

# **VAT ADMINISTRATION & ITS EFFECTIVENESS IN NEPAL**

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TU Regd. No. 7-1-230-5-2001

**A Thesis Submitted to:**

Office of the Dean

Faculty of Management

Tribhuvan University

In partial fulfillment of the requirements for the degree of

**Master of Business Studies (M.B.S.)**

Kathmandu

May 2011

# RECOMMENDATION

This is to certify that the Thesis

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Entitled

**“VAT ADMINISTRATION & ITS EFFECTIVENESS IN  
NEPAL”**

Has been prepared as approved by this department in the prescribed format of the Faculty of Management. This thesis is forwarded for examination.

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## **VIVA-VOCE SHEET**

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and found the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirements for the degree of  
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# DECLARATION

I hereby declare that the work reported in this thesis report entitled “*VAT Administration and its Effectiveness in Nepal*” and submitted to Tribhuvan University, faculty of Management, Shanker Dev Campus is my genuine and original work done to fulfill the requirements for the Master’s Degree in Business Studies (MBS). It was prepared under the supervision of Dr. Kamal Deep Dhakal, Campus Chief, Shanker Dev Campus.

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## **Acknowledgements**

This research report is prepared for the partial fulfillment of the requirements for the degree of Master of Business Studies (M.B.S.). This research paper reveals the truth on the issue of VAT Administration and its effectiveness in Nepal, an important subject for most of the tax researcher. The result concluded from this paper may be helpful for students, teachers, tax experts and tax payers to find the data about VAT. This research also provides a useful foundation for the further research work.

Many individuals have contributed their time and efforts to produce it in this form. I would like to express thankfulness to my supervisor Dr. Kamal Deep Dhakal who contributed much to build up theoretical concept, provided useful suggestions frequently and guided me up to this point. I would like to thank all the staff of Shanker Dev Campus Library. My friends Shashi Bhattarai, Ganesh Prasad Acharya and Megha Nath Dhakal also assisted me.

I am very much thankful to my nephew Nishant Labh who provided complete computer solution during the preparation of this research work. Finally, my thanks to my brother Nilesh Kumar Karna and parents for their support and tolerance during the preparation of this research work.

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## Acronyms

AM	: Arithmetic Mean
CV	: Coefficient of Variation
C.P.	: Cost Price
Etc.	: etcetera
Exc.	: Exclusive
FY	: Fiscal Year
i.e.	: that is
GDP	: Gross Domestic Product
Govt.	: Government
GON	: Government of Nepal
GST	: Goods and Sales Tax
Incl.	: Inclusive
IRO	: Inland Revenue Office
IRD	: Inland Revenue Department
MOD VAT	: Modified Value Added Tax
MST	: Multi stage sales tax
Prof	: Professor
Prog.	: Program
PAN	: Permanent Account Number
Rs.	: Rupees
S. P.	: Selling Price
SAARC	: South Asian Association for regional Cooperation
SD	: Standard Deviation
VAT	: Value Added Tax

# **CHAPTER-ONE**

## **INTRODUCTION**

### **1.1 Background**

Value Added Tax, popularly known as ‘VAT’, is a special type of indirect tax in which a sum of money is levied at a particular stage in the sale of a product or service. In 1954, the value added tax system was initiated by the then joint director of the tax authority of France, Maurice Laure. VAT came into effect on the first time on 10th April, 1954.

Tax becomes the main source of revenue of the state. Value Added Tax is the latest innovation in the field of taxation. VAT is considered as the reform tax system of the 21<sup>st</sup> century, which has already been implemented popularly in more than 135 countries in the world. VAT is multi staged, commodity and services based tax which is levied on the value added of business at different stages of production and distribution. It imposed on value of goods and services. The value added tax is indirect tax depends upon consumer. VAT applies to supplies of goods and services for consideration other than exempt goods by taxable person. VAT shall be charge on any supply of goods or services. VAT is a tax on trading transaction. The real VAT payer is the consumer not the producer.

VAT is a tax on consumption – it is charged on the value of imports and on the value added (mark-up) on goods and services supplied by one business to another or to final consumers. It is not a tax on output neither is it a tax on businesses. Value added tax (VAT) is used in many countries as a revenue-equivalent alternative to the retail sales tax or a use tax. This is a particular kind of tax that is levied at each stage of the production process. Producers pay the tax at the (usually) common rate, and have a right to claim a tax credit on business purchases through the invoices they provide for the tax administration. When it

comes to international trade, or to trade between different tax jurisdictions, usually exports are taxes at zero-rate, whereas imports are taxed at the rate of the importer. That is why the ideally administered VAT is destination-based. Since the tax is collected through several locations, it leaves fewer opportunities for tax evasion. In Nepal, Value Added Tax Act was enacted by 1995 and started to implement only at 16 Nov. 1997. Value Added Tax Act replaced four - different Tax Act, such as Sales Tax Act, Hotel Tax Act, Contract Tax Act and Entertainment Tax Act. The sales tax has been reformed to VAT. There is a flat VAT rate of 13% in Nepal. It is a modern tax system which enables to efficient collection system, to increase efficiency and to reduce tax evasion. It is also refereed as the backbone of income tax system in Nepal. (Adhikari, Gurung and Bhattarai, 2010)

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

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

It is believe that successful implementation of VAT will helps to generate customs duties and income tax also and it is expected to enhance the revenue collection and it is closely associated with the GDP. This Act classifies goods and services under

three category they are VAT able goods and services, exempted goods and services and zero rated goods and services. It is applied at a single rate (presently 13%, initially 10%) based on addition of value of the goods and services at each stage in the process of supply and delivery of goods and services. (Adhikari, Gurung and Bhattarai, 2010)

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

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

## **1.2 Focus of the Study**

This research has focused to examine the effective implementation of VAT in Nepal. Implementation of VAT is in its preliminary stage. It deeply focuses on finding the path for effective implementation and their root cause of avoidance, evasion and leakage points along with the role of different stakeholders for its effective implementation. The business community as well as the consumer's doesn't seem to be supportive in its implementation: there seems some information gap between the policy maker and stakeholder is the main problem of

VAT implementation. The main focus of this study is to know about VAT implementation through “VAT administration and its effectiveness in Nepal” to draw the attention of new researchers and policy makers in order to aware them in their vital role for effective implementation of VAT.

### **1.3 Statement of the Problem**

The possibility of increasing revenue substantially through direct tax is limited in the context of Nepal’s agricultural based rural economy. There is also low revenue due to the existence and dominance of the income from illegal business and lack of basic accounting in various economic activities. Further the direct tax is very difficult to collect effectively because of very low administration expertise resulting in the large scale tax evasion. In this context, VAT is the only solution. Although, due to the lack of proper knowledge about VAT system and proper support of the business community the Government of Nepal has not still been able to implement VAT system effectively. To avoid the deficit budget VAT would be an important tool. It reduces the fiscal budget deficit. To maintain the deficit budget, resource mobilization, to collect revenue, to substitute foreign loan, VAT plays an important role in the economy. The main problems related to this study are:

- What is the level of knowledge on concerned parties about VAT and its impact on them.
- What are the problem and obstacles in the implementation of VAT in society?
- What are the suggestions measures for effective implementation reflected from society?
- What is the contribution of VAT on economic growth?



### **1.4 Objective of the Study**

The main objective of this study is to analyze VAT and its effectiveness in Nepal. It also deals with how to implement the VAT system effectively in Nepal. The main objectives of this study are:

- To identify knowledge, attitude and behavior of concern bodies.
- To analyze and identify the problems of VAT faced by society.
- To analyze the success of VAT administration to collect the VAT.
- To evaluate the contribution of VAT on economic indicators.
- To provide the suggestions for effective implementation.

### **1.5 Significance of the Study**

VAT is the indirect tax system and no doubts in its possibilities to collect revenue compare to other tax system. The findings of this research will be worth to the business community as VAT is being complex and less familiar in Nepal. It can help them to provide about practical knowledge and procedure to the business community especially maintaining proper records system for the VAT purpose. As an important part is an attempt of this kind of study will helpful for those who want to see strength and weakness of VAT in Nepal, implementation status and possibilities of VAT in near future. This study is useful for researchers, students, academicians and policy maker to know about the effectiveness implementation of VAT in Nepal. And the persons such as accountants, consultants, auditors, manager and teachers and who are interested in this subject can be benefited from this study.

### **1.6 Limitations of the Study**

Being a time-bound research activity, this study has the following limitations despite the utmost care taken by the researcher:

- The survey is concentrated within the Kathmandu valley and Janakpur city.

- The sample size is only 60 respondents.
- Information regarding the contribution of VAT on the GDP is collected from secondary data.
- The study period is 2060/2061 to 2065/2066.
- The unavailability of adequate reference materials of Nepalese context has been a serious limitation in arriving meaningful conclusions.

## **1.7 Organization of the Study**

This study has been organized over altogether five chapters, starting from Introduction, Review of Literature, Research Methodology, Data Presentation and Analysis and Conclusion and Summary. A brief outline of these chapters has been presented below:

### **Chapter One: Introduction**

It includes background of the study, focus of the study, statement of the problem, objectives of the study, significance of the study, limitations of the study and organization of the study itself.

### **Chapter Two: Conceptual Framework and Review of Literature**

This chapter concerns about the concept of Value Added Tax (VAT) and review of related thesis or articles to highlight the related terms and to present the available information about previous related studies. Especially it includes conceptual review and review of major studies.

### **Chapter Three: Research Methodology**

This chapter includes research design, population and sample, nature and sources of data, data analysis tools and data processing procedure

#### **Chapter Four: Data Presentation and Analysis**

Various data are gathered from the application of different methods and presented and tabulated as required by the research objectives. Data are interpreted and analyzed with the help of various analytical tools and technique. It also includes major finding of the study.

#### **Chapter Five: Summary, Conclusion and Recommendation**

This chapter includes summary and conclusion of the study. It also includes recommendation on the basis of the study.

## **CHAPTER - TWO**

### **CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE**

This chapter is basically concerned with the review of literature relevance to the VAT. It covers the theories and previous study on the topic done by academicians and researchers within and outside the nations.

#### **2.1 Conceptual Review**

##### **2.1.1 Meaning of VAT**

VAT applies to supplies of goods and services for consideration other than exempt goods by taxable person. VAT shall be charge on any supply of goods or services. VAT is a tax on trading transaction. The real VAT payer is the consumer not the producer. The VAT is a broad based tax as it covers the value added to each commodity by a form during all stage of production and distribution. It is a modern tax system to improve the collection of taxes, to increase efficiency and to reduce tax evasion. It is also regarded as the backbone of income tax system. VAT is levied in the final price of the Supply. VAT is an indirect tax. However it is not new form of taxation. It is improve and modified form of traditional sales tax. VAT is levied on value added at each stage of production and distribution activities. The stage may be import, export, manufacturing, wholesaling, and retailing.

VAT is a tax on consumption – it is charged on the value of imports and on the value added (mark-up) on goods and services supplied by one business to another or to final consumers. It is not a tax on output neither is it a tax on businesses. Value added tax (VAT) is used in many countries as a revenue-equivalent alternative to the retail sales tax or a use tax. This is a particular kind of tax that is

levied at each stage of the production process. Producers pay the tax at the (usually) common rate, and have a right to claim a tax credit on business purchases through the invoices they provide for the tax administration

VAT is based on the principle of self assessment system. VAT is collected by taxable person. A taxable person is entitled to deduct the input tax from the tax collected by the sales. Similarly, if the input tax exceeds the tax collected, the taxpayer may adjust in any tax payable. After, adjusting it, if any tax from tax amount remains, taxpayer is entitled to deduct from tax payable in next month. VAT Act has made provision regarding tax refund also. The following table shows simple process of calculating VAT.

<b>Activities</b>	<b>C.P. Exc. of VAT (Rs.)</b>	<b>Value Added (Rs.)</b>	<b>S.P. Exc. VAT (Rs.)</b>	<b>VAT@ 13%</b>	<b>S.P. Inc. of VAT (Rs.)</b>	<b>VAT payable to Govt. (Rs.)</b>
Imported Goods	10,000.00	-	-	1,300.00	-	1,300.00
Importer To Manufacturer	10,000.00	3,000.00	13,000.00	1,690.00	14,690.00	390.00
Manufacturer To Wholesaler	13,000.00	6,500.00	19,500.00	2,535.00	22,035.00	845.00
Wholesaler To Retailer	19,500.00	39,00.00	23,400.00	3,042.00	26,442.00	507.00
Retailer To Customer	23,400.00	2,340.00	25,740.00	33,46.20	29,086.20	304.20
<b>Total VAT Receivable by the Government</b>						<b>3,346.20</b>

Table no. 2.1 Calculation of VAT

Source: Estimated figure during the study (2011).

### **2.1.2 History and Development of VAT**

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

France was the first implementer of VAT in 1954 covering only in the industrial sector. The VAT was limited to only up to whole level. But these countries limited the VAT only on import and manufacturing stage. In late 60s, VAT started to become popular. Countries like Denmark and Brazil adopted this system of tax in 1967. France, the first implementer of VAT, extended it to the retail level for the first time. And Germany also adopted VAT in the same year. In 1969, the countries like Netherlands and Sweden also adopted VAT in their countries. In 1970, 1971 and 1973, Luxembourg, Belgium and Ireland introduced the VAT respectively.

In Asia, Vietnam was the first country to introduce this most scientific tax system. The country adopted VAT in 1973. The trend being VAT popular was increasing all over the world. In 1977, 1984, 1985, 1986, South Korea, China, Indonesia and

Taiwan introduced VAT respectively. Similarly, VAT was introduced by Philippine in 1988, Japan in 1989, Thailand in 1992 and Singapore in 1994.

In SAARC region, Pakistan was the first adaptor of VAT. It implemented VAT in 1990. Bangladesh in 1991 and India introduced VAT first as modified value added tax (MOD VAT) in 1996. But actually in India, VAT replaced sales tax on 4 January 2005. In Nepal, VAT Act was enacted by 1995 and started to implement only at 16 Nov. 1997. The countries adopting VAT and the year are as follows:

<b>Year</b>	<b>Countries</b>
1954	France
1960	Ivory Coast
1961	Senegal
1967	Brazil, Denmark
1968	Germany, Uruguay
1969	Netherlands, Sweden
1970	Ecuador, Luxembourg, Norway
1971	Belgium
1972	Ireland
1973	Austria, Bolivia, Italy, UK, Vietnam
1975	Argentina, chili, Colombia, Kostunica, Nicaragua
1976	Honduras, Israel, Peru
1977	Korea, Panama
1980	Mexico
1982	Haiti
1983	Dominican Republic, Guatemala
1984	China
1985	Indonesia, Turkey
1986	Morocco, New Zealand, Niger, Portugal, Spain, Taiwan

1987	Granada , Greece,
1988	Hungary, Philippine, Tunisia
1989	Japan, Malawi
1990	Iceland, Kenya, Pakistan, Trinidad, Tobago
1991	Bangladesh, Benin, Canada, Jamaica, Mali, South Africa, Egypt, Algeria, Armenia, Azerbaijan, Belarus, Cyprus, EL Salvador, Estonia, Fiji, Kazakhstan, Kyrgyz Republic Russia
1992	Tajikistan, Thailand, Turkmenistan, Ukraine, Uzbekistan, Moldova
1993	Burkina Faso, check republic, Paraguay Poland, Rumania, Georgia, Slovakia, Venezuela
1994	Bulgaria, Finland, Lithuania, Singapore, western Samoa, Madagascar, Nigeria
1995	Gabon, Ghana, Switzerland, Zambia, Malta, Mauritania, Togo, Latvia
1996	Albania, guinea, Uganda
1997	Barbara, Congo, Nepal
1998	Croatia, magnolia, Sri Lanka, Tanzania, Vanuatu
1999	Cambodia, Cameron, Mozambique, Netherlands, Papua, new guinea, Slovenia
2000	Australia, Chad, Macedonia, Namibia, Sudan
2001	Rwanda, Jordan
2002	Lebanon
2003	Ethiopia, Lesotho, Serbia, Montenegro, Gambia
2004	Zimbabwe, Cape Verde
2005	India
2006	Bosnia and Herzegovina

Source: The VAT in Developing and Transitional Countries (2007).



### **2.1.3 Reason for Introducing VAT in Nepal**

VAT is considered as the most important tax reform in the 120<sup>th</sup> century. VAT was introduced in Nepal for several reasons. It was necessary to introduce VAT in order to avoid cascading effects. Under VAT tax was levied only on value added on each stage where as sales tax was lived on total sales by which consumer has to bear big burden of tax amount and discourage them to pay tax. So, to encourage consumer VAT is introduced.

The main reason to introduce VAT in Nepal is as noted below:

- To avoid cascading effects
- To make tax more scientific and modernize
- Widening tax net
- Development of the country
- Economic growth of the country
- Transparent tax system
- Reduces foreign dependencies

### **2.1.4 Principle Governing VAT**

The following are the principles wh8ich govern Value Added Tax (VAT):

**I. Principles of Transparency:** VAT is a transparent tax. It is an account based tax system. VAT has made tax system transparent. Tax evasion is not pervasive where accounting system is transparent.

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

**III. Principles of Neutrality:** Neutrality means not to discriminate one to another. VAT does not discriminate one economic activity against others. Tax rate on goods and services to be taxed are not discriminated by VAT. So, in this regard, VAT is neutral.

**IV. Principles of Destination and Zero Rating:** under this principle, goods and services are taxed at consumption point, not based on production. Goods and services that are exported are taxed at zero rate( i.e. the taxpayer gets refund of VAT earlier paid in purchasing raw materials and interrelated goods but he should not pay tax on value added.) (Bhattarai and Koirala, 2065)

### **2.1.5 Characteristics of VAT**

The main characteristics of VAT are stated as follows:

- It is a form of indirect taxation.
  - It is a broad-based tax as it covers the value added to each commodity by a firm during all stages of production and distribution.
  - It is based on value added principle. Value added can be obtained either by adding payments to factors of production or deducting cost of inputs from sales value.
  - It is a substitute for sales tax, hotel tax, contract tax and entertainment tax.
  - It is based on self-assessment system and provides the facility of tax credit and tax refund.
  - It avoids cascading effect existed in sales tax and catch up effect.
- (Bhattarai & Koirala, 2062)

### **2.1.6 Merits and Demerits of VAT**

#### **Merits:**

Following are the merits of VAT:

- As compared to other taxes, there is less chance of tax evasion. VAT minimizes tax evasion due to its catch-up effects.
- It is simple to administer as compared to other indirect taxes.
- It is transparent and has minimum burden to customers as it is collected in small fragments at various stages of production and distribution.
- It is based on value added not on total price. So, price does not increase as a result of VAT.
- There is mass participation of tax payers.

### **Demerits:**

Following are the demerits of VAT:

- It is costly to implement as it is based on full billing system
- It is relatively complex to understand. The calculation of value added in every stage is not an easy task.
- To implement the VAT successfully, customers need to be conscious, otherwise tax evasion will be widespread.

(Bhattarai & Koirala, 2062).

### **2.1.7 Types of VAT**

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

- I. The Consumption Type:** this classification is considered as neutral type because under this type no discrimination is done with respect to capital or consumable goods. It is really a superior form of VAT because full credit if inputs, irrespective of what type of purchase are done, is provided. All capital purchased from other firms, in year of purchase, are excluded from the base while depreciation is not deducted from the tax base in the subsequent years.

Since, investment is relieved from taxation under this variant; the base of tax is consumption. That is why this variant of VAT is known as the consumption type of VAT.

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

**II. The Income Type:** the income type of VAT doesn't exclude capital goods purchased from other firms from the tax base in the year of purchase whereas depreciation is excluded from the tax base in subsequent years. In this variant, capital equipment is divided over a period on the basis of their useful life. As in consumption type, in this variant, all the purchase of capital goods is not allowed to deduct in the same year when it is purchased. Only a relevant portion to a particular period is allowed to deduct and the remaining portion is carried over for the next period. The tax falls both on consumption and net investment and the conceptual tax base of this category is the net natural income. Under this type, tax base equals to private personal income. Many countries don't prefer this VAT system as it faces the same problem as we face in calculating income for a particular period. It is consistent with the origin principle of taxation where exports are taxed and inputs are relaxed from the tax (VAT Act, 1995).

**III. Gross National Product Type:** Under this variant, capital goods purchased by a firm from other firms are not deductible from the tax base in the year of purchase and not the depreciation is allowed to deduct from the tax base in the subsequent years. Hence, tax is levied both on consumption and gross investment and the conceptual tax base of this variant is gross domestic product.( Paudel, 2010)

### **2.1.8 Method of Computing VAT**

VAT can be collected by using different methods of computation. However, the choice of the appropriate method depends basically on the types of VAT employed and the principle under which VAT is adopted. The VAT can be computed by employing any of the three methods:

**I. Tax Credit Method** “This method is also called the Invoice Method. Under this method, tax is levied on the total value of sales and it requires that the amount of VAT charged be explicitly stated on the invoice associated with any taxable transaction. The amount of tax merchant submits of tax authorities is simply the difference between the tax collected on his sales and the tax he paid on his purchases”. (Khadka, 1997: 6). Under this method tax liability is derived by deducting tax paid by the seller in purchasing from the total amount of tax collected from tax. Nepal has adopted the tax credit method. Since business is required to state the tax on invoices under the tax credit method, it facilitates border tax adjustments. This implies that the amount of tax that levied on export can be refunded to exporters. Similarly, this method is effective under the destination principle where exports are zero-rated and the tax credit chain is not broken. It also provides the facility of cross checking. VAT liability can be calculated as shown in the table below:

VAT Rate 13 % (In Rs.)

Details	Stage of production and distribution				
	Primary producer	Producer	Wholesaler	Retailer	Total
Purchase	-	1,000	1,200	1,500	3,700
VAT on Purchase (A)	-	130	156	195	481
Sales	100	1,200	1,500	1,800	5,500
VAT on Sale (B)	130	156	195	234	715
Net VAT liability (B-A)	130	26	39	39	234

Table no. 2.2 Calculation of VAT under Tax Credit Method

Source: Estimated figure during the study (2010).

**II. Subtraction Method:** Under this method, VAT liability is calculated by subtracting the cost of materials from sale proceeds. Tax liability is computed by applying the applicable VAT rate to the difference between his total sales and total purchases. This method is appropriate for the consumption variant of VAT. VAT liability can be calculated as shown in the table below:

VAT Rate 13 % (In Rs.)

Stage of production and distribution	Net Purchase price( A)	Sales Price(B)	Value Added	VAT Liability
Primary producer	-	1,000	1,000	130
Producer	1,000	1,200	200	26
Wholesaler	1,200	1,000	300	39
Retailer	1,500	1,800	300	39

Total	3,700	5,500	1,800	234
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Table no. 2.3 Calculation of VAT under Subtraction Method

Source: Estimated figure during the study (2010).

**III Addition Method:** Under this method, the tax base is obtained by adding the incomes produced by the firm or by adding the payment made by the firm to the factors of production employed in turning out the product, such as wages, interest, rent, royalties and profits. This method is appropriate for the income type of VAT. VAT liability can be calculated as shown in the table below:

VAT Rate 13 % (In Rs.)

Details	Stage of production and distribution				
	Primary producer	Producer	Wholesaler	Retailer	Total
Wage	400	90	125	135	750
Rent	200	30	55	45	330
Interest	100	20	30	30	180
Profit	300	60	90	90	540
Value added	1000	200	300	300	1800
VAT Liability	130	26	39	39	234

Table no. 2.4 Calculation of VAT under Addition Method

Source: Estimated figure during the study (2010).

## 2.2 Comparison of VAT with Sales Tax

Often referred to as the "goods and service tax", the value added tax avoids the cascade effect of sales tax by taxing only the value added at each stage of production. For this reason, throughout the world, VAT has been gaining favor over traditional sales taxes. The Value Added Tax is a form of indirect tax that is imposed at different

stages of production on goods and services. VAT is levied on the import goods as well and the same rate is maintained as that of the local produce. Most of the European and non-European countries have adopted this system of taxation. The transparent and neutral nature of taxation has prompted VAT to emerge as one of the robust revenue raisers in these countries. Sales tax, as compared to VAT is the percentage of revenue imposed on the retail sale of goods. Unlike VAT, sales tax is levied on the total value of goods and services purchased.

The value added tax system, unlike the conventional sales tax system, efficiently addresses the problems of cascading and input tax credit that causes an automatic hike in the consumer price level. The incidence of cascading is avoided in VAT as the tax is imposed on the value addition at every stage of production. The final consumers are the ultimate bearers of the burden. This indirect yet coherent form of taxation involves transparency and is therefore easily comprehensible. Understanding the differences and details of these two different approaches can be challenging. You may require help with taxes from accountants or tax professionals.

The economic effect of VAT falls on the final prices of the goods and services while sales tax relies on the final sale to the customers. The value added tax system requires an effective accounting. To deal with this disadvantage, the same tax is charged to each member involved in the production of the goods and services. The implementation of the tax remains indifferent to the position of the member in the production cycle or its position with respect to the customers. The system of taxation under VAT is also successful in avoiding tax evasions that is frequent in sales tax. Sales tax is subjected to evasion by the consumers who engage in buying products through the internet and other activities such as buying at wholesale or through an employer. VAT is one of the newest instruments of the global economy and is widely accepted and implemented in most of the nations.



## **2.3 Value Added Tax in Nepal**

### **2.3.1 History and Development of VAT in Nepal**

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

In Nepal, Value Added Tax Act was enacted by 1995 and started to implement only at 16 Nov. 1997. Value Added Tax Act repelled four-different Tax Act, such as Sales Tax Act, Hotel Tax Act, Contract Tax Act and Entertainment Tax Act. VAT replaces the old Sales Tax, Contract Tax, Hotel Tax and Entertainment Tax. It is believe that successful implementation of VAT will helps to generate customs duties and income tax also and it is expected to enhance the revenue collection and it is closely associated with the GDP. This Act classifies goods and services under three category they are VAT able goods and services, exempted goods and services and zero rated goods and services. It is applied at a single rate (presently 13%, initially 10%) based on addition of value of the goods and services at each stage in the process of supply and delivery of goods and services.

Since then second amendment have already been made on Value Added Tax Act, 1995, and 8<sup>th</sup> amendment have been made in the Value Added Tax Rules, 1997. Various directives have been issued by the concerned authority to implement the VAT in Nepal. ( Adhikari, Gurung and Bhattra, 2010)

### **2.3.2 Basic Features of Nepalese VAT System**

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

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

- The consumption of VAT through tax credit method.

- The principle of destination.
- The level of threshold is Rupees 2 million.
- The facility of tax refund.
- The application of VAT to all business turns over through the retail stages.
- The rate of VAT is single and positive @ 13%.
- The provision of exemption and zero rate for the goods and services.
- The allowance of tax credit for taxable supplies including the zero rate supply.
- Small entrepreneurs are exempted to register in VAT office.
- Self assessment system.

( Adhikari, Gurung and Bhattra, 2010)

### **2.3.3 Registration and Threshold**

The number of taxpayers may be one of the key indicators of success or failure of VAT. Other things remaining the same, the higher the number of taxpayers higher the amount of revenue from VAT. VAT is subject matter of law, for this registrant is must. The criteria for the registration in any business are based on annual taxable turnover or transaction of more than 2 million rupees. Small vendors those who do have less than 2 millions annual turnover may also registered their business voluntarily.

Every business firm or supplier who does transaction of taxable goods and services is required to register under VAT system and collect tax. The registered firm or vendor obtains a registration certificate and registration number from the tax office. Failure to register is an offence and charged a fine. However, it is not necessary to register the firms whose transaction is of tax exempted goods and services. The PAN (Permanent Account Number) is compulsory to all Nepalese

business neither it is small vender nor firms. The threshold for VAT registration is now Rs. 2 Million but the threshold limit amount is changed time to time by the concerned authority. If the transaction is less than threshold it is not necessary to register for VAT purpose. But for more than Rs. 2 Million taxable transaction the firm must be registered in IRO and should collect value added tax.

#### **2.3.4 De-registration**

A VAT registration may be cancelled by anyone whose total taxable sales for consecutive calendar quarters is not more than Rs. 2 Million and who has been registered for a full fiscal year or by persons who no longer have commercial activities. Regarding the cancellation of registration the VAT Act has mentioned the following conditions:

- In case of an incorporated firm, if the incorporated firm is close down, sold or transferred.
- If the business is running under proprietorship with the owner dead.
- In case of partnership firm, if it dissolved.
- If registered person ceased to be engaged in the taxable transaction
- If the business was registered by mistake.
- If the distributor or producers stops selling or producing taxable goods and services
- If the taxpayer does not at all file return or files return of zero amount continuously for one year.

#### **2.3.5 Tax Invoice**

Tax invoice establishes both the liabilities of the supplier and the most of the deduction allowed to the registered to issue a tax invoice in the prescribed form wherever a transaction takes place. A tax invoice should be issued by VAT taxpayers and contains the following information:

- A sequential identification number
- The data of the information
- The data of issue of all invoices, if it is different from the data of the transaction
- The name, address and PAN of the vendor
- The name, address and PAN of the buyer, if registered
- The type of transaction.
- A description sufficient to identification the goods and services supplied.
- The quality of the goods of the extent of services for corresponding description.
- The rate of VAT and the amount of payable, excluding VAT, for each description of goods and services
- The value of any goods or services provided in part exchange
- The total amount payable, excluding VAT
- The rate and amount of tax charged
- The total amount charged including VAT

A minimum of three copies of each invoice is essential. The original copy must be given to the buyers and remains two copies must retain by vendor. These copies must be available at any reasonable times for inspection a tax office. The invoices must be issued in a sequential numerical order. However, invoices can be prepared with different serial numbers for branches of different sections with prior approval of the VAT office (such as restaurants, bars, laundry etc. in case of Hotel). (Bhatta, 2009)

### **2.3.6 Accounting**

The effectiveness of VAT depends on the VAT accounting system. It should not contain unnecessary details. So that it cannot provide appropriate and useful information. The VAT accounting should be information based as well as less

costly. The accounting in VAT is the process of mainly purchase, sales, VAT account and stock. Thus, purchase and sales book are the main part of VAT accounting. Registrants should maintain or record all the purchase during the period, all the goods and services either trading or non-trading appearing in separate columns. Likewise, the sales book is another main part of VAT accounting. It should be posted on the basis of sales invoice in chronological order. The VAT accounting is monthly summary showing sources of the figures used in the VAT return. In order to complete the VAT return, a taxpayer need to ensure that the amount of VAT collected on sales , the time of good and service supplied and provided that .( Wagle, 2010)

Despite a picture of Nepal, there are many people illiterate, farmers, and small vendors. They are not well organized. The business sector is dominated with small vendors. Small vendors are not keeping systematic accounting records because of keeping records are costly and lack of knowledge. Most of small vendors businesses are family based business. The large scale businesses are keep systematic accounting records both manual and computerized.

### **2.3.7 VAT Filling**

VAT is based on self-assessment .Tax payer himself/herself calculates all taxes. Every registered taxpayer requires submitting the return to a tax officer within 25 days after the close of tax period. (Wagle, 2010)

### **2.3.8 VAT Collection**

The producer and supplier are the agents for tax collection on behalf of the department on VAT administration. Usually they collect VAT on sales and deposit the collected amount after crediting the tax in prescribed public account. Tax should be collected in selling price that comprises the costs related to transportation and distribution expenses as well as profit. Excise duty, custom and

other tax except income tax are also included under selling price .In Nepal, if the taxpayer fails to deposit collected tax by regular system then tax officer may implement various methods and measures to collect the tax arrears. (Wagle, 2010)

### **2.3.9 VAT Refund**

Tax refund is a very important aspect of VAT. It must be made simple easy and systematic. In connection to exports tax refund is granted after verifying the export declaration forms, letter of credit or bills of entry and proof of payment to authenticate the export and the import declaration forms or purchase invoices to authenticate the tax paid on inputs. The Inland Revenue Department has adopted an internal policy to provide within 30 days of the receipt of the refund claim although the time limit fixed under the law is 60 days. In the case of Non exporter, there is a possibility of a future adjustment to the excess input tax credit. The carry forward system is there so no need for taxpayers to prepare refund claims and tax administration does not have to process refund claim. (Wagle, 2010)

### **2.3.10 Tax Rates**

#### **I. Zero Rates**

In addition to the positive rate of 13%, a zero – rate was also prescribed under the Nepalese VAT Act, 2053. The transactions which are listed in Schedule -2 of VAT Act are taxed at 0% rate. For example goods exported from Nepal are taxed at 0% so as to promote the export of goods and services from Nepal. Likewise some other transactions are also included in list and GON can add or remove some transaction from yearly Finance Act. Person having transaction as per Schedule -2 can get input tax credit as per Sec. 17 of VAT act but they are not taxed VAT on their sales.

## **II. Standard Rate**

Under this system, all the value added economic transactions regarding transfer, sales, supply, import and exports of goods and services are taxable @ 13 % except some provisions made by Value Added Tax Act i.e. provision for exempted goods and services. This 13% is known as standard rate.

## **III. Exempted Goods and Services**

Under the Nepalese VAT Act, some goods and services are exempted from VAT. They are listed on Schedule -1 of VAT Act. The list can be changed from yearly finance Act. VAT is exempted to certain goods and services which are related to basic need of people and Government does not want to tax those areas. For example, basic agriculture products, Hospitals and medical products, education sectors, business of gold, silvers, etc. are exempted from tax net and they are not taxed under VAT act. Persons dealing with goods and services mentioned in schedule -1 do not get input tax credit. However, persons dealing in both exempted and non exempted goods and services may claim VAT paid on purchases at the proportionate basis. (Wagle, 2010)

### **2.3.11 Tax Credit**

VAT is grounded on tax credit method. All the tax paid on purchase of goods and services including assets, stationery and other expenses related to business are allowed to credit full amount from the output tax collected on sales. There are some goods, which are very difficult to ascertain whether stated in rule, tax may not be deducted in respect to the following goods and services. (Wagle, 2010)

### **2.3.12 Assessment**

Tax assessment is a process of determining the amount of tax, any individual or company is liable to pay. VAT is self assessment tax. Tax payer assesses their liability .They are self allowed to get credit tax period on purchase. In cases where

taxpayer may assesses wrongly or may fail to pay correct tax, to correct this situation there is a provision of management tax assessment which is done by tax officials in under noted circumstances:

- Non submissions of returns in time
- Furnishing of incomplete return
- Return having misrepresentation
- When the tax officers has sufficient reason to believe that tax burden is shown lower than the actual and
- When the tax officer has sufficient reason that there is under billing.

### **2.3.13 Appeal**

Tax payers may not always agree with the assessment made by the tax officers. In that case, Taxpayer may file an appeal to Revenue Tribunal within 35 days against tax assessment on penalty charged by a tax officer or an order by the director general relating to the suspension of this place of transaction. Before filing appeal the tax payers must deposit the disputed amount of the assessed tax due, the rest of the amount of tax due plus the whole amount of the fine shall have to be deposited or a bank guarantee of the same has to be provided. A provision of appeal to director general had been included in first amendment of VAT act as a choice of taxpayer.

### **2.3.14 Offences**

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

- No registration within 90 days from the commencement of the Act.
- No publication of registration certificate within the business premises publicly.
- Not giving information regarding transfer of location or area of business to the authority within 15 days from such transfer.



- Not issuance of bill.
- VAT collection without registration.
- Not filing of tax statement as per the prescribed period.
- Any kind of cheating forgery or fraudulent transaction.
- Creating obstacle to the tax officer during the inspection of business transaction. ( Wagle, 2010)

Fines will be imposed if the taxpayer fails to file his return within the specified time. A registrant will make his VAT payment at a bank where he will receive a bank voucher as proof of payment. This number is to be entered on his VAT return to be submitted within 25 days after the end of the month of business transaction.

The VAT Act imposes fines for failing to register. Similarly, if a registrant fails to use his registration number or clearly display his registration certificate in the business premises, he is liable to fine. Other penalties may be imposed if, for example, a registrant fails to file a return, issue invoices, keep an up-to-date account of transactions, obstructs visits by a tax officer in investigation, prepares false accounts and invoices or attempts to evade tax. Similarly, IRO/IRD may purchase or cause to purchase under invoiced goods. (<http://www.ird.gov.np>)

### **2.3.15 Rewards**

If a person provides information which is solid showing that a taxpayer has evaded or attempted to evade all or some portion of tax, he/she will be awarded with the amount equal to 20% of the amount of tax collected on that basis of such information. In conclusion, VAT is based on the principle of self assessment system. VAT applies to supplies of goods and services for consideration other than exempt goods by taxable persons. VAT is collected by taxable person. A taxable

person is entitled to deduct the input tax from the tax collected by the sales. Similarly if the input tax exceeds the tax collected, the taxpayer may adjust in any tax payable. After adjusting it, if any tax amount remains, taxpayer is entitled to deduct from tax payable in next month. VAT Act has made provision regarding tax refund also. Conditions and procedures of tax refund are also stipulated in the VAT Act. (Wagle, 2010)

### **2.3.16 Conscious Consumer Lottery Program**

In order to encourage billing system and thereby improve the tax system and motivate the consumers to take bills on the purchase of goods and services and motivate the sellers to issue bills on the sale of goods and services, a conscious consumer lottery program has been introduced since Magh, 2060.

Types of bills to be included in lottery program are as follows:

- I.** Purchase bill issued by VAT registered taxpayers to consumers who are not registered in VAT.
- II.** Tax invoice or abbreviated tax invoice in the name of natural person among individual purchasers who are unregistered.
- III.** All types of bills except the purchase of vehicle (excluding bicycle) and star hotel will be allowed to participate in the program.

However, bills issued in the name of government authority, public enterprises, local level authorities and diplomatic missions and the bills issued by the public enterprises will not be entertained in the program.

Provision of Cash Prizes to Consumers	Total Prize amount
First winner - 1 Person.	Rs.1,00,000
Second winner- 5 Persons (Rs.20,000 each)	Rs.1,00,000
Third winner- 10 Persons (Rs.10,000 each)	Rs.1,00,000

Consolation Prize - 20 Persons (Rs.5,000 each)	Rs.1,00,000
Total	Rs. 4,00,000

The prize will be declared once a month on the basis of coupons distributed in that month.

Procedures of conducting lottery program:

**I.** IRD will print lottery coupons with serial numbers of two copies.

**II.** A separate number will be marked in each coupon.

**III.** One coupon will be issued to the purchaser after receiving the purchase bill of Rs. 1,000 and a copy will be retained by the contractor conducting the program. For instance, if a consumer submits 3 bills containing the purchase of Rs. 400 each, he will receive one coupon and will be eligible to get another coupon in each additional amount of Rs. 1,000. However, surplus amount will not be entertained for the purpose of competition once coupons are issued after submission of the bills.

**IV.** The bills worth less than Rs. 250 will not be entertained in the program.

Provision of Cash Prizes to sellers:

In order to motivate the sellers to give bills to the buyers, those sellers whose invoices have enabled the cash prizes to the consumers will also get the following Cash Prizes: -

	Total Prize Amount
First winner - 1 Seller	Rs.25,000
Second winner- 5 Sellers (Rs.5, 000 each)	Rs.25,000
Third winner- 10 Sellers (Rs.3, 000 each)	Rs.30,000

Consolation Prize - 20 Sellers (Rs.2, 000 each)	Rs.40,000
Total	Rs. 1, 20,000

(<http://www.ird.gov.np>)

## **2.4 VAT Administration in Nepal**

The success and effectiveness of VAT in Nepal depends upon its strong enough capability from an effective operation. And VAT administration is responsible for it. It is responsible for the execution of the program work assessment, taxpayer's education, registration, assessment, collection and verification of taxpayer's book and records. The greater preparation is needed to increase implementing capability of administration. The present VAT administration may be simplified into two functional head as department and offices. So, department and field officers under this department and officers under this department are responsible for administering VAT. In absence of technical component, honest and dedicated administration the expected smooth working of a VAT becomes really a myth and fully VAT advantage can't be achieved.

An argument often used against the introduction of VAT is the weakness of the tax administration. This is a valid concern. VAT performance would be poor under a weak administration. However, if a tax administration is weak, its strengthening is a priority regardless of what taxes the country has in place. At present Nepal has not adequate number of efficient manpower. Qualified, well-trained and competent manpower is necessary to investigate and the audit of the business transactions for tax purpose. VAT system requires extra skill and knowledge especially for investigation and auditing. But the present manpower proves inefficient for handling VAT in Nepal. Failure to detect false records and invoices, high claim of tax credit and detect over refunding are the major weakness of VAT administration. VAT administration is still weak and less attractive for the personnel. Most of the officers engaged in the VAT administration are not

motivated. Due to lack of motivation many officials are not actively engaged in the implementation of VAT effectively.

## **2.5 Problems of VAT implementation in Nepal**

Nepal has different kinds of problem, constraints and challenges in the all sectors of VAT implementation such as administrative, political, geographical, social, and economic and others. Because of these reasons Nepal has not achieved a satisfactory level of the economic growth. VAT is considered to be the best fiscal tool; practically it is also proved that it has many short comings. VAT influences the level of economic activities and other variables like price, wages, foreign trade etc directly or indirectly.

As already discussed, VAT in terms of revenue raised by it cannot be termed successful. The reasons behind this may be numerous including the conflict situation in the country. The following major problems are worth noting:

- Lack of enforcement spirit in administration
- Lack of taxpayer monitoring by tax administration
- Single rate which is high for basic goods and services. It is advantageous too to tax evaders both in not depositing collected tax and evading the tax.
- Threshold problem which is working as the shield to bring all the tax payers in the tax net.
- Exemption problem which is helping as the shield to hide the transaction of taxable goods and making the tax net small.
- Billing problem, the major one which has barred to make VAT a total success.
- Customs valuation problem which is working as the starting point of under invoicing of the goods.
- Unification problem which has brought VAT in shadow of income tax.

- Business community's ego problem which is inducing to oppose the enforcement of VAT.

The problem of compliance and prevent evasion in the VAT remain the same. The administration has not given success attention toward the development of good information system, technical database inspection and auditing system. Thus tax investigating and audit should be effective in order to make taxpayer more careful in fulfilling their duties. VAT administration is still weak and less attractive for the personnel. Most of the officers engaged in the VAT administration are not motivated. Due to lack of motivation many officials are not actively engaged in the implementation of VAT effectively.

## **2.6 Review of Related Studies**

Review of related studies covers review of past studies conducted by others researches such as review of thesis, research articles and journals and project reports as relevant with this study are reviewed here in:-

### **2.6.1 Review of Books and Articles**

In this context, Dr. Rup Bahadur Khadka (2000), in his book entitled "VAT in Asia pacific region" writes VAT is the most recent innovation in the field of taxation. VAT is the multi staged, commodity and service based tax which is levied on the value added of business at different stages of production and distribution. This book has covered all aspects of VAT including the nature, the various types and method of VAT computation, reason for growing popularity of VAT etc. in this book the structures and operation of VAT in Asia pacific countries, which also explained the possibilities of introduction of VAT in Nepal were examined.

Paulo dos Santos (2002) in his paper "VAT Introduction - Administrative Issues" states that in administrative terms, VAT implementation in the Caribbean

countries is feasible if certain requirements are satisfied. First, a strong and explicit political commitment from the top authorities; second, the preparation of a detailed implementation plan with realistic dates for the main milestones; third, the provision of the necessary resources for implementation, which should be clearly identified in an implementation budget. For some of the Caribbean countries, international help in terms of technical support will be necessary to bring the experience of other countries in implementing VAT to the region. These are the vital considerations in the process of planning, executing and following up on the implementation of a VAT-type tax. Following them closely will, with no doubt, ensure a smooth transition to an efficient, effective VAT.

In this context, Glenn P. Jenkins and Chun Yan Kuo in his paper entitled, “A VAT Revenue Simulation Model for Tax Reform in Developing Countries” explains that a methodology is developed to construct a revenue estimation model for a value added tax system in countries which, at present, have an indirect tax system containing sales, excise taxes, and tariffs. It is assumed that the VAT will replace the sales taxes and allow for a rationalization of the excise and tariff systems. These procedures are applied to the case of Nepal, which is considering the introduction of a value added tax system. It is shown that, in a developing country, tax policies that might seem very realistic and politically non-controversial are likely to yield a very narrow VAT tax base. In the case of Nepal, the VAT tax base becomes less than 20 percent of gross domestic expenditure. It is further reduced if compliance is less than 100 percent. Hence, if a government of a developing country wants to rely more on the VAT over time, it must move aggressively to broaden the base and enhance compliance. Such policies may require harder political choices than is usually required from governments of most industrialized countries. Resources also will have to be spent to enhance the effectiveness of the tax administration.

Y. Ravikumar (2005) published an article on “VAT in India–Issues and Concerns” states that the move towards the VAT regime is a welcome step for the Indian Economy, but to get the complete benefits of this VAT, it is necessary that the whole nation should understand the issues and concerns of the trade and the industry at large in evolving a common system of taxation across the country. The states, who have not yet implemented the VAT, have to understand the problems being faced by the trading community at large and should implement the VAT as quickly as possible so as to reduce the concerns of trade. This would pave the way for initiating the steps for the introduction of the GST in a near future. As already steps have been initiated in integrating the taxation on goods and services at the central level (already inter sectoral credit has been introduced), it would be necessary to initiate the steps for ensuring a uniform value added tax law across the country which would then pave the way for implementation of a common GST across the country.

Christophe Grandcolas (2005) in his research entitled “The Occasional Failure in VAT Implementation: Lessons for the Pacific” explains that in administrative terms, VAT systems can work well in Pacific Island Countries if certain requirements are satisfied. Firstly, there must be a strong and explicit political commitment from the highest authority. Secondly, a detailed implementation plan with realistic dates for the main milestones must be prepared, and lastly, the necessary resources for implementation must be provided and this should be clearly identified in an implementation budget. For all the Pacific Island Countries, international help in terms of technical support will help to bring the experience of other countries in implementing VAT. However, it is also important to pay attention to all the other aspects discussed in this paper that have helped other countries implement successful VAT. These are the vital considerations in the process of planning, executing and following up on the implementation of a



VAT-type tax. Following these considerations closely will, with no doubt, ensure a smooth transition to an efficient and effective VAT.

Dr. Kandel P. (2005), in his article “Implementation of VAT in Nepal: Success or Failure?”, concludes that now its time to see weather we have been successful in VAT implementation or not during these years. Certainly, the major basis to evaluate is its contribution to national treasury in terms of revenue. While gauging the success or failure of VAT in Nepal, one cannot clearly say whether it has failed or succeeded. From the point of view of transparency in tax administration, increase in number of taxpayers it is satisfactory. But, from the point of view of revenue raised by VAT itself, it is not a success in comparison to the aim envisaged while introducing it. It was assumed at the time of its initiation hat would become the major revenue source in Nepal providing folds of revenue in comparison to the then sale tax. The revenue raised today, in comparison to expectation is negligible. The trend of credit return, deregistration etc. is also discouraging. Thus, the VAT story in Nepal is neither total success nor total failure. However, if certain problems related to monitoring enforcement, threshold, rate and above all invoices are solved; there is possibility of emerging the VAT a real success as well.

### **2.6.2 Review of Thesis**

The study conducted by Khatiwada, Tara Nath (2003) is related with problems and prospects regarding VAT implementation in Nepal. He has accessed the following conclusions;

It is very difficult to bring all potential taxpayer into tax net due to lack of transparency in business activities, week cross checking mechanism transaction manipulation practices of some business community to pay less tax and or escape from tax liabilities. Unsupportive and negative attitude of business community is the main problem for better implementation. He also added that the crisis of

confidence between tax authority and business community has become obstacles in successful implementation of VAT in Nepal

Kuikel, Rabin (2004) “Effectiveness of VAT in Revenue Collection in Nepal”, had concluded that the main reasons behind the introduction of VAT in Nepal are to increase revenue mobilization by broadening the tax base to make system neutral and efficient, to establish a fair and transparent and to promote economic growth. The tax revenue structure shows that the share of indirect tax in total tax has continuously declined but the share of VAT to indirect tax has been increasing with some fluctuation. To enhance its revenue collection there is a need to establish proper accounting and invoicing system. Tax administrators, taxpayers and consumers need to be educated about VAT system. He tried to analyze the trend of revenue collection before and after the introduction of VAT in Nepal. He had conducted an empirical investigation regarding to effectiveness and problems of VAT in Nepal. He further explained that VAT eliminates various defects of sales tax by replacing it such as pyramiding and cascading effects, other source of taxation are not able to get required level of revenue generation. So, implementation of VAT for Nepal is both a compulsion and necessity. It is only the preliminary stage of VAT implementation in Nepal. So, the revenue contribution from VAT is not as high as expected due to various reasons. Availability of clear VAT laws, and rules, effective and efficient administration, honest tax payer, and establishment of proper invoicing mechanism and extension of tax coverage are the most important factors which obviously increase the revenue mobilization through VAT and effectiveness of VAT can be achieved.

Neupane, Ram H. (2005) “Value Added Tax in Nepal”, explained that, the primary reason for growing popularity of VAT in its broad coverage, without distorting the economic efficiency. Most of trading house purchase their goods and make fake bill and most of product are sold without issuing the VAT bill. Narrow

tax base, smuggling, under valuation, unauthorized trade, weak tax administration, and lack of public consciousness, open boarder are the major problems of VAT implementation in Nepal. The narrow tax base of the previous sales tax failed to generate the minimum required amount of revenue because it included only import and manufacturing unit. The liberalization and globalization concept has also affected Nepalese tax system. In Nepal share of tax revenue is greater than non-tax revenue. Among total tax revenue indirect tax occupied about two third and share of direct tax is about one third of total tax revenue. The basic reason for low revenue collection from VAT is mainly due to the minimum use of invoice by purchases.

The study conducted by Shrestha, Sajana Maiya (2008) entiteled A Study on VAT: Implementation, Problems & its Effectiveness in The Nepalese economy conclude that there will be improvements in revenue collection due to VAT system. According to survey, the main problems in VAT collection are smuggling and under valuation, tax unconsciousness of people, tax evasion and improper billing system. Similarly, the major problem in VAT collection is registration, collection, tax refund. The view of most respondents is that the VAT system has positive effect in nation's economic growth. Most of Nepalese people are unknown about VAT system and they don't know the proper records of VAT account. So, the VAT administration takes corrective action and efforts for successful VAT. The most important factors for the effectiveness of VAT in revenue collection are proper implementation, clear VAT law, rules and regulation, broad coverage, tax education and effective and efficient administration etc. Finally, it VAT itself not more revenue generator, it is only transparent and scientific system of collecting revenue. It needs more administrative support and efforts. According to the survey the implementation of VAT in Nepal have poor results than expectation. The reasons are poor planning, unaccountable staffs, weak and corrupt bureaucracy etc. Corruption is widely

spreading in political as well as administration from top level to bottom level of authority. People are less literate about theoretical concept of VAT, so they cannot play creative support for the implement of VAT. It is necessary for the taxpayers to know about the VAT with its benefits. Different education programs, seminars etc. should be organized for taxpayers as well as general public in all over the country with the objectives of aware them about VAT which helps to bring more and more tax payers in the tax circumference. Likewise the VAT system can be developing by adopting automatic billing system. Tomorrow, there may be possibilities for further improvements learned through our mistakes that will also be required. In order to make VAT effective, it is essential to create an environment in which invoices are issued properly, accounts are maintained accurately, tax is based on transactions, and fair competition among industrialists and businessmen is established with respect to tax. Until and unless such a situation is created, VAT implementation will not be easy and pressure will be created in some or another way.

The study conducted by Bhatta, Prem P. (2009) entitled “a study on implementation aspect of VAT in Nepal”, in his research paper he concluded that being better economic developed country is the objective of every country of this world. To meet the objective it is essential to have sufficient revenue generation. Generally tax revenue plays the great role for development of nation's economy. Tax revenue consists of direct tax and indirect tax. Value added Tax (VAT) is a type of indirect tax. It is the most recent innovation in the field of the taxation. It is levied on the value added of the goods and the services. It is theoretically, the tax is broad based as it covers the value added to each commodity by a firm during all stages of production and distribution. Value Added Tax (VAT) is tax based on goods and services. This tax is levied on the sale, exchange, transfer, import etc. of all goods and services apart from those specified by the law as tax-exempt. VAT is most scientific, modern and new innovation in the filed of taxation. VAT has been

most essential alternative of different tax reform programs for developing countries like Nepal. It leads to revenue enhancement, transparent and scientific tax system. There will be vital scopes for increasing the revenue from VAT in coming days. Most of the customers, traders/businessmen are lacked with the concept of VAT. They are facing billing, accounting problems. Due to different reasons the operating of VAT is extremely geographical structure, open boarder, traditional business system, and low public consciousness level, under valuation of pricing, corruption and accountability. VAT is more efficient tax to avoid the cascading and pyramiding effects. On reviewing registration trend, people are being more conscious toward the advantages of registering in VAT and the implementation scenario of VAT is going on sound wards. The revenue collection from import is very much higher than from internal source.

The study conducted by Wagle, Mahesh (2010) entitled “A study on Contemporary Issues on VAT System of Nepal”, in his research paper he concluded that the ultimate goal of every country of this world including Nepal is to get better economic development and to ensure the rapid rate of economic growth. To get the pace of economic development it is essential to have sufficient revenue generation, particularly revenue collection through taxation is a primary source and it plays the great role for development of nation's economy. In which the indirect tax has occupied two-third place of total tax revenue. In this regard, Value Added Tax has been a centre point of attraction and Nepal too adopted this and implemented the VAT system in 1997. After the implementation of VAT system, contact tax, hotel tax, sales tax and entertainment taxes have been replaced by it. It was not easy for government to implement VAT; there were lots of debates, discussion and interaction on VAT. But at the present context, looking at the contribution of these replaced taxes in tax revenue and gross domestic product the contribution, it's generally increasing before, the implementation of VAT. The conducted field survey shows there are many problems on this field. Level of

awareness of the accountant and businessman paying VAT is at low level on some provision of VAT Act. Their knowledge is very important so that proper use and implementation of VAT system can be ensured. Likewise, revenue administration has various issues that can be improved with good attitude of people. For example, making tax payer friendly environment at tax office and giving enough respect to the tax payer can improve the image of tax officer also. Though theoretically, the VAT system is transparent; it broadens the tax base and discourages tax evasion, however, under invoicing and not issuing complete sales bills is there everywhere. So, to improve these kinds of tax evasion, revenue administration should be effective and conscious. Nepal is landlocked country and there is open boarder with and India has not adopted fully VAT system which brings serious problem in foreign trade with third countries. Small retails that are scattered from Terai to Himalaya are illiterate and it brings them problems to maintain proper records. This needs proper administrative efforts for successful VAT. It is found to be the best alternative for reducing such problems mentioned above. Self- policing feature of VAT discourage them who are in the activities of tax evasion and avoidance. So, it can be concluded that until and unless, everybody feel that it is their responsibility to pay tax, there will not be optimum VAT collection. Paying tax is the matter of proud of people of the country. They get return from the government in various ways for the tax they have paid. In Nepal, people has attitude of avoiding paying tax. It is because of the political situation of the country and corrupted government system. There is a huge frustration at the level of general public in Nepal that there is nothing we get from this country and they think paying tax useless. The root cause may be the attitude of people and if it could be improved by anyway, there will be a tremendous growth in revenue collection. For doing this, there should be responsible and accountable government in Nepal which can only take initiatives to do major changes on mindsets of the people.

Furthermore, the study conducted by Paudel, Ganesh Prasad (2010) entitled “An Analytical study on Value Added Tax in Nepal”, in his research paper he concluded that Nepal is one of the least developed countries in the world. It has poor economic condition. Taxation is major source of domestic resources. Tax includes both direct and indirect tax and more than fifty percent share of revenue has been collected through indirect tax. VAT replaces sales tax, hotel tax, entertainment tax and contract tax. He revealed that most of the taxpayers are not conscious about VAT. Taxpayers are unknown about threshold limit, tax exemption and zero rating and other issues which are related with VAT registration. The main problem in effective implementation of VAT is the billing system. The businessmen involve under invoicing and they use to maintain of double accounts. Right valuation of goods at the boarder ensures a proper billing system.

## **2.7 Research Gap**

After, reviewing, literature and researches available, it is found that a number of studies have done on Value Added Tax System. Various researches cover Nepal, India, Brazil, Pakistan, China and other developing countries. Many years have already been passed since it came into implementation in Nepal but less study had undertaken on the topic of VAT in Nepalese context and most of the studies were related with theoretical aspects. This research has tried to analyze the current administrative effectiveness and implementation part of VAT in Nepal and trend of registration, refund and collection of value added tax in the process of tax implementation.

## **CHAPTER - THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Meaning of Research Methodology**

A systematic methodology is required to pick out an actual result for any special study. Research means the search for knowledge and methodology refers to the various sequential steps that are adopted in the study. Research methodology is the description, explanation and justification of various methods of conducting research. The study of the methodology facilitates understanding or social scientific inquiry. The method requires that ordering of concepts and propositions, procedures of selecting and analyzing evidence.

#### **3.2 Research design**

The research design is the task of defining the research problem. Research design is plan, structure and strategy of investigation conceived so as to obtain answer to research questions and to control variances. It is the conceptual structure within which the research is carried out by analyzing both primary and secondary data.

#### **3.3 Population and Sample**

From the total population, 60 respondents were taken as sample representing various sectors of VAT, Out of them 20%, 40% and 40% questionnaire are distributed with tax experts, businessmen and customer respectively. Out of total question 40% are distributed in Janakpur city and remaining 60% at Kathmandu Valley. And only 52 were collected and used for analysis.

#### **3.4 Sources of Data**

Both primary and secondary sources of data have been collected in order to achieve the real and correct data as far as available.



- Primary data have been gathered through questionnaire, interview and discussion with the concerned people.
- Secondary data were received from books, journals, newspapers, reports and dissertations, seminar papers, budget speech, economic survey report, IRD reports, thesis of previous researchers and Different websites

The research has also consulted the library to gather necessary data and theoretical knowledge and information during the course of study.

### **3.5 Data Collection Technique**

The annual reports of the IRD were obtained from IRD office and websites. The main sources of data are annual report of IRD, economic survey report, budget speech, besides, a details review materials are collected from the library of Shanker Dev Campus central bank library and central library of T.U.

### **3.6 Statistical tools**

The analysis of data has been done through the use of statistical tools. The applied statistical tools were tabulation of data, presentation of data, and analysis of data. The statistical tools used are mean, standard deviation, coefficient of correlation analysis between actual and estimated, trend analysis of VAT revenue are used to achieve the objective of the study.

#### **I. Average/Mean**

An average is a single value related from a group of values to represent them in someway, a value, which is supposed to stand for whole group of which it is a part, as typical of all the values in the group. There are various types of averages. Arithmetic mean (AM, Simple & Weighted), median, mode, geometric mean, harmonic mean are the major types of averages. The most popular and widely used measure representing the entire data by one value is the Arithmetic Mean. The

value of the Arithmetic Mean is obtained by adding together all the items and by dividing this total by the number of items.

Mathematically, Arithmetic Mean (AM) is given by,

$$\bar{X} = \frac{\sum X}{n}$$

Where,  $\bar{X}$  = Arithmetic mean

$\sum x$  = Sum of all the values of the variable X

n = Number of observations

## **II. Standard Deviation (SD)**

Standard deviation is defined as the positive square root of the mean of the square of the deviation taken from arithmetic mean. Standard deviation is used to measure dispersion. Standard deviation is calculated as follows:

$$SD (\delta) = \sqrt{\frac{\sum X^2}{n} - \left(\frac{\sum X}{n}\right)^2}$$

Where, X= variable value

n = no. of observations

## **III. Coefficient of Variation (CV)**

The coefficient of variation reflects the relation between standard deviation and mean. The relative measure of dispersion based on the standard deviations known as coefficient of variation. The coefficient of dispersion based on standard deviation multiplied by 100 is known as the CV. It is used for comparing variability of two distributions; the CV is defined as,

$$CV = \frac{SD}{Mean} \times 100 = \frac{\delta}{\bar{x}} \times 100$$

Greater the CV, the more variable or conversely less consistent, less uniform, less stable and homogenous than the consistent more uniform, more stable and homogenous.

#### IV. Karl Person's Coefficient of Correlation (r)

Correlation analysis is the statistical tools that we can use to describe the degree to which one variable is liner related to another. Coefficient of correlation is the measurement of the degree of relationship between two casually related sets of figure whether positive or negative. Its values lie somewhere ranging between - 1 to +1. '+1' denotes the perfect positive correlation, '0' denotes there is no correlation and '-1' denotes correlation is said to be perfect negative. Karl Pearson's method, popularly known as Pearsonian coefficient of correlation, is most widely used in practice The correlation coefficient between two variables X and Y, usually denoted by  $r(X,Y)$ ,  $r_{xy}$  is a numerical measure of linear relationship between them and is define by

$$r_{xy} = \frac{n \sum xy - \sum x \sum y}{\sqrt{[n \sum x^2 - (\sum x)^2]} \sqrt{[n \sum y^2 - (\sum y)^2]}}$$

#### V. Regression analysis

Regression is the determination of statistical relationship between two or more variable. The regression used in the study determine the statistical relationship between independent variable X i.e. (Estimated VAT Revenue) and dependent variable Y i.e. Actual VAT revenue. The basic relationship between X and Y is given by:

$$Y_c = a + bx$$

Where,  $Y_c$  denotes the estimated values of Y for given value of X.

$$A = \frac{\sum X}{n}, b = \frac{\sum XY}{\sum x^2}$$

#### VI. Time Series Analysis

Time series analysis shows the relationship between two variables, one being the time. It helps in understanding the past behavior of a variable in the time series.

Further, it helps future forecasting and planning with the help of past and present data and factors affecting them will make possible to forecast the future magnitude. It helps in evaluating the present accomplishment. The actual performance can be compared with expected performance and analyze the cause of such variation.

### **3.7 Data analysis procedure**

All data will not be in readymade format or data obtained from various sources cannot be directly used in their original form. Data should be manipulated according to needs. Data, information, figures and facts so obtained need to be checked, rechecked, edited and tabulated for computation. All data may not necessary, select essential data, classify them and tabulate them such a way that they will represent some qualitative as quantitative results. Then only tabulated data will be used in the research. For the purpose of study, collected and obtained data are scanned and tabulated under various heads. Selected suitable tools and proper analysis make data effective. The various calculated results obtained through statistical tools are tabulated under different heading. Then they are compared, analyzed with each other to interpret results.

## **CHAPTER FOUR**

### **DATA PRESENTATION AND ANALYSIS**

This chapter has been divided into two parts: The first part deals with the secondary data presentation, the data are collected from secondary source means from annual report of Inland Revenue department, Economic survey report. And the Second part is concerned with empirical study i.e. the analysis and views of Business person, consumers and Tax experts about the information and application of VAT, reaction towards VAT policy obstacles faced by them while paying and refunding VAT, feedback and wide performance analysis on VAT and Implementation part of VAT in Nepal. The title of each table represents its questionnaire respectively.

#### **(A) Analysis of Secondary Data**

#### **4.1 Contribution of VAT on Economic Growth**

##### **4.1.1 VAT Registrants in Nepal**

The number of taxpayers may be one of the key indicators of success or failure of VAT. If other things remaining the same, higher the number of taxpayer higher the amount of revenue from VAT. VAT is subject matter of law, for this registrant is must. The criteria for the registration in any business are based on annual taxable turnover or transaction of more than Rs. 2 million rupees. All supplies dealing with taxable goods and services of annual turnover Rs. 2 million (threshold limit) are required to register under VAT Act and collect VAT. However, it is not necessary for them to register, if they deal with only tax exempted goods and services. Small venders those who do have less than Rs. 2 millions annual turnovers may also registered their business voluntarily. The present position of VAT registrants in Nepal can be shown in following table.

<b>year</b>	<b>No. Of Registrants</b>	<b>% Increase</b>
2060/61	34,174	14.10
2061/62	39,776	16.39
2062/63	46,831	17.74
2063/64	53,072	13.10
2064/65	59,707	12.50
2065/66	69,653	16.66
Average % increment		15.13

Table 4.1 VAT Registrants in Nepal

Source: Inland Revenue Department (Annual Report 2064/65 and 2065/66)

From the above table no. 4.1 it is clear that in the FY 2060/61 the total no. of VAT registrants was 34,174. The no. of VAT registrants increased and reached 39,776 in FY 2061/62, 46,831 in FY 2062/603, 53,072 in FY 2063/64, in 2064/65 the no. of VAT registrants was 59,707. At the end of Year 2065/66 the total no. of VAT registrants is 69,653. It is found that the VAT registrants were increasing year by year i.e. in increasing trend. The increasing rate in FY 2060/61 is 14.10% while in Year 2065/66 it 16.66%. From the year 2060/61 to 2062/63 the VAT registrants no. is in increasing trend while from year 2063//64 and 2064/65 it is in decreasing trend. It is also found that the in the above table in the year2062/63 the increasing rate of VAT registrants is high i.e. 17.74%. The above table can be presented by below figure.

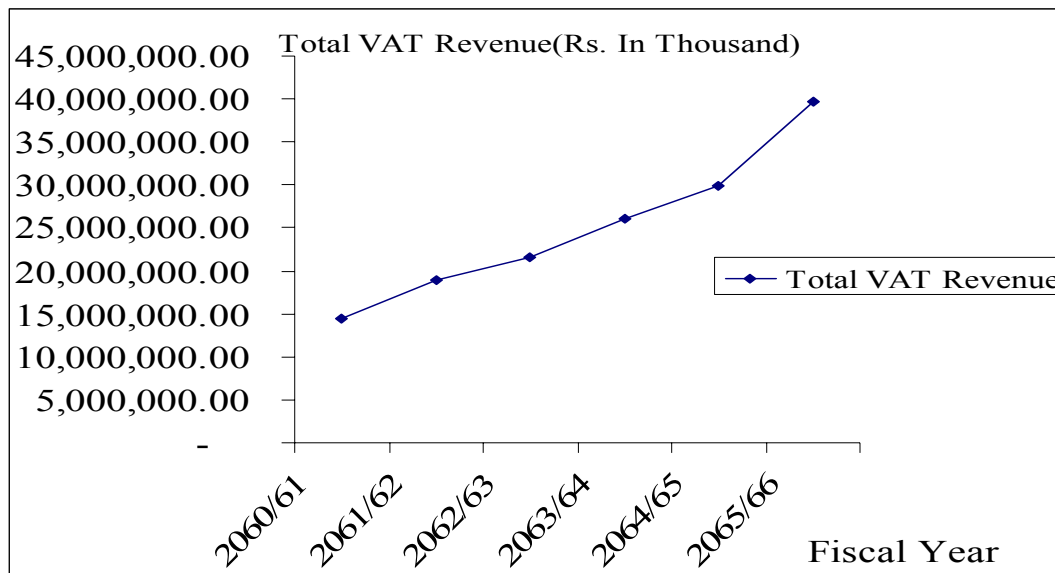


Figure no. 4.1 VAT Registrants in Nepal

From the above figure no. 4.1 it is clear that the no. of VAT registration is increasing day by day i.e. in increasing trend. The trend show in increasing from year 2060/61 to 2062/63 in percentage/ the highest increment was in year 2062/63 and the lowest increment was in year 2064/65.the fluctuation of VAT registration is not so high because average increment was 15.13%.

#### 4.1.2 VAT Collection in Nepal

The producer and supplier are the agents for tax collection on behalf of the department on VAT administration. Usually they collect VAT on sales and deposit the collected amount after crediting the tax in prescribed public account. Tax should be collected in selling price that comprises the costs related to transportation and distribution expenses as well as profit. Excise duty, custom and other tax except income tax are also included under selling price .In Nepal, if the taxpayer fails to deposit collected tax by regular system then tax officer may implement various methods and measures to collect the tax arrears. VAT plays significant role to the revenue collected by Inland Revenue i.e. VAT is the major source of total revenue of Nepal. The present VAT collection is presented in following table.

(Rs in Thousand)

Year	VAT Revenue (Rs.)	Growth Rate (%)
2060/61	14,478,896.00	7.32
2061/62	18,885,400.00	30.43
2062/63	21,613,043.00	14.14
2063/64	26,095,599.00	20.74
2064/65	29,815,702.00	14.26
2065/66	39,700,921.00	33.15
Average % Growth		20.06

Table 4.2 VAT revenue Collection in Nepal

Source: Inland Revenue Department (Annual Report 2064/65 and 2065/66)

In the above table no 4.2it is found that the revenue from VAT in Nepal is increasing day by day. In year 2060/61 the total amount of VAT revenue is 14,478,896.00, which increased by 30.43 % in 2061/62 and reached 18,885,400.00. it is also analyzed that in FY 2062/63 and 2063/64 the revenue is in decreasing trend but in FY 2065/66 the increasing rate 33.15% and revenue increased and reached the 39,700,921.00. The average growth rate is 20.06 %The above VAT revenue collection table can be presented in following figure to clear the trend.



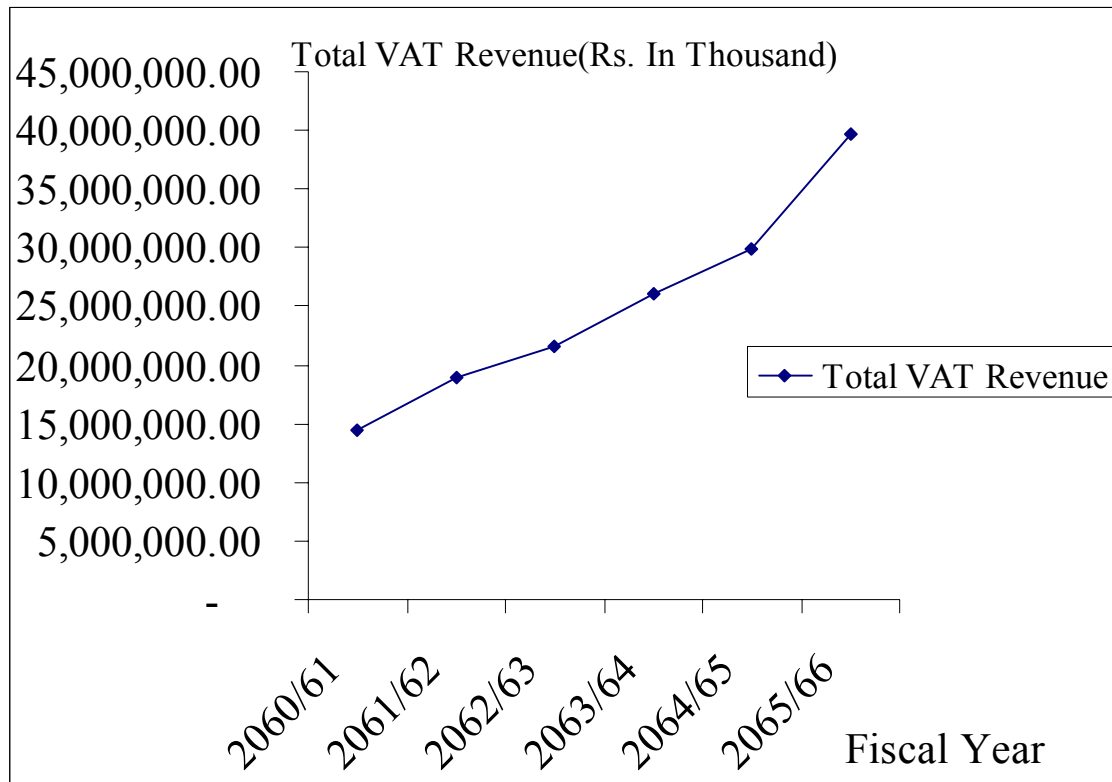


Figure 4.2 VAT revenue Collection in Nepal

From the above figure 4.2 it is obvious that the VAT collection by the Nepal Government is in increasing trend. In FY 2060/61 to 2062/63 the increasing rate is slow but after the FY 2063/64 to FY 2065/66 it is increasing in high rate. The average growth rate is 20.06 %.

Total VAT collection can be divided into parts. One is domestic and other is import. Currently, about one third of total VAT revenue comes from domestic products and two thirds from imports. The taxpayers are allowed to claim VAT paid in imports as credit or import is considered as negative VAT. Tax payers deduct the VAT paid on imports at the custom points from the VAT collected on their sales and pay the balance to the government. The composition of VAT revenue is shown in table 4.3.

(Rs in Thousand)

Year	VAT Collection	Domestic Product	Import Product	Domestic / Import Ratio
2060/61	14,478,896.00	5,604,123.00	8,874,773.00	39:61
2061/62	18,885,400.00	6,614,973.00	12,270,427.00	35:65
2062/63	21,613,043.00	8,150,502.00	13,462,541.00	38:62
2063/64	26,095,599.00	9,631,330.00	16,464,269.00	37:63
2064/65	29,815,702.00	10,808,241.00	19,007,462.00	36:64
2065/66	39,700,921.00	13,918,493.00	25,782,428.00	35:65

Table 4.3 VAT Revenue from Domestic Product and Import

Source: Inland Revenue Department (Annual Report 2064/65 and 2065/66)

From the above table no 4.3 it is clear that the more VAT is generated from Imports. The ratio of domestic and import is 39:61 in FY 2060/61 while in FY 2065/66 it is 35:65. The following figure gives the clear view of composition of VAT revenue.

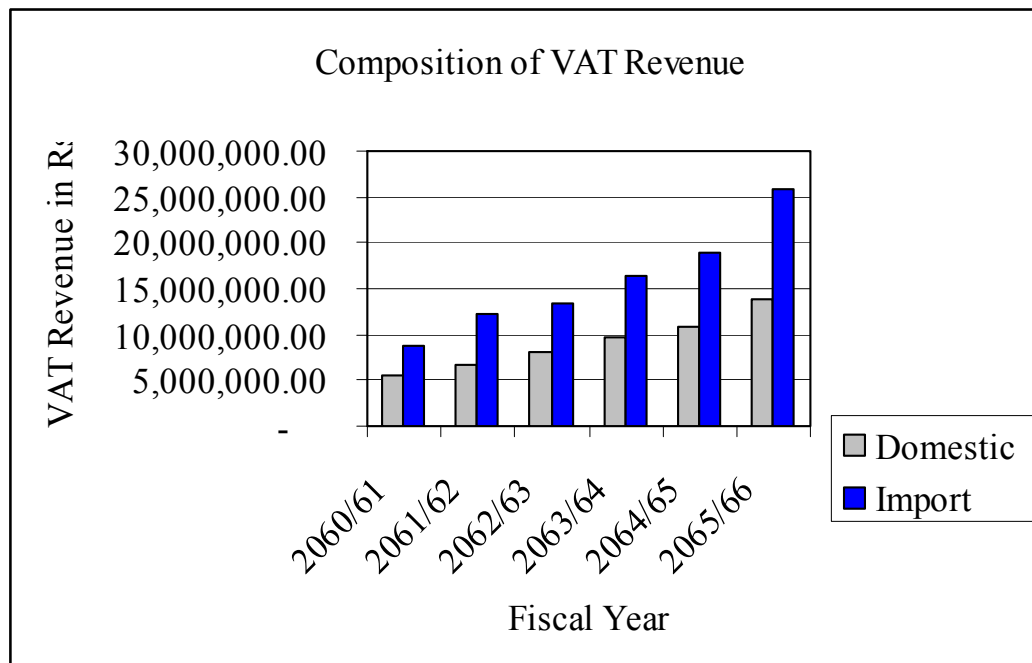


Figure 4.3 VAT Revenue from Domestic Product and Import

#### 4.1.3 Contribution of VAT on Total Revenue and Total Tax Revenue

VAT is the indirect tax system and no doubts in its possibilities to collect revenue compare to other tax system. VAT plays great role in the revenue mobilization in Nepal. The reason behind VAT system, it makes transparency in all kinds of transaction, helps to make the wide area of tax and discourages tax evasion. So it is needless to say that VAT is the most important sources of the government revenue in Nepal.

The contribution of VAT to total revenue is presented in below table.

(Rs in Thousand)

Year	Total Revenue	VAT Revenue	% of VAT to Total Revenue
2060/61	62,331,000.00	14,478,896.00	23.23
2061/62	70,122,700.00	18,885,400.00	26.93
2062/63	71,733,127.00	21,613,043.00	30.13
2063/64	87,711,208.00	26,095,599.00	29.75
2064/65	107,622,480.00	29,815,702.00	27.70
2065/66	143,474,489.00	39,700,921.00	27.67
Average Contribution			27.57

Table no. 4.4 Contribution of VAT to Total Revenue

Source: Inland Revenue Department (Annual Report 2064/65 and 2065/66)

As shown in above table no 4.4 it is observed that the VAT contributes higher revenue to the Total Revenue of Nepal. In FY 2060/61 the percentage of VAT to Total Revenue is 23.23% while it is in increasing trend and reached 30.13% in FY 2062/63. But after that the revenue from VAT is in decreasing trend. As shown in above table in FY 2063/64 it only 29.75% and 27.70% in FY 2064/65 and in FY 2065/66 it is decreased to 27.67 %. The average contribution is 27.57%. It is

observed that the government implementation on VAT is not in good progress. The above table can be presented in following figure;

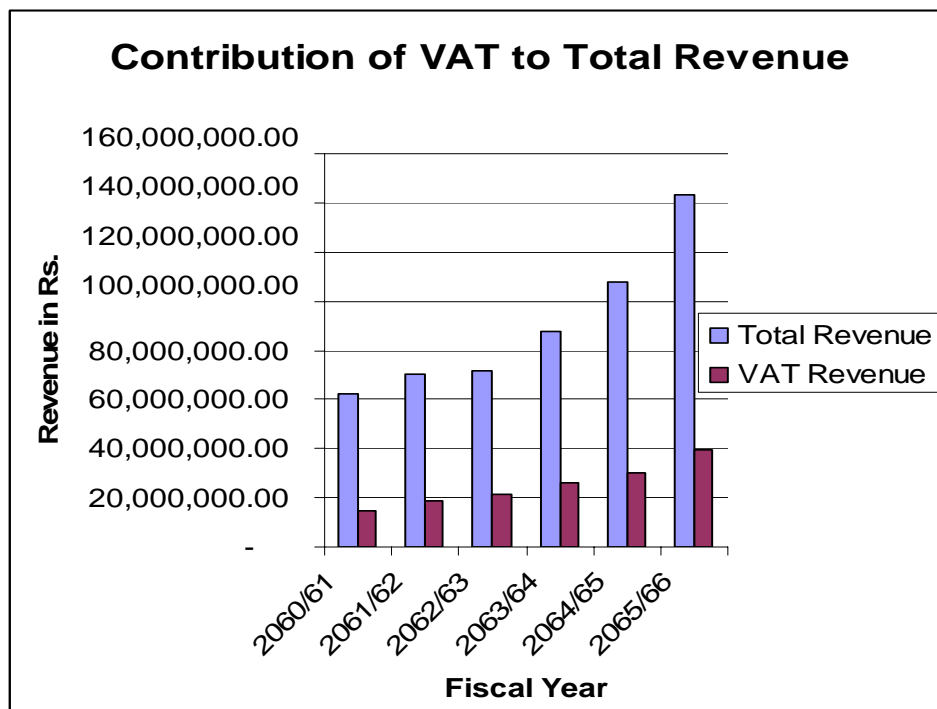


Figure no. 4.4 Contribution of VAT to Total Revenue

The contribution of VAT to Total Tax Revenue can be presented as follows:

(Rs in Thousand)

Year	Total Tax Revenue	VAT Revenue	% of VAT to Total Tax Revenue
2060/61	48,173,000.00	14,478,896.00	30.06
2061/62	54,104,700.00	18,885,400.00	34.91
2062/63	57,430,400.00	21,613,043.00	37.63
2063/64	71,127,000.00	26,095,599.00	36.69
2064/65	85,155,457.00	29,815,702.00	35.01
2065/66	117,051,906.00	39,700,921.00	33.92
	Average Contribution		34.70

Table no. 4.5 Contribution of VAT to total tax revenue

Source: Inland Revenue Department (Annual Report 2064/65 and 2065/66)

As shown in above table no 4.5 it is observed that the VAT contributes more revenue than other in total tax revenue. In the year 206/61 the contribution is 30.06% while it is increased to 34.91 % in the year 2061/62. And in the year 2061/63, 2063/64 and 2064/65 it is 37.63%, 36.69% and 35.01% respectively. In the year 2065/66 the contribution is 33.92%. it is clear that the from year 2060/61 to 2064/65 it is in increasing trend but in the year 2065/66 it is decreased and it contributes only 33.92% only. The average contribution is 34.70%. The above table can be presented in following figure to clarify the contribution.

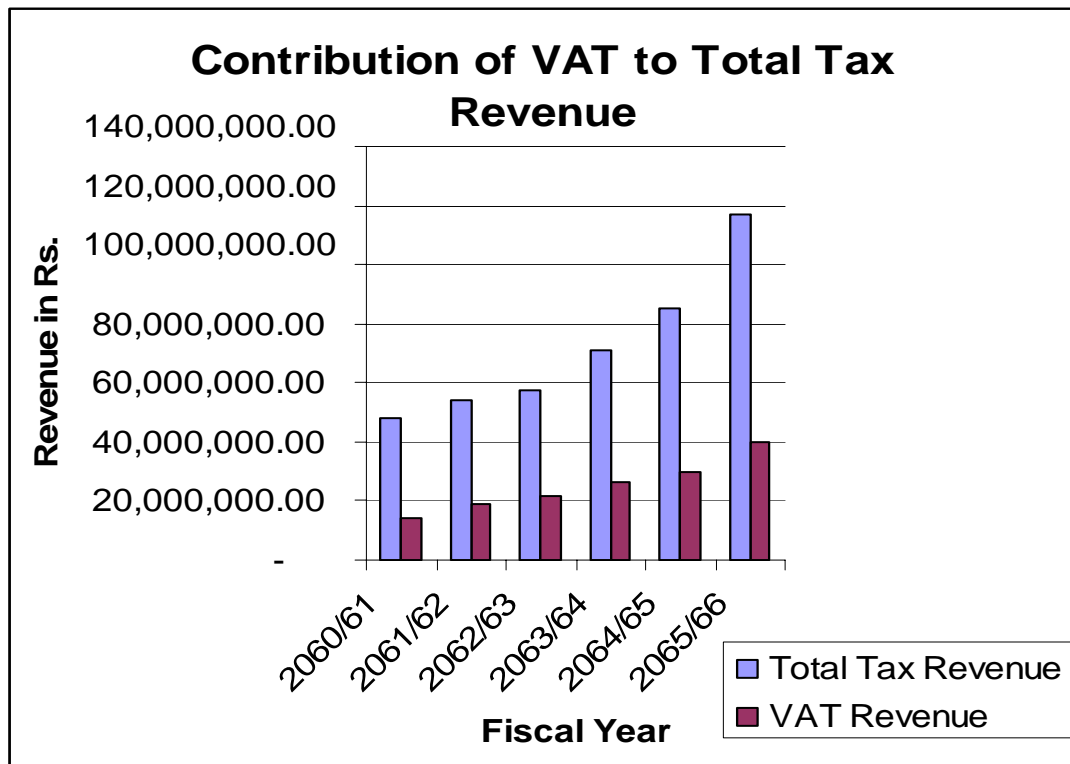


Figure no 4.5 Contribution of VAT to total tax revenue

#### 4.1.4 Contribution of VAT on Gross Domestic Product (GDP)

It is believe that successful implementation of VAT will helps to generate customs duties and income tax also and it is expected to enhance the revenue collection and it is closely associated with the GDP. The Contribution of VAT to GDP is shown in Table no. 4.6.

(Rs in Thousand)

<b>Year</b>	<b>Gross Domestic Product (GDP)</b>	<b>VAT Revenue</b>	<b>% of VAT to GDP</b>
2060/61	472,424,000.00	14,478,896.00	3.06
2061/62	504,101,000.00	18,885,400.00	3.75
2062/63	582,950,000.00	21,613,043.00	3.71
2063/64	670,588,700.00	26,095,599.00	3.89
2064/65	820,814,000.00	29,815,702.00	3.63
2065/66	960,012,000.00	39,700,921.00	4.14

Table no. 4.6 Contribution of VAT to GDP

Source: Inland Revenue Department (Annual Report 2064/65 and 2065/66)

From the above table no 4.6 in the contribution of VAT to GDP, it is clear that the contribution in the year 2060/61 is 3.06 %. The contribution on GDP is neither in increasing nor in decreasing trend. In the year 2061/62 contribution is 3.75%, in year 2062/63, 3.71 % in year 2063/64 it is 3.89 and 3.63 % in year 2064/65 and the contribution on GDP is 4.14 % in year 2065/66 which is higher. And lowest contribution is in year 3.06 % in year 2060/61. The following figure gives the clear picture of contribution of VAT to GDP.

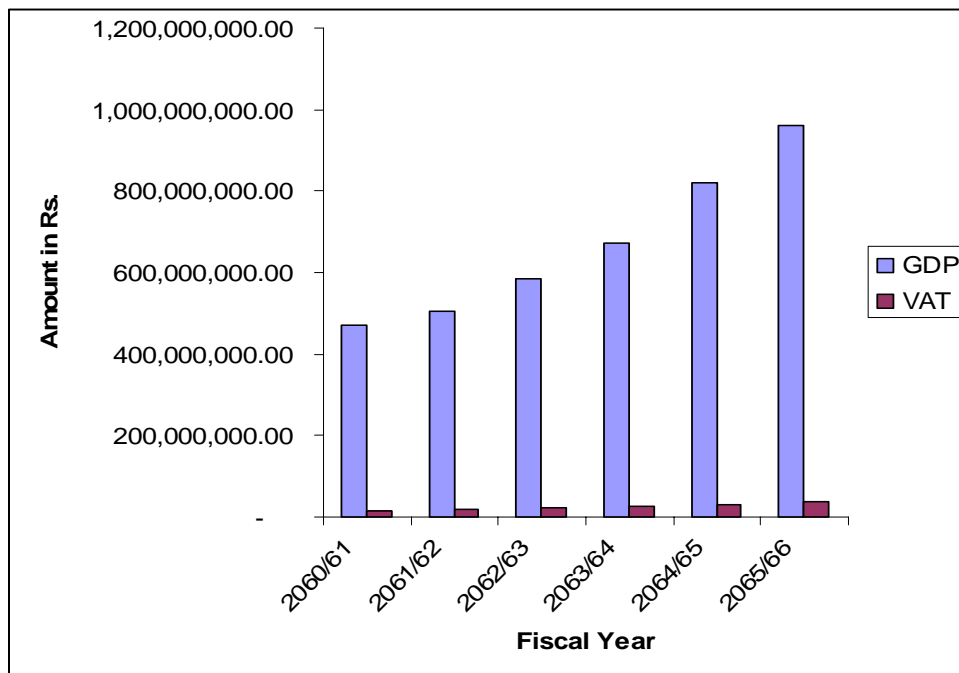


Figure no. 4.6 Contribution of VAT to GDP

#### 4.1.5 VAT collection: Budgeted Vs Actual

Government set the amount for VAT to be collected for the year previously. The VAT budgeted and actual collected can be shown in table no. 4.7.

(Rs. In thousand)

Year	Budgeted VAT Collection	Actual VAT Collection	% Achievement
2060/61	15,503,500.00	14,478,896.00	93.39
2061/62	16,950,000.00	18,885,400.00	111.42
2062/63	23,650,000.00	21,613,043.00	91.39
2063/64	26,463,000.00	26,095,599.00	98.61
2064/65	29,651,900.00	29,815,702.00	100.55
2065/66	41,000,000.00	39,700,921.00	96.83

Table no. 4.7 VAT Revenue Collection: Budgeted and Actual

Source: Inland Revenue Department (Annual Report 2064/65 and 2065/66)

From above table no 4.7 it is obvious that VAT achievement is 93.39% in FY 2060/61 and it is increased to 111.42% in FY 2061/62 i.e. government is able to collect more than the budgeted VAT. But for the FY 2062/63 it is 91.39% and 98.61% in FY 2063/64. And in FY 2064/65 government able to collect 100.55% of VAT as previously budgeted. But in FY 2065/66, government is able to collect only 96.83% of VAT. It can be shown in figure 4.19.

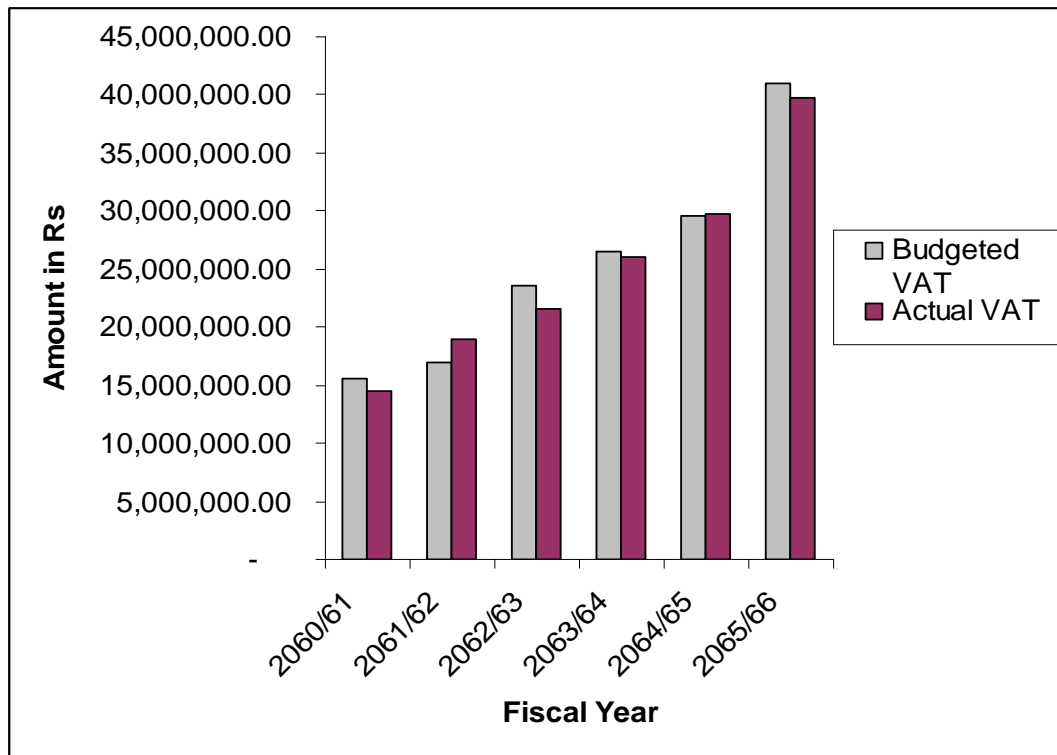


Figure no. 4.7 VAT Revenue Collection: Budgeted and Actual

#### 4.1.5.1 Karl Pearson's Coefficient of correlation (r)

In data analysis and examining activities, the estimated and actual data are comparatively fitted in various forms. The basic purpose of computing coefficient of correlation is to justify whether the data are significant for future activities or not and whether the actual data are fair from targeted data or not. So to find out the position of both targeted and actual data, we use this tool. The calculation is presented in following table.



<b>Year</b>	<b>Budgeted VAT Collection (Rs. In thousand)</b>	<b>Actual VAT Collection (Rs. In thousand)</b>
2060/61	15,503,500.00	14,478,896.00
2061/62	16,950,000.00	18,885,400.00
2062/63	23,650,000.00	21,613,043.00
2063/64	26,463,000.00	26,095,599.00
2064/65	29,651,900.00	29,815,702.00
2065/66	41,000,000.00	39,700,921.00
<b>Average( Mean)</b>	<b>25,536,400.00</b>	<b>25,098,260.17</b>
<b>Standard Deviation (S.D.)</b>	<b>9,325,906.98</b>	<b>8,944,315.64</b>
<b>Coefficient of Variation (C.V.)</b>	<b>36.52</b>	<b>35.64</b>
<b>Correlation Coefficient (<math>r_{xy}</math>)</b>	<b>0.99</b>	

As from the above table the correlation coefficient ( $r_{xy}$ ) is 0.99 i.e. near by +1. it denotes that there is perfect positive correlation between Budgeted and actual VAT revenue collection .

#### **4.1.5.2 Regression and Time Series Analysis**

Regression is the determination of statistical relationship between two or more variable. The regression used in the study determines the statistical relationship between independent variable X (i.e. Budgeted VAT collection) and dependent variable Y (i.e. actual VAT collection). The basic relationship between X and Y is given by  $Y_c = a + bx$

Where,  $Y_c$  denotes the estimated values of Y for given value of X.

Time series analysis shows the relationship between two variables, one being the time. It helps in understanding the past behavior of a variable in the time series. Further, it helps future forecasting and planning with the help of past and present data.

Regression analysis can be used to calculate the estimated for coming years. The regression line is presented in following way.

<b>Year (X)</b>	<b>X</b>	<b>Actual VAT Collection (Y)</b>	<b>(X) = X - <math>\bar{X}</math> ( 2062/63)</b>	<b>X<sup>2</sup></b>	<b>X*Y</b>
2060/61	1	14,478,896.00	(2.00)	4.00	57,915,584.00
2061/62	2	18,885,400.00	(1.00)	1.00	18,885,400.00
2062/63	3	21,613,043.00	-	-	-
2063/64	4	26,095,599.00	1.00	1.00	26,095,599.00
2064/65	5	29,815,702.00	2.00	4.00	119,262,808.00
2065/66	6	39,700,921.00	3.00	9.00	357,308,289.00
		$\Sigma Y =$ <b>150,589,561.00</b>	<b>3.00</b>	$\Sigma X^2$ <b>= 19.00</b>	$\Sigma XY =$ <b>579,467,680.00</b>

$$a = \frac{\sum Y}{n} = \frac{150589561}{6} = 25,098,260.17$$

$$b = \frac{\sum XY}{\sum x^2} = \frac{579467680}{19} = 8,262,451.26$$

The estimate revenue for the year 2066/67 is calculated as

$$Y_c = a + bx = 25,098,260.17 + 8,262,451.26 * 7 = 57,837,158.84$$

∴ The Estimated VAT revenue for 2066/67 will be Rs. 57,837,158.84 thousand

### **(B) Empirical Study: Analysis of Primary Data**

As we presented and analyzed the secondary data we know the position and implementation part of the VAT system in Nepal. For further study we have conducted interviews, questionnaire and group discussion with tax expert, businessmen and consumers about the VAT system. The empirical study i.e. the analysis and views of Business person, consumers and Tax experts about the

information and application of VAT, reaction towards VAT policy obstacles faced by them while paying and refunding VAT, feedback and wide performance analysis on VAT and Implementation part of VAT in Nepal. The title of each table represents its questionnaire respectively.

## **4.2 Level of Knowledge of VAT & Its application on Concern Parties**

### **4.2.1 Information & Application of VAT**

In the questionnaire we ask concern bodies about their knowledge of VAT that from which source they are informed either from government awareness program or media or from the business center. And whether they pay or take VAT bill or not i.e. the information of VAT application is also taken from the questionnaire. The answers from different bodies are presented in the following table

<b>Information of VAT (Source of Knowledge about VAT?)</b>					
<b>Responses</b>	<b>Respondents</b>				<b>%</b>
	Tax Officers/Experts	Businessmen	Consumers	Total	
Government Awareness Program	7	9	7	23	44.00
Media	8	4	11	23	44.00
Business Center	3	1	2	6	12.00
Total	18	14	20	52	100.00

Table no. 4.8 Source of Knowledge about VAT

From the above table 4.8 it is obvious that the concern parties of VAT will get information from different sources. 44% of them were told that they had knowledge from government awareness program, while another 44 % were say that they get knowledge from media and remaining 12% told that the get information from business center while they were go to buy some products.

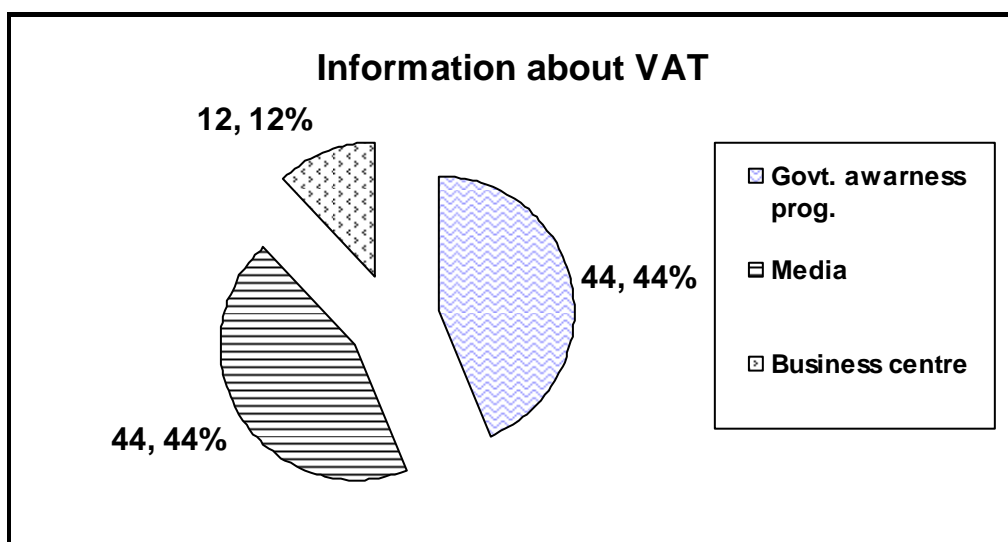


Figure no.4.8 Source of knowledge about VAT

Application of VAT (Do You Take VAT Bill on ever purchases?)					
Responses	Respondents			Total	%
	Tax Officers/Experts	Businessmen	Consumers		
YES	8	14	3	25	48.00
No	10	0	17	27	52.00
Total	18	14	20	52	100.00

Table no. 4.9 Taking of VAT bill on Purchases

From the table 4.9 on the question that Do you take VAT bill or not? In this sense the answer or views from different parties are as follows 48% of them said that they takes VAT bill on every purchase while 52% says that they do not take VAT bill. It is obvious that the no. of VAT bill takers is less than that of non bill taking. And from the above it is also obvious 10/18 of tax experts/officers said that they do not take VAT bill.

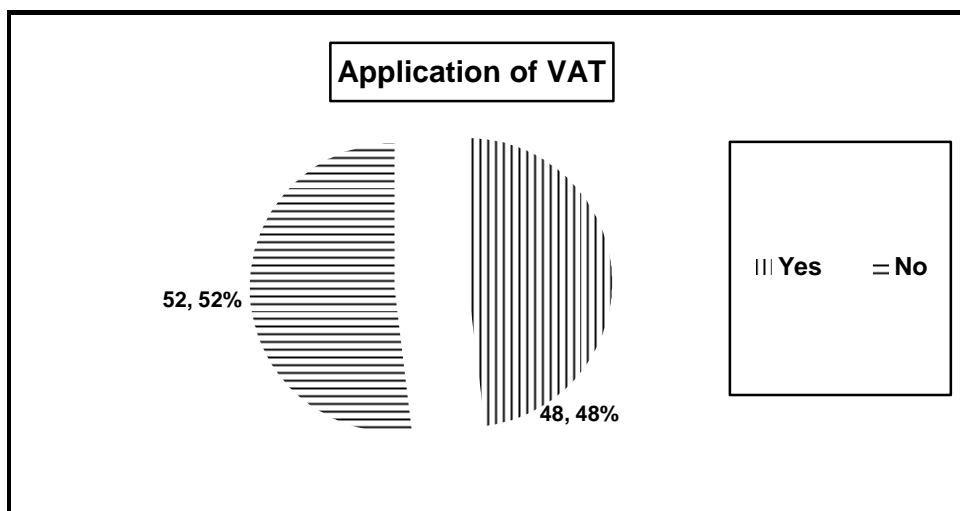


Figure no 4.9 Taking of VAT bill on Purchases

#### 4.2.2 Reaction towards VAT Policy

We seek answer from the concern bodies about the reaction towards the VAT policy and their response are presented in below table.

Reaction Towards Policy (Is VAT System results in Price rise?)					
Responses	Respondents				
	Tax Officers/Experts	Businessmen	Consumers	Total	%
YES	7	10	12	29	56.00
No	11	4	8	23	44.00
Total	18	14	20	52	100.00

Table no. 4.10 Is VAT system results in Price rise?

From the table no 4.10 it is clear that the 56 % thinks that VAT results in price rise while only 44 % think that it doesn't result in price rise. 7/11 of tax experts also argue that it results in price rise. And 10/14 of businessmen and 12/20 of consumer also thinks that the VAT system results in price rise. From the above table there is clear picture of concern parties thinking towards VAT system that it results in price rise.

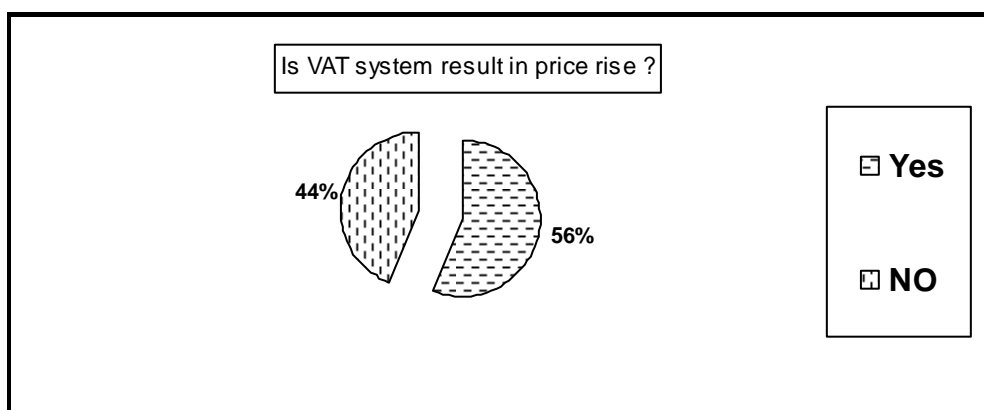


Figure no. 4.10 Is VAT system result in price rise?

Reaction Towards Policy (Is VAT Appropriate Tax System?)					
Responses	Respondents			Total	%
	Tax Officers/Experts	Businessmen	Consumers		
YES	14	7	12	33	63.00
No	4	7	8	19	37.00
Total	18	14	20	52	100.00

Table no 4.11 Is VAT appropriate Tax Systems?

We also questioned the concern parties about the VAT system that it is appropriate Tax system in Nepal or not and their answer is 63 % of them said that it is appropriate for developing country like Nepal. It helps in economic activities. Remaining 37 % said that the VAT is not appropriate Tax system for Nepal.

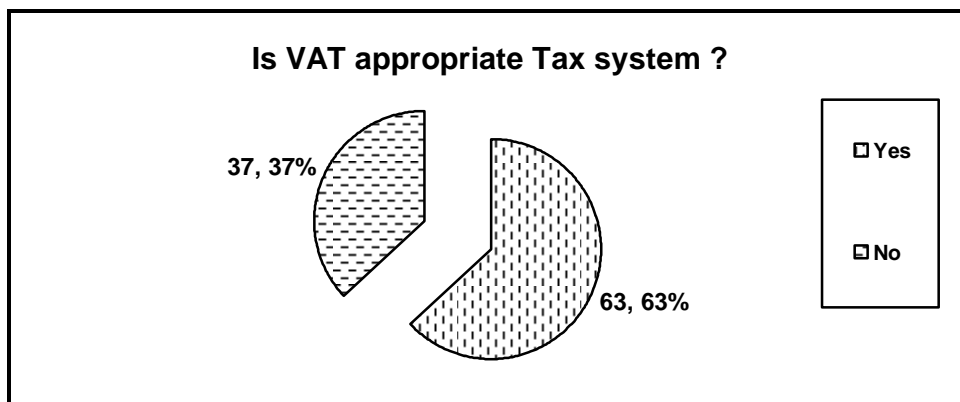


Figure no. 4.11 Is VAT appropriate Tax system?

### 4.3 Problems & Obstacles in Implementation of VAT in Society

#### 4.3.1 Obstacles

Obstacles (Customer Who Take VAT Bill)					
Responses	Respondents				
	Tax Officers/Experts	Businessmen	Consumers	Total	%
Less Than 30%	15	2	16	33	63.00
30 % To 60%	3	9	3	15	29.00
More Than 60%	0	3	1	4	8.00
Total	18	14	20	52	100.00

Table no. 4.12 Customer who takes VAT bill.

From the table no 4.12 we have information that the customer who takes VAT bill is less than 30% as the 63% of concern bodies answered. 29% of them said that the customer who takes VAT bill is 30% to 60%. And remaining 4% said that it is more than 60%. Now it is obvious that the customer who demand /takes VAT bill is less than 30% in Nepal. Now when the VAT bill is not taken by the customer then the VAT is not charged by the business person and government didn't get the revenue. But the businessmen must issue the VAT bill to the consumer.

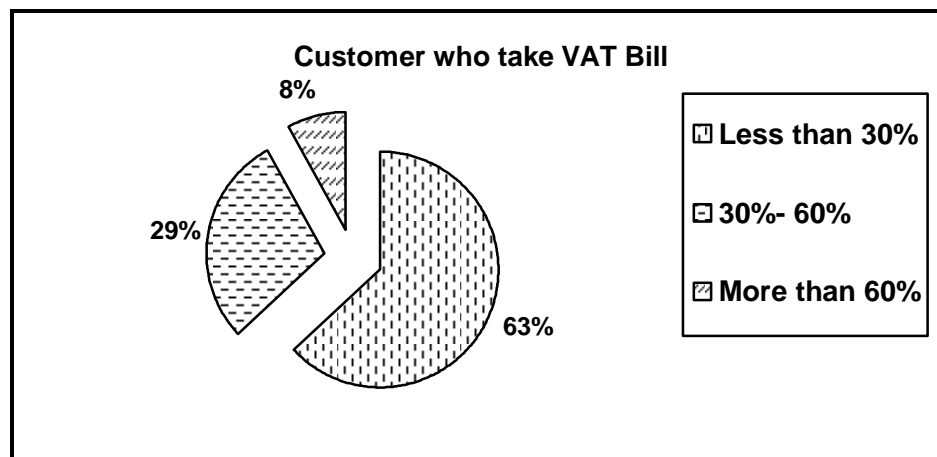


Figure no. 4.12 Customer who takes VAT bill.

<b>Obstacles (Is Threshold Limit is Enough to secure the small Businessmen?)</b>					
<b>Responses</b>	<b>Respondents</b>				
	Tax Officers/Experts	Businessmen	Consumers	Total	%
Yes	15	2	1	18	35.00
No	3	9	8	20	38.00
No Idea	0	3	11	14	27.00
Total	18	14	20	52	100.00

Table no. 4.13 Is Threshold Limit is enough to secure the small Businessmen?

From the above table no. 4.13 in the question related to small businessmen only 35% of them tell that current threshold limit is enough to secure the small businessmen. 38 % tells that it doesn't secure and 27% of them tell that they do not have idea about the threshold limit.

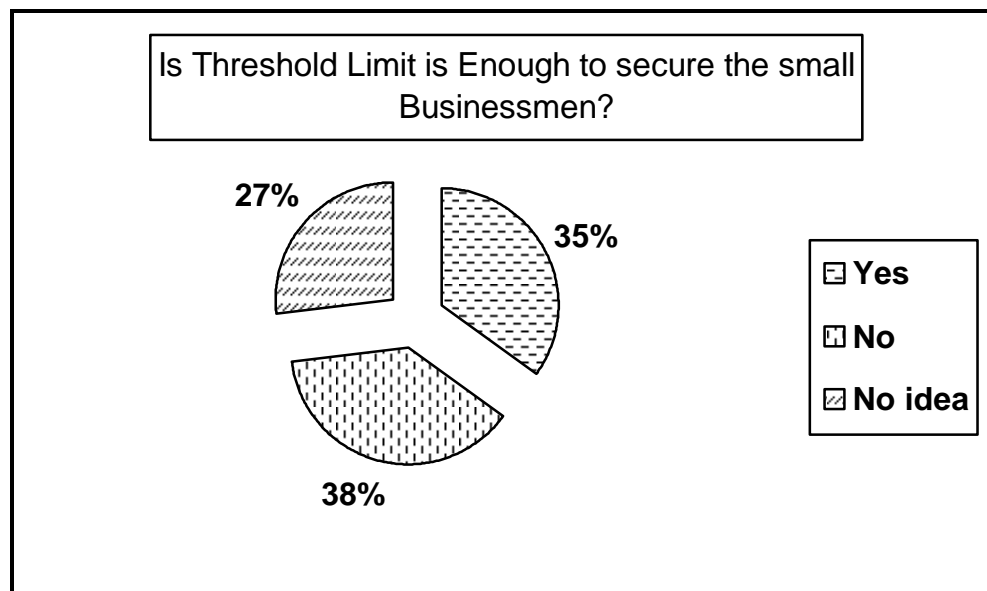


Figure no. 4.13 Is Threshold Limit is enough to secure the small Businessmen?



<b>Obstacles (Obstacles Faced with paying and refunding VAT?)</b>					
<b>Responses</b>	<b>Respondents</b>				
	Tax Officers/Experts	Businessmen	Consumers	Total	%
Positive Comments	2	0	2	4	8.00
Negative Comments	2	4	3	9	17.00
No Comments	14	10	15	39	75.00
Total	18	14	20	52	100.00

Table no. 4.14 Obstacles Faced with paying and refunding VAT

The obstacles faced by the concern bodies while paying and refunding VAT is presented in the above table no. 4.14. 8% of them say that have no any obstacles that they give positive comments regarding the obstacles while paying and refunding the VAT. But 17% of them tell that they have various problems regarding the same i.e. they gave negative comments on the above question. They said that process is very long for paying and refunding VAT. 75% of concern bodies do not gave comments on the above question means either they have no any problems or obstacles while paying and refunding the VAT.

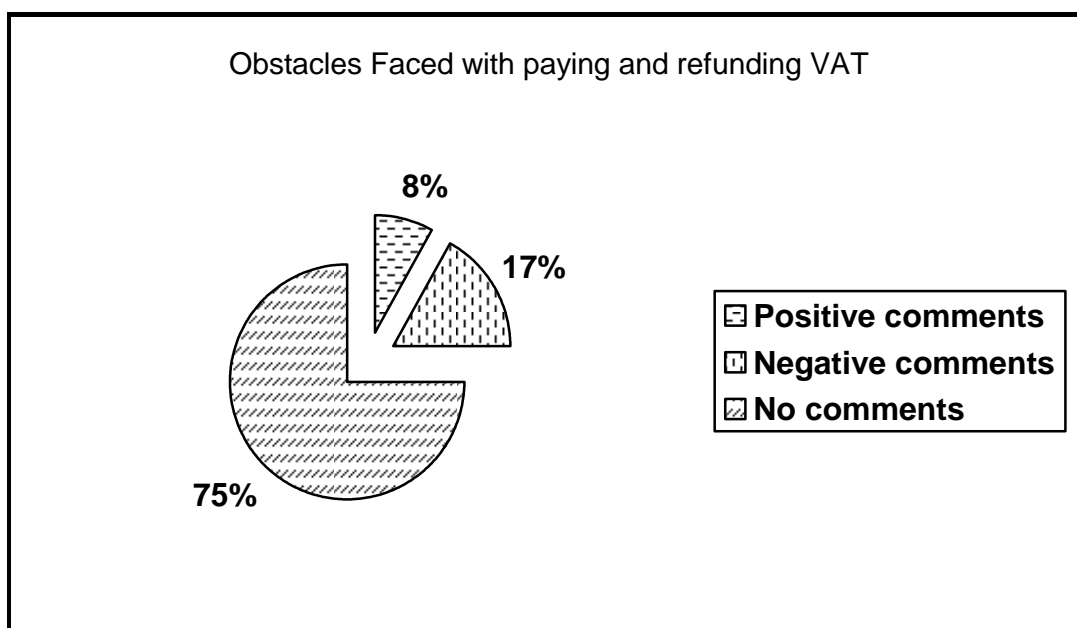


Figure no. 4.14 Obstacles Faced with paying and refunding VAT

#### 4.3.2 Governing Factor Analysis

<b>Governing Factor Analysis (Responsible factor of ineffective implementation of VAT in Nepal)</b>					
<b>Responses</b>	<b>Respondents</b>				
	Tax Officers/Experts	Businessmen	Consumers	Total	%
Lack of Consumer Awareness	2	1	4	7	13.00
Weakness of government action plan	3	2	6	11	21.00
Administrative inefficiency	0	1	2	3	6.00
Under Invoicing	0	0	0	0	0
Above All	13	10	8	31	60.00
No Idea	0	0	0	0	0
Total	18	14	20	52	100.00

Table no. 4.15 Responsible factor of ineffective implementation of VAT in Nepal

As we want to clarify the idea about the factors that are responsible for the ineffective implementation of VAT in Nepal the answer from the concern parties are 13% of were tell that the lack of consumer awareness is the main factor for ineffective implementation of VAT in Nepal while 11% tells that weakness of government action plan is the main factor and 3% tells that there is administrative inefficiency. But is notable that no one tell that the under invoicing is the factor fro ineffective implementation of VAT in Nepal. However, we all know that there is under invoicing problem and which creates obstacles in VAT collection. But 31 % of them highlight that the factor relating them are lack of consumer awareness program, lack of government action plan, administrative inefficiency and under invoicing means they all highlight all problem relating the ineffective implementation of VAT in Nepal.

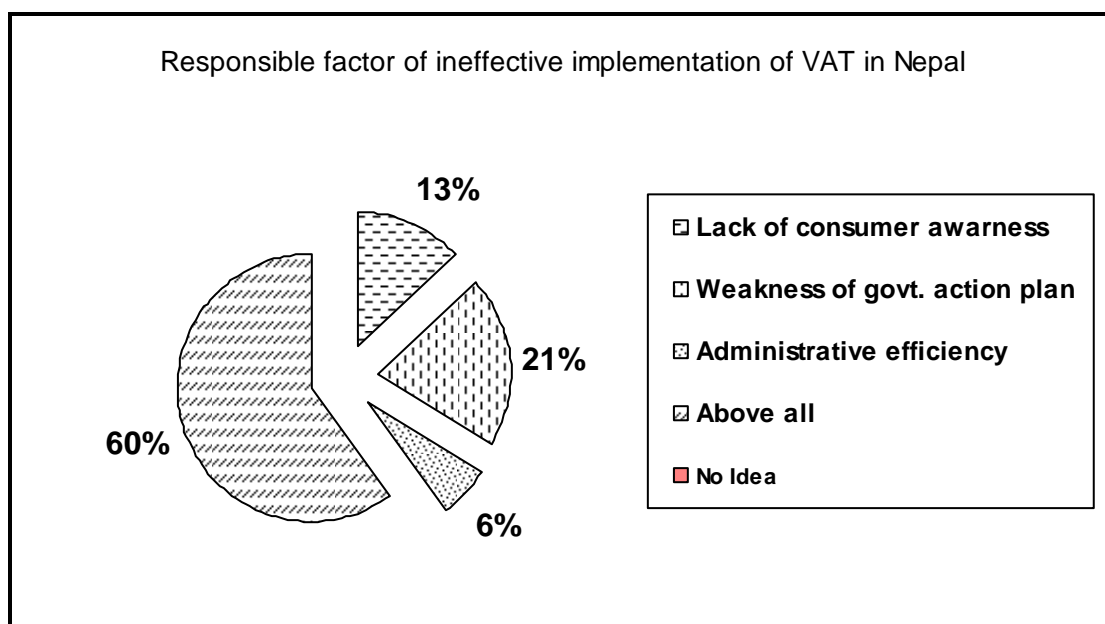


Figure no. 4.15 Responsible factor of ineffective implementation of VAT in Nepal

## 4.4 Suggestion measures for Effective Implementation reflected from Society

### 4.4.1 Wide Performance Analysis on VAT

Wide Performance Analysis on VAT (VAT replaced the Sales tax successfully?)					
Responses	Respondents				
	Tax Officers/Experts	Businessmen	Consumers	Total	%
Yes	7	4	5	16	31.00
No	8	8	7	23	44.00
No Idea	3	2	8	13	25.00
Total	18	14	20	52	100.00

Table no. 4.16 VAT replaced the Sales tax successfully

In the question is VAT replaced the Sales tax or not. From the table 4.16 it is clear that only 31% tell that it replaced the sales tax successfully and 44% tells that it doesn't while 25% of them tell that they do not have idea about the same as it replaced the Sales tax successfully or not.

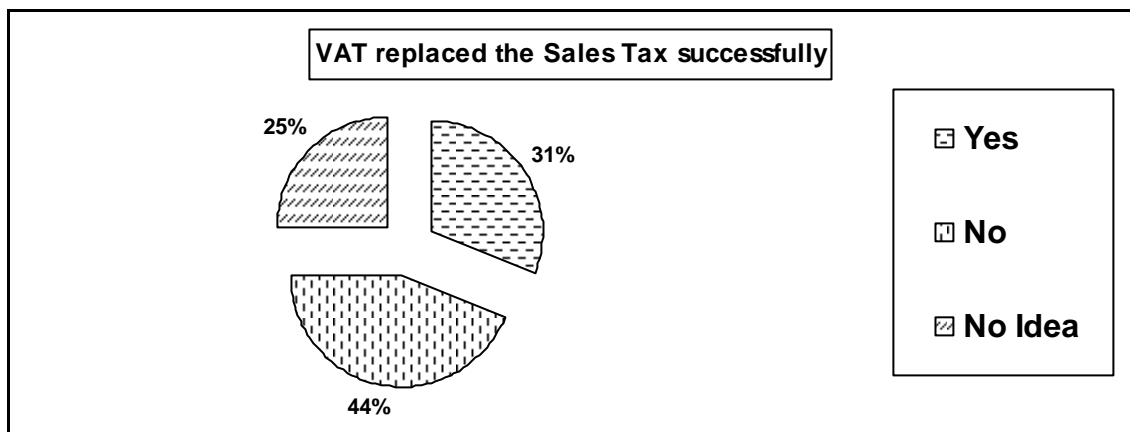


Figure no. 4.16 VAT replaced Sales Tax successfully

<b>Wide Performance Analysis on VAT (Is it suitable time to amend the VAT rate?)</b>					
<b>Responses</b>	<b>Respondents</b>				
	Tax Officers/Experts	Businessmen	Consumers	Total	%
Yes	9	0	11	20	38.00
No	5	6	7	18	35.00
No Idea	4	8	2	14	27.00
Total	18	14	20	52	100.00

Table no. 4.17 Is it suitable time to amend the VAT rate?

As we want to know that is VAT rate is need to be amended or not. 38% of concern parties tell that it is suitable time to amend the VAT rate in Nepal while 35% tells that there is no need of amendment in VAT rate while 27% tells that they have no idea about the same. Now it is remarkable that out of 18 tax experts 9 were i.e. 50% tell that it is time to amend the VAT rate. While only 5 out of 18 tax experts tell that there is no need to change in the VAT rate.

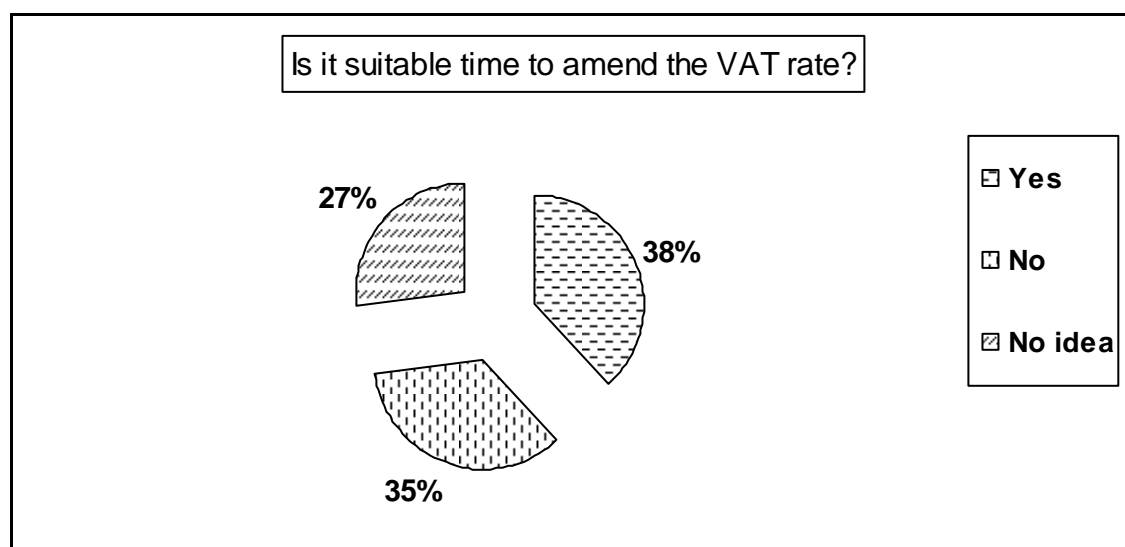


Figure no. 4.17 Is it suitable time to amend the VAT rate?

#### 4.4.2 Transactional Performance Analysis

Transactional Performance Analysis (Is Government successful to collect expected VAT?)					
Responses	Respondents				
	Tax Officers/Experts	Businessmen	Consumers	Total	%
Yes	2	3	1	6	12.00
No	9	5	12	26	50.00
In Progress	7	6	7	20	38.00
Total	18	14	20	52	100.00

Table no. 4.18 Is Government successful to collect expected VAT?

The transactional performance of the VAT is measured through the collection of VAT. From the table no. 4.18 only 12% tells that the government is successful to collect the expected VAT, 50 % of them were answered that the government is not able to collect expected VAT while 38% tells that government is in progress in collecting the VAT revenue.

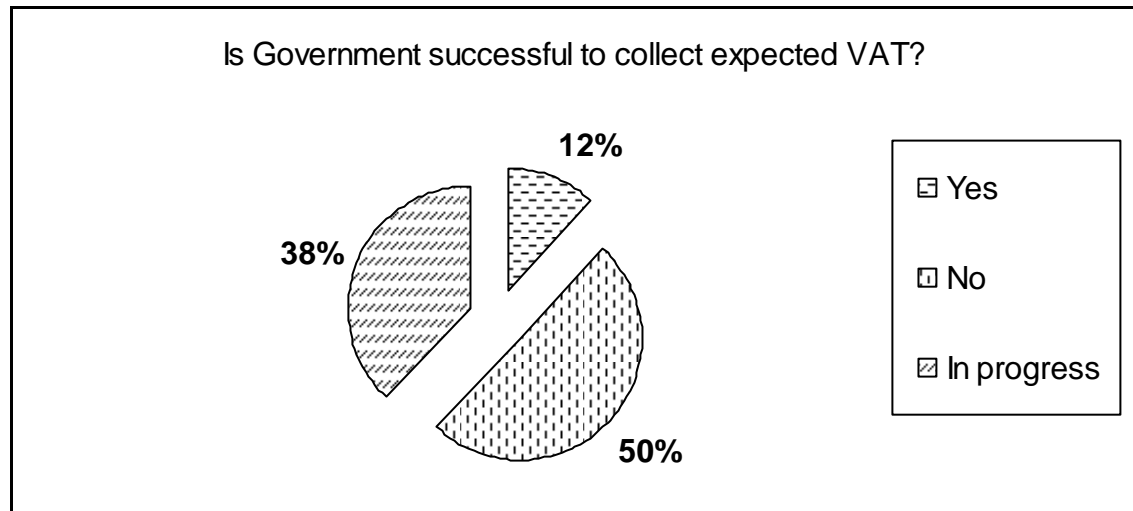


Figure no. 4.18 Is Government successful to collect expected VAT?

#### 4.4.3 Suggestion for improvements

<b>Suggestion for improvements (Do you have any comments on VAT?)</b>					
<b>Responses</b>	<b>Respondents</b>				
	Tax Officers/Experts	Businessmen	Consumers	Total	%
Positive Comments	8	2	7	17	33.00
Negative Comments	1	1	6	8	15.00
No Comments	9	11	7	27	52.00
Total	18	14	20	52	100.00

Table no. 4.19 Do you have any comments on VAT

While seeking the information regarding the comments on VAT system of Nepal we have results as shown in above table no 4.19. 33% of them said positive comments while 15% have given negative comments and 52% do not gave any comments on the VAT system of Nepal.

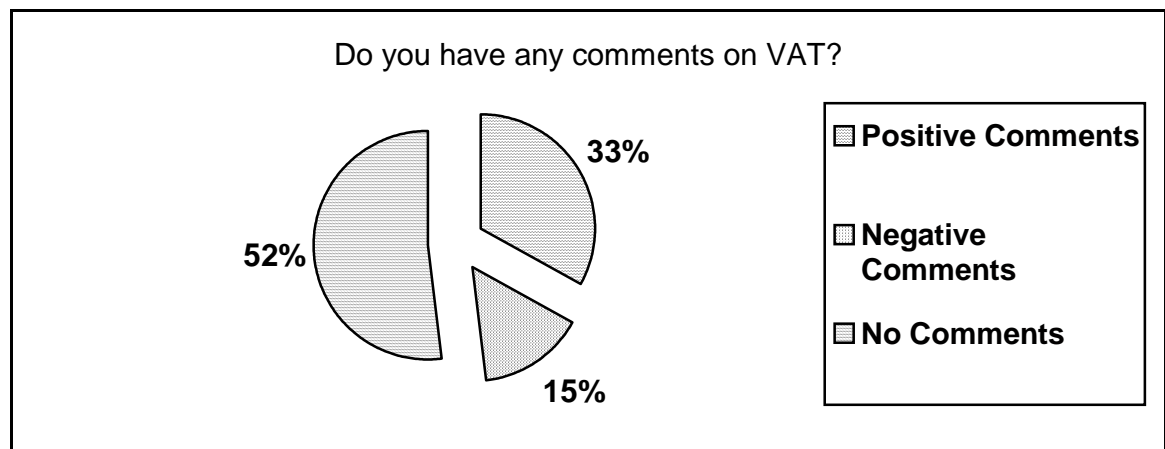


Figure no. 4.19 Do you have any comments on VAT?

With related to positive comments they told that the VAT system is very remarkable and good tax system for developing country like Nepal. It generates more revenue to the governments. That it helps in GDP. But in the negative comments there are various points they have given like: lack of consumer awareness program, duplicate billing system, corrupted governments authority, unstable government plan and policies, one of them tell about VAT system that “A good vehicle with wrong driver” means there is problem in implementation part. So, we must go ahead with action plan and implement effectively.

## **4.5 Major Findings of the Study**

### **4.5.1 Findings from the Secondary Data**

- The numbers of taxpayers are increasing year by year in FY 2060/61 the total no. of VAT registrants was 34,174. The no. of VAT registrants increased and reached 39,776 in FY 2061/62, 46,831 in FY 2062/63, 53,072 in FY 2063/64, in 2064/65 the no. of VAT registrants was 59,707. At the end of Year 2065/66 the total no. of VAT registrants is 69,653. It is found that the VAT registrants were increasing year by year i.e. in increasing trend. The increasing rate in FY 2060/61 is 14.10% while in Year 2065/66 it 16.66%. From the year 2060/61 to 2062/63 the VAT registrants no. is in increasing trend while from year 2063//64 and 2064/65 it is in decreasing trend. It is also found that the in the above table in the year 2062/63 the increasing rate of VAT registrants is high i.e. 17.74%.
- It is found that the revenue from VAT in Nepal is increasing day by day. In year 2060/61 the total amount of VAT revenue is 14,478,896.00, which increased by 30.43 % in 2061/62 and reached 18,885,400.00. it is also analyzed that in FY 2062/63 and 2063/64 the revenue is in decreasing trend but in FY 2065/66 the increasing rate 33.15% and revenue increased and reached the 39,700,921.00. The average growth rate is 20.06 %



- It is clear that the more VAT is generated from Imports. The ratio of domestic and import is 39:61 in FY 2060/61 while in FY 2065/66 it is 35:65. The following figure gives the clear view of composition of VAT revenue.
- It is observed that the VAT contributes higher revenue to the Total Revenue of Nepal. In FY 2060/61 the percentage of VAT to Total Revenue is 23.23% while it is in increasing trend and reached 30.13% in FY 2062/63. But after that the revenue from VAT is in decreasing trend. As shown in above table in FY 2063/64 it only 29.75% and 27.70% in FY 2064/65 and in FY 2065/66 it is decreased to 27.67 %. The average contribution is 27.57%. It is observed that the government implementation on VAT is not in good progress.
- It is observed that the VAT contributes more revenue than other in total tax revenue. In the year 206/61 the contribution is 30.06% while it is increased to 34.91 % in the year 2061/62. And in the year 2061/63, 2063/64 and 2064/65 it is 37.63%, 36.69% and 35.01% respectively. In the year 2065/66 the contribution is 33.92%. it is clear that the from year 2060/61 to 2064/65 it is in increasing trend but in the year 2065/66 it is decreased and it contributes only 33.92% only. The average contribution is 34.70%. The above table can be presented in following figure to clarify the contribution.
- In the contribution of VAT to GDP, it is clear that the contribution in the year 2060/61 is 3.06 %. The contribution on GDP is neither in increasing nor in decreasing trend. In the year 2061/62 contribution is 3.75%, in year 2062/63, 3.71 % in year 2063/64 it is 3.89 and 3.63 % in year 2064/65 and the contribution on GDP is 4.14 % in year 2065/66 which is higher. And lowest contribution is in year 3.06 % in year 2060/61. The following figure gives the clear picture of contribution of VAT to GDP.
- It is obvious that VAT achievement is 93.39% in FY 2060.61 and it is increased to 111.42% in FY 2061/62 i.e. government is able to collect more than the

budgeted VAT. But for the FY 2062/63 it is 91.39% and 98.61% in FY 2063/64. And in FY 2064/65 government able to collect 100.55% of VAT as previously budgeted. But in FY 2065/66, government is able to collect only 96.83% of VAT.

#### **4.5.2 Findings from the Primary Data**

As we presented and analyzed the secondary data we know the position and implementation part of the VAT system in Nepal. For further study we have conducted interviews, questionnaire and group discussion with tax expert, businessmen and consumers about the VAT system. The empirical study i.e. the analysis and views of Business person, consumers and Tax experts about the information and application of VAT, reaction towards VAT policy obstacles faced by them while paying and refunding VAT, feedback and wide performance analysis on VAT and Implementation part of VAT in Nepal. The title of each table represents its questionnaire respectively.

- It is obvious that the concern parties of VAT will get information from different sources. 44% of them were told that they had knowledge from government awareness program, while another 44 % were say that they get knowledge from media and remaining 12% told that the get information from business center while they were go to buy some products.
- On the question that Do you take VAT bill or not? In this sense the answer or views from different parties are as follows 48% of them said that they takes VAT bill on every purchase while 52% says that they do not take VAT bill. It is obvious that the no. of VAT bill takers is less than that of non bill taking. And from the above it is also obvious 10/18 of tax experts/officers said that they do not take VAT bill.
- It is clear that the 56 % thinks that VAT results in price rise while only 44 % think that it doesn't result in price rise. 7/11 of tax experts also argue that it results in price rise. And 10/14 of businessmen and 12/20 of consumer also thinks that the VAT system results in price rise. From the above table

there is clear picture of concern parties thinking towards VAT system that it results in price rise.

- We also questioned the concern parties about the VAT system that it is appropriate Tax system in Nepal or not and their answer is 63 % of them said that it is appropriate for developing country like Nepal. It helps in economic activities. Remaining 37 % said that the VAT is not appropriate Tax system for Nepal.
- We have information that the customer who takes VAT bill is less than 30% as the 63% of concern bodies answered. 29% of them said that the customer who takes VAT bill is 30% to 60%. And remaining 4% said that it is more than 60%. Now it is obvious that the customer who demand /takes VAT bill is less than 30% in Nepal. Now when the VAT bill is not taken by the customer then the VAT is not charged by the business person and government didn't get the revenue. But the businessmen must issue the VAT bill to the consumer.
- In the question related to small businessmen only 35% of them tell that current threshold limit is enough to secure the small businessmen. 38 % tells that it doesn't secure and 27% of them tell that they do not have idea about the threshold limit.
- The obstacles faced by the concern bodies while paying and refunding VAT is presented in the above table no. 4.7. 8% of them say that have no any obstacles that they give positive comments regarding the obstacles while paying and refunding the VAT. But 17% of them tell that they have various problems regarding the same i.e. they gave negative comments on the above question. They said that process is very long for paying and refunding VAT. 75% of concern bodies do not gave comments on the above question means either they have no any problems or obstacles while paying and refunding the VAT.

- As we want to clarify the idea about the factors that are responsible for the ineffective implementation of VAT in Nepal the answer from the concern parties are 13% of were tell that the lack of consumer awareness is the main factor for ineffective implementation of VAT in Nepal while 11% tells that weakness of government action plan is the main factor and 3% tells that there is administrative inefficiency. But is notable that no one tell that the under invoicing is the factor fro ineffective implementation of VAT in Nepal. However, we all know that there is under invoicing problem and which creates obstacles in VAT collection. But 31 % of them highlight that the factor relating them are lack of consumer awareness program, lack of government action plan, administrative inefficiency and under invoicing means they all highlight all problem relating the ineffective implementation of VAT in Nepal.
- In the question is VAT replaced the Sales tax or not. It is clear that only 31% tell that it replaced the sales tax successfully and 44% tells that it doesn't while 25% of them tell that the do not have idea about the same as it replaced the Sales tax successfully or not.
- As we want to know that is VAT rate is need to be amended or not. 38% of concern parties tell that it is suitable time to amend the VAT rate in Nepal while 35% tells that there is no need of amendment in VAT rate while 27% tells that they have no idea about the same. Now it is remarkable that out of 18 tax experts 9 were i.e. 50% tell that it is time to amend the VAT rate. While only 5 out of 18 tax experts tell that there is no need to change in the VAT rate.
- The transactional performance of the VAT is measured through the collection of VAT. From the table no. 4.18 only 12% tells that the government is successful to collect the expected VAT, 50 % of them were answered that the government is not able to collect expected VAT while 38% tells that government is in progress in collecting the VAT revenue.

- While seeking the information regarding the comments on VAT system of Nepal we have results as 33% of them said positive comments while 15% have given negative comments and 52% do not gave any comments on the VAT system of Nepal. With related to positive comments they told that the VAT system is very remarkable and good tax system for developing country like Nepal. It generates more revenue to the governments. That it helps in GDP. But in the negative comments there are various points they have given like: lack of consumer awareness program, duplicate billing system, corrupted governments authority, unstable government plan and policies, one of them tell about VAT system that “A good vehicle with wrong driver” means there is problem in implementation part. So, we must go ahead with action plan and implement effectively.

## **CHAPTER FIVE**

### **SUMMARY CONCLUSION AND RECOMMENDATION**

#### **5.1 Summary**

Value Added Tax, popularly known as 'VAT', is a special type of indirect tax in which a sum of money is levied at a particular stage in the sale of a product or service. In 1954, the value added tax system was initiated by the then joint director of the tax authority of France, Maurice Laure. VAT came into effect on the first time on 10th April, 1954.

VAT applies to supplies of goods and services for consideration other than exempt goods by taxable person. VAT shall be charge on any supply of goods or services. VAT is a tax on trading transaction. The real VAT payer is the consumer not the producer. In Nepal, Value Added Tax Act was enacted by 1995 and started to implement only at 16 Nov. 1997. Value Added Tax Act replaced four - different Tax Act, such as Sales Tax Act, Hotel Tax Act, Contract Tax Act and Entertainment Tax Act. The sales tax has been reformed to VAT. There is a flat VAT rate of 13% in Nepal. It is a modern tax system which enables to efficient collection system, to increase efficiency and to reduce tax evasion. It is also refereed as the backbone of income tax system in Nepal

Nepal has different kinds of problem, constraints and challenges in the all sectors of VAT implementation such as administrative, political, geographical, social, and economic and others. Because of these reasons Nepal has not achieved a satisfactory level of the economic growth. VAT is considered to be the best fiscal tool; practically it is also proved that it has many short comings. VAT influences the level of economic activities and other variables like price, wages, foreign trade etc directly or indirectly.

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

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

It is found that the concern bodies do not have clear concept about the VAT. They do not take VAT bills. There is also problem with paying and refunding of VAT. The concern bodies said that the process of paying and refunding of VAT is too long. Lack of consumer, Awareness Weakness of government action plan, Administrative inefficiency and under invoicing is the main factor for ineffective implementation of VAT. From the table no 4.2 it is found that the revenue from VAT in Nepal is increasing day by day. In year 2060/61 the total amount of VAT revenue is 14,478,896.00 which increased by 30.43 % in 2061/62 and reached 18,885,400.00. it is also analyzed that in FY 2062/63 and 2063/64 the revenue is in decreasing trend but in FY 2065/66 the increasing rate 33.15% and revenue increased and reached the 39,700,921.00. The average growth rate is 20.06 %

We ask concern bodies about their knowledge of VAT that from which source they are informed either from government awareness program or media or from the business center. And whether they pay or take VAT bill or not i.e. the information of VAT application is also taken from the questionnaire.

While seeking the information regarding the comments on VAT system of Nepal we have results as shown in table no 4.19. 33% of them said positive comments while 15% have given negative comments and 52% do not gave any comments on the VAT system of Nepal. With related to positive comments they told that the VAT system is very remarkable and good tax system for developing country like Nepal. It generates more revenue to the governments. That it helps in GDP. But in the negative comments there are various points they have given like: lack of consumer awareness program, duplicate billing system, corrupted governments authority, unstable government plan and policies, one of them tell about VAT system that “good vehicle with wrong driver”.

## **5.2 Conclusion**

In Nepal, Value Added Tax Act was enacted by 1995 and started to implement only at 16 Nov. 1997. Value Added Tax (VAT) Act replaced four - different Tax Act, such as Sales Tax Act, Hotel Tax Act, Contract Tax Act and Entertainment Tax Act. The sales tax has been reformed to VAT. There is a flat VAT rate of 13% in Nepal. It is a modern tax system which enables to efficient collection system, to increase efficiency and to reduce tax evasion. It is also refereed as the backbone of income tax system in Nepal.

It is believe that successful implementation of VAT will helps to generate customs duties and income tax also and it is expected to enhance the revenue collection and it is closely associated with the GDP. This Act classifies goods and services under three category they are VAT able goods and services, exempted goods and services and zero rated goods and services. It is applied at a single rate (presently



13%, initially 10%) based on addition of value of the goods and services at each stage in the process of supply and delivery of goods and services. Implementation of VAT was not easy in the initial days. It was a matter of great debate. Even after the enactment of law, there were a lot of constraints and difficulties in introducing and implementing VAT in Nepal. A large number of entrepreneurs, traders and business communities were against VAT system. The initial two year of VAT implementation was very turbulent. Now it has become familiar and VAT is currently well receipted by the consumers as well as business and industrial communities of Nepal. This is account based tax system that leads to transparency and accountability on the both part of tax payers and tax collectors. Since then second amendment have already been made on Value Added Tax Act, 1995, and 8<sup>th</sup> amendment have been made in the Value Added Tax Rules, 1997. Various directives have been issued by the concerned authority to implement the VAT in Nepal.

The success and effectiveness of VAT in Nepal depends upon its strong enough capability fro an effective operation. And VAT administration is responsible for it. It is responsible for the execution of the program work assessment, taxpayer's education, registration, assessment, collection and verification of taxpayer's book and records. The grater preparation is needed to increase implementing capability of administration. The present VAT administration may be simplified into two functional head as department and offices. So, department and field officers under this department and officers under this department are responsible for administrating VAT. In absence of technical component, honest and dedicated administration the expected smooth working of a VAT becomes rally a myth and fully VAT advantage can't be achieved.

An argument often used against the introduction of VAT is the weakness of the tax administration. This is a valid concern. VAT performance would be poor under

a weak administration. However, if a tax administration is weak, its strengthening is a priority regardless of what taxes the country has in place. At present Nepal has not adequate number of efficient manpower. Qualified, well-trained and competent manpower is necessary to investigate and the audit of the business transactions for tax purpose. VAT system requires extra skill and knowledge especially for investigation and auditing. But the present manpower proves inefficient for handling VAT in Nepal. Failure to detect false records and invoices, high claim of tax credit and detect over refunding are the major weakness of VAT administration. VAT administration is still weak and less attractive for the personnel. Most of the officers engaged in the VAT administration are not motivated. Due to lack of motivation many officials are not actively engaged in the implementation of VAT effectively.

Nepal has different kinds of problem, constraints and challenges in the all sectors of VAT implementation such as administrative, political, geographical, social, and economic and others. Because of these reasons Nepal has not achieved a satisfactory level of the economic growth. VAT is considered to be the best fiscal tool; practically it is also proved that it has many short comings. VAT influences the level of economic activities and other variables like price, wages, foreign trade etc directly or indirectly.

As already discussed, VAT in terms of revenue raised by it cannot be termed successful. The reasons behind this may be numerous including the conflict situation in the country. The following major problems are worth noting: Lack of enforcement spirit in administration, Lack of taxpayer monitoring by tax administration, Single rate which is high for basic goods and services. It is advantageous too to tax evaders both in not depositing collected tax and evading the tax., Threshold problem which is working as the shield to bring all the tax payers in the tax net., Exemption problem which is helping as the shield to hide

the transaction of taxable goods and making the tax net small., Billing problem, the major one which has barred to make VAT a total success., Customs valuation problem which is working as the starting point of under invoicing of the goods.

The problem of compliance and prevent evasion in the VAT remain the same. The administration has not given success attention toward the development of good information system, technical database inspection and auditing system. Thus tax investigating and audit should be effective in order to make taxpayer more careful in fulfilling their duties. VAT administration is still weak and less attractive for the personnel. Most of the officers engaged in the VAT administration are not motivated. Due to lack of motivation many officials are not actively engaged in the implementation of VAT effectively.

It is found that the concern bodies do not have clear concept about the VAT. They do not take VAT bills. There is also problem with paying and refunding of VAT. The concern bodies said that the process of paying and refunding of VAT is too long. Lack of consumer, Awareness Weakness of government action plan, Administrative inefficiency and under invoicing is the main factor for ineffective implementation of VAT. In the table no 4.2 it is found that the revenue from VAT in Nepal is increasing day by day. In year 2060/61 the total amount of VAT revenue is 14,478,896.00 which increased by 30.43 % in 2061/62 and reached 18,885,400.00. it is also analyzed that in FY 2062/63 and 2063/64 the revenue is in decreasing trend but in FY 2065/66 the increasing rate 33.15% and revenue increased and reached the 39,700,921.00. The average growth rate is 20.06 %.

### **5.3 Recommendations**

The following are the some major recommendations of this study:

- It is found that the concern bodies do not have clear concept about the VAT. So it is necessary to lunch the consumer awareness program to give ideas about various aspect of VAT to the existing and potential tax payers.
- VAT is important for domestic resource mobilization in Nepal. At present, there is unfavorable business environment. VAT in Nepal should be designed and implemented in such a way that it may work fully with available administration under the present business environment.
- The billing system should be made compulsory in business transaction and effectively monitored.
- Research and investigation should be conducted on various issues of VAT such as effect of VAT on prices, investment and economic growth.
- The administration should be watchful to discourage any kind of malpractice, fraud, evasion and avoidance of tax. Reward and punishment system must be strictly followed according to performance.
- Most of concern peoples are unaware about VAT. So, VAT related information should be published regularly through journals, magazines, newspapers, radios and televisions.
- During the study period, the views are collected which showed monitoring system in the VAT is not so effective e so that the taxpayers are encouraged for tax evading practice. Many businessmen don't issue invoices and most of others issues improper invoices i.e. duplicate invoices. So, this system should be checked through an effective monitoring system.

- Threshold and tax refund are two possible ways for tax evasion. An effective tax auditing, investigation and monitoring system should be developed.
- Refund system should be made simple and effective and the period of such refund should be minimized.

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## **Appendix –I**

### **EXEMPT GOODS AND SERVICES**

#### **Group 1**

##### **Basic Agricultural Products**

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

#### **Group 2**

##### **Goods of Basic Necessity**

- (a) Unprocessed mustard oil
- (b) Drinking water supplied openly by tankers and taps
- (c) Fuel wood and charcoal
- (d) Kerosene (apart from aviation fuel)
- (e) Salt

#### **Group 3**

##### **Livestock and their Products**

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

- (b) Cows, buffaloes, lambs, and their fresh milk (including pasteurized milk) and yogurt.
- (c) Ducks, cocks and hens, turkeys, partridges and similar fowl and their fresh meat, other unprocessed varieties, and eggs.
- (d) Fresh or dried meat (unpacked)

#### **Group 4**

##### **Agriculture Related Products and Equipment**

- (a) The seeds of crops and plants listed in Group 1
- (b) Fertilizers, chemical fertilizers, and products used for treating the soil
- (c) General equipment used for agricultural work
  - a. Hand equipment used for digging or cleaning the soil and for cutting wood, twigs, etc (apart from hand saws)
  - b. Small hand equipment used for separating the grains and cleaning the husk (dehuskers)
  - c. Hand equipment used for cutting animal fodder and the plough
- (d) Chemical pesticides used exclusively or primarily in crops
- (e) The following items used in agricultural work
  - Tractor
  - Cultivator
  - *Hairo*
  - Leveler
  - Equipment used for cutting animal fodder
  - Thresher
  - Fishing net
  - Readymade cages to keep fish
  - Fish incubator
  - Pumping pipe of up to 8 horsepower and its hose pipe of up to 30 meters
- (f) The utensil in which hens are given drinking water, the box in which chick lets are kept.

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

### **Group 5**

#### **Medicines, Medical Treatment and other Health Services**

- (a) Surgical and medical services provided by Government owned health organizations
- (b) Human blood, ingredients contained in the human blood, and vaccines
- (c) Human and animal parts and tissues used in medical research
- (d) Medicines used for treating animals and people and family planning products
- (e) Equipment/material made for and solely appropriate for use by the disabled
- (f) X-ray films and oxygen gas used for medical treatment
- (g) Medical raw materials imported or bought by a medicine industry as per the limit specified by the Department of Drug Management

### **Group 6**

#### **Education**

- (a) Research work carried out in schools and universities
- (b) Commercial or professional training courses and refresher training courses organized without profit motive
- (c) Educational services provided by schools and universities

### **Group 7**

#### **Books, Newspapers, Printed Material, and Printing and Publishing**

- (a) Books, newspapers, magazines, and periodic publications
- (b) Newsprint paper

### **Group 8**

#### **Culture, Arts and Craftsmanship Related Services**

- (a) Fine arts, sculpture, architecture and similar handicrafts and related services
- (b) Cultural programs
- (c) Entry fees to libraries, museums, art museums, zoos and botanical gardens (national parks)

## **Group 9**

### **Passenger Transport and Goods Transportation Services**

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

## **Group 10**

### **Commercial or Professional Services**

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

## **Group 11**

### **Miscellaneous Goods and Services**

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

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

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

- Postal stamps

(2) Financial and insurance services

(3) Bank notes and cheque books

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

(4) Gold and silver

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

(5) Electricity

(6) Raw Wool

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

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

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

- (10) Products made of jute
- (11) Only those industrial machineries on which a maximum of 5 % customs duty is levied, as per Part 84 of the Customs Tariff.
- (12) Woolen carpets and their cutting, dying, washing and knitting.
- (13) Aluminum, copper, and bronze scrapes, blocks, sheets, and readymade utensils.
- (14) Cotton *saris*, *lungi* (wrap around), *dhoti* (for male and female), *petani*, and *gamcha* (small cotton towels)
- (15) Cotton thread
- (16) Woolen thread (apart from artificial and acrylic) used to knit handmade sweaters in the country
- (17) Goods received as donation in any natural calamities or for philanthropic purposes with permission from the Ministry of Finance of Government of Nepal

## **Group 12**

### **Building and Land**

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

## **Group 13**

### **Betting, Casinos, and Lotteries**

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

## **ZERO RATING GOODS**

Goods or Services payable at zero rate:

1. ~~Goods or services purchased or imported by His Majesty King, Her Majesty Queen, His Majesty Crown Prince, and other members of the Royal Family.~~
2. Export of goods
  - (a) Goods exported outside the Nepal; or
  - (b) Goods shipped for use as stores on a flight to an eventual destination outside the Nepal; or
  - (c) Goods loaded for use as stores on aircraft to a destination outside Nepal or as merchandise for sale by retail or supplied to persons in the course of such a flight.
3. Export of services
  - (a) A supply of services by a person resident in the Nepal to a person outside the Nepal and having no business establishment, agent, or legal representative acting on his behalf in the Nepal.
  - (b) Where goods are supplied on a here or loan basis by a registered person resident in Nepal to a person resident outside the Nepal
4. Imports of goods a services by accredited diplomats
5. Medical industries can get zero rate facility, if they intended
6. Local purchase from those which were provided exemption from sales tax as per the agreement made previously.

## Appendix –II

### Questionnaire

Dear Respondent,

I am endeavoring to prepare a research report on "**VAT Administration and its Effectiveness in Nepal**" in Partial fulfillment of the requirements of the degree of **Master of Business Studies (MBS)**. The questionnaire given below will be a key milestone for my research work. Hence, I kindly request you to give sincere and unbiased response with respect to the given questionnaire. Moreover, the information you provide hereby will be kept confidential and be solely used for this research purpose only.

Thanking you for your kind co-operation!

Respondent's Profile	Researcher
Name: .....	.....
Education: .....	Shailesh Kumar Karn
Address: .....	Shanker Dev Campus
Occupation: .....	Putalisadak, Kathmandu, Nepal.
Position: .....	T.U. Reg. No. 7-1-230-5-2001
Date: .....	Master's of Business Studies (MBS)
	2010

#### **Questions:**

**1. What is the source of your knowledge about VAT?**

- |                                 |          |
|---------------------------------|----------|
| a) Government awareness program | b) Media |
| c) Business center              |          |

**2. Do you take VAT bill on every purchase?**

- |        |       |
|--------|-------|
| a) Yes | b) No |
|--------|-------|

**3. Do you think that VAT system results in price rise?**

- |        |       |
|--------|-------|
| a) Yes | b) No |
|--------|-------|



4. Is VAT appropriate tax system in Nepal?
  - a) Yes
  - b) No
5. The customer who demand / take VAT bill on purchases is about
  - a) less than 30%
  - b) 30% to 60%
  - c) More than 60%
6. Is the present threshold limit is enough to secured the small businessmen?
  - a) Yes
  - b) No
  - c) No idea
7. Which of the following factor is responsible to make VAT ineffective in Nepal?
  - a) Lack of consumer awareness
  - b) Weakness of government action plan
  - c) Administrative inefficiency
  - d) Under invoicing
  - e) Above all
  - f) No idea
8. What are the obstacles you faced with paying and refunding of VAT?

.....

.....
9. Do you think VAT replaced the Sales Tax successfully?
  - a) Yes
  - b) No
  - c)No idea
- 10 Do you think the Government of Nepal is successful to collect expected revenue from VAT system?
  - a) Yes
  - b) No
  - c) In progress
11. Do you think it is suitable time to amend the VAT rate in Nepal?
  - a) Yes
  - b) No
  - c) No idea
12. Do you have any comments on VAT system of Nepal?

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