the other one is DMLI which is established to control the fiscal crime and black money raised from illegal activities. Among various motto of NRB, one of its mottos is control the illegal cash flow of country like hundi and other unwanted activities. Also, for the above functions government agencies' are established so that better and transparent economy will be present and the government agencies will have organization structure, efficient man power and proper law and effective policies. But what is lacking between these departments is co-operation. There is lack of proper cooperation between these departments. IRD only can't control the evasion of tax, if

it's given to control alone in such situation not only the government loses VAT. Additionally it loses income tax and other duties.

5.2 Trend of VAT in Nepal

Some composition of VAT in Nepal is as follows:

) A high level VAT implementation team with a close co-operation with government departments should perform the task of implementing the VAT. The VAT implementation team should be a very active and effective one it should include the preventatives of various sectors with special preference to business organization.

) The role of private sector in implementing the VAT should not be underestimated. Private sector should actively participate in the VAT implementation process. For this, the private sector should be taken into confidence. A close co- operation should be sought from the private sector.

) Tax administration should be kept away from political intervention and any sort of influences from the outside. Capable persons should be selected in the leadership of tax administration.

) To increase the capability of administration training of tax personal should be kept on the topmost priority. Training should be designed for various levels and purpose. General training for all and specialized training for particular persons and foreign training should be designed and provided. Foreign tax tours may be helpful in this case. Tax manuals and directions should be prepared specially and circulated among tax personal.

) A good working environment should be created in the administration. Reward and punishment system should the made effective. Tax officials should be encouraged to do better by providing them incentives like quick promotion; foreign training, etc. Tax officials should be well paid.

) Taxpayers should be provided better services tax persons should be polite, co-operating and quick in their works. A proper respect should be paid to the taxpayers. The taxpayers who are found honest and cooperative with the administration should be honored publicly. Such a program would raise the

status of the taxpayers and establish their separate identity in the society. This may be conductive to increase tax compliance.

⟩ The use of discretionary power such as raid power by the tax officials should be limited. Tax officials should not be allowed to use such power unless there is a strong case to do so. Tax officials should always try to behave with the taxpayers on equal footing.

⟩ Tax collection and payment activities should be made transparent. Rule and regulations should also be made simple and unambiguous. The limitation of discretionary power and transparency in tax rule and tax collection activates would reduce the chances of malpractice.

⟩ There should be strong supervision of the tax persons who work in the field. Any misdeed should severely be punished.

⟩ A good co- ordination of the VAT department with the other tax departments should be established to facilitate cross checking of records to tax matters. A coordinated tax audit program carried out by both. VAT and income tax departments are very much desirable.

⟩ There should be a proper co-ordination of the activities between local VAT offices and head office. Duties should be clearly divided between local tax offices and the head office. A proper balance should be maintained in the working of VAT offices at the central and local level.

⟩ There should be a fully computerized operation with master file management and a single TIN. The TIN should be required to use for other purpose like bank accounts, purchase of capital, shares etc.

⟩ A good working environment should be highly strengthened and detection should be made very effective. A system to derive information from a number of sources should be developed.

⟩ Tax audit should be carefully planned. The audit campaigns carried out annually have a very little effectiveness in detecting substantial tax evasion. Their shock or surprise element is lost, unless they are done only in a small number of cases and are continuously carried out to through detection. No detection can be justified unless it results in the detection of substantial tax

evasion and the case leads to successful prosecution of the guilty persons. To this purpose, the administration should have adequate expertise in this regard.

) Extensive auditing should be carried out in larger businesses where revenue risk is higher. A general audit and desk audit should be designed for small businesses.

) Collection of VAT through banking is an attractive opportunity to reduce the chances of administrative harassments on taxpayers and collusion between taxpayers and tax officials.

) A large publicity campaign should be launched before implementation of VAT. The publicity campaign should aim at educating both taxpayers and general public. The publicity program should include advertisements and information through mass media, free distribution of pamphlets, booklets, etc. public discussion program; program and films on the television, etc. The goal of publicity campaign should not only be to disseminate the knowledge about the tax but also to make the people mentally prepared to accept the tax.

) The cases of corruption and bribing should be strong controlled by an effective monitoring and evaluation system. Reward and punishment should be a main "motto" of operating the tax administration.

CHAPTER VI

SUMMARY OF FINDINGS, CONCLUSION AND

RECOMMENDATIONS

6.1 Summary of Findings

Value added tax (VAT) is known as the most recent and effective innovation in the taxation field. It is levied on the value added of the good and services. Theoretically, the tax is board based as it covers the value added to each commodity by a firm during all stages of production and distribution. Value added tax is considered as one form of sales taxation which is also called as a multiple stages tax. After the study of VAT problem major findings are as follows:

1. 18 years of VAT operation enters into 19 year. But the data presented in this research is only the 10 year which is because of the several constraints like unavailability of data, short time period of research etc. Due to various complexities and problems this tax system has not been able to achieve the expected level of success.

2. Theoretically VAT is superior to sales tax in many forms. As it was abolished already, there is no possibility to compare it with VAT now. So only theoretical superiority is established.

3. A large amount of government revenue comes from taxation. More than 75 percent of government revenue comes from taxation whereas the contribution of non-tax revenue is less than 25 percent in Nepalese tax structure. The contribution of tax revenue was expected to increase after the implementation of VAT. But implementation of vat did not increase the contribution of tax revenue on total revenue significantly.

4. Through VAT has been implemented in Nepal in order to generate more revenue, but the efficiency of the Nepalese VAT administration is not satisfactory and not up to the expectation of the general people.

5. More revenue can be generated through VAT by widening its coverage. The small traders which fall on the threshold limit could not have been brought into VAT net yet. The government has been thresholds limit 2 million to 5

million but they should be registered for the increasing tax revenue and cascading effect implement. The revenue can increase by discoursing tax evasion. There is wide range of practice of evading tax.

6. Mostly Nepalese VAT is based on import base consumption i.e. 83.12 billion in 2015/16 from import and 44.3 billion from internal source.

7. Credit return and zero return is increasing then debit return. In 2016, only 18 percent return is debit, 57 percent is credit and 25 percent is zero return.

8. Only list consumers have habit of taking bills on their purchases. Customers have no habit to take bill on their purchase. This implies that there is very low public awareness and consciousness level towards VAT. On the other hand, businessmen do not want to issue bills. The businessmen have the intension of 'malpractice' on VAT. So they don't provide bills to customers. Only some super markets issue the bill without asks. This indicates the very need of supervision and rational auditing.

9. The percentage of customers demanding bills on their purchase is very low nearly 12 percent. This might be the cause of ignorance and no habit of taking bills.

10. There is little knowledge about VAT to taxpayers and low public consciousness level in Nepal. To educate taxpayers and all the concerned bodies, educational program has to be launched in an effective way. But whatever program has been underway is not sufficient to create its impact on people. Most of the respondents suggest that Radio/TV might be best media to educate taxpayers and consumers. Newspaper might be another good alternative.

11. The expected amount of VAT collection is not possible due to lack of maintenance of proper accounts which is very serious problems. Billing is also a very serious problem regarding VAT collection. Customers do not have the habit of keeping bills on their every purchase and business does not feel liable to provide bills on their every sale to customers. The only motive not to provide bills is for tax evasion.

12. It has been noticed that traditional Nepalese businessmen do not have the habit of maintaining their account. Tax evasion is very difficult if account is properly maintained. Some are illiterate and some desire to evade tax.

13. Administrative incapability, under invoicing/ no –billing and lack of public awareness towards VAT are major problems in the process of VAT implementation in Nepal.

14. Number of taxpayer's registrants under VAT has been increasing year after year. The ratio of registrants just kept fluctuating. This is certainly not a good sign which will have a long term bearing on revenue collection. Number of taxpayers cancelling their registration under VAT is also generally in the increasing trend, though this has reduced.

15. Data collection is most challenging task for Nepalese VAT administration. The real payer of VAT is consumers, but what happens is instead of providing the collected VAT the business man use it for themselves which has been a very serious issue. Also, some business persons have fake registration number with the name of other layman people like potter.

16. Under invoicing problem is one of the emerging problem where basically the under billing is originated by customs points. From last few years department of customs facilitates the self-declaration system for import in customs point. Imported goods are imposed with many types of taxes in customs point like custom duty, excise, value added tax etc. To pay less amount of tax, imports declare fewer prices of goods. As a result, there is difference between actual price and the billing price or declaration price. So, it creates many problems.

17. In Nepalese market some business man claims with the help of fake bill. Using the fake bill the exporter's claim for given facilities like tax credit, refund facilities or during income tax also. They seek for refund facility with the help of fake bill. Without export they may prepare fake document.

18. Value added tax act provides a large list of exempted goods and services. This list is increasing every year. This is not a sound feature for VAT.

19. From the misusing of open border between two countries, Nepal and India some goods and services are out of VAT range.

6.2 Conclusion

Value Added Tax puts greater significances in revenue mobilization in Nepal. The Reason behind this is that VAT system is transparent with broad tax base and discouraging tax evasion. So, it is necessary to say that VAT is the most important source if the government revenue. VAT is a most scientific, innovation and powerful tax system with built in quality of universal application for both developed and developing economies. VAT system makes it possible to broaden the tax base, eliminate the tax evasion and cascading, create an investment friendly environment and finally to increase to government revenue. This is a matter of great pride that Nepal has entered in to a major global tax system with the introduction of VAT. However there are several issues in VAT system in Nepal, which can be explain below:

⟩ VAT as a major instrument and important policy tools have an important role towards increasing the rate of capital formulation and also achieving a high rate of economic growth.

⟩ VAT is expected to occupy an importance part of Nepal's revenue in a country with a narrow basis for revenue to assume this tax which is based on consumption and imposed at all stages of production and distribution due to catch-up self-policing feature the VAT system is more effective.

⟩ In Now days developing as well as developed countries in the world have increasingly focused their attention towards reforming the tax system by standardizing and improving the poorly designed Tax structure in order to mobilize high volume of resources for the development purposes and make the economy healthy and efficient in this sense the successful implementation and effective structure of VAT system to contribute the government revenue of Nepal.

⟩ Adoption of VAT system for Nepal is both compulsion and necessary .The globalization and recent trend of trade and tax system has affected the Nepalese economy. As Nepal is one of the members of WTO, it is necessary to decrease the custom duty and excise duty. Consumption based tax is only an alternative to more revenue which directly helps to increase domestic resources for development works.

) The structure and the trend of Nepalese VAT system improving and increasing continuously. It shows that there is better improvement and making effective policy or administration part. But it is not sufficient to reach the economic goal of the nation.

) In spite of VAT is a major instrument to achieve the high rate of economic growth, there are many challenges and problems on the successively implementation on VAT system in Nepal. The main problems and challenges are lack of suitable policy of government, ineffective billing system, existence of open boarder large amount of unauthorized trade, lack of coordination of VAT department and traders, lack of public awareness etc.

) To make effective and efficient implementation of VAT there may be improve some problems in VAT system such as, effective policy of government ,increasing awareness of the consumer improving billing system, review the policy of threshold, exemption ,to overviews on smuggling and undervaluation etc.

) Lastly, this research try to shows that the structure, composition, significance and challenges of VAT system in Nepal and also find out that the broad base and uniform basis VAT is a better instrument for managing the economy, promote the exports and improving the balance of payments.

6.3 Recommendations

On the basis of research, the following corrective measures are recommended for the better administration and implementation of VAT system in Nepal:

1. A proper coordination should be established between MoF,IRD, DOC, RID, DMLI and NRB. MoF should amend the unpractical act rules and regulation and provide better direction for its division and departments. Also other MoFs agencies can help IRD role for due to collection, finding their bank account, DOC should improve the valuation system to improve the under invoicing and fake invoicing, RID can act as an import role to reduce the tax evasion because it has armed police force and better law to enforce the VAT smuggler and DMLI can act as an important role to find who earns money to who are involved in tax crime. On the other hand, if black money is found in time by government agencies people can't take over the tax law.

2. Inland Revenue Department have key role for better VAT administration. But in current situation IRD should establish IRO/TSO, in different emerging cities. For the timely payment, bank counter should be established with any bank payment system. Furthermore, e- payment should be started.

3. Skill and capacity of officer is most important for tax administration. For better tax administration, tax officer need to have both national and international training, tax seminar research programmed. Tax administration should change HR policy, man power to skilled human capital by the help of training.

4. Huge goods and services are exempted in VAT act; government should amend the VAT act except basic needs government should not provide exemption. In a sound value added tax system the exempted goods are too shot. Some refund system is suitable for improvement the economic growth and competition with the imported goods like sugar, oil cloth, and hydropower industries but at least 20 percent value should be added for better implementation of refund system. Multi-rate VAT is one of the best alternatives to reduce the exempted goods and services.

5. Open border between Nepal and India should be managed, Nepal and India have historical and cultural relation which is true but open boarder is not for the smuggled goods and services. Government should place customs office in different custom point and armed police force should be mobilized properly to detect the ford in border crime and other activities. Border should be effectively controlled to prevent the illegal trade. Warehouse and highways checking should be done effectively to prevent any kind of illegal trade.

6. Taxpayers, customers are clearly ignoring the VAT system and taking it for granted. They have lack of proper knowledge about computation of tax liability, taking invoice or bill on their purchases. So, emphasis should be given in educating the tax payers. The issuance of proper bill for every taxable sells must be made mandatory.

7. The success of VAT system is not only the success of the IRD, but also the success of nation as a whole. The role of general media, radio, TV, newspaper plays an important one. Emphasis should be given on mass media.

Awareness towards VAT system should be created among general public, non- governmental and government organization.

8. Government has been providing tax refund facility to business organization and foreign diplomacy and foreign aided project. Tax refund is one of the sources of tax leakage. Therefore, tax authority should manage tax refund facility properly.

9. Research and investigation should be conducted on various issues, such as the effect of VAT on price, economic growth, investment and measures for solving VAT problems should be recommended by the expert group. VAT law needs to be reviewed on the basis of experience gained so far.

10. The accounting system should be transparent. Taxpayers should be encouraged to register their business voluntarily. Instead of forcefully coercing tax payers, providing various facilities to them can increase VAT compliance. The tax administration can select genuine business persons and reward them.

11. VAT collection on import is remarkably higher than domestic production. Government should take effective steps to encourage domestic production.

12. Lots of efforts should be made to reestablish a functionally well-organized organization where the tasks are carried out in a modern, sufficient, and transparent and service- minded manner.

13. Most of the national economic activities are dependent upon agriculture and large portion of GDP coming from agricultural sector remains out of the tax net. Thus VAT should also be levied on agricultural sector with sufficient exception for generating more tax revenue. This will increase VAT/ GDP ratio.

14. Lastly, the periodic information about VAT is now available on the website as well. For the researcher this is a great privilege. But the websites are not updated and doesn't have the older reports. So the website must be updated form time to time and must be kept up-to-date. And all backup copies of the old annual reports and economics surveys must also be available on the website. This facilitates the researchers greatly and other concerned bodies, even the consumers, because for minor information, they would not have to frequent the Inland Revenue Department and Ministry of Finance.

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