

# **Practices of Value Added Tax**

## **With Reference to Chitwan District**



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## **RECOMMENDATION**

This is to certify that the thesis

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**Practices of Value Added Tax**  
**With reference to Chitwan District**

Has been approved by this department in the prescribed format of the faculty of management. This thesis is forwarded for examination.

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And Found the Thesis to be original work of the student and written according to the prescribed format. We recommend the thesis to be acceptance as Partial Fulfillment of the requirements for the degree of **Master of Business Studies (M.B.S.)**

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## **DECLARATION**

I hereby declare that the thesis entitled **Practices of Value Added Tax With reference to Chitwan District** submitted to the Office of the Dean, Faculty of Management, Tribhuvan University is my original work. It has been prepared for the partial fulfillment of the requirements for the Degree of Master of Business Studies (MBS) under the supervision of Mr. Kapil Deb Subedi of Saptagandaki Multiple Campus.

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The present research study “**Practices of Value Added Tax With reference to Chitwan District**” has been prepared for the partial fulfillment of the requirement for the Degree of Master of Business Studies (MBS). Although VAT is no longer a new topic in the T.U curriculum, still I chose this topic mainly because of my curiosity to know why VAT is falling short of target in spite of its implementation. In fact, VAT promises a great change in the revenue structure of any country and is said to be more efficient and superior to sales tax in revenue generation. Moreover, many people are still ignorant and confused about the very name VAT.

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# TABLES OF CONTENTS

TITLE	PAGE NO.
<b>CHAPTER-I INTRODUCTION</b>	<b>1-9</b>
1.1 Background of the Study	1
1.2 Statement of the problem	4
1.3 Objective of the study	5
1.4 Significance of study	5
1.5 Limitation of study	5
1.6 Organization of the study	6
<b>CHAPTER –II REVIEW OF LITERATURE</b>	<b>7-50</b>
2.1 Conceptual Framework	7
2.2 Theoretical aspect of VAT	10
2.2.1 VAT Records	10
2.2.1.1 Purchase Book	11
2.2.1.2 Sales Book	11
2.2.1.3 VAT Accounts	12
2.2.1.4 Tax Invoice	12
2.2.1.5 Credit or debit note	13
2.2.1.6 When an item purchased is to be returned	14
2.2.1.7 Others	14
2.2.2 Types of VAT	15
2.2.3 Methods of calculation of VAT	16
2.2.3.1 Additive method	16
2.2.3.2 Subtraction method	17
2.2.3.3 Tax credit method	17
2.2.4 Principles of VAT	17
2.2.4.1 Territorial Scope	17
2.2.4.2 Approach of VAT on imports	18
2.2.4.3 Principle of Non discrimination	19
2.2.5 Taxable persons	19

2.2.5.1 Taxable person within the scope of Law	19
2.2.5.2 Excluding person with low levels of Business Activity	19
2.2.6 VAT Register	19
2.2.6.1 Voluntary Registration	20
2.2.6.2 Exporters and Person engaged in international activities	20
2.2.6.3 Effect of not registered	20
2.2.6.4 Cancellation of Registration	20
2.2.6.5 Continuing registration despite a charge in the taxable person	20
2.2.7 Supplies of goods and services	20
2.2.7.1 Transaction within the scope of Law	21
2.2.7.2 Supplies of goods	21
2.2.7.3 Supplies of services	21
2.2.7.4 Supplies by employees	21
2.2.7.5 Supplies by agent	21
2.1.7.6 Mixed supplies and multiple supplies	21
2.2.7.6.1 When a supply of goods takes place	22
2.2.7.6.2 When a supply of service takes place	22
2.2.7.6.3 Where a supply of goods takes place	22
2.2.7.6.4 Where a supply of services takes place	22
2.2.8 Treatment of imports	22
2.2.8.1 Taxable supplies	22
2.2.8.2 Payment for a supply	23
2.2.8.3 Transaction where no payment is payable	23
2.2.8.4 Supplies where payment is not full	23
2.2.8.5 Exempt supplies	24
2.2.8.6 Taxable Value Supplies	25
2.2.8.6.1 Charge to VAT	25
2.2.8.6.2 Value of International supplies	25
2.2.8.6.3 Tax inclusive Vs. Exclusive Base	25
2.2.8.6.4 Fair market value of supply	25
2.2.9 Adjustments and Rebates	25
2.2.9.1 Value of imports	25
2.2.9.2 Payment of VAT	26

2.2.9.3 Rates of VAT	26
2.2.9.4 Zero Rates	26
2.2.9.5 Zero Rating exports and international supplies	26
2.2.9.6 Paying VAT to tax authorities	26
2.2.9.7 Entitlement to Credit for input Tax	27
2.2.9.8 Partial Exemption	27
2.2.9.9 Disallowed Input Tax	27
2.2.9.10 Capital Goods	27
2.2.10 Procedures and Administration	27
2.2.10.1 Need for specific VAT Rules	27
2.2.10.2 Combining VAT and Customs administration on Imports	27
2.2.10.3 Handling VAT on Internal Supplies	28
2.2.10.4 Regulations, Instructions and Guidance	28
2.2.10.5 VAT Invoices	28
2.2.10.6 VAT Returns	28
2.2.10.7 Payment of VAT	28
2.2.10.8 Assessment of VAT	28
2.2.10.9 VAT periods	28
2.2.10.10 Payment of Excess VAT Credit	29
2.2.11 Historical Background	29
2.2.11.1 International experience of VAT	31
2.2.11.2 Introduction of VAT in Nepal	32
2.2.12 Basic Features of VAT in Nepal	34
2.2.12.1 Taxable Supply	34
2.2.12.2 Place of supply	35
2.2.12.3 Time of supply of VAT	35
2.2.12.4 Taxable Value of VAT	35
2.2.12.6 Tax Refund in VAT	36
2.2.12.7 VAT Administration	36
2.2.12.7.1 Registration	36
2.2.12.8 Invoicing	37
2.2.12.8.1 Tax Invoice	37
2.2.12.8.2 Abbreviated Invoice	37
2.2.12.9 VAT Accounting	37



2.2.12.9.1 Submission of return	37
2.2.12.9.2 Payment of Tax	38
2.2.12.10 Tax Assessment	38
2.2.12.10.1 General	38
2.2.12.10.2 Computer Assessment	38
2.2.12.10.3 Management Assessment	39
2.2.12.11 Collection	39
2.2.12.12 Penal Provisions	39
2.2.12.13 Appeals	40
2.2.12.14 Tax law designing and drafting	40
2.2.12.15 Sales tax vs. VAT again	40
2.2.12.16 VAT and Inflation	41
2.3 Review of Related Studies	42
2.4 Research Gap	50

### **CHAPTER-III RESEARCH METHODOLOGY 51-53**

3.1 Research Design	51
3.2 Population and Sample	51
3.3 Nature and Sources of Data	52
2.3.1 Primary Sources	52
2.3.2 Secondary Sources	52
3.4 Method of Data Analysis	53

### **CHAPTER-IV PRESENTATION AND ANALYSIS OF DATA 54-92**

4.1 Presentation of Data	54
4.1.1 Revenue Structure of Nepal	54
4.1.2 Structure of Tax Revenue	55
4.1.3 Registration	57
4.1.4 Non-Filers	59
4.1.5 Tax Returns	60
4.1.6 Revenue Collection from VAT	61
4.1.7 Composition of VAT Revenue	63

4.1.8	Share of VAT Revenue to Gross Domestic Product (GDP)	64
4.1.9	Share of VAT Revenue in Total Revenue	65
4.1.10	Share of VAT Revenue in Total Tax Revenue	66
4.2	Analysis of the Data with Various Statistical Tools	67
4.2.1	Time Series Analysis	67
4.2.2	Correlation Analysis	68
4.2.2.1	Gross Domestic Product with Value Added Tax Revenue	69
4.2.2.2	Total Revenue with Value Added Tax Revenue	69
4.2.2.3	Total Tax Revenue with Value Added Tax Revenue	70
4.2.2.4	Total Indirect Tax Revenue with Value Added Tax Revenue	70
4.2.3	Hypothesis testing (Student's t-distribution)	71
4.2.3.1	Test of VAT/TR (Total Revenue) and VAT/TXR ratio	72
4.3	Survey Result	73
4.3.1	The most challenging problem	74
4.3.2	Making VAT effectively successful	75
4.3.3	Tax structure of VAT	76
4.3.4	Expanding the base of VAT	77
4.3.5	Rate structure of VAT	78
4.3.6	Existing Exemption	79
4.3.7	Price rise due to VAT system	79
4.3.8	Effect on VAT on Revenue Mobilization	81
4.3.9	Effect on VAT on Economic Growth	82
4.3.10	The Most Responsible Group for tax Evasion	83
4.4	Major Findings of the study	84

## **CHAPTER-V SUMMARY, CONCLUSION AND**

### **RECOMMENDATIONS**

**88-92**

5.1	Summary	88
5.2	Conclusion	89
5.3	Recommendations	90

## **BIBLIOGRAPHY**

## **APPENDIX I**

## LIST OF TABLES

<b>TABLE NO.</b>	<b>TITLE</b>	<b>PAGE NO.</b>
Table 3.1	Group of Respondents and Sample size	54
Table 4.1	Revenue Trend in Nepal	54
Table 4.2	Structure of Total Tax Revenue	56
Table 4.3	Year-wise number of VAT Registrants	58
Table 4.4	Year-wise number of Non filers (2003-2011)	60
Table 4.5	Status of Tax Returns (2003-2011)	61
Table 4.6	Revenue collection from VAT	62
Table 4.7	Composition of VAT Revenue	64
Table 4.8	VAT Revenue as percentage of GDP	65
Table 4.9	VAT Revenue as percentage of Total Revenue	66
Table 4.10	VAT Revenue as % of Total Tax Revenue	66
Table 4.11	Predicted GDP and VAT Revenue	68
Table 4.12	Sample size of the field survey	73
Table 4.13	View on most challenging problem	74
Table 4.14	View on making VAT effectively successful	75
Table 4.15	View on Tax structure of VAT	76
Table 4.16	View on expanding the Base of VAT	77
Table 4.17	View on Rate Structure of VAT	78
Table 4.18	View on Exemptions	79
Table 4.19	View on price Rise Due to VAT system	80
Table N4.20	Primary reason for price rise	81
Table 4.21	View on effect of VAT on Revenue Mobilization	82
Table 4.22	View on effect on VAT on Economic Growth	83
Table 4.23	View on most responsible Group for Tax Evasion.	84

## LIST OF FIGURES

<b>FIGURE NO.</b>	<b>TITLE</b>	<b>PAGE NO.</b>
Figure No.1	Structure of Total Tax Revenue	57
Figure No.2	Year-wise number of VAT Registrants	59
Figure No.3	Revenue collection from VAT	63

## **ABBREVIATION**

ADB	=Asian Development bank
APC	=Average Propensity to consume
CBS	=Central bureau of statistics
DANIDA	=Danish International development Agency
DCs	=Developing Countries
e.g.	=For example
EU	=European Union
FNCCI	=Federation of Nepalese Chamber of Commerce and Industry
FY	=Fiscal year
GATT	=General Agreement on Tariff and Trade
GDI	=Gross Domestic Income
GDP	=Gross Domestic Product
GNP	=Gross National Product
GON	=Government of Nepal
HIID	=Harvard Institute for International Development
i.e.	= that is
IMF	=International Monetary Fund
IRD	=Internal Revenue Department
LDC	=Least development Country
MBS	=Master of Business Studies
MNC	=Multinational company
MOD VAT	=Modified Value Added Tax
MOF	=Ministry of Finance
MST	=Multi Stage Tax
NGO	=Non Government organization
NRB	=Nepal Rastra Bank
PAN	=Permanent Account Number
RLST	=Retail Level Sales Tax
R&D	=Research and Development
SAARC	=South Asian Association for Regional Cooperation
TPIN	=Tax Payer's Identification Number
TR	=Total Revenue

TXR	=Total Tax Revenue
UDCs	=Under Developing Countries
VAT	=Value Added Tax
Viz.	=Videlicet
WDR	=World Development Report
WB	=World Bank
WLST	= Wholesale Level Sales Tax
WTO	=World Trade Organization

# CHAPTER-ONE

## INTRODUCTION

### 1.1 Background of the Study

The emergence of the consumption based Value-Added Tax (VAT) and its unprecedented success in the developed world, motivated largely by its greater efficiency and buoyancy, encouraged the developing countries to adopt VAT during the decades of the eighties and nineties. However, with the exception of a few, many countries faced multiple difficulties in the adoption and implementation of VAT. Nepal, undeterred by the concern generally expressed in the developing countries, decided to take the bold initiative and move forward with the introduction of VAT in the country, the goal being to develop it into a major national tax. The move launched more than two decade ago was initially confronted with resistance from some of the stakeholders but owing to the efforts on public awareness about the progressive and futuristic dimensions of the tax and political recognition of its significance, the desired support eventually came in. The confidence-building measures introduced over the period helped to further improve the operational environment with the result that VAT is now an accepted part of the country's fiscal landscape. The efforts to address the issues spurred by its introduction, whether concerning the legislative side or the operational element, remain a part of the continuous reform process.

There is a predominant role of the indirect taxes, especially import duty and the sales tax in the Nepalese tax structure. The primary purpose of taxation is to divert control of economic resources from taxpayers to the state for its own use or transfer to others (Goode, 1983). Taxes are very popular and there is much to be said for encouraging the people in underdeveloped areas to save a larger part of their incomes voluntarily (Higgins, 2001). Traditionally, taxation in developing countries had two purposes. Tax concessions and similar fiscal incentives have been thought of as a means of stimulating private enterprise. The second purpose of taxation- the mobilization of resource to finance public enterprise is far important.

Nepal's accession to the world trade organization (WTO) has brought new challenges in the Nepalese economy. It has ensured the free flow of foreign goods and services into the

territorial boundary of Nepal. The provisions regarding the most favored Nation, National treatment, Non discrimination and predictability are the mandatory to its members. The compliance with the agreement is the most. Otherwise there is a tribunal body for dispute settlement. Under such circumstances Nepal no longer can rely on custom duty, which used to be the significant component of revenue generation. It is also the signatory of there bilateral trade agreement. In the first half of 1980s Nepal had to face the problem of deficit balance of payment due to high public expenditure. The budget deficit was balanced by printing paper notes. It increase inflation and imported and aggregated the problem of balance of payment. The size of import could be met with the size of export.

To solve this problem Nepal introduced the "Economic Stabilization Program" in 1985 by taking economic adjustment loan from International Monetary Fund (IMF). Under this program the government did the works like reducing aggregate demand by absorbing excessive liquidity of the economy, controlling the bank loans that goes to the private sectors and the government, encouraging export and discouraging import. Therefore the problem of balance of payment of 1980s to give continuity to the economic stabilization program of 1985 again taking economic stabilization facility from IMF (Joshi, 2008). Nepal had been generating bulk of its tax revenue from import duties. The restrictive economic policies of India benefited Nepal until the beginning of 1990s. Indian tourists were engrossed to buy goods by Nepal from third countries. These goods also used to be deflected to India by both the Nepali and Indian traders. The lure of this type of the trade however was diminishing by the advent of the liberal economic policy of India in early 1990s.

There was extreme reduction in the import tariff, quantitative restrictions and licensing system in India since 1991. As a result, the volume of import from the third countries in the Nepalese market for the Indian buyers shrieked. Further Nepal reduced its import tariff corresponding to the to the liberal economic policy adopted in 1992-93 and in line with the customs duties reform-taking place around the world generally. Consequently import duties proved to be less insignificant in the later years. The consequences were already evident as the relative position of the import duties decreased from 37% in 1990/91 to 34% in 1996/97. Further some, Nepal was not in the position to levy import duties on trade taking places within the South Asian Association for Regional Cooperation (SAARC). This reduced its dependence on its trade tax.



As the part of the tax reforms in Nepal, sales tax in Nepal was introduced in 2022 B.S. by Finance Act. At that time, it was imposed on retail level. In 2022 B.S., sales tax Act. And rules introduced. The sales tax collection point was shifted to wholesale level in Ashwin 2025 B.S. and import/production stage on Ashadh in 2031 B.S. In 2049/50 B.S. policy of imposing sales tax in two stages i.e. import level/production level and wholesale level was introduced but this system was again changed in fiscal year 2051/52 B.S. Due to unsuitability of sales tax in Nepal Value added Tax (VAT) has been implemented as the joint form of sales tax, hotel tax and contract tax (Puspa Raj Kandel, 2004) from 16 November 1997. Before the reform program was implemented in FY 1986/87, Nepal's Tax system was almost administratively unmanaged in terms of rates, incentives, deductions, tax holidays etc. without much revenue being collected in the national exchequer.

Revenue mobilization was stagnant to less than 10% of GDP. It was just 8.7% in FY 1985/86. Thus it was realized that tax system must be drastically reformed if some more revenue was to be mobilized. Therefore, the government took initiative first of all to reform the sales tax system. Until FY 1984/85 there were upto 17 rates of sales tax. Besides this, there was mark-up system to accommodate the distribution cost and the Value Added. Since the mark-up rates different for different products, the sales tax applicable to them also unavoidably different. Apart from this sales tax were different for imported and domestic products. Therefore sales tax was selected for reform in FY 1986/87 reducing the number of tax rates from 17 to 4. Simply the tax rates were 5%, 10%, 15% and 20%. Beside that mark-up system was also abolished in 1987/88. Uniform rates were made for both domestic and imported products. The design of tax in Nepal was so poor and defective as revenue rising instruments they always has disappointing performance.

The sales tax now been reformed to VAT. Value Added Tax has replaced the then sales tax, hotel tax, contract tax and entertainment tax. There is a single rate of 13%. In the process of reform Department of tax, department of customs and department of excise have been merged into a single department, which have been named as Internal Revenue Department. VAT is relatively a new tax. It was first introduced as the comprehensive national tax 40 years ago in France. William Von Siemen recommended it for the first time in Germany in 1919 in order to replace the multistage sales tax. In 1921 professor Thomas S. Adams recommended VAT in the U.K. ([www.VAT.Com](http://www.VAT.Com).)

Likewise, in 1949 the tax reform commission, headed by professor Carl S. soup, had proposed board structure of VAT for Japan with the aim of removing the problem regarding calculation of the prevailing tax systems. France launched it in 1954, which couldn't cross its boundary till 1959. But the introduction and the application of the VAT was with the greater place in the nineteen sixties. All European members' states were required to apply the agreed provisions of VAT.

Following the adoption of VAT by western European countries, many developing countries have been giving increased attention to this form as a means of rationalizing their sales and improving their revenues (Lent, 1973). With the alignment of the laws of potential candidates for membership, has ensured increasing consistency in the form of VAT operating in Europe. All the number states of the organization of Economic Cooperation and Development (OCED) apart from the United States of America have introduced the VAT in their tax regimes. Asian nations excluding Brunei and Malaysia have adopted VAT. India had introduced VAT as modified Value Added TAX. (MoDVAT). China also adopted partial VAT in 1984 and id full-fledged in 1994 (Dhungana, 2003).

## **1.2 Statement of the problem**

Nepal is a underdeveloped country. Her economy is vulnerable to minor changes due to its rugged topography, low productivity, and the lack of industrialization, dependence on India, landlockedness etc. So, she is in need of effective collection system for her treasure that will be mobilized for the welfare of her citizens ultimately results in the development of the country. For the purpose like other developed nations Nepal has brought different reforms in the tax collection system. Among them introduction and implementation of VAT in place of sales tax is one of them. Its implementation has not been successful till the date. For the development works of the country there is the need of the financial resource. Among the source of nation's treasury tax collection is one of them. Most of the people are uneducated as a result we can't aspect greater that they are aware towards the tax and tax collection system. This is the main cause why the government is always unsuccessful to collect its targeted tax revenue. Moreover VAT has been new term and educated groups too. Since it has some technical aspect consumers aren't aware of it as a result tax evaders are benefited while the nation has been adversely affected. So the main

problem of the study is to find out the current level of public awareness towards VAT in Nepal. The major issues the present study attempts to resolve are as follows;

1. Do the practices of VAT in Nepal resemble the theoretical aspects?
2. What is the contribution of VAT to total GDP and GNP of Nepal?
3. What are the major practices of VAT in Nepal?
4. Whether the tax payers are aware about the system of Vat applied by Govt.?

### **1.3 Objective of the study**

The main objective of this study is to examine the practices and pattern of value added taxes in chitwan district. Specific objectives are mentioned as below.

- a. To review the theoretical aspect of VAT.
- b. To examine the contribution of VAT on total tax revenue, GNP and GDP
- c. To analyze the practices of VAT in Chitwan District.

### **1.4 Significance of study**

In Nepal most of the plans regarding tax collection do not meet the target as a result the nation is unable to collect the targeted revenue. There are many other reasons behind it but among them the major problem is most of the people are uneducated moreover those who are educated they are also ignorant about tax and tax collection system. So this study will find out the level of public awareness towards VAT in Nepal, which is the major source of revenue. Beside that how can the awareness level be increased that finally result in public support to the VAT system from their heart. This will become the support to the tax office. The study will be helpful to the researchers, policymakers, students and other tax implementation agencies providing insights to the concerned stakeholders for pattern and practices of VAT in Nepal.

### **1.5 Limitation of study**

The limitation of the study is as follows:

- ) The survey is done only in Chitwan that may not represent the whole population.
- ) The sample consists only 100 respondents which might be too small sample size for generalization of results.
- ) There may be greater personal prejudice as the direct personal interview is employed in the study.
- ) Mostly the sellers are irresponsive to answer the questions regarding the tax matter so they may have given made answers.

- J Information regarding the contribution of VAT in the GDP is collected from the secondary source.

## **1.6 Organization of the study**

The study is designed with the following of chapter plan

### **Chapter I: Introduction**

This chapter includes the brief background and definitions of the tax and VAT. This study is concerned with the historical development of VAT, contribution of VAT in GDP and the public awareness towards VAT in Nepal. This chapter includes the sub chapters like statement of the problem, objective of the study, rational of the study, limitation of the study and organization of the study.

### **Chapter II: Conceptual framework and Review of literature**

This chapter includes the literature related to the findings of a few past researches in contribution of VAT in the national economy, historical background of VAT in the world as well as in Nepal, its implementations and success rate and the public awareness towards it.

### **Chapter III: Research methodology**

In this study, the survey research is being adopted. Most of the information for the study is collected from the books, tax journals, tax newspapers, budget and websites related to tax and VAT.

### **Chapter IV: Presentation and analysis of data**

The collected data are thoroughly checked complied and presented in appropriate table to facilitate analysis and interpretation. Tabulation is done to get answers for the specific objectives. Analysis is done descriptively as well as statically. For the statistical tools such as percentage, bar graphs, pie chart, line graph and trend analysis will be used.

### **Chapter V: Summary, conclusion and recommendation**

This chapter will include the summary of the study, conclusions drawn and the recommendations made in this study.

## **CHAPTER – TWO**

### **REVIEW OF LITERATURE**

#### **2.1 Conceptual Framework**

VAT works on the principle that when raw material passes through various manufacturing stages and manufactured product passes through various distribution stages, tax should be levied on the 'Value Added' at each stage and not on the gross sales price. This ensures that same commodity does not get taxed again and again and there is no cascading effect. In simple terms, 'value added' means difference between selling price and purchase price. VAT avoids cascading effect of a tax.

Basically, VAT is multi-point tax, with provision for granting set off (credit) of the tax paid at the earlier stage. Thus, tax burden is passed on when goods are sold. This process continues till goods are finally consumed. Hence, VAT is termed as 'consumption type' tax. VAT works on the principle of 'tax credit system'.

Generally, any tax is related to selling price of product. In modern production technology, raw material passes through various stages and processes till it reaches the ultimate stage e.g., steel ingots are made in a steel mill. These are rolled into plates by a re-rolling unit, while third manufacturer makes furniture from these plates. Thus, output of the first manufacturer becomes input for second manufacturer, who carries out further processing and supply it to third manufacturer. This process continues till a final product emerges. This product then goes to distributor/wholesaler, who sells it to retailer and then it reaches the ultimate consumer. If a tax is based on selling price of a product, the tax burden goes on increasing as raw material and final product passes from one stage to other.

For example, let us assume that tax on a product is 10% of selling price. Manufacturer 'A' supplies his output to 'B' at Rs. 100. Thus, 'B' gets the material at Rs. 110, inclusive of tax @ 10%. He carries out further processing and sells his output to 'C' at Rs. 150. While calculating his cost, 'B' has considered his purchase cost of materials as Rs. 110 and added Rs. 40 as his conversion charges. While selling product to C, B will charge tax again @ 10%. Thus C will get the item at Rs. 165 (150+10% tax). In fact, 'value added' by B is only Rs. 40 (150–110), tax on which would have been only Rs. 4, while the tax paid was Rs. 15. As stages of production and/or sales continue, each subsequent

purchaser has to pay tax again and again on the material which has already suffered tax. Tax is also paid on tax. This is called *cascading effect*.

System of VAT works on tax credit method. In Tax Credit Method of VAT, the tax is levied on full sale price, but credit is given of tax paid on purchases. Thus, effectively, tax is levied only on 'Value Added'. Most of the countries have adopted 'tax credit' method for implementation of VAT.

The aforesaid illustration will work out as follows under VAT system.

'B' will purchase goods from 'A' @ Rs. 110, which is inclusive of duty of Rs. 10. Since 'B' is going to get credit of duty of Rs. 10, he will not consider this amount for his costing. He will charge conversion charges of Rs. 40.00 and sell his goods at Rs. 140. He will charge 10% tax and raise invoice of Rs. 154.00 to 'C'. (140 *plus* tax @ 10%). In the Invoice prepared by 'B', the duty shown will be Rs. 14. However, 'B' will get credit of Rs. 10 paid on the raw material purchased by him from 'A'. Thus, effective duty paid by 'B' will be only Rs. 4. 'C' will get the goods at Rs. 154 and not at Rs. 165 which he would have got in absence of VAT. Thus, in effect, 'B' has to pay duty only on value added by him.

Value Added Tax (VAT) is the most recent innovation in the field of taxation. It is considered as the reformed from the sales tax. Sales tax is levied on the sales of goods and services, is commonly divided into three groups namely: turnover tax, single-stage tax and VAT. Turnover tax is levied at all the stages of production and the distribution process. The single tax may be levied at manufacturing level or at Wholesale Level Sales Tax (WLST) or at Retail Level Sales Tax (RLST) so the single tax is known as manufacturer's tax, wholesaler's tax and retailer's tax. On the other hand VAT is imposed on the value added each stage of production and distribution. VAT is the multiple stage tax, which grown as the hybrid from of the turnover tax in the sense that VAT is also charged on all stages of production and distribution process. VAT however differs from the sales turnover tax as the later is imposed on the total value at each stage while the former is imposed only on the value added at each stage. VAT is similar to the retail stage sales tax. Theoretically, VAT is broad - based as it covers the value added to each commodity by a firm during all stages of production and distribution process. There is presumption that VAT is shifted completely to the consumer.

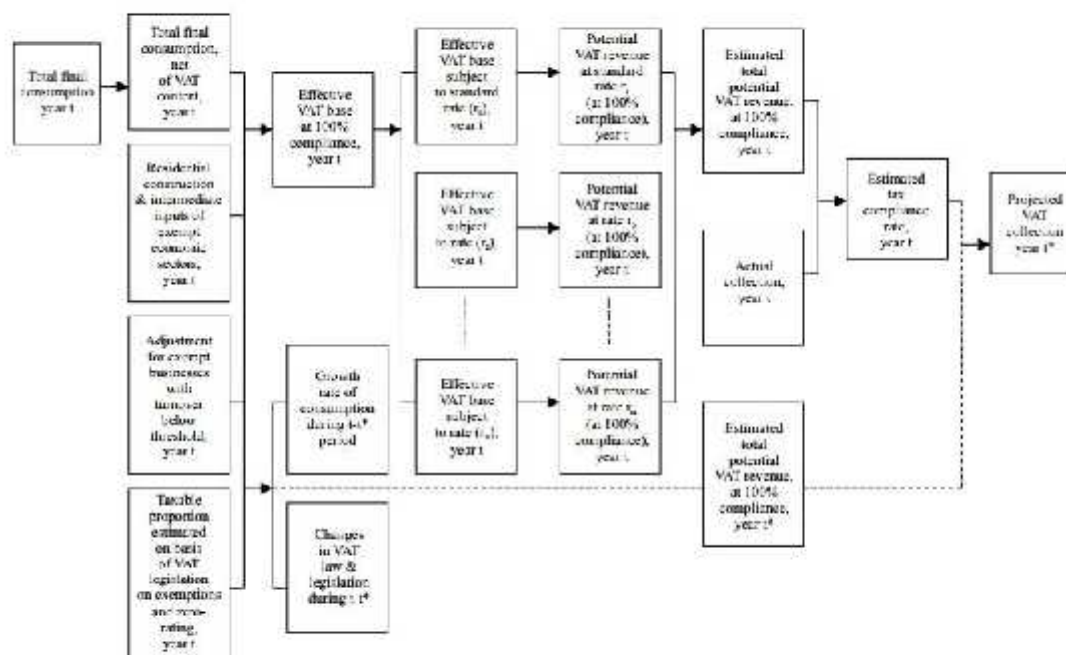
The value added tax is “a broad-based business tax imposed at each stage of the production and distribution process that, when applied nationally, is typically designed to tax final household consumption” (Tait, Ebel, and Le, 2005, p. 461). The idea of a VAT can be traced back to the writing of von Siemens, a German businessman, in the 1920s. Since 1948, when a rudimentary form of the tax was first applied at the manufacturers’ level in France, more than 130 countries have introduced the VAT, collecting on average a quarter of the total government revenues (Ebrill et al., 2001; ITD, 2005). In many countries, VAT is regarded as the workhorse of the revenue systems. Subject to adjustments on administrative or policy grounds, a typical destination-based VAT applies the tax to domestic supplies and imports while excluding exports from the tax base. The incremental collection of the VAT requires that registered taxpayers be allowed to take a credit for capital and intermediate supplies through the invoice-credit mechanism (Tait, 1991; Ebrill et al., 2001).

The key objectives of the VAT modeling are to project VAT revenue, to estimate compliance level and tax expenditures in VAT, and, more broadly, to analyze the revenue impact of proposed changes in VAT policy and/or administration. There are three major approaches for VAT modeling: aggregate national account approach, sector wise national account approach, and input-output (I-O) approach. Jenkins, Kuo, and Shukla (2000) provide an extensive review of the three approaches. In the aggregate national account approach, the gross domestic product of a country is adjusted for trade balance, capital formation, exemption and exemption-induced cascading, government expenditures on wages and salaries, exemption threshold, and collection leakage. The sector wise national account approach begins with the data on outputs by sector and incorporates adjustments for imports, exports, intermediate inputs, investment, and for exempt and zero-rated outputs and inputs. The I-O approach relies primarily on I-O tables to derive the detailed final consumption of goods and services by household, government, and business (intermediate inputs and capital purchases). Similar to the other two approaches, further adjustments have to be

made to account for the impact of exemption, zero rating, and threshold. Annual national statistics and business and household consumption surveys can be used as supplementary data sources for necessary assumptions for all three modeling approaches. The three different approaches should generate consistent results of projected VAT revenues and compliance rate. As the I-O data present the most detailed accounting of the supply and use, and consumption expenditures of goods and services in an economy, the I-O

modeling of the VAT can be considered the best approach to estimate the disaggregate impact of policy change on the collection and compliance at commodity level. Note, however, in a number of less developed countries, the I-O data may be outdated; this leads to the problem that the data may no longer be descriptive of the current state of the economy, especially in countries undergoing fast and sustainable growth. The nonexistence of recent I-O tables requires that one has to resort to an aggregate national account approach or sector wise national account approach to estimate the VAT base.

**Figure 1. I-O Modeling Approach — Conceptual Framework for VAT Forecasting**



Note: t is the base year in which the latest I-O tables are available, and t\* is the year of forecast.

## 2.2 Theoretical aspect of VAT

### 2.2.1 VAT Records

Value Added Tax (VAT) is tax based on the transaction of goods and services. The taxpayer has to maintain accounts of his/her transaction. This type of accounting is simple. For this purpose, the taxpayer has to maintain a purchase book, a Sale book and VAT accounts. Besides that has to issue tax invoice or abbreviated tax invoice while selling/supplying goods or services. A brief introduction to the accounting system related to these is described below.



### **2.2.1.1 Purchase Book**

A registered taxpayer has to maintain a complete record of all the purchase and imports made of goods and service the tax amount paid should be stated. A sample of purchase book is as follows:

- J 'Purchase of non taxable' implies purchase or import of the items listed in schedule 1 of the VAT Act. This list includes primarily goods and services related to basic needs, social welfare service, goods made for the use of disabled persons, educational and cultural goods and services etc.
- J 'Purchase of taxable' implies the purchase of those goods and services within the country. Taxable imports imply the import of goods and services that is not in the 'tax exempted' list of goods and services.
- J The purchase book does not have to be submitted at the VAT office, but has to be shown at the time of inspection or if and when the tax officer wishes to see it.
- J The person has to get the purchase book certified by the tax officer either by taking it to the Inland Revenue Office or at the time when the tax officer comes on business inspection.
- J The purchase book has to be maintained safely up to a period of six years after the transaction period is over.

(Pandit, 2000)

### **2.2.1.2 Sales Book**

The sales book is similar to the purchase book. The sales of good and services throughout the tax period should be recorded in this. An example is given below.

- J In the sales book, the date when the sale was made, the invoice number, and the name and registration number of the buyer has to be stated. Similarly, the total sales value, the sales value of non-taxable goods, the zero-rated sales value, the sales value of taxable goods and the amount of tax should be stated
- J 'Sales of non-taxable' implies the sales of the items listed in schedule 1 of the VAT Act.
- J Zero-rated sales imply the sale of those taxable items, listed in Schedule 2 of the VAT Ac within the country of their export outside the country.

- J The person has to get the sales book certified either by taking it to the Inland Revenue Office or by the concerned tax officer at the time when he/she comes on an inspection of the transaction of the taxpayer.
- J The purchase book does not have to be submitted at the IRD office, but has to be shown when the tax officer wishes to see it.
- J The purchase book has to be maintained safely up to a period of six years after the transaction period is over.

(Pandit, 2000)

### **2.2.1.3 VAT Accounts**

VAT accounts are an integrated, abbreviated version of the purchase book and sales book as described above. The VAT account shows the tax paid on purchases, the tax collected through sales and the self-assessed tax amount that has to be paid to the Government by the taxpayer.

The taxpayer has to maintain this account each month and keep it with oneself. This does not have to be submitted at the Inland Revenue Office along with the VAT statement but has to be shown to the Tax Officer when he/she wishes to see it.

### **2.2.1.4 Tax Invoice**

There are two types of tax invoice:

#### **Tax Invoice**

A registered taxpayer has to issue a tax invoice while selling goods or services. But 'Tax Invoice' has to be stated as 'title' only in the first copy of the bill and not in the other two, out of a total of three copies. The first original copy has to be given to the recipient, the second copy has to be maintained in a separate record to be submitted at the tax office if and when asked for and the third copy should be maintained as record for the purpose of one's transaction.

#### **An-Example of Tax Invoice**

Invoice number Transaction date:

Seller's taxpayer identification number:

Date of issue of invoice:

Seller's name:

Address:

Buyer's name:

It is not necessary that all sellers have to issue the invoice in the pattern given above. Based on one's transaction, the invoice pattern can be changed with the permission of the tax officer, but all information contained in the sample pattern above has to be entered.

- ) 'Tax Invoice' should be stated as title only in the first original copy of the invoice.
- ) Issuing and receiving invoice is one of the prime duties of a VAT registrant.
- ) If a tax invoice is not issued, the VAT registrant has to face penalty and will also fore go the facility of tax deduction.

([www.ird.gov.np](http://www.ird.gov.np))

### **Abbreviated Tax Invoice**

In the sale of up to NRs. 5,000 including tax, and abbreviated tax invoice can be issued. An example of an abbreviated tax invoice is given below. To issue an abbreviated tax invoice the taxpayer has to take the permission of the tax officer.

### **An Example of and abbreviated Tax Invoice**

Date: .....

Invoice Number:

Seller's Name:

Address:

Taxpayer Identification Number:

Tax Rate (%):

- ) In case where most sales comprise of small items and low costs, the invoice can be issued by combining the items as 'some goods' under particulars.
- ) If the buyer demands a tax invoice instead of an abbreviated one then a tax invoice has to be issued.
- ) When calculating the tax amount to prepare the tax statement to be presented, the total amount in the tax invoice has to be multiplied by the tax fraction.

([www.ird.gov.np](http://www.ird.gov.np))

#### **2.2.1.5 Credit or debit note**

- ) If there is a difference in value after the commodity or service has been supplied based on the tax invoice, then a debit or credit note has to be issued.
- ) When issuing such a note it has to be stated whether it is a credit note or debit note.

- J The relevant tax invoice number also has to be stated.
- J If the goods have been returned the reason for doing so has to be stated.
- J The item returned along with its cost has to be stated.
- J The difference arising in the tax amount after the debit or credit not has been issued also has to be clearly stated.

(Pandit, 2000)

#### **2.2.1.6 When an Item Purchased is to be returned**

The quantity, quality and the nature of the item is the same:

- J If an item purchased is damaged, torn or stained and exchanged with the same or similar item, the same tax amount stated in the tax invoice has to be maintained. Or, since the tax invoice has already been issued, preparing a credit not and issuing a new invoice can exchanged the item.
- J If an item purchased is damaged torn or stained and is exchanged with the same or similar item, the same tax amount stated in the tax invoice has to be maintained. Or since the tax invoice has already been issued, preparing a credit note and issuing a new invoice can exchange the item. If the item is similar but cost is different.
- J Let us assume that the cost of the item purchased was NRs. 100. But at the time of exchange, if for some reason the cost has come down to NRs. 75, then a credit note has to be issued.
- J If for some reasons the cost of the above item purchased at NRs. 100 has reached NRs. 150 at the time of exchange, then the tax amount on the additional NRs. 50 have to be charged and a reference to the tax invoice number has to be made.

([www.ird.gov.np](http://www.ird.gov.np))

#### **2.2.1.7 Others**

Once the purchase book, sales book and the VAT account have been prepared, it will be easy for the taxpayer to calculate the tax amount that he/she has to pay while preparing the VAT return. To estimate how much tax has to be submitted to the Government within a stipulated time period, the tax incurred has to be deducted from the tax collected within that period. If the tax collected is more than the tax paid, then the person has to submit that extra tax amount received from sales to the Government. But, if the tax paid in purchase is more than the tax collected from sales then the person can adjust the extra

amount in the tax due in the following month. If this process continues for six consecutive months and the amount is still not adjusted then the taxpayer can write an application to the concerned Inland Revenue Office to get a refund of the amount that has not been adjusted. Once such an application is received, the tax officer has to refund this amount within 60 days from the date that the application has been received. If the amount due is not refunded within 60 days, it has to be paid back along with interest.

### **2.2.2 Types of VAT**

There are three types of VAT according to their modes of treatment of capital goods. The various types of VAT are:

#### **Consumption type**

If all the goods (investments) bought from other firms are excluded from the tax base (Value Added in the year of purchase but depreciation is included in the tax base, it is known as consumption type VAT. It can be clarified by the following question.

**Value added Tax base = wages + interests+ rents+depreciation+profit-capital**

**Purchased from outside (in the year of purchase)**

Or

**Value added Tax base = sales-purchase (including purchase of capital goods from outside in the year of purchase) ([www.ird.gov.np](http://www.ird.gov.np))**

The above equation clearly shows that the tax base is consumption because investments (Capital goods purchase from outside the business use) are free from taxation. Under this type of VAT investment is encouraged because it is excluded from tax base. Similarly, imports are taxed whereas exports are relieved from tax.

Thus, tax base from the nation under this type is equal to domestic consumption of the country. Nepal has adopted it with tax credit mechanism from very beginning.

#### **The Income Type**

Under this type of VAT, capital goods purchased from outside suppliers are also included in the tax base in year of purchase but the depreciation is excluded from the tax base. The following equation makes clear idea about the tax base under it.

**Value Added Tax base = wages+interest+rents+profits+capital goods purchased from outside (in the year of purchase)**

Or

**Value Added Tax base = sales-purchase excluding purchase of capital goods from outside (in the year of purchase) - depreciation. ([www.ird.com.np](http://www.ird.com.np))**

The above equation clearly shows that the value added is equal to the consumption plus net investment. It means the tax base for the nation is net national income that comprises the consumption and net investment of all firms within the country.

### **The gross national type**

The production type of VAT includes capital good purchased from other firms in the tax base in the year of purchased and also includes depreciation in the tax base. It can be clearly shown by the following equation:

**Value Added Tax base = wages+interest+rents+depreciation+profit+ goods+purchased from outside (In the year of purchase)**

Or

**Value Added Tax base = Sales - Purchase excluding purchase of capital goods from outside (in the year of purchase)**

The aforementioned equation obviously shows that tax is imposed both on consumption and gross investment. This means that Value Added by all firms within the country constitutes the Gross National Product (G.N.P). That is why the tax base of this type of VAT is conceptually equal to the GNP, Thus, this type of VAT is also termed as "Gross National Type of VAT" ([www.ird.com.np](http://www.ird.com.np))

### **Methods of calculation of VAT**

VAT is levied on the sum total of value added by a firm in due course of production and distribution. There are three methods of calculation of VAT.

#### **2.2.3.1 Additive method**

This method is also known as the direct value added computation method Under this method the tax base so obtained by adding the incomes produced by the firm, In order words, the tax base is computed by adding the payments made by the firm to the factors of production employed in turning out the product such as wages, interest, rent, royalties and profit. This method is appropriate for the income types of VAT that included in its base the rewards to all factors. ([www.ird.com.np](http://www.ird.com.np))

### **2.2.3.2 Subtraction Method**

Under this method, value added is determined as net turnover, which is obtained by subtracting the cost of materials from sales proceeds. Thus, VAT is levied on the amount, which is derived by subtracting purchase from sales. This method is appropriate for the consumption Variant VAT. ([www.ird.com.np](http://www.ird.com.np))

### **2.2.3.3 Tax credit method**

This method is known as the invoiced method. Under the method, tax is levied on the total sales and taxpayers are permitted to deduct from their gross tax liability the tax they have already paid by their suppliers and passed on to them. Thus, in contrast to the subtraction method, which deducts purchase from sales and levies taxes on the difference, tax on purchase is subtracted from the tax on sales under the tax credit method. ([www.ird.com.np](http://www.ird.com.np))

## **2.2.4 Principles of VAT**

### **2.2.4.1 Territorial Scope**

Because the VAT is an indirect tax focusing on the transaction or activity rather than on the economic operator, the primary determination of the territorial scope of the territorial scope of the charge to VAT is by reference to the location of a transaction if the transaction occurs within the state, then it is within the charge of VAT. Attention must also be paid to the person to be charged to VAT on the transaction, to ensure that the amount of VAT due can be enforced and collected. It is therefore necessary to provide rules to determine the identity of the person responsible for payment of the VAT when some element of the transaction being taxed takes place outside the jurisdiction of the state.

There are conflicting principles on which the territorial scope of VAT can be based: The origin principle and the destination principle. As these names suggest, the origin principle charges a transaction, only part of which occurs within the jurisdiction, if the transaction originates or is created within the state and the destination principle charges the transaction if it is destined for consumption in the state. Potential problems of double taxation; states that impose a VAT on imports remove exports from the charge to tax. This will also remove double taxation if both states have the same system. There is no international agreement either determining that states should follow one of these principles rather than the other of seeking to reach common rules to avoid double

taxation. In practice, however, and with limited exception states have adopted the destination basis as the primary basis.

The main exception is that of Russia and states within the commonwealth of independent states, adopting an origin basis. The European commission had formally proposed that the European Union Change from the present destination basis to a form of origin basis, originally for 1997 for transaction within the EU, although that date now been deferred.

#### Internal Charge to VAT

The common pattern of Invoice based VAT is that a charge to VAT is imposed on all transaction within the state and within the scope of the VAT. Each taxable person is allowed a deduction against the total VAT charged by the person to take account of any VAT paid by the person on inputs related to transaction within the scope of VAT.

A transaction within the scope of VAT and on which VAT is imposed is commonly called an output and the VAT collected on it is called output tax. A transaction made to the person making the output is known as an input, and the VAT paid by that person when obtaining the input is an input tax. The internal charge to tax is charge amounting to the output tax received by a person less the input tax paid by the person.

The normal approach is to impose output tax on transaction and person if

- J The transaction are "supplies of good and services"
- J Those supplies are "taxable and exempt from VAT"
- J Those taxable supplies are made by a "taxable person" that is a person within the scope of the charge to VAT and
- J The taxable person makes those supplies as part of the person's business activities and not as part of a hobby of non-commercial activity.

([www.ird.com.np](http://www.ird.com.np))

#### **2.2.4.2 Approach of VAT on imports**

States have normally adopted the practice of treating imports of good separately from imports of service. Imports of goods are identified by the physical entry of the goods.

Services can not be identified in this way. Instead states have chosen to adopt rules that treat a supply of a service as occurring within a state if the supply meets certain criteria.

An import of service is taxable only if the supplier is a taxable person. Since there is usually a registration threshold for VAT, a foreign supplier that supplies only services with a low annual value may not be a taxable person.



### **2.2.4.3 Principle of Non discrimination**

The existence of separate charge on locally supplies goods and imported goods gives rise to the possibility of discrimination between the two classes of supplies.

Most states are obliged by international agreement no to discriminate against supplies by way of import. The primary source of this obligation is Article III of GATT. A growing number of states are also under other obligations include the terms of customs unions and free trade area agreements, double tax agreements and bilateral trading and investment agreements.

## **2.2.5 Taxable persons**

### **2.2.5.1 Taxable person within the scope of Law**

A person within the scope of VAT is usually as a taxable person. A VAT law should include all legal person created under the law of the state that engage in economic activities of any kinds, as well as all physical persons. A VAT law may regard an association or partnership, although the association does not for general legal purpose, have separate personally. Government bodies at the national, regional and local levels are to be included as taxable persons.

### **2.2.5.2 Excluding person with low levels of Business Activity**

Most states require only some of the many persons active in business within the state to be taxable persons. Setting a minimum level or threshold of business activity and requiring only those persons with levels of activity above the minimum to be taxable person normally achieves this. Those with levels of activity below that level are not required to be taxable persons, although they are often given the right to voluntarily choose to be taxable person. The usual measure of business activity is the total turnover of taxable goods and services supplied by the person over a set period.

## **2.2.6 VAT Register**

To administrator the VAT, it is standard practice to establish a formal state register of those who are registered person. There must be a requirement that any person who is, or should be a taxable person take the necessary action to seek to be registered for the VAT.

### **2.2.6.1 Voluntary Registration**

States often allow those who are not required to be registered to register voluntarily. This may be appropriate for many organizations that intend to have a large turnover, but have not yet reached it, incur large expenditure in one year, expecting the income in the next year, or are carrying out business with this information to be known by the customers. Voluntary registration also allows those operating just below the threshold level to avoid any competitive disadvantages compared with other operators who are required to register.

### **2.2.6.2 Exporters and Person engaged in international activities**

In most of the states VAT is not levied to the exporters. To avoid the exporters from paying VAT provisions is made for them to claim back any input tax they have paid in making the exports. Therefore, exporters and those in a similar position must be registered. If they have not registered then they are not entitled to claim back the input tax.

### **2.2.6.3 Effect of not registered**

A person who is to register for the VAT is taxable person who is subject to collect VAT on all supplied whether or not the person is registered.

### **2.2.6.4 Cancellation of Registration**

There are main three conditions for the cancellation of VAT registration. The first case is where a person has been registered for VAT property or not, the person registered for VAT but if this current level of business is below the threshold then his registration for VAT is cancelled. The second case is when the person is not allowed to carry any business activity by the law. The third case is when the person has registered for VAT by mistakenly or by misrepresentation on the part of the person.

### **2.2.6.5 Continuing registration despite a change in the taxable person**

Situations will arise where a person ceases carrying on a business unavoidably. For example, the death, insolvency, winding up of a company may mean that the person registered as running a business is no longer running it. The business will usually continue at least for a time to be run by some other person.

## **2.2.7 Supplies of goods and services**

### **2.2.7.1 Transaction within the scope of Law**

A board-based VAT brings its charge every kind of economic transactions, subject to limited exemptions. Transactions are usually stated to be within the scope of VAT if they are supplies of goods and services. The aim is to bring within the charge of all economic activity. The terms cover transaction dealing with land or other immovable property and with intellectual property rights.

### **2.2.7.2 Supplies of goods**

Supply of goods is a transfer of right to dispose of tangible movable property or of immovable property other than land. A supply of goods is not constituted merely by transfer of possession, which is a transfer of the use of goods, not of the goods themselves.

### **2.2.7.3 Supplies of services**

A supply of services is often defined as any supply within the scope of VAT that is not a supply of goods or a supply of land. A supply will occur whenever there is some transaction or event involving a taxable person whereby the taxable person receives payment for the effect of that transaction or event.

### **2.2.7.4 Supplies by employees**

The service undertaken by an employment for the employer that employee does not form a supply made by that employee. An employee can never be taxable person by providing that a person is taxable person in respect only of supplies made by that person immediately.

### **2.2.7.5 Supplies by agent**

When a supplier supplies goods or services through an agent to another person, the supply is made not by the agent but the supplier. An employee is the employer's agent. The employee's service, if supplied directly or indirectly to a third person, is a supply by the employer.

### **2.2.7.6 Mixed supplies and multiple supplies**

On board practical rule is to treat any supply incidental to a main supply as part of that main supply.

#### **2.2.7.6.1 When a supply of goods takes place**

Generally a supply of goods takes place when a VAT invoice issued for the supply goods are delivered, goods are made available, the goods are removed or transported to the customer, or the goods are paid fully partially.

#### **2.2.7.6.2 When a supply of service takes place**

Services are not delivered or appropriated in the same way as goods. Instead it is usual to determined the time of supply by reference to when the services have been rendered.

#### **2.2.7.6.3 Where a supply of goods takes place**

The VAT usually based on the destination principle that is with goods being subject to VAT where they are either received or consumed. For this reason, the goods crossing frontier are subject to a regime similar to custom duties on arrival. Therefore it is necessary to clarify where goods are received. In the case of imported goods, the adoption of customs law will help deal with this problem.

#### **2.2.7.6.4 Where a supply of services takes place**

Determining the location of a supply of services ca be a matter of considerable difficulty, especially for international services. Custom rules can not be used because they do not apply to services. There is no clear and universally accepted answer to the question of how to treat international services. The primary rule in the European Union is that the service is supplied where the supplier has established his business or has a fixed establishment or his permanent address or where he usually resides.

### **2.2.8 Treatment of imports**

The destination principle requires a charge to VAT to be placed on all imports. This is usually done.

#### **2.2.8.1 Taxable supplies**

A taxable supply is the supply or transaction on which VAT is imposed. When taxable supply is made and then a taxable person must be imposed and collect VAT and account for it to the tax authorities. Even if the person does not do this, the tax authorities are still entitled to collect VAT from the taxable person on the assumption that the VAT has been

imposed. VAT is a tax on supplies made in the course or furtherance of economic activity or put another way as part of a business. So it is confined to activities of this nature and is not imposed on other activities such as the personal hobbies of individual gifts made for personal reasons or charitable activities with any business or commercial content.

#### **2.2.8.2 Payment for a supply**

A supply is made for payment, consideration or compensations if the taxable person making the supply receives or is entitled to receive, payment for the supply. For this purpose, it does not matter in what from the payment is made. An exchange of goods is a supply for payment or consideration by both parties to the bargain as is a supply of goods in exchange for the provisions of services by the person receiving the goods. In addition, it does not matter, who makes the payment.

It will usually come from the person receiving the supply, but the source is irrelevant. Therefore some laws make it clear that all forms of payment are to be included as payment of consideration for the supply even if this includes grants made by public authorities or other third parties.

The concept that a supply is within the scope of VAT only if there is payment or consideration for it allows from the fundamental nature of the tax as one imposed on the value added by a transaction. If a supply does not result in gain for the supplier, the same reasoning argues that the consideration should include all forms of payment received by the supplier, in cash or in kind, whenever and however paid and regardless of who pays them.

#### **2.2.8.3 Transaction where no payment is payable**

In principle, if there is nothing paid or payable for a supply, then it is not a taxable supply. Safeguards are needed to prevent the operation of this principle from allowing transaction to escape a charge to VAT in appropriate situations.

#### **2.2.8.4 Supplies where payment is not full**

Together with transaction for which no payment is made, but where it is deemed to be made, mention must be made of supplies where the payment made is than the full payment or consideration that should or might be paid in the open market. If some payment is made, then the supply is within the scope of Vat.

### **2.2.8.5 Exempt supplies**

Exempt supplies are not taxable supplies. The standard way of dealing with this is to exempt certain form of supply that are otherwise with the scope of VAT from liability to VAT. By contrast, some states have adopted the practice of listing those supplies that subject to VAT.

It is open assumed that exemption results in the reduction of the VAT burden on the supply. This is true if the person supplies is a consumer and is not receiving the supply. It is not true if the person supplied is taxable person. Exemption of a supply to a business results in an increase in the burden of VAT on the supply.

The reason for this is that the person running the business can offset the VAT against the VAT charged by the business, so claiming a full rebate for any VAT. The person making the exempt supply will probably have had to pay VAT on some part of the supplies made to it and will therefore have to pass some VAT on the business as a part of its price.

It is this VAT that can be recovered if the supply is subject to tax, but that can not be recovered if it is exempt. To avoid the distortions cased by this failure to recover, it is good policy not to exempt the types of supply that are typically made to business.

New Zealand has maintained special exemptions on land and buildings supplies by nonprofit organizations and individuals and financial services. The tax exempt supplies can be put in to alternative taxes. States generally have accepted treaty obligations to exempt certain supplies or imports as a part of the recognition of diplomatic and consular immunities and of similar immunities for international organizations. There involve immunity from taxation for the embassies and consulates and for the recognized diplomats.

International practice recognizes agreed categories of goods that are exempted from customs duty on import. Practice on this is well established and ranges from the import of a limited quantity of goods bought duty free in other states to exemption of gifts to charities or similar organizations.

## **2.2.8.6 Taxable Value Supplies**

### **2.2.8.6.1 Charge to VAT**

VAT is designed as a tax levied as a proportion of the value added on any taxable supply. It is therefore necessary to attribute a value to all taxable supplies to ensure that this objective is achieved. To be consistent with the fundamental principles of the tax the value to be taxed must reflect the value added by the supply.

### **2.2.8.6.2 Value of International supplies**

The general rule for valuing a supply for VAT purpose is to value it at the total of all payments, or consideration, that the supplier receives or is entitled to receive as a result of the supply. In other words, the value is taken as the actual realized value.

### **2.2.8.6.3 Tax inclusive Vs. Exclusive Base**

The Value of a supply should be taken as including all other taxes paid on that supply. VAT is not an alternative from the excise tax or custom duty, but is a separate tax. Both custom duties and excise taxes reflect the stat's separate decisions to increase the price of the dutiable and excisable products by the amount of the duty or tax. That represents the value of final consumption of the goods for the VAT purpose and is therefore the basis of the Value for VAT.

It is felt that the combined effect of excise duty and VAT on a product is too high, the answer lies in adjusting the level of excise duty not of the VAT.

### **2.2.8.6.4 Fair market value of supply**

The open market price or some other objectively determined price will need to be determined in any case where a supply is treated as made for consideration although no consideration is actually paid or payable.

## **2.2.9 Adjustments and Rebates**

The Value added is always the discounted price. This is both consistent with the principles of the tax and the most practical answer. Complication arises where the effect of a discount or an arrangement on purchase result in later adjustment. In this case no amount should be taken of the charge in connection with the first transaction.

### **2.2.9.1 Value of imports**

In the special case of imports of goods it is standard practice to use the customs value of goods as the amount for VAT calculation, subject to specific adjustments. The customs

value generally represents an international agreed upon approach to the valuation of goods subject to customs duty and therefore minimizes the scope for difficulty or dispute in levying VAT on import.

#### **2.2.9.2 Payment of VAT**

There are two elements to establish how much VAT the taxable person must pay to the tax authorities. The first is the rate of VAT to be paid on the value of the supply. The second effect is the offset of input tax against output tax to identify the net VAT payable.

#### **2.2.9.3 Rates of VAT**

It is generally accepted that the VAT should not be used as a vehicle for imposing luxury rate of indirect tax. VAT will have a main or basic rate and one or more lower rates. Arguments for lower rates therefore concentrate on socially important goods such as food and socially important services that are not exempted or outside the scope of VAT.

#### **2.2.9.4 Zero Rates**

A zero rate means that, while no VAT is due on the supply, the supplier remains entitled to claim any tax incurred in making that supply and is therefore entitled to a refund of that input tax if there is no output tax against which to offset the input tax. From one point of view a tax rate of 0% is nonsense. It is not a rate of tax, and no tax is collected. A zero rate is therefore an exemption of the supply from output tax.

#### **2.2.9.5 Zero Rating exports and international supplies**

The main use of zero rating is to deal with exports of goods and exported supplies of international services. The destination principle calls not only for removing a direct charge to VAT from exports and international services but also for removing any VAT indirectly imposed on those supplies in the form of the input tax paid by supplier. Few states zero rate some internal supplies. This is widely viewed as inappropriate because it amounts to subsidy of the activity or transaction treated in this way. It would be better to identify the policy reason for the subsidy and address it through a direct subsidy.

#### **2.2.9.6 Paying VAT to tax authorities**

A taxable person is liable to pay VAT to the state authorities at regular intervals after deduction of any allowable input tax.



### **2.2.9.7 Entitlement to Credit for input Tax**

Any VAT incurred by taxable person as input tax should be repaid to that person in some way. The usual method of repayment is allowing the input tax to be set off as a deduction of credit against output tax collection during the same period. A duty is imposed on the taxable person to pay only the net amount to the tax authorities.

### **2.2.9.8 Partial Exemption**

The principles are that input tax incurred only for the purpose of making taxable supplies is allowed, but input tax incurred only some other purpose or purpose should not be allowed. Input tax incurred partially for the purpose of making taxable supplies and partly for other purpose should be apportioned so that only the part devoted for making taxable supplies is available for credit.

### **2.2.9.9 Disallowed Input Tax**

It is increasingly common practice for states to deny input tax credit for certain kinds of supply. The main group may be described as supplies of or for luxuries, amusement or entertainment.

### **2.1.9.10 Capital Goods**

For revenue protection reasons, some states have rules that input tax on capital goods or certain kinds of capital goods to be set off over a period of years in much the same way as the deduction of capital expenditure is controlled by capital allowances or depreciation for income tax purpose.

## **2.2.10 Procedures and Administration**

### **2.2.10.1 Need for specific VAT Rules**

Legislative approaches to dealing with administrative and procedural provision of tax law vary from state to state. In general, there are distinct advantages combining as far as possible the procedure and administration of VAT with that of other taxes.

### **2.2.10.2 Combining VAT and Customs administration on Imports**

The case of combining the collection of VAT on imports with the collection of customs duties is particularly strong. This approach ensures that powerful provisions exist to

handle VAT on Imports with minimum of legal difficulty, administrative provision and taxpayer's confusion.

### **2.2.10.3 Handling VAT on Internal Supplies**

There is also strong argument for combining the administration of the direct taxes. In particular, many taxpayers with business income will also be taxable persons for VAT purpose.

### **2.2.10.4 Regulations, Instructions and Guidance**

The tax an invasive tax and potentially applies to every aspect of the economy.

### **2.2.10.5 VAT Invoices**

A VAT invoice, chit, bill roll print or other document that is issued by a taxable person who makes a taxable supply and that records the supply and the amount of VAT payable on it. In an invoice-based VAT system the issue of invoices in the proper form is an essential part of the procedure for imposing and enforcing the VAT. The requirement that a special invoice be issued is a feature unique to VAT.

### **2.2.10.6 VAT Returns**

There should be a standard form return, so that taxable persons know precisely what is required of them and can comply more easily with the formalities of making a return and so that the tax administration can process return effectively.

### **2.2.10.7 Payment of VAT**

All taxable persons must pay to the tax authorities at specified time the net amount of VAT due for the VAT period on a self-assessment basis.

### **2.2.10.8 Assessment of VAT**

Where a taxable person has not made a return a period for, which a return should have been made the tax authorities should be given reserve powers to impose an obligation on the taxable person to pay VAT to tax authorities.

### **2.2.10.9 VAT periods**

The standard period is calendar month; often taxable persons with small levels of taxable turnover are allowed to use longer periods of three months or a year.

#### **2.2.10.10 Payment of Excess VAT Credit**

Where the input tax credit for any VAT period exceeds the output tax collected there is excess of VAT credit or of deductible input tax. As a direct result the taxable person will pay no VAT to the tax authorities for that period. In such case the tax authorities use that excess to offset future obligations.

#### **2.2.11 Historical Background**

The concept of VAT is originated from Germany in 1919. At the mean time Dr. Wilhem Von Siemen developed the philosophy and principle of VAT by recommending it for Germany to replace turnover tax (multistage sales tax) to avoid the problems of cascading effect. Professor Thomas S. Adams recommended VAT for the U.S.A. in 1921. A detailed structure of Value Added Tax was designed for Japan in 1949 to replace enterprise and turnover taxes. Due to the new concept and fear of its complicated nature, these countries couldn't introduce immediately. France introduced VAT for the first time in 1954. Ivory Coast introduced VAT in 1960, while Senegal adopted it in 1961. Denmark and Brazil implemented it in 1967.

Among the SAARC countries, India introduced MoDVAT (Modified Value Added Tax) in 1986 for manufacturing products in order to correct excise duty. Pakistan, Bangladesh and Srilanka adopted VAT in 1990, 1991 and 1998 respectively. Now a day more than 115 countries have implemented VAT as an indirect taxation in the world.

The concept of introducing VAT was developed along with the eight plan (1992-1997) when the government indicated its intention to convert the import/manufacturing level sales tax into VAT in that document of the plan. Preparation of VAT was initiated in September 1993 when VAT task force was created in the sales tax and excise department in order to make the necessary preparation for the interlocution of VAT. A VAT steering committee was also formed to evaluate and monitor VAT preparatory activities. After the depth study on various aspects relating to the structure and operation of VAT, the task force prepared the draft of VAT law in 1994.(pandit,2000)

It was discussed in depth at several stages within taskforce with concerned parties. After reviewed by the steering committee, the draft was sent to various business groups for their comments. Although the business community did not provide any written comments on the draft of VAT law, the private sector opposed to the implementation of VAT.

Due to the disagreement of private sector and political instability in those days, the government did not indicate its commitment to introduce VAT. They expressed the arguments that the infrastructures and preparation were insufficient to implement the VAT effectively. In September 1995, along with the formation of coalition government, it committed to introduce VAT in the same fiscal year 1995/96. The VAT bill was presented to the parliament on December 1995. As per the parliamentary process, it was referred to the Finance Committee (a parliamentary committee) and the committee returned the bill to the parliament on the same month together with its report for amendments to few provisions. The lower house of the parliament passed the VAT bill on the same month while upper house of the parliament passed it on January 1996. (Pandit,2000)

The Royal Seal was provided to "Value Added Tax Act. 1995 (2052)" on 21<sup>st</sup> March 1996. For the effective implementation and administration of VAT, the government established one VAT department in center and 17 VAT offices in different districts by changing the name of sales tax and excise department and its offices as VAT Department and VAT offices respectively.) 16<sup>th</sup> July 1996 (1<sup>st</sup> Shrawan, 2053). The Government has issued VAT rules 1997 (2053) in 24<sup>th</sup> March 1997. (www.ird.gov.np)

Since the strong opposition from the business community and from the opposition political parties, the government could not enact VAT laws immediately and had made a provision section 1.2 of Act and section 1.2 of the rules that VAT laws shall come into force on such date as HMG may specify by notification published in the Nepal Gazette. In this way the implementation of the VAT has postponed for some time although the Act was already provided the Royal seal. The Act finally had come to force as government specified the date of implementation of VAT by publishing in the Nepal Gazette on 16<sup>th</sup> November 1997 (1<sup>st</sup> Mangshir 2054). However, it could not be implemented VAT in full phase since 17<sup>th</sup> July 1998 (1<sup>st</sup> Shrawan 2055). (www.ird.gov.np)

It has been introduced as an improved indirect tax for the replacement of the sales tax. It has replaced hotel tax, entertainment tax, and contract tax and has been supposed to collect the same revenue as the four taxes it has replaced. Now VAT is administered through Inland Revenue Department and Inland Revenue Office as Department of VAT and department of Taxation are merged as Inland Revenue Department since July 2001 (2058/04/01).

Nepal has adopted board based consumption type VAT with credit method. This means the tax base is domestic consumption only. Some social or political grounds including exports of goods and services are zero-rated. Some goods and services like goods and services of basic needs. Agricultural products, social welfare services, educational goods and services and cultural goods and services are tax exempted. Otherwise tax levied at 13%, which previously was 10%.

#### **2.2.11.1 International experience of VAT**

After three and half decades of proposition of concept of VAT by Dr. Wilhelm Von Siemen in Germany, France took the courage to put VAT into practice in 1954. In the 1960s, then European community adopted VAT as its standard tax system. Adoption of turned to be precondition to get its membership. Later VAT took global momentum during 1970s. Now, around 125 countries have incorporated VAT into their tax system and several new countries are sincerely contemplating the introduction of VAT.

while the VAT system of New Zealand stands as an example in the world, the implementation of VAT in Ghana for the first time was not a good experience. New Zealand, in 1977, was the first state to adopt a form of VAT with minimal exemptions. The New Zealand exemption are financial service, certain supplies by mosses profit bodies, certain supplies of accommodation and land; supplies of gold and fine metals. The threshold of NewZealnd, NZ \$ 2500 was suggested to increase and later on it was raised to NZ \$ 40,000.

The New Zealand example has been followed in Singapore. VAT was implemented successfully in Singapore. In the process of implementing VAT in Singapore, there was active involvement of various institutions. The high level of preparation and participation made it a success story. But the situation was just the reverse in Ghana. Low level of commitment at the political level impeded the implementation of VAT in the country. VAT was abolished after three months of its introduction in 1995 and was reintroduced again in 1998. Introduction of various exemptions distorted the basic norms of the system. VAT was introduced in 1995 and was abolished after a charge in the Government

in 1997 and it was reintroduced in 1999 in Malta.  
([en.wikipedia.org/wiki/Value\\_added\\_tax](http://en.wikipedia.org/wiki/Value_added_tax))

China implemented VAT on Experimental basis in selected provinces and on selected goods only. In 1982, VAT implemented throughout China but only one selected goods.

The process of including more goods was extended from 1984 and VAT was implemented fully in 1994. Initially, this tax was limited to only the production stage of selected goods, both subtraction and tax credit methods of tax calculation were adopted, only a partial tax credit system was adopted, and several rates were applied. In addition, since this tax was levied on the basis of goods such as production tax, business tax, sales tax, etc. it became rather complex and China could not benefit much from this tax system. The experience of China indicates that in order for VAT to be effective it should be implemented fully no partially. India implemented MOD-VAT in 1986 on certain goods and this was gradually expanded. Owing to reason such as Indians federal system and the constitutional provisions that grant the rights to governments at different level to implement tax, it is not possible to replace the tax being imposed on goods and services at the central, state and local levels by VAT at the central level. The states of Maharastra, Andhara Pradesh, Kerala, West Bengal, Rajsthan and Uttar Pradesh made effort to convert their sales tax system into the VAT system. ([en.wikipedia.org/wiki/Value\\_added\\_tax](http://en.wikipedia.org/wiki/Value_added_tax))

However owing to factors such as Maharastra establishing a very high threshold, some states trying to only partially implement VAT and the fact that the neighboring states had not satisfactory, the experience illustrated the fact that the implementation of VAT can not be successful if applied only to limited areas or on limited goods by establishing a very high or low threshold. VAT was introduced in Bangladesh in 1991. It has a uniform tax rate of 15 percent. It has exempted VAT experts, which has helped to boost its export trade. ([en.wikipedia.org/wiki/Value\\_added\\_tax](http://en.wikipedia.org/wiki/Value_added_tax))

### **2.2.11.2 Introduction of VAT in Nepal**

Measures for economic reform were introduced in Nepal after the restoration of the multi-party democratic system. Tax reform was a part of this economic reform and value added tax emerged as the main feature of the tax reform program. To bring about sustainability in internal resource mobilization, His Majesty's Government of Nepal adopted the policy to integrate the prevailing commodity taxes under VAT within the period of the eight five year development plan (1992/93-1996/7). In the budget speech of

the fiscal year 1993/94 and the speeches thereafter the intention to introduce VAT declared. It was necessary to introduce this tax system owing to the following reasons:

To increase revenue mobilization by broadening the tax base,

To make the tax system neutral and efficient and

To establish a fair and transparent tax system

The preparation for the introduction of VAT was commenced in September 1993. For this purpose a steering committee and a task force were formed. The financial assistance for preparatory work to introduce VAT was provided by the United State's Agency for International Development (USAID) and the technical assistance by the Harvard Institute for International Development (HIID) of the Harvard University, USA. However, the announcement in 129094 to hold mid-term election brought about slackness in the preparation activities for VAT.

The new minority government dissolved the task force and the USAID activities were suspended. New coalition government decided to introduce VAT at the earliest date. As a consequence, the USAID/HIID technical assistance resumed and continued until the end of September 1997.

The VAT bill was presented to the parliament on 3 December 1995. It was referred to the finance Committee of the parliament, which held discussions over it on 24, 25 and 26 December 1995. The Finance Committee sent the bill to the parliament on 27 December 1995 together with its report for amendments to a few provisions. The lower House of parliament passed the VAT Bill on 30 December 1995 and the Upper House of parliament on January 1996. The VAT regulations were initially drafted in July 1996. Like the VAT Act. Regulations were discussed at different stages and finally approved by the cabinet on 27 January 1997.

As VAT was a new concept in Nepal, a comprehensive taxpayer education program was launched to impart knowledge regarding the various aspects of VAT to parliamentarians, industrialists, businessmen, journalists, consumers as well as various sections of the society. Seminars and interaction programs were organized as the part of the taxpayer educational program. Interaction programs were also held with various specific associations and professional organizations. To educate the potential taxpayers and various sectors of the society on various aspects of VAT, brochures were prepared and distributed in large scale.

Through the budget speech of the fiscal year 1996/97, His Majesty's government of Nepal declared that all taxpayers should register within 90 days from April 16, 1997 and that VAT collection would commence from the beginning of the fiscal year 1997/1998. But after the change in the government in April 1997, the new government decided to postpone the date for VAT implementation and published a gazette notification declaring that VAT would commence on 16 November 1997. However after the implementation of this Act there stood strong opposition from the business community.

Nepal has adopted, as all VAT levying countries, the consumption type VAT with tax credit method. But within this provisions based n our specific context have been made regarding the following aspects: goods and services to be exempted, the threshold level, the structure of the tax rate, provisions of tax refund and tax credit etc. Therefore, mistakes have been observed in the VAT structure and operations process. VAT also puts pressure on the reform of customs duty and income tax. For example, to ease the implementation of VAT, the government had adopted the policy of accepting the transaction price for the purpose of customs duties and made provisions for the income tax to be assessed on the basis of VAT accounts. The practice of VAT in Nepal includes the following aspects:

### **2.2.12 Basic Features of VAT in Nepal**

Type	Consumption type of VAT
Method of calculation	Tax credit method
Principle of levy VAT	Destination principle
Level Threshold	Rs. 2 million
Rate	13%
Provisions of exemptions	As per Schedule 1
Provisions of Zero rating	As per Schedule 2
Facility of tax refund	To exporters, diplomats, non exporters and Zero rated and exempt

Source: [www.ird.gov.np](http://www.ird.gov.np)

#### **2.2.12.1 Taxable Supply**

VAT levied on taxable supply, which is defined as the process of selling exchanging or delivering goods or services; or the grant of permission thereto or a contract thereof for a consideration. To be taxable supply the consideration can be in money of money's work.



### 2.2.12.2 Place of supply

Under the Nepalese VAT system the place of supply is defined as follows

Goods/Service	Place of supply
Movable goods	Point of sale or transfer
Immovable goods	Location
Imported Goods	First entrance point of customs
Goods supplied by the vendor	Vendor's Residence
Service	Point of service receipt

Source: [www.ird.gov.np](http://www.ird.gov.np)

### 2.2.12.3 Time of supply of VAT

General Rule	Earlier of the time of the supply or the issue or receipt of the payment
Special Provisions	Time of the issue of invoice for continuously provides services and date of first payment for partial payment

Source: [www.ird.gov.np](http://www.ird.gov.np)

### 2.2.12.4 Taxable Value of VAT

Expenditures to be included	All other related expenditure incurred by the supplies and taxes except VAT
Lower transaction Value	Prevelling market value is approved

Source: [www.ird.gov.np](http://www.ird.gov.np)

### Tax Credit

It is necessary to meet the following conditions for entitlement of an input tax credit

In case of taxable supply	Inputs should be used only for taxable sales, should have valid invoice and should claim within one year
In case of mixed supply	Tax credit for taxable sales and no tax credit for exempt sales
In case of personal use	Partial tax credit for mixed use and no tax credit for only personal use

Source: [www.ird.gov.np](http://www.ird.gov.np)

### 2.2.12.6 Tax Refund in VAT

Refund to exporters	more than 50% sales as export
Refund to non-exporters	Excess tax credit constantly for half year
Refund to diplomats	zero rated imports and refund for domestic products.
Refund to others	Refund of VAT collected by mistake

Source: www.ird.gov.np

### 2.2.12.7 VAT Administration

#### 2.2.12.7.1 Registration

Compulsory registration	Volume of transaction exceed the level of threshold
Voluntary registration	vendors falling below the threshold level for registration

Source: www.ird.gov.np

#### Deregistration

The taxpayer is deregistration in the following conditions:

In case of incorporated body	Closed, sold, and transerred
In case of partnership firm	partnership is dissolved
In case of sole trading	death of owner
In case of registered person	cases to be engaged in taxable transaction or registered in error

Source: www.ird.gov.np

#### Taxpayer identification number

TPIN is issued by the VAT administration. TPIN once issued for a particular taxpayer is not issued to others even the taxpayer is deregistered. The TPIN should be mentioned in the following documents:

- ) Tax invoice or abbreviated invoice
- ) Purchase and sales books;
- ) Correspondence to the VAT office;
- ) Documents relating to the income tax;
- ) Documents relating to the customs duties;

- )] Documents relating to the exports/imports; and
- )] Documents relating to obtaining loan from the banks or the financial institutions exceeding Rs. 1,00,000  
(www.ird.gov.np)

## **2.2.12.8 Invoicing**

### **2.2.12.8.1 Tax Invoice**

A VAT registrant is required to issue a tax invoice in the prescribed form whenever a transaction takes place. A minimum of three copies of each invoice must be prepared. The first copy must be given to the buyer and the vendor must retain the rest copies.

### **2.2.12.8.2 Abbreviated Invoice**

VAT registrant may prepare abbreviated invoice under the following conditions:

- )] The recipient of goods or service for which an abbreviated invoice is issued shall not be entitled to put tax credit in that purchase.
- )] The abbreviated invoice shall not be issued for transaction exceeding Rs. 5000 inclusive of VAT.
- )] The registered person must keep the daily record of sales.
- )] Any cash rolls used by the retailer must be totaled daily and retained for inspection at any reasonable time.  
(Source: www.ird.gov.np)

## **2.2.12.9 VAT Accounting**

Purchase Book	Account of the purchase for VAT use
Sales Book	Account of the sales for VAT purpose
VAT	Monthly summary of taxable purchase, sales and VAT paid on purchase; and VAT charged on sales.
Others	With prior approval of VAT authority

Source: www.ird.gov.np

### **2.2.12.9.1 Submission of return**

A VAT registered must submit a VAT return to the concerned VAT office within 25 days of the month following the end of the accounting period. In case of compulsory registrants, it is necessary to submit VAT return every month but the voluntary registrants

have to submit the returns on a trimester basis. Otherwise, the registrant will be subject to a penalty of 0.5% of payable tax per day or Rs. 500, whichever is higher.

#### **2.2.12.9.2 Payment of Tax**

If a registrant's output tax liability is greater than his input tax credit, the registrant is to remit the difference to the government with 25 days from the close of the month in which the tax liability occurred. If the input tax liability is greater than the output tax liability, the balance of credit is to be carried forward for the next month.

#### **2.2.12.10 Tax Assessment**

##### **2.2.12.10.1 General**

VAT is self assessed tax. Taxpayers determine their tax liability themselves and pay tax. But sometimes the taxpayers fail to remit tax on time due to fraudulent reason as well as others. At this time tax authority may carry out tax assessment under the following situations:

- ) Tax return is not filed
- ) Tax return is late
- ) Tax return contains incomplete information and
- ) The tax administration has the reason to believe that the tax is otherwise is declared.

(www.ird.gov.np)

##### **2.2.12.10.2 Computer Assessment**

Computer prints out the list of non filers after 45 days of the expiry of the tax period. Then the computer assessment is carried out in the following ways:

- ) Find out highest amount declared by the tax payer in his tax returns during the previous 12 months from the VAT payable.
- ) If the tax payer has not filed any return, find the turnover figure stated on the registration application. Divided by the number of filing periods in a year and then multiply by the VAT rate.
- ) Pick the highest figures in 1 or 2 above.

To increase the number found in 3 by 30% to get the assessment amount. Then the different sections exchange information for the accuracy of the calculation carried out by the computer and finally assessment orders are issued and distributed to the concerned parties.

(www.ird.gov.np)

### **2.2.12.10.3 Management Assessment**

The tax officers do management assessment when a taxpayer receives updated information after submitting his returns and informs it to the tax officer or in the case of those taxpayers where tax officers find errors during the tax audit.

The management assessment process is given below.

- J Tax officer assesses tax and determines interest and penalties;
- J Tax officer creates management assessment on trimester basis in case of others;
- J Management assessment must be batched and submitted to the computer section.
- J VAT assessment will only normally extend back four years from the time the taxpayers is given the notice of assessment.

(www.ird.gov.np)

### **2.2.12.11 Collection**

VAT administration collects tax through the following methods:

- J Tax officers are empowered to recover tax dues from the credit in VAT debtors' accounts.
- J Tax officers also can issue to third party who is indebted to the VAT debtor a demand for the payment of the money owed by the third party to the VAT debtor.
- J Tax officers are also authorized to suspend the transaction of a VAT debtor.
- J Tax officer also can withhold export/import of VAT debtor.
- J Tax dues also can be realized by seizing and selling the property of the VAT debtor.
- J Tax officers can collect tax arrears within six years of such arrears becoming due.

(www.ird.gov.np)

### **2.2.12.12 Penal Provisions**

Type of non-compliance	Penalty provisions
Failure to register before the	Liable tax plus Rs. 10,000 or 10% of the

commencement of the business	payable tax whichever is higher
Non-issuance of invoice	Rs. 500 each time
Failure to maintain required account	Rs. 10,000 each time
Fraudulent or tax evading activity	Not exceeding 100 of the tax amount or 6 months jail or both

Source: [www.ird.gov.np](http://www.ird.gov.np)

### **2.2.12.13 Appeals**

A taxpayer may file an appeal to the Revenue Tribunal within 35 days against a tax assessment or penalty order by a tax officer of an order by the Director General relating to the suspension of his place of transaction. Before filing an appeal, the tax payer must deposit the disputed amount of the tax assessed tax due; the rest amount of the tax due surplus the whole amount of the fine shall have to be deposited or a bank guarantee of the same has to be provided.

### **2.2.12.14 Tax law designing and drafting**

It is International monetary fund publication. It deals with the drafting and designing of different tax laws. VAT is also discussed here. VAT has been dealt by David Williams. The article confers standard practices on VAT in the international context. It begins with the general introduction of the VAT. The present status of VAT, its terminologies, economic implication, territorial scope, charges to VAT and its principle of non-discrimination are covered in the introduction section.

### **2.2.12.15 Sales tax vs. VAT again**

According to Nil Seine VAT, (as well as any other tax) distorts what would have happened without it. Because the price for someone rises, not all the goods that would have been traded were there no tax are traded. Correspondingly, some people are worse off than the government is made better off by tax income. In other words, a deadweight loss is created. The income lost by those being taxed is greater than the government's income; the tax inefficient.

There is an important additional function of VAT as a suppressant - cash flow. All inputs must be paid (cash outflow) inclusive of VAT. This money must come from somewhere. In many cases this is debt, with interest cost. If not debt then at the very least there is an opportunity cost (the money cannot be invested elsewhere) Sure there is VAT included in the sale price (cash inflow), but this is only received a while later. Therefore not only are intermediate companies administering and collection VAT on behalf of governments, they are also financing it. Furthermore, if a customer is late paying, the intermediate company must still pay the VAT over to the government even if they have not themselves been paid yet, which can be a further huge drain on cash flow. This alone has put many companies out of business and is a fundamental reason why VAT is a major contributor to the far; far lower GDP per capita of EU when compared to USA.

(<http://en.wikipedia.org/wiki>)

#### **2.2.12.15 VAT and Inflation**

According to an article by Alan S.Tait based on his survey global voice in concerned countries introducing value-added tax is that the introduction of the tax would set in motion a spiral in which tax, prices and wages would feed on each other that is, VAT would be inflationary was heard. There are a number of variables influencing price change, and therefore, it is difficult to empirically assess the effect of VAT on prices. The impact of VAT on prices, therefore, cannot be strictly segregated from the general trend in inflation.

First, the taxes that have been replaced are also relevant. They could be a wholesale sales tax of the cascading type, a simpler VAT, a multistage ring system, a cascade production tax and so on.

Second, the design to yield equal or higher revenue also makes a difference. Third, other concurrent changes such as rise in oil or steel prices in international and internal market, increase in utility rates, changes in wage level, administrative changes such as tighter monetary policy, price control, monitoring of prices and so on, make due impact on the price rise. It is seen that the net price effect of VAT would be nil if the VAT is equal-yield tax. There would not be any effect on the overall price change although there may be changes in relative price. The tax being revenue neutral, the aggregate demand is unchanged and so there would be no impact on the aggregate price level. The economists all over the world have viewed that VAT not inflationary.

Thus, this brings us to conclude that the potentially inflationary effect can be constrained by government policies to inform the public and traders about the expected effect of VAT on prices, the use of price control, monitoring of prices, offsetting adjustment in other taxes and generous provisions to ensure to full credit for previously paid taxes on inputs. Moreover a mechanized form of Government can give it better shape through administration. (www.economywatch.com)

## **2.3 Review of Related Studies**

This chapter is developed to the review of various contemporary literature of tax reform on VAT. In this section it is tried to review the existing empirical literature briefly on the subject in various developing countries including Nepal.

Carl S, Shoup(1969) explains values added tax as the latest and probably the final stage in the historical development of general sales taxation at the national level which is levied on the value added, the difference between the sales proceed and the cost of the materials, etc, that has purchased from other firms. VAT has eliminated the uneven impact of the turnover tax and the manufacturers and wholesaler sales taxes. A comprehensive consumption type of VAT is equivalent to a retail sales tax in its pure form except that the later does not after an option between the destination principle and the origin principle shoup has explain VAT differently in closed and open economy as follows.

### **Value Added Tax in Closed Economy**

i. Gross Product Value Added Tax: Under this type of VAT, purchases from other firms that are deductible from sales exclude purchase of capital goods which includes any asset that will not be used up entirely within the tax year of purchase. Further depreciation in successive years is not allowed to deduct from the tax base. Thus this tax creates an incentive to the firms to use that method of production, which do not require capital assets and do not involve frequency year to year fluctuation in physical volume of inventories. Therefore, tax base = GNP =  $C+I=W+P+D$

Where, C= Consumption, I = Gross Investment, W = Wages, P = Net profit after depreciation, D = Depreciation.



ii. Income type of Value added Tax: In these types of VAT, tax base excludes depreciation although purchases of capital goods are not permitted to deduct. Thus, Aggregate base  $NNI = C+I-D=W+P$

iii. Capital exemption types of Value Added Tax: There are types of VAT which exempt purchase of capital goods from the tax base in either way a) Wages types of value added Tax: In a two-sector economy, the base for this type of VAT ID NNI after deduction from the firm's capital for that year. Therefore tax base =  $Y_p = Y - p = C+I-D=W$  Where,  $Y_p = NNP$  and  $Y = NNI$ . b) Consumption type of Value Added Tax: this type of VAT requires the deduction of full value of the capital goods purchased from the other firms in the same tax year but depreciation are not allowed to deduct in subsequent year. Therefore, tax bas =  $C=W+P+D-I$

#### Value Added Tax in Open Economy

In an open economy, considering relative unimportant of the gross – product type of VAT from practical point of view, more focus is given to capital – exemption types of VAT.

i) Wage type of VAT: Under this type of VAT, in an open economy, the destination principle is less suitable as it would require each import be broken down into the same two elements, so that a tax rebate can be given for the value Added Tax paid domestically at earlier stages on the wage element. These complications are entailed under origin principle; moreover, no tax refunds on account of the exemption of profits will be required.

ii) Consumption type of VAT: Considering a two country world, this type of VAT under destination principle would exempt one country's firm's export sale and would impose a tax on the import purchase of another country's firm. This type would be much simple for both tax payer and tax administration under destination principle. The tax bases under two different principles are given by:

Under destination principle,

Tax base =  $C = W+P+D-X+M$ :

Under origin Principle,

Tax base =  $C+I = W+P+D-X+M$ :

$I =$  capital goods purchased.

In conclusion, consumption type of VAT is regarded superior however, wage type of VAT is simpler than consumption type under the origin principle, While analyzing the computing method of VAT the author favors the tax credit method, however, the origin principle and the tax credit method are somewhat in compatible though perhaps not so much. So a country moving to the origin principle need give up the use of the tax credit method. Lastly, VAT a more productive and neutral tax is also complex and regressive in nature.

A study of VAT in developing countries undertaken by the IMF staffs (1973) states that many developing countries have been giving increased attention to VAT as a means of rationalizing their sales taxes and improving their revenue following the adoption of this form of tax by Western European Countries Comparative analytical methodology is being used to analyze the VAT structure of seven developing countries and its covers several issues such as revenue productively administrative difficulties and comparison of VAT with other sales taxes. The study considers that VAT can be mode neutral only. With a comprehensive a uniform coverage. More elastic and revenue productive by a lower rate ease in cross-checking, less incentive for tax evasion, and superior even than the retailer's sales tax on the ground of neutrally are the good features of VAT and achievement of these features largely depends on the implementation aspect. Experience shows that developing countries are adopt to limit the range of the VAT by excluding the most troublesome sectors because they pose different problems. In general, VAT will have faster speed than the GDP trend; Fundamental difficulties in developing countries arise from the problem of dealing with small taxpayers. VAT is suggested to extend retail level only after getting experience from other sales taxes. Lastly, study considers VAT as a major step in the process of Tax reform in the world, however, it may be and additional burden when administrative structure is poorly designed.

John F. Due (1976) analyzed the different aspect of VAT. Especially, in the context of developing countries through a paper entitled "Value Added Taxation in Developing Economic". The first part of the study deals theoretical aspect including nature and history of VAT and the next part analyses the implementation aspect in developing countries and makes useful recommendation for its successful implementation.

Theoretical Aspect:

Considering the types of VAT, he states that there are several bases for classifying Value Added Taxes. VAT serves distinctive features of 'Fractional' impact without 'cascade' features and it applies only to the valued added, but at more than one stage in production and distribution. The evaluation criterion of the tax in the developing countries must be based on the goals of the country, and hence the criterions for taxation are:

I) Maximum net contribution to economic development, II) Minimum adverse effect on efficiency in the utilization of resources and encouragement of greater efficiency, if possible. III) Ease of administration of the taxes. IV) Maximum contribution to the attainment.

Richard A. Musgrave and Peggy B. Musgrave (1976) state that a sales tax may be imposed in either single or multiple stages. A properly implemented Value Added Tax is equivalent to corresponding single stage tax, from the economists' point of view. VAT has come to be the basic instrument of tax coordination among common market countries, where it has replaced widespread use of turnover taxes. Bases of a consumption types of VAT is same as that of retail, sales tax, notwithstanding, the difference in techniques; only the method of collection differs. Hence Choice between the two must be made in terms of administrative convenience. Only the value-added approach is feasible if a sales tax is to be imposed on net product.

Among the three types of VAT: GNP types, income type and consumption type, the last one is most important from the practical point of view and it also involves both efficiency and equity criterion. Among the three types of computing base for VAT, the addition method is readily applicable to the income type but clumsy for the consumption type of VAT. By making the tax credit for each firm contingent on presentation of the tax receipt made out to the preceding supplier. The invoice method includes a self-enforcing element because each will demand copy of such a receipt. This method, further, constitutes an advantage of the value added approach, especially in those countries where tax compliance is otherwise poor.

Richard Goode (1984) in a book "Government Finance in Developing Countries" state that the Value Added Tax is the most important tax innovation of the second half of the twentieth century and it applies to the value added at successive stages of production and distribution. VAT, a sales tax on consumption is fairer than an income tax because the later result in double taxation of saving is unconvincing but the former lacks the

progressiveness which is served by the later. The following merits of VAT are explained by him: i) It is board-based and relatively natural ii) It avoids both simple cascading and cumulative taxation of goods of producer that are not physically incorporated in the product. Iii) Spreading the tax over the several stages of production and distribution is often considered an administrative advantage compared with collection it all at one stage because enterprises have less incentive to evade tax. Iv) it generates the possibility of using information as a crosscheck on compliance with other taxes, particularly income taxes. Besides these, suitability of VAT is questionable for countries where small enterprise is important, accounting is unreliable and administration is we is weak.

Alan A. Tait (1991) in a paper entitled “VAT policy, Issues: Structure Regressively, Inflation and Exports” mainly deals on the policy issues of VAT by illustrating some theoretical as well as empirical proofs. He was made the following conclusions. VAT provides a new buoyant revenue base and improves tax system in terms of neutrality and efficiency. Experience broadly shows that VAT contributes from 12 percent to 30 percent of revenue in most countries, representing about 5 to 10 percent of gross national production. However, VAT is more complicated than other sales taxes from administrative point of view as substantial refunds can be involved. Further, Collecting VAT and paying refunds make it inefficient.

Lastly at least if VAT can not promote exports would make the system easier. A VAT admonition is affected by the decisions regarding: Where all retail state are included, should services be taxed, choice of proper rates, and the treatment of capital goods, financial service, foods, small traders.

Kwang Choi (1993) analyses and evaluates the vat experience in Korea through this paper “Value Added Tax in the public of Korea” The study captures all the aspects from its introduction to effects on the economy. VAT in the republic of Korea was introduced in 1977 as a major step of tax reform with the objectives of simplifying tax structure and its administration, promoting exports and capital formation, besides these, introduction of VAT was also supported by the expectation of higher revenue productively and maintaining neutrality in the existing indirect tax system. A single rate of 10 percent was used since the introduction of VAT and general characteristics remained same as the VAT adopted by the European countries. Korea, VAT was of the consumption type covering all the stage of production and distribution and the tax credit method was used for

computation. Experience showed good symptoms for the prospects of VAT, as the effects of VAT on the economy were lesser than expectation made by either VAT supporter or opponents. VAT showed a good impact on investment and encouraged exporters as compared to the previous tax system, and there were no major impacts on price increase, as well.

However VAT being a member of indirect taxation, could not remain exception from the Viewpoint of regressively. To some extent, there was regressive impact of VAT with respect to income. The experience showed that practice is not as simple as theory. It creates a host of problems that gave rise to voluminous paper work, more or less arbitrary distortions in trade and consumption, and inequalities in the distribution of tax burden. From the policy point of view, VAT revolved around three issues: (i) coverage of the VAT, (ii) the level and structure of the tax rate and (iii) the treatment of small taxpayers. The study, by analyzing positive and negative results of VAT, concludes that Korean VAT has worked relatively well and in some cases much better than its designers and taxpayers had anticipated. As compared to previous taxes, VAT has broadened the tax base, reduced evasion, increased revenue and eliminated many problems that were in existence. Further, Korean experience provided proper lesson for other countries to tackle with the problems and issues relating to VAT implementation including coverage, rate structure, administration, special taxpayers, coordination with direct taxation etc.

Dr. Govinda Bahadur Thapa made an effort on “Value Added Tax in Nepalese Context” by means of an article in (1994), published in Mirmire, the conclusion derived was considering the present condition of Nepal facing government expenditure, low revenue effort, high dependency on foreign loan, need of more economic growth of the economy, and because of low revenue potentiality from direct taxes there is prompt need to improve the sales tax of Nepal. But there is less chance to mobilize more revenue through existing form of sales tax. In this context there is no any other alternate except introducing VAT in Nepal.

Rup Bahadur Khadka (2000) Identifying the major area to be reformed, he states that since the implementation of VAT is great jump from the traditional tax system to a modern one, several things still need to be done for the successful implementation of VAT in Nepal.

He points out a few key ones:

- i) The tax administration should be reoriented in the light of this modern tax.
- ii) The tax investigation and audit should be made effective.
- iii) Adequate measure must be taken so that both tax performing their new responsibilities under VAT system.
- iv) The tax investigation and audit should be made effective.
- v) Adequate measure must be taken so that both tax performing their new responsibilities under VAT system.
- vi) VAT administration should be computerized for its effective implementation.
- vii) There should be the provision of tax payer education programme.
- viii) The existing exemption list is rather long. So the exemption list must be shortened gradually.

Raju Chaudhari (2001), in his dissertation, VAT in Nepal: An Analysis of its problems and prospects, having the objective to review historical background of VAT, to examine the structure of VAT in Nepal, to observe the contribution of VAT to resource mobilization and to analyze the existing problems of VAT in Nepal through the primary and secondary data and information, has concluded that the main problems for business houses are account keeping and billing and the weakness of VAT administration are lack of motivation and service minded attitude among tax officials lack of honesty in VAT officers. Though from the theoretical point of view it is sure that VAT system is the best and advanced fiscal tool, its effect in the context of Nepal is not as expected because of the lack of strong and honest tax administrator, lack of motivation and service minded attitude among the tax officials, lack of the cooperation of business community, lack of strong coordination between tax collectors and tax payers, lack of strong political commitment and weak public consciousness. He has further recommended some suggestions for better solution of these problems. Tax related information should be published regularly. Interview programs with professor, researchers, tax experts, and economists should be conducted and published through advertising media. Often escape away from actual custom duty, as under valuation of the goods has been a tradition. Thus to overcome these problems, the government either has to collect the custom duty of the actual price of the goods or it has to fix the actual price of the goods in the market. Enforcement should be effective through more audits, investigation and collection visits

and integrated approach to total tax system should be introduced for successful implementation of VAT.

Bhattarai & Koirala (2007) in a book “Taxation in Nepal with Tax Planning and VAT” state that VAT is a general consumption tax assessed on the value added to goods and services. It is a general tax that applies, in principle, to all commercial activities involving the production and distribution of goods and the provision of services. It is a consumption tax because it is borne ultimately by the final consumer. It is not a charge on companies. It is charged as a percentage of price, which means that the actual tax burden is visible at each stage in the production and distribution chain. It is an indirect tax, in that the tax is collected from someone other than the person who actually bears the cost of the tax (namely the seller rather than the consumer). As VAT is intended as a tax on consumption, exports (which are, by definition, consumed abroad) are usually not subject to VAT or VAT is refunded.

Bhattarai & Koirala also analyzed the basic 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 can be obtained either by adding payments to factors of production (i.e., wages+rent+interest+profit) 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 contain catch-up effect.

Subedi (2010), in his dissertation, VAT in Nepal: An Analysis of its problems and prospects examined the value added tax practices in Nepal and studied the contribution of VAT to resource mobilization. His study analyzed the existing problems of VAT in Nepal through the primary and secondary data and information. The study had major findings as below;

- I. Main problems for business houses are account keeping and billing and the weakness of VAT administration are lack of motivation and service minded attitude among tax officials and lack of honesty in VAT officers.

- II. Though from the theoretical point of view it is sure that VAT system is the best and advanced fiscal tool, its effect in the context of Nepal is not as expected because of the lack of strong and honest tax administer, lack of motivation and service minded attitude among the tax officials, lack of the cooperation of business community, lack of strong coordination between tax collectors and tax payers, lack of strong political commitment and weak public consciousness.
- III. He has further recommended some suggestion for better solution of these problems. Tax related information should be published regularly. Interview programs with professor, researchers, tax experts, and economists should be conducted and published through advertising media.

#### **2.4 Research Gap**

There are a number of studies related to the value added taxes in Nepal. All the studies are related with the study of problems and prospects of value added tax implementation in Nepal. Some studies have also focused the contribution of VAT in government revenue in Nepal. Major studies are conducted in the context of past data, and they have applied the descriptive methodology but the present study is different from the earlier work in the sense that it has adopted the analytical and survey approach in the study of VAT practices in Nepal. Further the present study also focuses in the practice adopted in Chitwan districts by making survey of businessman, VAT implementation agency officers and academicians hence this study will contribute to the field from newer perspectives.



## **CHAPTER- THREE**

### **RESEARCH METHODOLOGY**

Research methodology is a research method used to meet the specified objectives. It is a systematic way to find out the probable solution. It refers to the various sequential steps (along with rationale of each step) to be adopted by a researcher in studying the problem with certain objectives in view. Thus the research method designed to achieve the objectives of this thesis contains research design, population and sample, data collection procedure, tools for analysis and methods of analysis and presentations.

#### **3.5 Research Design**

The research design is a plan, structure and strategy of investigation conceived so as to obtain answers to research questions and to control variance. The plan is the overall scheme or program of the research. It includes an outline of what the investigator will do from writing the hypothesis and their operational implications to the final analysis of the data. The purpose of the research design is to provide a maximum amount of information relevant to the problem under investigation at a minimum cost.

This research study is concerned with past phenomena both numerical as well as opinions. This study is both descriptive and analytical.

#### **3.6 Population and Sample**

The population for this study was comprised of the entire person belonging to or associated with Value Added Tax in Nepal. They were Tax administrators, Auditors, Experts, Business persons and Customers. In order to fulfill the objectives of the study, 100 samples from the population in the Chitwan district were carefully selected by consultation with lecturers and best judgment of the researcher. The respondents could be divided into three groups. The following Table shows the groups of respondents and the size of samples.

**Table 3.1**  
**Group of Respondents and Sample size**

S. No.	Group of Respondents	Sample Size	Percentage
1.	Tax Authorities/Policy Makers	10	10
2.	Experts/Economists	25	25
3.	Auditors	5	5
4.	Businessmen	30	30
5.	Consumers	30	30
	Total	100	100

### **3.7 Nature and Sources of Data**

Both primary as well as secondary data were collected in order to achieve the real and factual result out of this research. Since the nature of these primary and secondary data is different, collection procedure also tend to vary. A set of questionnaires was designed and distributed to the selected respondents well-learned in and at least familiar to VAT and its implications. Information and data were also collected from respondent through field visit by the researcher. The secondary data were collected through annual reports, different books and publications. The sources and data collection procedure is explained below.

#### **2.3.1 Primary Sources**

The primary data were collected through following techniques:

- a. Interview
- b. Questionnaire
- c. Telephone queries
- d. Discussion with resource persons
- e. Field Survey

#### **2.3.2 Secondary Sources**

The secondary data of this research were collected from the following sources:

- a. Published and unpublished reports, articles and dissertations on the concerned subject.
- b. Published documents of National Planning Commission
- c. Publication and annual report of Inland Revenue Department (IRD)
- d. Different publication of Central Bureau of Statistics.

- e. Publications of Nepal Rastra Bank
- f. Various books written by tax officers and scholars
- g. Publications, Budget Speeches and Economic Survey of various fiscal year of Ministry of Finance, the Government of Nepal.
- h. Newspapers, such as, Gorkhapatra, the Rising Nepal, Kantipur Daily, and so on
- i. Publications of various VAT Department.
- j. Websites

The collected data through secondary sources have been tabulated in different ways according to the requirements of the study.

### **3.8 Method of Data Analysis**

In the process of presentation and analysis of the data, various statistical tools were used in order to get the meaningful result. Collected data from primary and secondary sources were first processed for tabulation and analysis. For the purpose of analysis, following simple statistical tools were used:

- a. Simple Average,
- b. Simple Percentage,
- c. Graphs, Charts and Diagrams,
- d. Trend analysis
- e. Correlation
- f. Hypothesis testing (Student's t-test)

**CHAPTER-IV**  
**PRESENTATION AND ANALYSIS OF DATA**

**4.1 Presentation of Data**

**4.1.1 Revenue Structure of Nepal**

The total revenue of government of Nepal is collected from tax and non-tax sectors. The tax revenue, which is compulsory sacrifice of the peoples, can divide into two components i.e. direct tax and indirect tax. Those revenues collected as income tax, land tax, property tax, etc are direct tax and those revenues collected as sales tax, value added tax (VAT), customs and contract tax etc are an indirect tax. Another sides, the government has received other kinds of revenues, e.g. postal service charge, fees fines and forfeiture etc are non-tax revenues. Non-tax revenue are not imposed specially views of revenue collection. In Nepalese economy amount of tax revenue is generally higher than that of non-tax revenue. In Nepal, the contribution of tax revenue used to be almost 80% and non-tax revenue almost 20%. The structure can see in the Table no.

**Table 4.1**  
**Revenue Trend in Nepal**

Rs.in million

Fiscal Year (FS)	Total Revenue (TR)	Tax Revenue (TXR)	Tax Revenue as % of TR	Non-Tax Revenue (NXTR)	Non-tax Revenue as % oTR
2001/2002	32937.90	28752.90	77.43	8380.90	22.57
2002/2003	37133.80	33152.10	77.29	9741.60	22.71
2003/2004	48893.60	38865.10	79.49	10028.8	20.51
2004/2005	50445.50	39330.60	77.97	11115.0	22.03
2005/2006	56229.80	42586.90	75.74	13642.7	24.26
2006/2007	62331.00	48173.00	77.29	14158.0	22.71
2007/2008	70122.70	54104.70	77.16	16018.0	22.84
2008/2009	72282.10	57430.40	79.45	14851.7	20.55
2009/2010	87712.08	71126.73	81.09	16585.35	18.91
2010/2011	107622.49	85155.54	79.12	22466.95	20.88

Source: Economic Survey 2010/2011, Ministry of Finance

The above table demonstrates the structures of total revenue of the government before and after implementation of VAT. The contribution of tax revenue on total revenue in the year 2001/02 is 77.43%. In the year 2003/04 it reached to 79.49%. On the other hand, the contribution of non-tax revenue on total revenue is 22.57% in 2001/02, which kept decreasing until it reached to 20.51% in the year 2003/04. It proves that tax revenue was in increasing order and non-tax revenue is in decreasing order before and after the implementation of VAT respectively. This proves that tax revenue increased in amount where it does not lead to the proportionate increasing scenario. On the other hand, the contribution of non tax revenue increased to 24.26% in the year 2005/06. But in the fiscal year 2009/10 tax revenue exceed 81.09%, which must be considered a good sign in the tax revenue collection following the implementation of VAT. But overall all judging figures presented in the table, no significant changes have occurred so far after the implementation of VAT.

#### **4.1.2 Structure of Tax Revenue**

Tax is the compulsory levy made to government treasury by public. Tax is levied either directly on income or indirectly on consumption of goods and services. Indirect tax is collected mainly from customs and the consumption of goods and services. Supremacy of tax user of indirect tax is one of the important features of the developing economies. The propensity to consumption is higher in developing countries due to their marginal income. The insignificant level of saving, marginal results in to the poor level of the collection of direct tax. The heavy reliance on indirect taxation in Nepal is justified on the administrative ground. Nepal is not in a condition to generate adequate revenue from direct taxation. Agriculture is the main occupation of the Nepalese people. The industrial development is very primitive in Nepal. It contributes only about 10% in the GDP. The per capita income of Nepalese people is extremely low. In Nepalese economy the contribution of direct tax is very low, it is almost 20% of total tax and contribution of indirect tax is remarkably higher than direct tax it is almost 80% of total tax revenue. The table below shows the structure of total tax revenue.

**Table 4.2**  
**Structure of Total Tax Revenue**

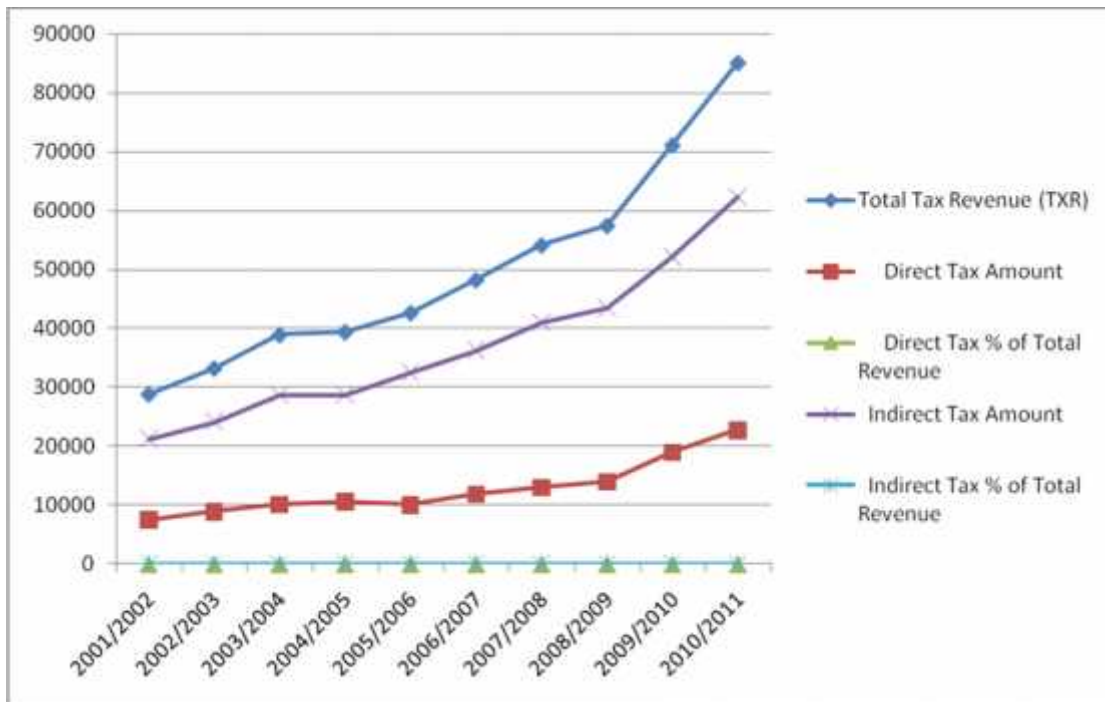
Rs. in million

Fiscal Year (FS)	Total Tax Revenue (TXR)	Direct Tax		Indirect Tax	
		Amount	% of Total Revenue	Amount	% of Total Revenue
2001/2002	28752.90	7516.10	26.14	21236.80	73.86
2002/2003	33152.10	8951.50	27.00	24200.60	73.00
2003/2004	38865.10	10159.40	26.14	28705.70	73.86
2004/2005	39330.60	10597.50	26.94	28733.10	73.06
2005/2006	42586.90	10105.70	23.73	32481.20	76.27
2006/2007	48173.00	11912.6	24.73	36260.4	75.27
2007/2008	54104.70	13071.8	24.16	41032.9	75.84
2008/2009	57430.40	13968.1	24.32	43462.3	75.68
2009/2010	71126.73	18980.29	26.69	52146.44	73.31
2010/2011	85155.54	22804.65	26.78	62350.89	73.22

Source: Economic Survey 2010/2011, MOF

According to above data, the contribution of the direct tax is very low. Contribution of direct tax revenue in the year 2001/02 is 26.14% and 27% in the year 2002/03 and thereafter slightly decreased. On the other hand contribution of indirect tax revenue is 73.86% in fiscal year 2001/02. Although, value added tax belongs to the indirect tax category, introduction of this tax does not increase the share of indirect tax on total revenue. The tax experts always say that implementation of VAT helps to collect more revenue. It also helps to collect more income tax and other direct taxes due to its transparency characteristics. This claim of tax experts might come true in the case of successful implementation. But hopefully, in spite of the decreasing trend of the direct taxes, in the fiscal year 2009/2010, it suddenly had started picking up once again but in an insignificant percentage of only 26.69 with reverse impact on the indirect tax revenue standing at 73.31, about 2% falling below the previous figure.

**Figure No.1**  
**Structure of Total Tax Revenue**



Source :Table 4.1

### 4.1.3 Registration

Registration is a preliminary step in the whole process of VAT system. The threshold limit of VAT registration used to be Rs. 2 million previously. But now, it has changed to Rs. 1 million only. All tax payers whose taxable transaction stands above Rs. 1 million are compulsorily required to register for VAT. But those firms whose turnover is apparently below the prescribed threshold limit also can go for registration if they so desire. The firms having more than Rs. 2 million who were not previously registered under sales tax required to register for VAT within 90 days from 16 November, 1997, or the date of issue of VAT Act. It was however not necessary to register if they only dealt with tax exempt goods and services. Similarly, the Nepalese VAT Act does not allow branch or division registration system.

**Table 4.3**  
**Year-wise number of VAT Registrants**

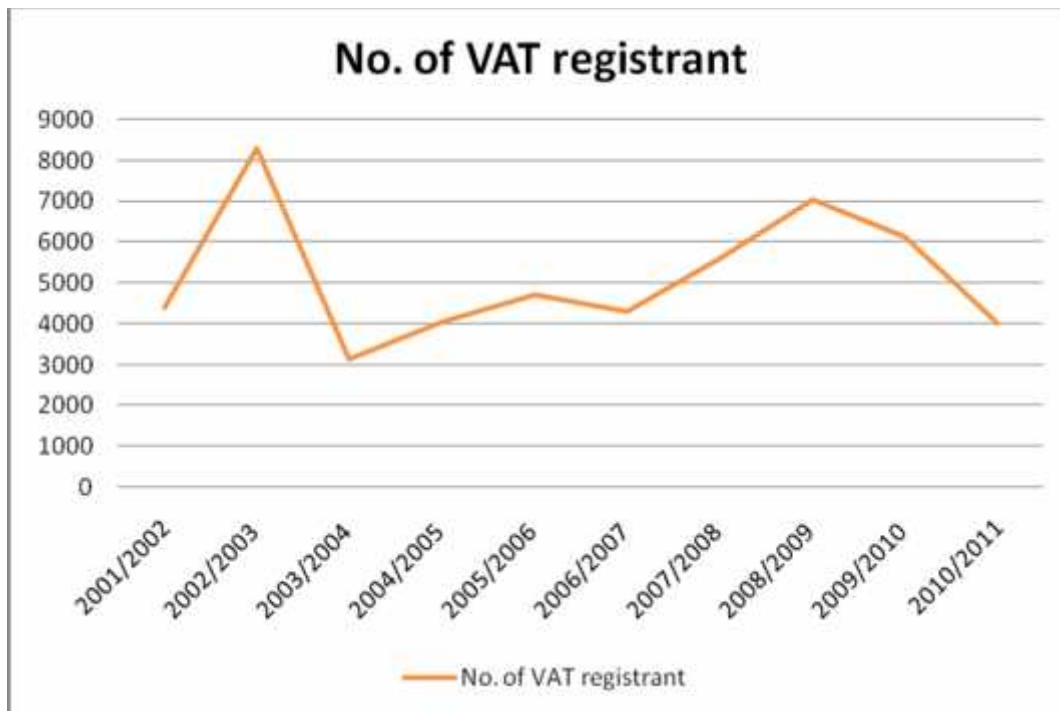
Fiscal Year	No. of VAT registrant	Cumulative Total	Rate of Increase (%)
2001/2002	4405	4405	-
2002/2003	8305	12710	88.53
2003/2004	3146	15856	62.12
2004/2005	4056	19912	28.92
2005/2006	4723	24635	16.44
2006/2007	4302	28937	8.91
2007/2008	5602	34539	30.21
2008/2009	7055	41594	25.93
2009/2010	6134	47728	13.05
2010/2011	4031	51759	34.28

Source: Annual Report 2010/2011, Inland Revenue Department

The member of VAT registrants increased gradually. In one side some tax payers registered under the revenue department and in the other side some registrant tax payers cancelled their registration under VAT department. This is proved by the above table and chart which shows in the year 2001/02, 4405 tax payers registered for VAT. In the year 2002/03 new tax payers registered were 8305 and by 88.53%. The growth rate of VAT registration remained at 34.28% in fiscal year 2010/11. Both voluntarily and compulsorily, the business communities came under VAT flag because there is a legal provision in the VAT law that the government bodies are required to buy only from the VAT registrants in case of their purchases exceeding certain amount. This seems to have compelled them to register for VAT. However, the figure above shows the trend is in the steady line with sporadic rise, but that is negligible.



**Figure No.2**  
**Year-wise number of VAT Registrants**



The percentage is on the decrease finally ending up at 13.10% in the fiscal year 2006/2007. This show the businessmen are getting disinterested in registration for VAT.

#### **4.1.4 Non-Filers**

There is a legal provision in the VAT law that all the registrants are required to submit their tax return after 25 days of completion of the tax period. It does not matter whether any transaction takes place within that period or not. It is necessary to submit the tax return within the specified time. Registrants who fail to submit their tax return is known as non-filers. The table and chart below illustrate the no. of non-filers in each fiscal year from 2000/2001 to 2007/2008.

**Table 4.4**  
**Year-wise number of Non filers (2003-2011)**

Fiscal Year	Total Registrants	Non-filers	Percentage
2003/2004	21093	1383	6.72
2004/2005	25149	3676	15.18
2005/2006	29872	5255	17.59
2006/2007	34174	7322	21.43
2007/2008	39776	8492	22.96
2008/2009	46831	13198	21.63
2009/2010	52965	7098	14.58
2010/2011	56996	9536	16.79

Source: Annual Report 2010/2011, Inland Revenue Department

The Table show that the status of Non-filers were in increasing trend from the fiscal years 2000/2001 to 2005/2006. In the fiscal year 2000/2001, only 4 percent failed to submit the tax return. But this trend was on the increase in each subsequent year until the fiscal year 2005/2006. But in 2006/2007, the trend once again declined showing a significant check on taxpayers' habit of not submitting the tax return. On the other hand, it foretells a good sign for the future trend as well because it is said that the morning shows the day.

#### **4.1.5 Tax Returns**

Tax Return means a return furnished by a Taxpayer in regard to the tax payable for transactions carried out during the Tax Period. Studies on the status of Tax Return facilitate the forecasting of the amount of potential tax collection. In general, the tax return includes debit, credit and nil tax return. Debit return implies the return which the tax payer furnishes declaring to pay tax. Debit return in a favorable position shows the output tax exceeding input tax credit. Credit return is just opposite of debit return. If input tax is greater than output tax, the possibility of credit return is realized. As the credit return increases the liability to refund also increases. So, debit return is favorable for the government. If there is no transaction during the particular tax period, then it is nil or zero return. The status of tax return is depicted in Table.

**Table 4.5**  
**Status of Tax Returns (2003-2011)**

Fiscal Year	Debit		Credit		Nil		Undecided		Total
	No.	%	No.	%	No.	%	No.	%	
2003/2004	6975	35.39	8250	41.86	4471	22.68	14	0.07	19710
2004/2005	6936	32.30	8844	41.19	5207	24.25	486	2.26	21473
2005/2006	7178	31.06	9553	41.36	5972	25.85	396	1.72	23099
2006/2007	8483	33.87	9625	38.42	6783	27.08	158	0.63	25059
2007/2008	9478	32.20	10260	36	8271	29	516	1.8	28525
2008/2009	10449	31.06	12882	38.17	10139	30.14	163	0.4	33633
2009/2010	11457	31.43	13594	37.29	11044	30.29	362	0.99	36457
2010/2011	12065	31.53	14376	37.57	11563	30.22	260	0.68	38264

Source: Annual Report 2010/2011, Inland Revenue Department

The table reveals that the credit return is higher than the debit return. This is considered something not so good for the VAT system. In the fiscal year 2003/2004, the ratio of debit return to the total return is 35.39% whereas the credit return stood at 41.86%. From then onwards, the figure just seemed to rise consistently. The nil return in that particular period was 22.68% and the undecided percentage is 0.02. Understandably, at the initial periods, the credit refund might rise due to the provision to carry forward credit from the sales tax and the provision also of getting credit facility of old stock. But the continuous increase of the credit refund is definitely not a good sign for the government who needs to think about this in time. It is a duty of Inland Revenue Department to seriously come up with measures to make sure this doesn't happen in future. Unless the government is proactive enough to figure out the actual cause behind the increasing trend of credit return, nil return and undecided return which in the above table is not high though, the government's intention to mobilize VAT as resource may be just a daydream. So complete tax audit and investigation on these issues must be a top priority of the government.

#### **4.1.6 Revenue Collection from VAT**

VAT is considered as modern and scientific tax system in sales tax family. Nepal has adopted VAT since fiscal year 1997/98. Since then the actual collection of VAT from the fiscal year 2003/2004 to 2010/2011 has been shown below.

**Table 4.6**  
**Revenue collection from VAT**

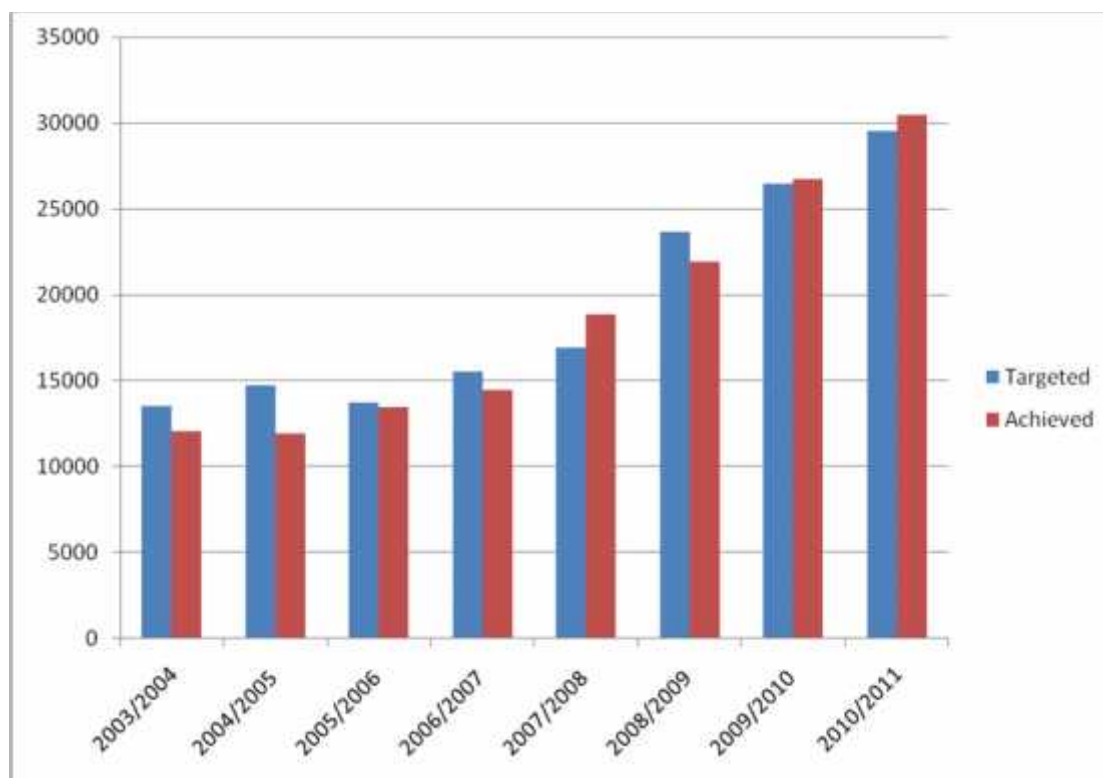
(Rs. in million)

Fiscal Year	Targeted	Achieved	% Change
2003/2004	13500.00	12050.00	-11
2004/2005	14750.00	11947.95	-19
2005/2006	13730.05	13449.12	-2
2006/2007	15503.50	14448.89	-7
2007/2008	16950.00	18894.63	11
2008/2009	23650.00	21946.01	-7
2009/2010	26463.00	26704.18	1
2010/2011	29554.00	30439.12	3

Source: Annual Report 2010/2011, Inland Revenue Department

VAT was introduced in order to meet the revenue gap that government had been facing for a long time. In the fiscal year 2003/04 total Rs. 12050.00 million was collected where as expected or targeted was Rs. 13500.00 million in the same year which is less by 11% than targeted. However, by small margin of 2% only differ between targeted and achieved in the fiscal year 2005/06. In the fiscal year 2007/08, the revenue actually collected even exceeded the targeted one. In figure, the targeted revenue for that period was Rs. 16950 million where as the collected revenue amounted to Rs. 18894.63, i.e. 11% more than the targeted one. But the boom period in revenue collection was to soon be followed by the depression when the 11% increase went far down to -7 in the fiscal year 2008/09 with the targeted revenue Rs. 23650 million and the actual collection

**Figure 3**  
**Revenue collection from VAT**



only amounting to Rs. 21996 million. This trend seems to be improved again in the following fiscal year 2006/07 when the actual revenue marginally exceeded the targeted one by 1 percent. The change in the revenue collection was triggered partially by the major change in the Nepalese political scenario that took place in the aftermath of the people’s movement part 2 on April 2005. Now as can be seen in the figure above, after for the last few years, comparatively the trend of revenue collection is good one although it is still in a fluctuating nature.

#### **4.1.7 Composition of VAT Revenue**

VAT is levied on both domestically produced goods and services and imported goods and services. Nepalese economy is agricultural based. More than 60% people are farmer and the farming is unorganized. Agriculture production through unorganized sector is exempted from VAT. Most of the products and services are imported from neighboring countries and third countries. Thus import generates more VAT revenue than domestically produced goods and services. The composition of VAT revenue collection from imports and exports are shown in a table.

**Table 4.7**  
**Composition of VAT Revenue**

(Rs. in million)

Fiscal Year	Total VAT Revenue	Domestic Product		Imports	
		Amount	%	Amount	%
2003/2004	12050.00	4744.72	39.38	7303.04	60.61
2004/2005	11947.95	4608.37	38.57	7339.58	61.43
2005/2006	13449.12	4819.61	35.84	8629.51	64.16
2006/2007	14448.89	5604.12	38.79	8874.77	61.42
2007/2008	18894.63	6624.33	35.06	12270.29	64.94
2008/2009	21946.01	8057.43	36.71	13888.58	63.29
2009/2010	26704.18	9689.98	36.29	17014.20	63.71
2010/2011	30439.12	10994.61	36.12	19444.51	63.88

Source: Annual Report 2010/2011, Inland Revenue Department

In fiscal year 2003/04, share of domestic and imported VAT revenue in total revenue was 39.38% and 60.61% respectively while in the fiscal year 2004/05 is 38.57% to 61.43%. In the fiscal year 2006/07, domestic products contributed 38.79% whereas imported goods contributed 61.42 % in the total VAT revenue. In Nepalese VAT structure, collection from imports share about two-third and collection from domestic source occupies one-third only.

#### **4.1.10 Share of VAT Revenue to Gross Domestic Product (GDP)**

Gross Domestic Product is the total final output of goods and services produced by the country's territory by residents and non-residents, regardless of its collection between domestic and foreign claims. The VAT/GDP ratio measures the consistency of the growth of VAT revenue with the corresponding growth in gross National Product. This is an indicator of the utilization of taxable capacity. Normally, the growth of VAT revenue mobilization in line with the growth in GDP is desirable for the rapid economic development of a country. The collection of VAT revenue is more reliable than the direct tax revenue, Non tax revenue which facilitates the process of economic planning and development in the country. VAT has been introduced in Nepal to increase the contribution towards revenue generation. The contribution of VAT revenue in GDP is shown below.

**Table 4.8**  
**VAT Revenue as percentage of GDP**

(Rs. in million)

Fiscal Year	GDP*	VAT Revenue	% of GDP
2003/2004	413428.70	12050.00	2.91
2004/2005	430396.60	11947.95	2.78
2005/2006	460325.30	13449.12	2.92
2006/2007	500699.10	14448.89	2.89
2007/2008	548484.70	18894.63	3.44
2008/2009	611088.50	21946.01	3.64
2009/2010	675484.00	26704.18	3.98
2010/2011	713040.91	29020.76	4.07
Average	542579.57	18557.69	3.33

Source: Economic Surveys 2010/2011, MOF.

Above table reveals that share of VAT revenue in GDP is 3.33% in an average through the analysis period. The contribution made through VAT in GDP is very low. In fiscal year 2003/2004, total amount Rs. 12050 million was collected as VAT which was only 2.91% of GDP. However, though insignificantly, the percentage shows the increasing trend, but very low percentage of GDP throughout all the years of analysis. The highest percentage i.e. 4.07% was recorded in the fiscal year 2010/2011 with VAT revenue amounting to 29020.76. So it can be said that the trend does show an increasing trend although in a snail pace which can be better seen in the graph. So in conclusion, the contribution made through VAT in GDP is very low.

#### **4.1.11 Share of VAT Revenue in Total Revenue**

Total Revenue includes Tax revenue and non-tax revenue. The contribution of VAT revenue to the total revenue has been shown in the Table

**Table 4.9**  
**VAT Revenue as percentage of Total Revenue**

(Rs. in million)

Fiscal Year	Total Revenue	VAT Revenue	% of Total Revenue
2003/2004	48893.9	12050.00	24.65
2004/2005	50445.6	11947.95	23.68
2005/2006	56229.7	13449.12	23.92
2006/2007	62331.0	14448.89	23.18
2007/2008	70122.7	18894.63	26.95
2008/2009	72282.1	21946.01	30.36
2009/2010	87712.08	26704.18	31.00
2010/2011	107622.49	30439.12	29.01
Average	69454.94	18734.98	26.59

Source: Economic Surveys 2010/2011, MOF.

Above table reveals that an average contribution of VAT to the total revenue is 26.59. In the fiscal year 2003/2004, its contribution was 24.65, it kept increasing in the following years ending up with 31.00%, the highest one in the fiscal year 2009/2010.

#### **4.1.10 Share of VAT Revenue in Total Tax Revenue**

The contribution of VAT revenue to the total tax revenue has been shown in the following table.

**Table 4.10**  
**VAT Revenue as % of Total Tax Revenue**

(Rs. in million)

Fiscal Year	Total Tax Revenue	VAT Revenue	% of Total Tax Revenue
2003/2004	38865.10	12050.00	31.00
2004/2005	39330.60	11947.95	30.38
2005/2006	42586.90	13449.12	31.58
2006/2007	48173.00	14448.89	29.99
2007/2008	54104.70	18894.63	34.92
2008/2009	57430.40	21946.01	38.21
2009/2010	71126.73	26704.18	37.54
2010/2011	85155.54	30439.12	35.75
Average	54596.62	18734.98	34.19

Source: Annual Report 2010/2011, Inland Revenue Department



The above table shows that there is high share of VAT in total revenue in Nepal. In the fiscal year 2003/04, the percentage of VAT in total tax revenue is 31% similarly in the fiscal year 2009/10 it was increased to 37.54% less by 0.67% from the previous fiscal year. The average contribution of VAT to the total revenue is 34.19% which is a fraction above the half of the total tax revenue. This proves that Nepalese tax revenue without the inclusion of VAT is unthinkable.

## **4.2 Analysis of the Data with Various Statistical Tools**

### **4.2.1 Time Series Analysis**

A time series is an arrangement of statistical data in a chronological order, i.e., in accordance with its time of occurrence. It reflects the dynamic pace of movements of a phenomenon over a period of time. Most of the series relating to Economics, Business and Commerce, e.g., the series relating to prices, production, and consumption of various commodities; agricultural and industrial production, national income and foreign exchange reserves; investments, sales and profits of business houses; bank deposits and bank clearings, prices and dividends of shares in a stock exchange market, etc., are all times series spread over a long period of time. One of the most commonly used method is the Least Square Method which is employed here to measure the trend for further prediction of the GDP and VAT revenue for the next five years from the fiscal years 2007-2008 to 2012-2113 to estimate whether there may be increase in the VAT/GDP ratio from the current average of 3.22%, given the same trend. Future amount of GDP and VAT are predicted on the basis of the data of the last fiscal years.

The parameter of time series analysis for the further prediction of GDP and VAT revenue, a and b, where a is the Y interception or the computed trend figure of y variable when  $X = 0$  and b represent the slop of the trend line or the amount of change in Y variable that is associated with a changeable of one unit in x variable. The x variable in time series represents time and Y represents GDP and VAT revenue. For predicting the amount of GDP, the parameter of the analysis, computed in the Appendix III are as follows:

$$a = 519986.70$$

$$b = 44132.47$$

Thus the trend line of dependent variable GDP and independent variable time (i.e. year) is:

$$\text{GDP (Yc)} = 519986.70 + 44132.47 x$$

Similarly, for predicting the VAT revenue, the parameters of the analysis, computed in the Appendix III are as follows:

$$a = 17062.97$$

$$b = 2478.72$$

Where the trend line of dependent variable VAT revenue and independent variable time (i.e. year) is:

$$\text{VAT Revenue (Yc)} = 17062.97 + 2478.72 x$$

Predicted amount of GDP and VAT revenue, computed in the appendix III for the period 2008-2009 to 2011-2012 is presented in the table.

**Table 4.11**  
**Predicted GDP and VAT Revenue**

(Rs. in million)

Fiscal Year	2011-2012	2012-2013	2013-2014	2014-2015
GDP	740649.04	784781.51	828913.98	873046.44
VAT	29456.57	31935.29	34414.01	36892.73
VAT/GDP (%)	3.98%	4.07%	4.15%	4.23%

The table shows that given the same trend, the ratio of VAT on GDP will grow in a nominal rate in the coming future. These ratios are presented in the figure 12 as well. In the figure 12, X-axis denotes years and y-axis denotes ratio of VAT on GDP. The figure depicts that the percentage of VAT of VAT on GDP will increase over 4% over the next five years. The remarkable point is that, if VAT revenue and amount of GDP follow the same trend lines in the coming years, the target of government to increase the percentage of VAT on GDP at or beyond 4% will be achieved. But this is only nominal growth. For the phenomenal increase like up to 5 or 6% at least, there must be several things that need to be taken into considerations by the government like the good administration, VAT education etc which were already described above.

#### **4.2.3 Correlation Analysis**

Correlation is defined as the association of two or more random variables or is the degree of relationship between variables, which seeks to determine how well a linear or other equation describes or explains the relationship between variables. The significance of correlation coefficient can be tested through t-test with certain level of significance at certain number of degree of freedom. One very convenient and useful way of interpreting

the value of coefficient of correlation between two variables is to use square of coefficient of correlation, which is called coefficient of determination.

#### **4.2.3.1 Gross Domestic Product with Value Added Tax Revenue**

The relationship of VAT revenue and GDP is examined with the help of seven year data from the fiscal year 2004/2005 to 2010/2011. Further, the relation of VAT with GDP, coefficient of determination and value of t-test are presented below:

##### **Statistical Tools of Analysis**

Correlation Coefficient (r) 0.989

Coefficient of determination (r<sup>2</sup>) 0.977

Value of t-test 14.64

Table value of t<sub>0.05,5</sub> 2.571

The association of VAT revenue with GDP is very high or in other words, the VAT revenue is perfectly correlated with GDP (i.e.  $r = 0.989$ ). The significance of correlation coefficient is high which is over 5 times greater than the value of  $t_{0.05,5}$  (i.e.  $14.64 > 2.571$ ). The coefficient of determination (r<sup>2</sup>) is 0.977 which means 97.7% of total variation in VAT revenue is explained by gross domestic product.

#### **4.2.2.2 Total Revenue with Value Added Tax Revenue**

The effect of VAT revenue to total revenue is identified with the help of six years VAT revenue from the fiscal year 2004-2005 to 2010-2011. The association of VAT and sales tax revenue with total revenue, coefficient of determination and value of t-test, computed Appendix V, and average ratio of VAT and sales tax with total revenue over the reviewed period are presented below:

##### **Statistical Tools of Analysis**

Correlation Coefficient (r) 0.978

Coefficient of determination (r<sup>2</sup>) 0.956

Value of t-test 10.42

Average % in total revenue 26.25

The relationship of total revenue with VAT revenue is very high. Or, there is almost linear relationship between total revenue and VAT revenue, where the calculated value of r is 0.978. The significance of correlation coefficient is also very high which is almost 4

times greater than the tabulated value of  $t_{0.005,5}$  (i.e.,  $10.42 > 2.571$ ). For testing the significance of correlation coefficient, 5% level of significance has been fixed. The coefficient of determination ( $r^2$ ) is 0.956 which means 95.6% of total variation in total revenue is explained by VAT revenue. The percentage of VAT revenue in total revenue over the reviewed period in an average is 26.25. This means 25.25% in total revenue is contributed by VAT revenue.

#### **4.2.2.3 Total Tax Revenue with Value Added Tax Revenue**

The effect of VAT on the total tax revenue is found out with the help of six years data from 2004-2005 to 2010-2011 on which the study has been confined. The correlation of total tax revenue with VAT and sales tax revenue, coefficient of determination and value of t-test and average ratio of VAT in total tax revenue are presented below:

##### **Statistical Tools of Analysis**

Correlation Coefficient ( $r$ ) 0.992

Coefficient of determination ( $r^2$ ) 0.984

Value of t-test 17.82

Average % in total tax revenue 49.78

The relationship of total tax revenue and VAT revenue is positive and very high or to put it another way, these are perfectly correlated where value of  $r$  is 0.991. The significance of correlation coefficient is also high which is more than 6 times greater than table value of  $t_{0.05,5}$  (i.e.,  $17.48 > 2.571$ ). For testing the significance of correlation coefficient 5% level of significance has been fixed and degree of freedom was 5. The coefficient of determination ( $r^2$ ) is 0.984 which means 98.4% of total variation in total tax revenue is explained by the VAT revenue. The average percentage of VAT in total tax over the reviewed period is 49.78. This means 49.78% in total tax revenue is contributed by VAT revenue.

#### **4.2.2.4 Total Indirect Tax Revenue with Value Added Tax Revenue**

The contribution of VAT in Total indirect tax revenue and association of total indirect tax with VAT is found out by analyzing the seven years data from the fiscal year 2004-2005 to 2010-2011 on which the study has been confined. The relationship of Indirect tax with VAT, coefficient of determination and value of t-test and average of percentage of VAT on indirect tax over the studied period are summarized below:

### **Statistical tools for analysis**

Correlation Coefficient (r) 0.986

Coefficient of determination (r<sup>2</sup>) 0.971

Value of t-test 13.04

Average % in total Indirect tax revenue 44.65

The association of total indirect tax and VAT is 0.986, which is very high. It can be said that it is perfectly correlated with each other. This result shows that the total indirect tax is largely affected by VAT. The significance of correlation coefficient between VAT and indirect tax revenue is also higher which is more than 5 times greater than table value of  $t_{0.05,5}$  (i.e.,  $13.04 > 2.571$ ). For the purpose of testing the significance of the relation, 5% coefficient of determination (r<sup>2</sup>) is 0.971, which means 97.1% of total variation in indirect tax revenue is explained by the VAT revenue. The contribution of VAT in indirect revenue in an average over the reviewed period has been 44.65%. The result shows that the correlation coefficient, coefficient of determination and contribution of VAT are all higher and increased proportionately over the succeeding fiscal years although with slight hiccups in the beginning of course.

#### **4.2.3 Hypothesis testing (Student's t-distribution)**

Hypothesis testing begins with an assumption, called a hypothesis that we make about a population parameter. Then we collect sample data, produce sample statistics, and use this information to decide how likely it is that our hypothesized population parameter is correct. Let us suppose that we assume a certain value for a population mean. To test the validity of our assumption, we gather sample data and determine the difference between the hypothesized value and the actual value of the sample mean. Then we judge whether the difference is significant. The smaller the difference, the greater the likelihood that our hypothesized value for mean is correct. The larger the difference, the smaller the likelihood (Levin & Rubin, 1996).

#### **Test of VAT/GDP and VAT/TR (Total Revenue) ratio**

The Hypothesis testing tool is used here to test whether there is significant difference between the mean ratios of VAT/GDP and VAT/TR. For that the following hypothesis is established

Null hypothesis (H<sub>0</sub>) :  $\mu_1 = \mu_2$

i.e., there is no significant difference between mean ratios of VAT/GDP and VAT/TR.

Alternative hypothesis (H1):  $\mu_1 \neq \mu_2$  (two tailed test)

i.e., there is no significant difference between mean ratios of VAT/GDP and VAT/TR.

For the purpose of testing the hypothesis,  $\mu_1$  denotes the mean of VAT/GDP ratio and  $\mu_2$  denotes the mean of VAT/TR ratio for the period of 2000-2001 to 2006-2007.

Likewise, X1 denotes VAT/GDP ratio and X2 denotes VAT/TR ratio whereas n1 and n2 denote no. of years.

For the purpose of getting conclusion, (generally used) 5% level of significance is fixed ( $t_{0.05}$ ) and degree of freedom ( $n_1+n_2-2$ ) is 12. The test is two tail test (viz., two tailed) because the study is directed to examine whether or not there is a significant difference between those two mean ratios  $\mu_1$  and  $\mu_2$ . Thus table value of t for 5% level of significance at 12 degree of freedom (y) is 1.782 (i.e.,  $t_{0.05,12} = 1.782$ ).

which is greater than table value (i.e.,  $18.42 > 1.782$ ). Alternative hypothesis is accepted and it can be concluded that there is significant difference between mean ratios of VAT & GDP and VAT & TR. In other words, VAT contributes lesser portion to GDP than the Total revenue.

#### **4.3.3.1 Test of VAT/TR (Total Revenue) and VAT/TXR (Total Tax Revenue) ratio**

The Hypothesis testing tool is used here to test whether there is significant difference between the mean ratios of VAT/TR and VAT/TXR. For that the following hypothesis is established

Null hypothesis (H0):  $\mu_1 = \mu_2$

i.e., there is no significant difference between mean ratios of VAT/TR and VAT/TXR.

Alternative hypothesis (H1):  $\mu_1 \neq \mu_2$  (two tailed test)

i.e., there is no significant difference between mean ratios of VAT/TR and VAT/TXR.

For the purpose of testing the hypothesis,  $\mu_1$  denotes the mean of VAT/TR ratio and  $\mu_2$  denotes the mean of VAT/TXR ratio for the period of 2000-2001 to 2006-2007. Likewise, X1 denotes VAT/TR ratio and X2 denotes VAT/TXR ratio whereas n1 and n2 denote no. of years.

For the purpose of getting conclusion, (generally used) 5% level of significance is fixed ( $t_{0.05}$ ) and degree of freedom ( $n_1+n_2-2$ ) is 12. The test is two tail test (viz., two tailed)

because the study is directed to examine whether or not there is a significant difference between those two mean ratios  $\mu_1$  and  $\mu_2$ . Thus table value of t for 5% level of significance at 12 degree of freedom (y) is 1.782 (i.e.,  $t_{0.05,12} = 1.782$ ). Computed value of t is 3.95, which is greater than table value (i.e.,  $3.95 > 1.782$ ).

Alternative hypothesis is accepted and it can be concluded that there is significant difference between mean ratios of VAT & TR and VAT & TXR. In other words, VAT contributes more portions to Total Tax Revenue (TXR) than the Total revenue.

#### 4.4 Survey Result

In the earlier period of implementation, there was lack of skilled and trained manpower and officers; administrative structure was not set up properly. But currently VAT and Tax offices are amalgamated into Inland Revenue offices in district as well as national level. Different informative programmed, seminars and meeting were held to make the businessmen consumers as well as tax officers known to the VAT. Currently business community is also in favor of VAT and further demanding to identify all the traders having taxable capacity and include into the tax net. In such situation, an empirical study is done to know the views of person of different field on different aspects of VAT. For the purpose of survey, a questionnaire was prepared and it was asked to fill up to the persons of different field as given in the table below.

**Table 4.12**  
**Sample size of the field survey**

Respondents	Sample Size	Percentage
Tax Authorities/Policy Makers	10	10
Experts/Economists	25	25
Auditors	5	5
Businessmen	30	30
Consumers	30	30
Total	100	100

Purposive sampling method is used in this field survey retailer, wholesalers and the members of different associations are included in the category of businessmen, students of the related field members are included in Economists. Members are included in other general consumers are included in consumers.

#### 4.3.5 The most challenging problem

From the experience of the other under developed countries. It is found that the future success of VAT basically depends on its implementation aspect. In the context of Nepalese economy there are many problems associated with the implementation of VAT Respondents were asked to identify the most challenging problem among under invoicing and unbillings, lack of proper accounts and weak tax administration survey result is summarizes in the table below.

**Table 4.13**

**What is the most challenging problem in VAT implementation?**

Respondents	Under invoicing and smugglings		Lack of proper billings		Lack of proper accounts		Weak Tax administration		I don't know		Total nos.
	No	%	No	%	No	%	No	%	No	%	
TA/PM	-	-	6	60	-	-	4	40	-	-	10
Experts/Economists	6	24	10	40	-	-	9	36	-	-	25
Auditors	1	20	1	20	2	40	1	20	-	-	5
Businessmen	13	43.3	-	-	-	-	17	56.7	-	-	30
Consumers	9	30	9	30	-	-	12	40	-	-	30
Total	29	29	26	26	2	2	43	43	-	-	100

Source: Field Survey, 2012

From the Field Survey it is found that 40% tax authorities/policy makers, 36% experts/economists, 20% auditors, 56.7% businessmen and 40% consumers argue that weak tax administration is the most challenging problem associated with VAT implementation. Consumers argue that weak tax administration is the cause so that businessmen are encouraged for under invoicing and smuggling. Lack of proper billings is identified as the most challenging problem by 60% tax authorities/policy makers, 40% experts/economists, 20% auditors and 30% consumers. Similarly, 24 experts/economists, 20% auditors, 43.3% businessmen and 30% consumers identified smuggling and under valuation as major problem, 40% auditors identified lack of proper accounts as the most challenging problem. Thus 43%, 29% and 2% of the respondents identified weak tax



administration, under invoicing and smugglings, lack of proper billing and lack of proper accounts respectively as the major problem. Thus weak tax administration along with under invoicing and smugglings are the most challenging problems associated with VAT implementation.

#### 4.3.6 Making VAT effectively successful

VAT is already implemented in Nepalese economy, however many problems are still existing in the practices in real field. To identify the problems of practices, solve them successively to make the VAT successful in future so that it will have positive effects on the different sectors of the economy. Hence the requirement is to choose the best alternative way to make VAT successful. The option given to make VAT effectively successful were (a) strengthen and improve the capacity of VAT administration, (b) educate tax payers about the significance of VAT, (c) mobilize cooperation of private sector through FNCCI, (d) Improve VAT laws and regulations. Respondent view on this question is summarized in the table below.

**Table No. 4.14**  
**View on making VAT effectively successful**

Respondents	Strengthen and improve the capacity of vat administration		Educate taxpayers on significance of VAT		Mobilize cooperation of private sector		Improve VAT laws & regulation		I don't know		Total no.
	No	%	No	%	No	%	No	%	No	%	
TA/PM	5	50	3	30	2	20	-	-	-	-	10
Experts/Economists	9	36	8	32	5	20	3	12	-	-	25
Auditors	2	40	1	20	1	20	1	20	-	-	5
Businessmen	8	26.7	4	13.3	18	60	17	56.7	-	-	30
Consumers	13	43.3	8	26.7	2	6.7	7	23.3	-	-	30
Total	37	37	24	24	28	28	11	11	-	-	100

Source: Field Survey,2012

Out of the five samples of tax authorities/policy makers 50%, 30% and 20% are on the support of (a), (b) and (c) respectively. Remaining all the respondents of different category are basically concentrated on the first option that strengthen and improve the capacity of VAT administration. Thus 37%, 28%, 24% and 11% of the total respondents provided their view on the options (a), (b) (c) and (d) respectively to make the vat effectively successful. This means that efficient and capable tax administration is still lacking for the successful operation of VAT.

#### 4.3.7 Tax structure of VAT

Tax structure which covers basically base, rate, coverage exemption etc. is one of the most important aspects for the successful operation of VAT in any economy. The tax structure of VAT in Nepal is designed on the VAT act 1996 and different laws and regulations are prepared in successive years. The field survey has been conducted to find out whether existing tax structure is appropriate or any comment. The summarized finding of the survey result is presented in the following table.

**Table 4.15**  
**View on Tax structure of VAT**

Respondents	It is ok		It has to be improved		Not compatible with existing rules.		It has very insignificant contribution w.r.t. GDP		I don't know		Total nos.
	No	%	No	%	No	%	No	%	No	%	
TA/PM	3	30	6	60	1	10	-	-	-	-	10
Experts/Economists	7	28	11	44	3	12	4	16	-	-	25
Auditors	-	-	3	60	1	20	1	20	-	-	5
Businessmen	12	40	9	30	2	6.7	7	23.3	-	-	30
Consumers	11	36.7	12	40	3	10	2	6.7	2	6.7	30
Total	33	33	41	41	10	10	14	14	2	2	100

Source: Field Survey

Out of the ten samples of the tax authority policy makers, 60% comment has to be improved. Similarly, 44% of experts/economists, 60% auditors, 30% businessmen and 40% consumers are the support of VAT improved. The respondents from other field i.e. Tax authorities/policy makers experts/economists, businessmen and consumers generally

agreed with the existing structure 40% of the total respondents agreed with the improved VAT structure following by 33% agree with the existing structure. Thus tax structure is not important rather it should be properly implemented in practice.

#### 4.3.8 Expanding the base of VAT

Expanding the base of VAT One of the most favorable aspect of VAT is its broader base so that a high potential revenue can be obtained by a relatively low rate of VAT The options given for expanding the tax base are reduce threshold of VAT, include all of the services incorporate agriculture sector and all of the above. Respondents view and findings are presented in table below.

**Table 4.16**  
**View on expanding the Base of VAT**

Respondents	Reduce threshold of VAT		Include all the services		In corporate agriculture sector		All		I don't know		Total nos.
	No	%	No	%	No	%	No	%	No	%	
TA/PM	2	20	4	40	1	10	3	30	-	-	10
Experts/Economists	6	24	9	36	4	16	6	24	-	-	25
Auditors	-	-	3	60	1	20	1	20	-	-	5
Businessmen	11	36.7	6	20	9	30	4	13.3	-	-	30
Consumers	4	13.3	8	26.7	6	20	8	26.7	4	13.3	30
Total	23	23	30	30	21	21	22	22	4	4	100

Source: Field Survey

Field Survey shows that 20% tax authorities/policy makers, 24% experts/economists, 36.7% businessmen and 13.3% consumers favor to reduce the existing threshold of VAT to expand the VAT base while 40%, 36%, 60%, 20% and 26.7% of respondent from the respective categories favor for including all the respondents desire to include all services, following by 23% to reduce the threshold, 22% agree to apply all the options i.e. reduce threshold, include all the services and incorporate agriculture sector to expand the VAT base and remaining 21% favor to incorporate agriculture sector.

### 4.3.5 Rate structure of VAT

Currently existing VAT is subject to 13 percent rate. Due to the broader base and coverage of VAT it was expected to have a greater revenue yield even with the 13 percent rate. However this expectation is not achieved in practice basically due to its weak implementation aspect. In such situation field survey was also conducted about the rate structure of VAT. Following table shows the survey result on the rate structure of VAT.

**Table No. 4.17**  
**View on Rate Structure of VAT**

Respondents	It is ok		Raise to 15%		Reduce to 10%		Establish two rates such as 13% & 15%		I don't know		Total nos
	No	%	No	%	No	%	No	%	No	%	
TA/PM	4	40	2	20	-	-	4	40	-	-	10
Experts/Economists	12	48	2	8	-	-	11	44	-	-	25
Auditors	4	80	-	-	-	-	1	20	-	-	5
Businessmen	7	23.3	5	16.7	11	36.7	7	23.3	-	-	30
Consumers	8	26.7	-	-	12	40	6	20	4	13.3	30
Total	35	35	9	9	23	23	29	29	4	4	100

Source: Field Survey

Survey result shows that most of the respondents agrees with the existing rate of 13%. However 40% tax authorities/policy makers, 44% experts/economists, 20% auditors, 23.3% businessmen and 20% consumers suggest implementing VAT by establishing two rates such as 13 percent and 15 percent. All the respondent from categories, tax authorities/policy makers, experts/economists, auditors, businessmen and consumers gave their view by supporting the existing VAT rate 23% and 4% of the respondents provided their view to reduce VAT rate by 10% and unknown regarding tax structure respectively many respondents agree that rate structure is not a instrument to raise the revenue from taxation until the tax system is not implemented well. Once the implementation will be effective, it will be better to change the rate structure to some extent according as the requirement.

### 4.3.6 Existing Exemption

VAT as a member of indirect tax is regressive by nature so exemptions on selected goods and services are must require. Exemptions is needed theoretically as well as practically not only to cut down the burden of indirect tax on poor but also due to the objective of simplifying administrative complications summarized finding of the survey on exemptions is presented in the survey on exemptions is presented in the table below.

**Table 4.18**  
**View on Exemptions**

Respondents	It is ok		It should be reduced		It should be increased		I don't know		Total nos.
	No	%	No	%	No	%	No	%	
TA/PM	7	70	3	30	-	-	-	-	10
Experts/Economists	13	52	9	36	3	12	-	-	25
Auditors	4	80	1	20	-	-	-	-	5
Businessmen	11	36.7	11	36.7	7	23.3	1	3.3	30
Consumers	12	40	8	26.7	4	13.3	6	20	30
Total	47	47	32	32	14	14	7	7	100

Source: Field Survey

From the field survey it is found that the existing exemptions is wide since basic concentration of the respondents is found to reduce the existing exemptions wide range exemptions provides an opportunity for tax evasion and may bring distortions in the economy. The finding shows that 70% tax authorities/policy makers, 52% experts/economists, 80% auditors, 36.7% businessmen and 40% consumers provided their view by supporting the existing coverage of exemptions. Similarly 30% tax authorities/policy makers, 36%, experts/economists, 20% auditors, 36.7% businessmen and 26.7% consumers provide their view to reduce the existing exemptions. 47% and 32% of the total respondents provide their view to existing exemptions is appropriate and to reduce the existing exemptions.

### 4.3.7 Price rise due to VAT system

During the earlier period of VAT implementation there was a strong opposition from the business community and basic argument behind it was that VAT will raise the price. This argument is true when the VAT will be subject to the same rate of when the VAT will be

subject to the same rate of sales tax since VAT collected at each stages of production and distribution. But VAT rate is 13 percent (10 percent in initial stage) while sales tax was levied at the rate of 15 percent after implementation of VAT there was a voice of price rise from some person of different groups. In such circumstances, field survey was also done to get the view that vat has increased price or not. The following table presents the respondents view on this aspect.

**Table No. 4.19**  
**View on price Rise Due to VAT system**

Respondents	Yes		No		I don't know		Total nos.
	No	%	No	%	No	%	
TA/PM	5	50	5	50	-	-	10
Experts/Economists	9	36	16	64	-	-	25
Auditors	3	60	2	40	-	-	5
Businessmen	17	56.7	13	43.3	-	-	30
Consumers	14	46.7	10	33.3	6	20	30
<b>Total</b>	<b>48</b>	<b>48</b>	<b>46</b>	<b>46</b>	<b>6</b>	<b>6</b>	<b>100</b>

Source: Field Survey

There were 50% tax authorities/policy makers, 36% experts/economists, 60% auditors, 56.7% businessmen and 46.7%, consumers who considered VAT has increased price. Among the total respondents providing the view on price rise due to VAT, there are 2 tax authorities/policy makers, 4 experts/economists, 6 businessmen and 3 consumers who argue that there is rise in price to some extent such as compliance cost high profit or non awareness of consumers. Respondent views are presented in the table below.

**Table 4.20****Primary reason for price rise**

Respondents	Compliance cost		High profit		Non awareness of consumers		Total nos.
	No	%	No	%	No	%	
TA/PM	1	50	1	50	-	-	2
Experts/Economists	1	25	-	-	3	75	4
Businessmen	3	50	-	-	3	50	6
Consumers	-	-	1	33.3	2	66.7	3
Total	5	33.3	2	13.3	8	53.3	15

Source: Field Survey

Survey result shows that 75% experts/economists, 50% businessmen and 66.7% consumers identified non awareness of consumers as the primary reason attributing to price rise similarly 50% tax authorities/policymakers, 25% experts/economists and 50% businessmen considered compliance cost as the primary reason attributing for price rise. Out of total 53.3%, 33.3% and 13.3% of the respondents provided their view respectively on no awareness of consumers, compliance cost and high profit respectively. All of the respondents argued that consumers are responsible for price rise. They said the non awareness of the consumers is the primary reason attributing to price rise, implying low level of public consciousness.

#### **4.3.8 Effect on VAT on Revenue Mobilization**

The government is not capable to operate the development activities in the country due to the lack of sufficient revenue besides to this large amount of foreign debt is forcing the economy towards the debt gap. In such circumstances, VAT was expected to have the greater revenue yield due to its broader base and other features such as catch up effect self enforcing nature, transparency etc. Survey result shows the concentration on the positive effect of VAT on revenue mobilization as compared to the replaced taxes but it depends on its effective implementation. The outcome of the survey in this aspect is shown in the table below.

**Table 4.21****View on effect of VAT on Revenue Mobilization**

Respondents	Positive		Negative		No effect		I don't know		Total nos.
	No	%	No	%	No	%	No	%	
TA/PM	2	20	1	10	7	70	-	-	10
Experts/Economists	11	44	7	28	7	28	-	-	25
Auditors	3	60	-	-	2	40	-	-	5
Businessmen	13	43.3	11	36.7	6	20	-	-	30
Consumers	13	43.3	9	30	6	20	2	6.7	30
Total	42	42	28	28	28	28	2	2	100

Source: Field Survey

Survey shows that 20% tax authorities/policymakers, 44% experts/economists, 60% auditors, 43.3% businessman and 43.3% consumers said that VAT will have positive effect on revenue mobilization as compared to the replaced taxes. In aggregate 42%, 28% and 28% of the respondents provided their view on positive, negative and no effect respectively.

#### 4.3.9 Effect on VAT on Economic Growth

The ultimate aim of the government is to achieve the economic development and accelerate the rate of economic growth. Economic Growth of country depends on the various aspects the choice the importance of the tax system differs significantly in different countries based on socio economic background, political environment, geographical structure, government policy and plans etc. The effect of VAT on economic growth is the aggregate effect of VAT on different sectors. Such as investment, revenue mobilization, foreign trade etc. Whether the effect of VAT on economic growth will be positive, negative or no effect is found out from the field survey as follows.



**Table 4.22****View on effect on VAT on Economic Growth**

Respondents	Positive		Negative		No effect		I don't know		Total nos.
	No	%	No	%	No	%	No	%	
TA/PM	7	70	-	-	3	30	-	-	10
Experts/Economists	13	52	-	-	11	-	1	-	25
Auditors	4	80	-	-	1	20	-	-	5
Businessmen	13	43.3	2	6.7	12	40	3	10	30
Consumers	11	36.7	6	20	9	30	4	13.3	30
Total	48	48	8	8	36	36	8	8	100

Source: Field Survey

Survey shows that 70% tax authorities/policy makers, 52% experts/economists, 80% auditors, 43.3% Businessmen and 36.7% consumers have expected to have positive effect of VAT on economic growth, Similarly 30% tax authorities/policy makers, 20% auditors, 40% businessmen and 30% consumers provided their view on no effect on VAT on economic growth. Thus 48%, 36%, and 8% of the total respondents provided their view respectively on positive, no effect and negative of VAT on economic growth while the remaining 8% were unknown about the matter.

#### **4.3.10 The Most Responsible Group for tax Evasion**

Any tax system can not provide the expected revenue yield whenever the tax evading loopholes exist. Evasion of tax not only losses the revenue but also creates economic distortion, market imperfection etc. However tax evading practice is a general phenomenon in any country and it can not be solved perfectly but it must be minimized as far as possible. Generally business enterprises may be taken responsible for tax evasion but it is not true in all the cases and time. There are other groups such as consumers, tax administration who may be supporting, helping or encouraging business enterprises for tax evasion, for their direct or indirect benefit and thus may be more responsible for tax evasion. Field survey was conducted to provide the view on most responsible group for tax evasions among business enterprise, consumers, tax administration or all the finding is presented below.

**Table 4.23****View on most responsible Group for Tax Evasion.**

Respondents	Business Enterprises		Consumers		Tax Administration		All		Total
	No	%	No	%			No	%	
TA/PM	3	30	1	10	2	20	4	40	10
Experts/Economists	9	36	-	-	5	20	11	44	25
Auditors	2	40	1	20	1	20	1	20	5
Businessmen	3	10	9	30	9	30	9	30	30
Consumers	16	53.3	6	20	3	10	5	16.7	30
Total	33	33	17	17	20	20	30	30	100

Source: Field Survey

According as the field survey 30% tax authorities/policy makers, 36% experts/economists, 40% auditors, 10% businessmen and 53.3% consumers said that business enterprises are most responsible for tax evasion under VAT system. Similarly 20% tax authorities/policy makers, 20% experts/economists, 20% auditors, 30% businessmen and 10% consumers said that tax administration is most responsible for tax evasion. But 10% tax authorities/policy makers, 20% auditors, 30% businessmen and 20% consumers said that consumers are most responsible and it is due to the low level of awareness. Remaining 40% tax authorities/policy makers, 44% economists/experts, 20% auditors, 30% business men and 16.7% consumers identified all the groups equally responsible for tax evasion. This out the total sample 33% respondents identified business enterprises responsible for tax evasion while other 30% and 20% to identify all the groups and tax administration.

#### 4.4 Major Findings of the study

On the basis of preceding chapters and data presentation and analysis, some important findings of the research are presented in summary as follows:

- 1 Number of taxpayer registrants under VAT has been increasing year after year. The ratio of registrants just kept fluctuating, decreasing sharply in the fiscal year 2006/2007, to just 13.10%.

- 2 The status of Non-filers is not also satisfactory. In the fiscal year 2005/2006, it had increased up to 21.63%, although it had decreased to 14.58% in the fiscal year 2006/2007. But the trend seems to be fluctuating. There is never a constant proportionate increase.
- 3 Credit returns status is on the increasing trend from every fiscal year. Nil tax return and undecided tax return are also increasing year after year. This is not a good sign for Nepalese revenue. Unless the government is active to find out the increasing trend of credit return, nil return and undecided return, VAT cannot be the effective tool for revenue generation.
- 4 The contribution of VAT to GDP is just 3.22 in an average of 10 years. The contribution of VAT to GDP reached 3.98% in the fiscal year 2010/11. So the VAT/GDP ratio is very low as indicated by the statistical tools like hypothesis testing also.
- 5 The contribution of VAT in total revenue is not up to the satisfactory level either. In an average, it could contribute just about 26.75% to the total revenue which is way above the VAT/GDP ratio as indicated by hypothesis testing.
- 6 Hopefully, an average share of VAT revenue in total tax revenue is pretty good, i.e just about 50% which simply indicates that VAT though implementation wise, faring very poorly, is still emerging as the important source of revenue generation.
- 7 So far as the price to the consumer is concerned, as with the sales tax, the consumer pays the same amount to the retailer. There is no difference in consumer price which paid for the product or service.
- 8 The correlation coefficient of VAT with GDP is 0.989 and coefficient of determination is 0.977. These results show that flexibility of VAT is greater than the sales tax whose correlation coefficient and coefficient determination are 0.983 and 0.966 respectively. Likewise, the association of total revenue with VAT revenue and coefficient of determination are 0.978 and 0.956 respectively and the relationship of tax revenue with VAT revenue is 0.991 and coefficient of determination is 0.984 with its average percentage in total tax revenue being 49.78. The correlation coefficient of indirect tax with VAT and coefficient determination is 0.986 and 0.971 respectively.

The contribution of VAT in indirect tax revenue is 44.65. So these result show that VAT revenue is growing quite proportionately or head to head with GDP, Total Revenue, Total tax revenue and Total Indirect Tax Revenue.

- 9 Most significantly, the hypothesis that the VAT/GDP ratio is different from the VAT/Total Revenue also proved correct when it was tested using the student's test. All these result show that there is only nominal share of VAT revenue in GDP as contrasted with its big share with Total Revenue and Total Tax revenue.
- 10 The field survey concluded existing tax structure is not appropriate. 41% of the respondents provide their view on tax structure is not important rather it should be properly implemented in practice.
- 11 30% of respondent from the respective categories favor for including all the respondents desire to include all services, following by 23% to reduce the threshold, 22% agree to apply all the options i.e. reduce threshold, include all the services and incorporate agriculture sector to expand the VAT base and remaining 21% favor to incorporate agriculture sector.
- 12 Many respondents agree that rate structure is not a instrument to raise the revenue from taxation until the tax system is not implemented well. Once the implementation will be effective, it will be better to change the rate structure to some extent according as the requirement.
- 13 From the field survey it is found that the existing exemptions is wide since basic concentration of the respondents is found to reduce the existing exemptions wide range exemptions provides an opportunity for tax evasion and may bring distortions in the economy.
- 14 There were 48% respondents who considered VAT has increased price. They argue that there is rise in price to some extent such as compliance cost high profit or non awareness of consumers.
- 15 Survey result shows 42% respondents from different categories provide their view on the positive effect of VAT on revenue mobilization as compared to the replaced taxes but they depends on its effective implementation.

- 16 From field survey,48% of the total respondents favor for on positive, 36%, and 8% of the total respondents provided their view on no effect and negative effect of VAT on economic growth.
- 17 Out the total sample 33% a respondent identified business enterprises responsible for tax evasion but there is other groups such as consumers, tax administration who may be supporting, helping or encouraging business enterprises for tax evasion, for their direct or indirect benefit and thus may be more responsible for tax evasion.

## **CHAPTER-FIVE**

### **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

This chapter is the final chapter of the research which briefly deals with the summary of the study. It also tries to draw the final conclusion of the study while attempting to offer various recommendations to make the various aspects of VAT better in future.

#### **5.1 Summary**

VAT has become a point of attraction for about 130 countries in the world including Nepal. Existed sales tax along with contract tax, entertainment tax and hotel tax were replaced by VAT since 1997 in Nepal. VAT was initially expected to have a high revenue yield due to its broader coverage and basis. Elimination economic distortions caused by tax system, elimination of cascading and pyramiding effects, creation of the competitive business environment, strengthening foreign trade etc, as it were, are other features of VAT theoretically, expected to be fulfilled in the real practice. It was not easy for the Nepalese government to implement VAT easily as there were many objections and complaints from the business community. But after some dialogue and negotiations, the government was able to implement it to the satisfaction of all. However, there are several issues in the applicability of VAT in Nepal. One of the key issues is administrative capability and situation which definitely are of great importance for the effective implementation of VAT in Nepal. This research work entitled, “Value Added Tax Practices In Chitwan has been carried out to ponder into the theoretical knowledge of VAT and to examine the administration system of VAT especially in the Chitwan, to assess the post-implementation period of VAT as compared to the period before the implementation in connection with generating revenue, to examine whether VAT is superior to Sales tax. To achieve those objectives, correlation analysis, time series analysis, t-test analysis empirical analysis have been done with the help of 7 years data (i.e. from the fiscal year 2001/2002 to 2010/2011) and questionnaire developed by the researcher.

The study objectives were to examine and analyze the VAT practices in Nepal with reference to Chitwan district. The study focused field survey of VAT payers and other stakeholders from Chitwan. For fulfilling this purpose, the researcher explained the research design, nature and sources of data and the statistical procedure and tools which have been used to conduct the research. The main body of the research work which has

two main sections viz. presentation and analysis of data, and major findings of the study. This study begins with the need for reforms on the present tax system in Nepal, the reform in Tax being the VAT. Its importance was also studied. . It also tries to show the superiority of VAT to different forms of Sales tax. The study then moves on to examine the trend preceding and following the implementation of VAT in Nepal. The sample survey of 100 concerned people consisting of tax officials, policy makers' experts, Auditors, Businessmen and consumers was conducted to throw light on the administration system of Nepal. About 10 questions were asked them about the various issues relating to administration of VAT in Nepal. The study also discusses the trend of registration, cancellation of registration, Non-filers. Tax return, revenue collection from VAT, composition of VAT revenue, share of VAT revenue to GDP, to Total Revenue and to Total Tax revenue. The chapter then studies the future trend of GDP/VAT ratio. This was done with the statistical tool of Time Series. This will set a benchmark for the future action plan to ensure the growth of the ratio. For studying these various issues, data from the 10 fiscal years, i.e. from 2001/2002 to 2010/2011 has been used. To analyze the relationship of VAT with GDP, Total Revenue, Total Tax Revenue, and Total Indirect Tax Revenue, different statistical tools like correlation coefficient, coefficient of determination and student's t-test method for hypothesis testing were also used. After all these studies were made, the study came up with major findings which were also included in this study.

## **5.2 Conclusion**

The ultimate goal of the underdeveloped countries like Nepal is to achieve the economic development and ensure the rapid rate of economic growth. It calls for a huge amount of investment in economic overheads and other development activities for which taxation is undoubtedly a primary source of Inland Revenue for the government. Taxation may be considered as a basic tool in the path of economic development for the underdeveloped countries. Recently, developing as well as developed countries in the world have increasingly focused their attention towards reforming the tax system by standardizing and improving the poorly designed tax structure in order to mobilize high volume of resources for the development purposes and make the economy healthy, efficient and self sufficient to a larger extent. Actually VAT was introduced in Nepal in an ambitious hope to increase the revenue and particularly stop the leakage made through other forms of taxes. But history has shown that the government has already tried many reforms in the

field of taxation but no alternative have effectively materialized because it lacked proper planning and in other words leading to administrative failure. Indeed, this is true in the case of VAT also, Nepalese businessmen are generally found to avoid the frequent contacts with the tax officials because they are widely known for unofficial benefits. Even in the administrative area, there is a widespread corruption. From the survey, it is clear that it is difficult for the customers to get the job done by officials without sufficiently bribing them. There is also a red tapism everywhere.

### **5.3 Recommendations**

On the basis of research, the following corrective measures are recommended for the better administration and implementation of VAT system in Nepal. So, for the government, administrative capability and transparency are the serious concerns. In order to make VAT applicable, following things should be considered

- i. Administrative power and credibility
- ii. Tax payer identification
- iii. Registration and educational program
- iv. Incentives for small traders
- v. Co-ordination with private sector
- vi. Feasibility of refund system
- vii. Electronic media

- 1 A proper co-ordination between IRD and MOF should be established. Unpractical Acts, Rules and Regulations should be amended. VAT laws needs to review on the basis of experience gained so far VAT laws should be effectively implemented.
- 2 Unproductive, corrupted, inefficient staff lacking practical and specialized training is a serious problem. So, providing training to such staff is highly essential.
- 3 The tax administration should be very watchful to prevent any kind of malpractice, fraud and tax evasion. Utmost care should be taken to prevent any kind of bribing and corruption. Tax officials should effectively be monitored.
- 4 Taxpayers, customers are clearly ignoring the VAT system and taking it for granted. They have lack of proper knowledge about computation of tax liability, taking invoice



or bill on their purchases. So, emphasis should be given in educating the tax payers. The issuance of proper bill for every taxable sells must be made mandatory.

- 5 The success of VAT system is not only the success of the IRD, but also the success of nation as a whole. The role of general media, radio, TV, newspaper plays an important one. Emphasis should be given on mass media. Awareness towards VAT system should be created among general public, nongovernmental and government organization.
- 6 Computer system and networking program through online service must be developed and linked so as to make the work simple and easy. Computer links between tax officer and custom offices should be maintained.
- 7 Government has been providing tax refund facility to business organization and foreign diplomacy and foreign aided project. Tax refund is one of the sources of tax leakage. Therefore, tax authority should manage tax refund facility properly.
- 8 Research and investigation should be conducted on various issues, such as the effect of VAT on price, economic growth, investment and measures for solving VAT problems should be recommended by the expert group. VAT law needs to be reviewed on the basis of experience gained so far.
- 9 The accounting system should be transparent. Taxpayers should be encouraged to register their business voluntarily. Instead of forcefully coercing tax payers, providing various facilities to them can increase VAT compliance. The tax administration can select genuine business persons and reward them.
- 10 Border should be effectively controlled to prevent the illegal trade. Warehouse and highways checking should be done effectively to prevent any kind of illegal trade
- 11 VAT collection on import is remarkably higher than domestic production. Government should take effective steps to encourage domestic production.
- 12 Lots of efforts should be made to reestablish a functionally well-organized organization where the tasks are carried out in a modern, effective, efficient, transparent and service-minded manner.

- 13 Most of the national economic activities are dependent upon agriculture and large portion of GDP coming from agricultural sector remains out of the tax net. Thus VAT should also be levied on agriculture sector with sufficient exception for generating more tax revenue. This will increase VAT/GDP ratio.
- 14 Most of the taxpayers are not satisfied with VAT administrators. They always have complaints against the administrators who do their jobs rather slowly, harassing the customers unnecessarily. The work that is to be finished today is postponed for the next day. This is their habit. Therefore it is suggested that tax administrators should be consumer-focused and result oriented.
- 15 Lastly, the periodic information about VAT is now available on the website as well. For the researcher this is a great privilege. But the websites are not updated and doesn't have the older reports. So the website must be updated from time to time and must be kept up-to-date. And all backup copies of the old (old fiscal years') annual reports and Economic surveys must also be available on the website. This facilitates the researchers greatly and other concerned bodies, even the consumers, because for minor information, they would not have to frequent the Inland Revenue Department and Ministry of Finance.

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Value Added Tax Rule, 2053

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[http://en.wikipedia.org/wiki/Value\\_added\\_tax](http://en.wikipedia.org/wiki/Value_added_tax)

[http://http://ec.europa.eu/taxation\\_customs/taxation/vat/how\\_vat\\_works/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/index_en.htm)

<http://www.duport.co.uk/guides/tax&vat/An%20Introduction%20to%20VAT.HTM>

<http://www.fncci.org/text/tax.pdf>

<http://www.imf.org>

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

<http://www.kantipuronline.com/kolnews.php?&nid=92120>

<http://www.mof.gov.np/publication/speech/2007/index.php>

<http://www.nepalchamber.org/policies/incometax.php>

**APPENDIX- I**  
**QUESTIONNAIRE**

**Name:**

**Address:**

**Occupation:**

**Please, you are requested to provide your view on VAT in Nepalese context.**

1. Which is the most challenging problem associated with VAT implementation?
  - i) Under invoicing and smugglings      ii) Lack of proper billings
  - iii) Lack of proper accounts      iv) Weak tax administration      v) I don't know.
  
2. What is your opinion to make VAT effectively successful?
  - i) Strengthen and improve the capacity of VAT administration      ii) Educate taxpayers About the significance of VAT      iii) Mobilize cooperation of private sector Through FNCCI      iv) Improve VAT laws and regulations      v) I don't know
  
3. What is your comment on tax structure of VAT?
  - i) It is ok      ii) It has to be improved      iii) It is not compatible with the existing rules And regulations      iv) It has very insignificant contribution with respect to GDP      v) I don't know
  
4. How could the base of VAT be expanded?
  - i) Reduce threshold of VAT      ii) include all the services      iii) In corporate agriculture Sector      iv) All      v) I don't know.
  
5. What is your suggestion on the rate structure of VAT?
  - i) It is ok      ii) Raise to 15%      iii) Reduce to 10%      iv) Establish two rates such as 13% and 15%      v) I don't know.
  
6. What is your comment on exemption?
  - i) It is ok      ii) It should be reduced      iii) It should be increased      iv) I don't know.

7. Do you consider that VAT has increased price?

- i) Yes      ii) No

If yes, what is the primary reason attributing to price rise?

- i) compliance cost      ii) high profit      iii) Non-awareness of consumers  
iv) I don't know.

8. What will be the effect on resource mobilization by VAT as compare to the taxes replaced by it?

- i) Positive      ii) Negative      iii) No effect      iv) I don't know

9. What will be the effect of VAT on economic growth?

- i) Positive      ii) Negative      iii) No effect      iv) I don't know

10. Who are most responsible for tax evasion?

- i) Business enterprises      ii) Consumers      iii) Tax administration  
iv) All      v) I don't know.

Any suggestion.....

**Thanking You**

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