

INTRODUCTION

1.1 Background of the Study

Nepal is a developing country located in south Asia. Nepal is the homeland of Mount Everest- highest peak of the world, birthplace of Lord Buddha, habitat of thousands of flora and fauna, and residence of hospitable Nepalese people. Nepal is blessed with highest mountain ranges, ample natural resources, and huge manpower; however despite unlimited potential, the nation has still long way to go to achieve the goal of poverty alleviation. Economy is mainly based on agriculture. Agriculture accounts 39 percent of GDP and, it consumes 80 percent of workforce. It is noted that only by the improvement in agriculture sector, we cannot achieve notable increase in per capita income. Nepal is landlocked country and cost of production is high because of the transportation cost from sea to the place of production. So, manufacturing industry and other technological sector is sharing less than 10 percent of GDP. Tourism is the most potential sector for Nepal but its development has been stagnated due to the poor security situation last decade.

In all modern countries, even those which rely primarily on market forces to allocate most goods and services, governments have an important role in several key sectors. Government today set the legal framework for the market, regulates the market system, promote competition, and care for those unable to care for themselves. As well, government has carried out development plans, handling administration, citizen welfare, maintaining security etc. Government needs revenue to fulfill such requirements.

How does government accomplish their economic responsibilities? There is no magic secret. Government must pay for their programs. The government funds come mainly from taxes and any shortfall is made up by borrowings from public and foreign sector. Those borrowings may be short-term and long-term. But

these are not under the tax system. Tax is that part of government revenue which is collected from their citizens for using the public property and using the government land and resources for the purpose of making profit.

Internal sources of public income are taxes, fees, prices, fines and penalties. Internal sources constitute tax and non-tax revenue. Non-tax revenue includes different source like grants and gifts, administrative income, business income, registration fees, fines and penalties. Other sources of government revenue are the Taxation, Customs, Excise Duty, Value Added Tax, Corporate and Personal Income Tax. For the economic development of the country internal resource mobilization is much better than external resource mobilization because internal sources are safer than external. It is better for developing countries to maximize the mobilization of domestic resources.

The government promulgates the Acts in different period for enhance Tax revenue and collects the taxes as per the provision made in the Act. The tax cannot be imposed without act of the parliament. Tax is a compulsory contribution from a person to the government without have any right to receive direct benefit from tax paid. Tax is a compulsory levy and those who are taxed have to pay it without getting corresponding benefit of services or goods from the government. A tax is not a price paid by one, for which he claims goods and services.

Hence, it should be noted that all compulsory payments are not taxes. The charge of price for goods and services by public authority is not a tax. The tax is paid to government for running it. The tax is collected from haves and basically, spent for the interest of haves-not in the society. A natural or artificial people pay the tax.

The tax has the objectives of raising revenue to have resources mobilization, equal distribution of wealth and income in the society, encouragement in production of certain products, encouragement in employment, saving and investment, removal of regional imbalance and enforcement of government policy.

The constitution of Nepal has clearly directed Nepalese government for a self-reliant economic system, encouragement to national enterprises, prevention of economic exploitation as well as upgrading the standard of the people. For self sustain, government must be able to generate sufficient government revenue that is most important source of financing. Through the proper administrative strategy, the national objective can be achieved.

Since, being major source of fund collection of tax should be relatively high to achieve maximum social and economic objectives. Tax helps in redistribution of economic means by the transformation of wealth from person with higher economic level to lower economic level.

Tax is an important source of Government revenue. Custom duties, Value Added Tax (VAT), Corporate and Income taxes are the examples of the sources of tax revenue. Tax revenue comprises of two types: one is direct tax and other is indirect tax. A direct tax is really paid by a person to whom it is legally imposed. Taxpayer does not collect this tax from other person. Income tax, expenditure tax, property tax, interest tax and vehicle tax are the examples of this type of tax. An indirect tax is imposed on one person but paid partially or fully by another. Value Added Tax (VAT), export and import duties, excise duty are examples of indirect tax.

Value added tax (VAT), or **goods and services tax (GST)**, or In contrast to sales tax, is a consumption tax levied on value added. VAT is the major form of this group. VAT is probably the best one and latest tax system. It is the tax imposed on added value of goods and services. It is levied on industry as well as commerce i.e., both goods and services. Accordingly, it measures the value generated in a country. The tax system aims to minimize tax evasion and increase resource mobilization. It is imposed on value added amount in each stage and so equivalent to multistage sales tax. VAT is neutral with respect to the number of passages that there are between the producer and the final consumer; where sales tax is levied on total value at each stage, the result is a cascade (downstream taxes levied on upstream taxes).

Maurice Lauré, joint director of the French tax authority, the *Direction générale des impôts*, was first to introduce VAT on April 10, 1954. Initially directed at large businesses, it was extended over time to include all business sectors. (Source: Wikipedia, the free Encyclopedia-Value Added Tax)

Taxation policy has always been an important instrument for augmenting revenue, especially in developing countries, where it is the major source of domestic revenue. It is also an important instrument for attaining a proper pattern of resource allocation, income distribution, and economic stability, in order that the benefits of economic development are evenly distributed. Increased revenues are desired for many other purposes including expanding socially desired government current expenditures, or even on pragmatic grounds, as to impress foreign aid donors with evidence of the nation's 'effort' to develop on the basis of domestic resources.

1.2 Statement of the Problems

Tax system plays a major role for the development of the country, Nepal has introduced comprehensive tax reform program after the restoration of the multi-party democratic system in BS 2046. The implementation of Value Added Tax has been taken as an important part of this process. It is envisaged that through the implementation of this tax, the base of tax will become wider and thereby increase tax collection, make the tax system economically efficient and increase transparency in our entire tax system. In order to create conducive policy environment to implement Value Added Tax more efficiently, Government made several changes in the customs and income tax system. Prior to the introduction of VAT on 16 Nov, 1997 efforts were made to establish a legal and institutional basis for this and through tax payers' educational and awareness program regarding various aspect of this tax was imparted to potential tax payers as well as different sections of the society.

In the implementation of VAT, the main glitch has been in terms of lack of public awareness. Until the time when a situation is created where the consumer himself/herself is self-motivated to ask for an invoice, it will be an uphill to

climb for VAT.

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

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

Though being the most important segment of government receipt, Nepalese government could not be able to collect the reasonable amount of tax receive as compared to expected. Its effectiveness is still doubtful and difficult in our Nepalese context due to various reasons.

Government made VAT the main source of revenue collection but the mainstream of VAT, billing system is still very weak. Still the consumers could not get genuine bills. Businessmen try not to issue the bill and if issued, they ask for high price (Value Added Price). Therefore the consumers have tendency of not taking the VAT bills.

The prize program made a bit improvement but still could not gather the mass consumers. In year 2065/066, Government has made target to collect Rs.410 billion from import and internal sales, while they achieved to collect Rs.257.82 billion from import and Rs.139.18 billion from internal sales with total of 397 billion almost 97% target achieved. The wholesale and retail stores are still

could not come to the mainstream of VAT. (Source: Annual Report 2065/66-IRD)

General expenditure only could not be covered by the internal source of revenue. Now the revenue saving is zero. This discourages the foreign assistance and only one way to the government is to broaden the tax base. To increase the VAT rate, where people's income is low, is giving more financial burden to the public. To be more specific to the problem, the study tried to find out the answers of the following questions.

-) Do the businessmen and consumers are aware enough about VAT?
-) Why shopkeepers hesitate to issue invoices and why customers do not demand for it while making the purchases?
-) What is the impact of VAT on Government revenue?
-) What are the major loopholes?
-) What is the trend of registration and collection of VAT?
-) What are the major challenges and difficulties that faced by the taxpayers?
-) What are the major challenges and difficulties that faced by the small traders?
-) Is our tax administration perfect? If not, what are the major challenges they face from the market on collecting taxes and what are their own weaknesses?

1.3 Objectives of the Study

Government had introduced VAT in 1997 by replacing Sales tax; aiming to modernizing, transparent, less tax evasion, and more effective to collect revenues. At the time while implementing VAT in Nepal, 21 November 1997, many business leaders were protesting against introduction of VAT. Now the 11 years passed and this study related with achievement and challenges from beginning to till date. It is the most important segment of Government revenue;

Nepalese Government could not be able to collect the reasonable amount of tax revenue as compared to expected. VAT being a new growing concept to Nepal, its effectiveness is still doubtful. There may be various reasons for not gaining the effective result from VAT as well as from total tax scenario. Therefore the study tried to recommend a package of suggestions and solutions for effective implementation and to help program makers for strategy formulation. Specifically, the researcher tried to focus the study on following issues.

-) To find out the reasons why shopkeepers hesitate to issue invoices and why customers do not demand for it while making the purchases.
-) To find out the major loopholes and to suggest recovery package.
-) To assess the impact of VAT on Government Revenue in Nepal.
-) To analyze the trend of registration, refund and collection of VAT.
-) To recommend a package of suggestions for effective implementation of VAT.

1.4 Importance of the Study

There is a global trend of the tax reform. There were as many as 25 tax reform program during 1984 to 1990 in major Asian developing countries and on Latin America, East Europe and Asia from 1990 to 1995. Concerning this global trend of tax reform, Nepal could not be independent of such changes but will certainly influenced from such global changes. HMG Nepal decided to introduce VAT in the first quarter of the decade 1990. Due to the mid-term election and regular changes in government, disturbs the smooth functioning. Similarly business community claims that VAT is not appropriate in Nepalese economy as it increase unnecessary tax burden to the taxpayers and it is difficult to administer too. However, the government claims that VAT is a modern and scientific tax system. It does not increase the tax burden but carry all the taxpayers in a roadmap of tax brackets. So it is possible to collect substantial amount of revenue.

In the country like ours, the problems of massive poverty, unemployment and low literacy rate are deep rooted. It is very difficult to carry out this new concept in practice. The problems can be minimized with the overall development of the country, which requires huge resources. Tax being one of the major sources, it helps the government to implement development activities. Therefore the topics 'VAT' and overall 'Tax System' are the integral part of our country's economy. It is essential to improve its efficiency by minimizing problems and facilitating the positive aspects. This thesis will somehow illustrate its importance and suggest the government to make new strategy and implement the current programme smoothly.

The concept of VAT is still new in the Nepalese business environment. This year (2062 B.S.) is the eighth year of introduction of VAT. Now it is necessary to undertake research to find out the effectiveness of VAT system in Nepalese Economy. VAT was introduced in Nepal in replacement of sales tax, entertainment tax and contract tax. When VAT was introduced in Nepal the business community was in favor of old tax system. Business community used to claim that VAT would create many more problems on the existing system. Now it is necessary to assess all the positive and negative impact and put it in front of the business community. Limited study is carried out in this issue and those already studied materials also could not access the critical path for the future review and effective implementation of the VAT system. Now it is necessary to undertake research to find out the key areas where certain change and corrections is necessary.

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

In the context of availability of limited studies in this area, findings of this study would be helpful to the government for formulating strategies and making the tax administration more transparent as well as public oriented. Besides this, the study will largely be benefited in terms of refining the current issues, revising the plans and policies and targeting the criteria and improving the overall impact of tax system to the National Government, Social Community and other beneficiary groups.

1.5 Limitations of the Study

Each and every study has its own limitation and boundaries. This study also has some limitations. They are as follows:

-) Major sources of data was secondary sources thus the error consisted in those sources may perceive in this research.
-) Lack of availability of plenty secondary sources.
-) The person selected for interview may not be sufficient to represent the universe.
-) Lack of Nepalese literature study in VAT.
-) Due to time and resource constraint data and information which were collected might not be sufficient for the study.
-) By nature of a research, all the factors of VAT could not be explored in detail.
-) The research covers the secondary data from FY 2064/65 to FY2068/69 only.

Although, findings of the study will be helpful to all concerned stakeholders throughout the country. The findings, however should be applied with due care as it studied only of particular place i.e. Kathmandu Valley.

1.6 Organizations of the Study

The thesis is organized into five different chapters:

-) Chapter first provides an introduction, which describes the background, statement of the problem, objective and significance of the study.
-) Second chapter is devoted to Review of Literature, which includes conceptual framework, and review of related studies.
-) Third chapter is research methodology. It contains rationale of the selection of the study area, research design, universe and sampling, nature and source of data collection, data processing and analysis, limitations of the study and viability of study.
-) Fourth chapter consists of the data analysis and presentation.
-) And fifth chapter is about summary, conclusion and recommendation.
-) Then Bibliography and
-) Questionnaire used in data collection and calculation of trend and correlation are placed there after in Annexes.

CHAPTER II

CONCEPTUAL FRAMEWORK & REVIEW OF LITERATURE

2.1 Conceptual Framework

2.1.1 Meaning of Tax

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

Government's major sources of public financing are revenues (Tax), foreign grants and loan, domestic debt and change in cash reserves. Government must find the revenues to pay for its public goods and for income redistribution program. Such revenues come from taxes levied on personal and corporate incomes, on wages, on sales of consumer goods, and on other items. It is like another 'price' in this case the price we pay for public goods. Taxes are not voluntary. So it is compulsory contribution to the national revenue from nation's citizens. Everyone is subject to the tax law; we are all obligated to pay for a share of the cost of public goods. Of course, through our democratic process, as citizens we impose taxes on ourselves and all of us have a right to use our share of public goods provided by the government. As this way government sets the rules of road, levies taxes and tools to pay for collective activities and construct/buy public goods like Highways. Finally, tax is a liability to pay an amount to the government. It is a contribution to the national revenue from taxpayers according to law.

Findlays Shirras defined tax as "a compulsory contribution to public authorities to meet the general expenses of the government which have been incurred for the public goods and without reference to special benefit." (Source: Bhattarai & Koirala, 2006)

According to *Prof. Seligman*- "Tax is a compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit conferred." (Source: Bhattarai & Koirala, 2006)

In the words of *Plehn*- "Taxes are general contribution of wealth levied upon persons, natural or corporate to defray expenses incurred in common benefits upon the residents of the states." (Source: Bhattarai & Koirala, 2006)

2.1.2 Principle of Taxation

In the distant past, taxes were levied by those in power against those out of power. Later on, economists and political philosophers developed systematic approaches to tax policy.

Benefit vs. Ability – to – Pay Principle

The different individual should be taxed in proportion to the benefit they receive from government program or a person's taxes should be related to his/her use of collective goods like public roads or parks. This is the **Benefit Principle**.

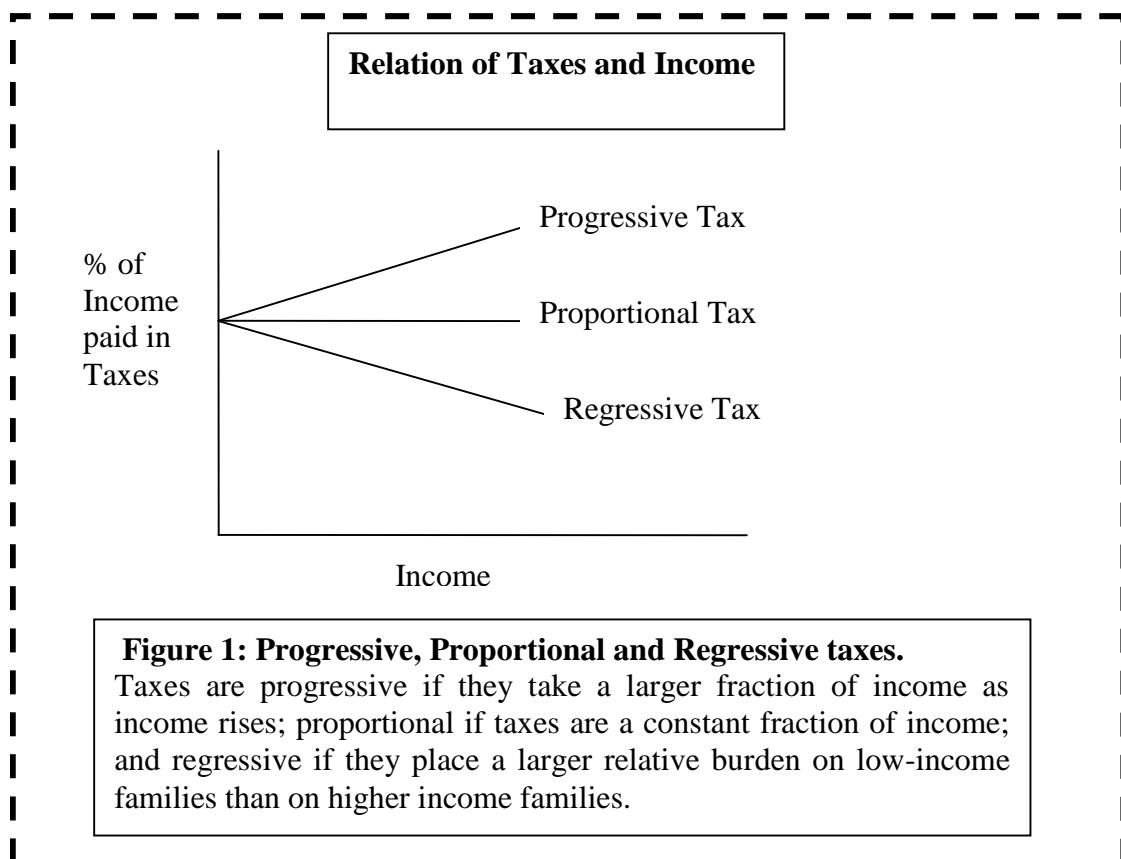
Ability to Pay Principle states that the amount of taxes people pay should relate to their income, wealth or ability to pay. Stated differently, taxation should be arranged to help accomplish what society regards as the proper and equitable distribution of incomes for the maximum total social utility.

The modern view about fairness or equity is explained by **Historical and Vertical Equity**:

Historical equity states that those who are essentially equal should be taxed equally. In the case of *benefit taxation*, if we receive exactly the same services from the highway or parks, the principle of historical equity states that we should therefore pay equal taxes. Or if the tax system follows the *ability to pay approach*, horizontal equity would dictate that people that have equal incomes should pay the same taxes. (Source: Bhattarai & Koirala, 2006)

A more controversial principle concerns **vertical equity**, which concerns the tax treatment of people with different level of income. Imagine A and B are alike in every respect except that B has ten times the property and income of A. Does that mean B should pay the same absolute tax as A for government services such as police protection? Since the more police and time needed to protect the property of B, it is perhaps fair for B to pay a large fraction of income in taxes.

Figure: 1



Source: (Source: Bhattarai & Koirala, 2006)

Progressive and Regressive Taxes

Today, advanced countries rely heavily on progressive income taxes. A family with Rs.50, 00,000/- of income is taxed more than one with Rs.2, 00,000/- of income. Not only does the higher income family pay a higher fraction of its income. It is contrast to a strictly proportioned tax, which makes all tax payers pay exactly the same proportion of income.

A tax is called proportional, progressive or regressive depending upon whether it takes from high-income people the same fraction of income, a larger fraction of income or a smaller fraction of income than it takes from low-income people.

2.1.3 Types of Tax

Direct and Indirect Tax

Taxes are classified as direct and indirect. A direct tax is paid by a person on whom it is legally imposed, examples are: Income Tax, Property Tax, Interest Tax etc. Indirect taxes are ones that are levied on goods and services only indirectly on individuals. Examples are excise duty, Import & Export duty and Value Added Tax etc.

Value Added Tax (VAT)

The value added tax or VAT for short, collects taxes at each stage of production. The VAT is a broad based tax as it covers the value added to each commodity by a form during all stage of production and distribution. It is a modern tax system to improve the collection of taxes, to increase efficiency and to reduce tax evasion. It is also regarded as the backbone of income tax system. VAT is levied in the final price of the Supply. VAT is an indirect tax. However it is not new form of taxation. It is improve and modified form of traditional sales tax. VAT is levied on value added at each stage of production and distribution activities. The stage may be import, export, manufacturing, wholesaling, and retailing. VAT is essentially the same as a national sales tax; it ends up taxing the sum of labor, interest, and other values added, which sum up to total final sales. The standard way to implement a VAT is to say a business owes some percentage on the price of the product minus all taxes previously paid on the good. If VAT rates were 10%, an orange juice maker would pay 10% of the Rs.50 per gallon price (Rs.5) minus taxes previously paid by the orange farmer (maybe Rs.2). In this example, the orange juice maker would have a Rs.3 tax liability. Each business has a strong incentive for its suppliers to pay their taxes, allowing VAT rates to be higher with less tax evasion than a retail sales tax.

Basis for VAT

By the method of collection, VAT can be accounts based or invoice based. Under the invoice method of collection, each seller charges VAT rate on his output and passes the buyer a special invoice that indicates the amount of tax charged. The buyer, if he is subject to VAT on his own sales, uses these invoices to obtain a credit (reduction) towards his own VAT liability. The difference in tax shown on invoices passed and invoices received is then paid to the government (or a refund is claimed, in in the case of negative liability). Under the accounts based method, no such specific invoices are used. Instead, the tax is calculated on the value added, measured as a difference between revenues and allowable purchases. Most countries today use invoice method, the only exception is Japan which uses accounts method.

By the timing of collection, VAT (as well as accounting in general) can be either accrual or cash based. Cash basis accounting is a very simple form of accounting. When a payment is received for the sale of goods or services, a deposit is made, and the revenue is recorded as of the date of the receipt of funds - no matter when the sale was made. Checks are written when funds are available to pay bills, and the expense is recorded as of the check date — regardless of when the expense was incurred. The primary focus is on the amount of cash in the bank, and the secondary focus is on making sure all bills are paid. Little effort is made to match revenues to the time period in which they are earned, or to match expenses to the time period in which they are incurred. Accrual basis accounting matches revenues to the time period in which they are earned and matches expenses to the time period in which they are incurred. While it is more complex than cash basis accounting, it provides much more information about your business. The accrual basis allows you to track receivables and payables. The accrual basis allows you to match revenues to the expenses incurred in earning them, giving you more meaningful financial reports. (*Source: Wikipedia, the free Encyclopedia-Value Added Tax*)

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

2.1.4 Types of VAT

There are three types of VAT:

-) The Consumption type VAT
-) The Income type VAT and
-) The Gross National Product type VAT

The Consumption type VAT

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

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

The Income type VAT

The income type VAT does not include capital goods purchased from other firms from the tax base in the year of purchase. This variant, however, does include depreciation from the tax base in the subsequent years. Moreover, under this system, an excess of year-end inventory over starting inventory is included. The tax falls both on consumption and net investment, and the conceptual tax base of this variant is the net national income.

The Gross National Product type VAT

Under this variant, capital goods purchased by a firm from other firms are not deductible from the tax base in the year of purchases. This variant does not allow the deduction of depreciation from the tax base in the subsequent years. Hence, the tax is levied both on consumption and gross investment, and the conceptual tax base of this variant is gross domestic product.

2.1.5 Features of Nepalese VAT System

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

-) Input Tax Credit
-) Tax Exemption
-) Self-Assessment
-) Threshold Limit
-) Tax Refund
-) Zero Rating

Input Tax Credit

Registered businessmen are obliged to collect and remit VAT on their taxable transactions. These registrants are entitled to recover the tax paid on their purchases. This recovery or refund is known as an input tax credit.

The Input Tax Credit (ITC) is the total of the tax paid or payable on taxable goods and services purchased in Nepal, and the tax paid on taxable goods imported into Nepal.

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

However, even though the purchase of goods or services may relate in part to a commercial activity, in certain circumstances the purchase may not generate an input tax credit entitlement when he sells goods or services which are tax-exempt.

Most registrants are entitled to claim input tax credits for the tax paid on acquisitions of capital goods for use primarily in commercial activities. Unlike the income tax deduction rules, the input tax credit for any VAT paid on capital goods is not amortized over the life of the asset. It can be claimed in full in the period in which it is acquired. If the capital goods are later put to a non-commercial use, special change-of-use rules will apply. Taxpayers whose export is more than 50% of total sales or those who are continuously on 6 months credit may claim for refund. Refund shall be paid back within 30 days from the receipt of refund claim.

(Source: <http://www.ird.gov.np/information.php?c=VAT>)

Tax Exemption

The purchaser will not pay VAT on tax-exempt goods and services and the supplier is not allowed input tax credits on purchases related to the following goods and services provided:

1. Goods and services of basic needs which include rice, pulses flour, fresh fish, meat, eggs, fruits, flowers, edible oil, piped water, wood fuel, and kerosene.
2. Basic agricultural products are also tax-exempt, for example, paddy, wheat, maize, millet, cereals and vegetables.

3. The expense of buying goods and services required to grow basic agricultural products are tax-exempt.
4. Social welfare services including medicine, medical services, veterinary services and educational services.
5. Goods made for the use of disabled persons.
6. Educational and cultural goods and services such as books and other printed materials, radio and television transmissions, artistic goods etc.
7. Personal services are also tax-exempt. These are services provided, for example, by professionals, by actors and other entertainers, people charging for academic and technical research and computer services.
8. Exemption from tax is also extended to the purchase and rent of land and buildings
9. Financial and insurance services.
10. Postage and revenue stamps, bank notes, cheque books.

(Source: <http://www.ird.gov.np/information.php?c=VAT>)

Self-Assessment

Section 18 of the VAT Act has required the taxpayers to submit tax return on self-assessment basis. VAT is levied on the basis of actual transaction. The businessmen himself/herself knows best what transaction has taken place and what cost. Since the taxpayers has to maintain his/ her sales record by themselves on the basis on invoices issued at the time of sales and purchase of goods and services, the VAT accounting is referred to as a self-accounting system. According to the laws of different countries world wide, while maintaining accounts for the purpose of VAT, a taxpayers has to record all the details in concerned with sales and purchase. The accounting system of VAT has been developed in such a way so as to ease the taxpayers' liability assessing for filing tax return and to ease the tax officials' audit of the taxpayers' transaction accounts.

(Source: <http://www.ird.gov.np/information.php?c=VAT>)

Threshold Limit

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

(Source: <http://www.ird.gov.np/information.php?c=VAT>)

Tax Refund

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

(Source: <http://www.ird.gov.np/information.php?c=VAT>)

Zero Rating

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

(Source: <http://www.ird.gov.np/information.php?c=VAT>)

2.1.6 Method of computing VAT

There are three methods of computing VAT:

- ❖ Addition Method.
- ❖ Tax credit Method.
- ❖ Subtraction Method.

Addition Method

Under this method, tax base is obtained by adding the payments made by a firm to the factors of production employed in production process such as wages, rent, interest, profit etc. This method is suitable for income type VAT.

Table: 1
Addition Method of computing VAT

Item	Raw material producer	Manufacturer	Whole seller	Retailer	Cumulative
Purchase Input – a	-	100	500	800	1400
Value added					
Wages	50	265	175	75	565
Rent	10	20	30	40	100
Other Expenses	15	30	40	35	120
Interest	10	40	20	30	100
Profit	15	45	35	20	115
Total value - b	100	400	300	200	1000
Added VAT @ 13%	13	52	39	26	130
Sales output a+b	100	500	800	1000	2400

Assumed data

Note: - Value added can be calculated in two ways,

1. Deducing purchases from sales of output (Rs2400 – Rs1400 = Rs1000) or
2. Adding input by the firm itself (excluding inputs supplied by others i.e. wages + rent + other expenses + interest + profit)

Tax Credit Method

Under this method, tax is imposed on total value of sales and taxpayers are allowed to deduct their gross tax liability from the taxes already paid by their supplier and pass on to them. This method is also known as invoice method.

Table: 2

Tax Credit Method of computing VAT

Item	Raw material producers	Manufacture	Whole seller	Retailer
Sales of output	100	500	800	1000
Less - purchase	-	100	500	800
Value added	100	400	300	200
Tax on total sale	13	65	104	130
Less – credit				
On purchase	-	13	65	104
Tax liability	10	52	39	26

Assumed data

Note: - Assume 13% VAT on a consumption basis.

Subtraction Method

Under this method, value added is determined as Net turnover. The net turnover is obtained by subtracting the cost of materials from sales precedes. This method is suitable consumption type VAT.

Table: 3

Subtraction Method of computing VAT

Item	Raw material producers	Manufacture	Whole seller	Retailer
Sales	100	500	800	1000
Cost of material	-	100	500	800
Value added	100	400	300	200
Value @ 13%	13	52	39	26

Assumed data

Out of three methods of computing VAT, tax credit method is widely used in the countries of the EC and elsewhere. The reason behind this is that this method possesses several advantages over addition and subtraction methods.

Since businesses are required to state the tax on invoices under the tax credit method it facilitates border tax adjustments. This implies that the amount of tax

that levied on exports can be returned to exporters. Similarly this method is effective under the destination principle where exports are zero-rated and the tax credit chain is not broken. It also provides the facility of cross checking.

2.1.7 Principle of VAT

There are two principles for levying VAT.

Origin Principle

Goods or services produced in a country are taxed at the place where they are produced. This implies that all exports are taxable and all imports are Non Taxable. Where there is a border and cross country trade, this principle gets importance to imported goods or services over domestic production. Countries with international boundaries do not prefer to have this principle. But in European Country, where there is common border this principle of taxation is essential. The main reason of not following this principle is of revenue loss. It also discourages the exports either directly or indirectly.

Destination Principle

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

2.1.8 Systems of Value Added Tax in Nepal: An Overview

2.1.8.1 General Background

Tax becomes the main source of revenue of the state. Value Added Tax is the latest innovation in the field of taxation. VAT is considered as the reform tax

system of the 21st century, which has already been implemented popularly in more than 135 countries in the world. VAT is multi staged; commodity and services based tax, which is levied on the value added of business at different stages of production and distribution. It is imposed on different stages. It imposed on value of goods and services. The value added tax is indirect tax depends upon consumer.

VAT is a broad based tax as it also covers the value added to each commodity by a firm during all stages of production and distribution. It is a modern tax system, which enables to efficient collection system, to increase efficiency and to reduce tax evasion. It is also refereed as the backbone of income tax system in Nepal.

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

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

2.1.8.2 History & Development of VAT

Tax is collected by government to meet the need of budget. Among the various types of tax, the sales tax is one of the major sources. VAT is the most scientific system of sales tax. In the early days, the tax from the consumption and production is collected as sales tax. But now, it is almost completely replaced by the VAT. The concept of VAT was introduced in 1919 by Dr. Wilhem Von Sieman in Germany. This concept was brought to replace the "Usnatzsterller"

(multi stage sales tax) due to its undesirable effects, particularly cascading and vertical integration of the latter tax (MST) for the first time. The Germany knew the administrative complication of the VAT system. So, it has the fear to implement. Therefore, the rate of *umsatzsteuer* is reduced instead of the implementation of VAT. In 1921, the America was implementing the corporate income tax. Prof. Thomas S Admas suggested the tax for the United State of America to replace the existing tax system. Until early 50s the development of VAT remained limited only in the theory.

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

In late 60s, VAT started to become popular. Countries like Denmark and Brazil adopted this system of tax in 1967. Germany also adopted VAT in the same year. In 1969, the countries like Netherlands and Sweden also adopted VAT in their countries. In 1970, 1971 and 1973, Luxembourg, Belgium and Ireland introduced the VAT respectively.

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

India introduced VAT first as modified value added tax (MOD VAT) in 1996. But actually in India, VAT replaced sales tax on 4 January 2005. Though some state did not opt for VAT (for political reasons), majority of the state embraced VAT, states like Andhra Pradesh and Maharashtra taking the lead. The Empowered Committee, constituted by Government of India, provided the basic framework for uniform VAT laws in the states but due to the federal nature of Indian constitution, States do have a liberty to set their own valuations for the

VAT levied in their own territory. (*Source: System of Value Added Tax in Nepal, ALDeRLS-Nepal*)

2.1.8.3 Value Added Tax in Nepal

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

In Nepal, Value Added Tax Act was enacted by 1995 and started to implement only at 16 Nov. 1997. Value Added Tax Act repealed four different Tax Act such as Sales Tax Act, Hotel Tax Act, Contract Tax Act and Entertainment Tax Act.

VAT replaces the old Sales Tax, Contract Tax, Hotel Tax and Entertainment Tax. It is believe that successful implementation of VAT will helps to generate customs duties and income tax also and it is expected to enhance the revenue collection and it is closely associated with the GDP. This Act classifies good and services under three categories they are Vatable goods and services, exempted goods and services and zero rated goods and services. It is applied at a single rate (presently 13%, initially 10%) based on addition of value of the goods and services at each stage in the process of supply and delivery of goods and services.

Since then second amendment have already been made on Value Added Tax Act, 1995, and 8th amendment have been made in the Value Added Tax Rules, 1997. Various directives have been issued by the concerned authority to implement the VAT in Nepal. (*Source: System of Value Added Tax in Nepal, ALDeRLS-Nepal*)

The current threshold for VAT registration is Rs.2 million. Those vendors whose annual turnover is below the threshold can, however, register voluntarily.

There is persistent increase in the number of VAT registrants. IT has crossed the 40,000 mark. Almost 69,653 business firms are registered in all over the Nepal upto Asadh 2066. At the time of conversion from the then sales tax to the VAT a total of 2045 taxpayers were converted as VAT registrants. As the taxpayers are

increasing, the amount of revenue collection and the level of tax compliance are improving today. (*Source: Annual Report FY 2065/66, IRD*)

Nepal cannot successfully and properly tear a curtain built from massive poverty, hunger, unemployment, and socio-political and geographical constraints over 50 years of planned development. Nepal cannot succeed to score much better than the 2.4% growth rate of GNP, where as the country like Indonesia and South Korea can achieve satisfactory growth rate of 6% and 7.7% respectively. (*Khadka, 2001*)

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

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

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

It was introduced in 1997 but still many businessmen in Nepal are not very clear on how this system works. Moreover this system requires proper recording of business transactions, which many firms lack. Existence of small traders in large

proportion and their inability to comply with the requirement of VAT due to their low scale of operation, lack of accounting records, illiteracy and high compliance cost. The existence of open boarder and large amount of unauthorized trade from India to Nepal is a challenge for implementing VAT. (*Khadka, 2001*)

2.1.9 Government, Development and Taxation Policy

Like in any other country, the Government of Nepal needs revenue to fulfill the functions of an independent state or country. Generally revenue means collecting taxes, in fact. The major responsibility of Government is development of infrastructure, maintain peace and security and give quality services to the public. Infrastructure means all the physical facilities such as Telephone, Electricity, Railways, and Highways etc. Peace and Security is the political and economic environment of a country in normal condition. It deals with day-to-day problem and crisis faced by the people. Contrary to expectations of an economic revival in the wake of the historic political breakthrough in April 2006 to end the decade-long Maoist insurgency, economic growth slowed in FY2007 owing mainly to unfavorable weather and renewed political unrest. The political transition is complex and remains the key risk to growth and development prospects. However, the renewed commitment of the main political parties to the peace process offers hope that the country can continue to make headway in its aspirations for social and economic transformation and in the delivery of a tangible peace dividend. Its being true because a decade long Moist insurgency comes to mainstream politics and successful execution of constituent assembly elections though in transition phase, government faces many difficulties due to bandha headache by different communities like Madhesi, Tharu, orher ethnic group. The first republic ambitious budget focused on public welfare by mobilizing internal sources.

From another angle of study, the government needs financial services to provide all those requirements of the citizens. And to fulfill the needs and requirements of the public as well as to maintain peace and security is the primary

responsibility of the government. The main requirement in this scenario is the earnings of government. The government needs money to operate its daily activities and to maintain its management as well to feed the employees who are working in government agencies and offices. The more money a government has, more it can spend for its public and for development of the nation. The main source of the government income is tax. Though government can earn money from other activities too, the reliable and important source is revenue by taxing.

Finally, there is deep connection between government, development and taxation. Both- physical infrastructure development and development of economic aspect of its public are dependent and revolve around her taxation policy and earning of the government.

In that sense, the reform initiatives taken by the Government of Nepal are grouped in three major heads as mentioned in next page: -

Policy Reforms:

- Improve the buoyancy and elasticity of the tax system by widening the tax base of value added tax, income tax, excise duty and custom.
- Streamline the tax rates and tax slabs in income tax, VAT, excise and custom.
- Minimize the exemption list in VAT.
- Discourage the tendency to provide tax rebate and exemption by reforming sectorial laws and cabinet decisions.
- Groom tax personnel towards developing taxpayer friendly behavior.
- Separate revenue group within Nepalese civil service to make the revenue service more professional and competitive.
- Increase Taxpayers compliance by the introduction of self –assessment system in Income Tax and VAT.
- Computerization of Income Tax and VAT.
- Streamline the rates of custom duties in line with WTO and SAFTA

provisions.

- Introduce electronic lodgement of customs declaration form using direct traders Input (DTI) module.
- Establish wide area network (WAN) in custom department and connect it with main nine custom offices.
- Form a separate risk management team in custom department for the purpose of intelligence and awareness in Cargo Selectivity Module.
- Strengthen and expand Automated System for Customs Data (ASYCUDA) system in remaining custom offices.

Legislative Reforms:

- Introduction of VAT in 1997 covering a wide range of business, keeping threshold at NRS.2 million.
- Introduction of new Income Tax Law in April 2002 covering global income into tax net.
- Introduction of new Excise Law in 2002 covering domestically manufactured and imported goods.
- Introduction of new Custom Act 2007, compatible with WTO valuation system.

Institutional Reforms:

- VAT and Income Tax Departments were merged into Inland Revenue Department. Twenty-one district level frontline offices and some service centers were established to administer the VAT, income tax and excise duty.
- A Large Taxpayer Office was established in 2005 to administer the state owned public enterprises, banks, finance companies and big business houses exceeding turn over of 250 millions NRs.
- A preliminary study was conducted to change current Inland Revenue

Department into an autonomous Revenue Authority Board.

- The revenue consultative committee, a think-tank body was formed for policy advice.
- Rigorous training programs were conducted to make employees more capable and professional.
- VAT system was computerised and income tax system is underway to be computerised.
- Process and procedures are being rationalised. Manuals, returns, formats and enclosures are being simplified.
- Taxpayer education program is highly focussed by the government through different interaction programs, public notices in national daily, websites and home page design and customer awareness program through lottery provision in VAT billing.
- Taxpayer's Charter and grievance handling system in tax administration was introduced.
- E-filing and ETDS system is being introduced this year in major income tax offices.
- Permanent account number distribution system was sourced out to the Federation of Nepalese Chambers and Commerce and Industries.
- Performance based incentives program is being introduced in 2006-07 in large Taxpayer office and Birgunj Dry port. Expansion is being proposed this year to some more offices in IROs and customs.
- Post Clearance Audit unit (PCA) was established in the department of custom.
- Computerized scanning machines were installed in major custom offices for the simplification of custom procedures.
- Single window clearance system was operationalised for the cargo of third country import in Birgunj custom office.

- Computer software relating to passenger clearance has been installed in TIA custom office in order to simplify the passenger clearance process.
- New revenue accounting system has been introduced.
- Accounting and auditing softwares are standardized.

(Source: Economic Survey, 2066, MOF and Annual Report FY 2065/66, IRD)

Reform Initiatives of Inland Revenue Department (IRD) in the Fiscal Year 2065/66

The main function of IRD is to mobilize internal revenue through increasing voluntary Tax Participation by fair, efficient, effective and modernized Tax Administration.

Mission

- “Paid tax for our own development, construction for modern and prosperous Nepal” Policy formulation and implementation with this slogan.
- Mobilizing maximum revenue through reliable, neutral, efficient, transparent and effective tax system and set up friendly investment environment.

Strategies

- Broaden the tax base without increasing tax rate.
- Long-lasting revenue growth and broaden tax base.
- Protection of Tax payer right.
- Easy way applied for business commencement and liquidation.
- Making friendly investment environment for economic development.
- Guaranteed for facilitating service.
- Cost saving of taxpayers through e-governance.

- Improve and enhance taxpayers through tax education.
- Modernization of administration through people, process and technology reforms.
- Facilitated participation in the tax system by all sectors.

Modernized administration through people process and technology

Objectives

- Maximize productivity of employees.
- Modernize information system to enhance services and enforcement mechanism.
- Maximize resources to frontline operations.

People:

- Account and audit standard training.
- Advance accounting and Balance Sheet reading training
- Specific issue training.
- Observation tours.

Processes:

- Coordinate with public information offices-bank and financial institutions, credit information bureau, customs and other offices.
- Registrations.
- Upgrading new version of software Oracle 8i to Oracle 10g
- Excise software
- Enhancement and expand E-system with personal e-PAN, e-TDS and e-VAT Return filing
- E-filing of Debit 1 and Debit 2 statement
- Arrears settlement and tax settlement commission.

Immediate Future Reforms:

- Autonomous revenue authority.
- E-governance master plan
- Computer networking with beer factory
- Compulsory Electronic Cash Register (ECR) will be introduced for retailers in selected areas of business.
- Computer billing system will be implemented with compulsory modem and telephonic line and fiscal printer to the target group of large importers and with high annual turnover.

Current Issues:

- Under invoicing and under billing.
- Cross border smuggling.
- Taxation on E-commerce.
- Increasing non filer and late filers.
- Auditing and investigation of tax evasion especially through transfer pricing.
- Collection of arrears.
- Tapping potential tax payers in tax net.
- Enhance tax payer's compliance level.
- Competency and professionalism of tax officials.

(Source: Annual report FY 2065/66, IRD)

2.1.10 Revenue Collection & Government Expenditure and its impact in Development

Nepal heavily depends on revenue collection for meeting its expenses. But in recent times, the government has failed to meet the target it set for itself for revenue mobilization, despite several initiatives. Unfriendly policies and worse

tax collecting methods have kept legitimate and even willing taxpayers away from tax office. The administration keeps turning deaf ears to the valley of complaints that come from taxpayers (be it businessman or ordinary citizens) related to bureaucratic hurdles being faced while paying tax.

The financial transaction statistics of the government of Nepal shows that total expenditure in the fiscal year 2065/66 was Rs. 219.66 billion, of which 58.2 percent was recurrent, 33.3 percent capital, and 8.6 percent repayment of principal. Expenditure trend of the past years shows share of recurrent expenditure in total expenditure is close to 60 to 62 percent between fiscal years 2058/59 and 2062/63. Such ratio has declined in subsequent years as expected. The share of capital expenditure in the total expenditure was about 26 percent between fiscal years 2059/60 and 2062/63 while it showed increasing trend in the subsequent years. Similarly, revenue mobilization covered about 63 to 70 percent of the total expenditure between fiscal years 2058/59 and 2065/66. During this period, total average revenue grew by 17.3 percent, while average growth rate of total expenditure remained at 17.8 percent. (*Source: Economic Survey 2066, MOF*)

The Government expenditure in the fiscal year 2065/66 totaled Rs.219.66 billion. Out of that total expenditure, revenue mobilization financed 65.3 percent, foreign grants 12.0 percent, foreign loan 4.5 percent, domestic borrowing 8.4 percent while change in reserves shared 9.8 percent. Among the sources of financing the total Government expenditure in the fiscal year 2064/65, revenue mobilization contributed 66.7 percent, foreign grants 12.8 percent, foreign loan 5.6 percent, domestic borrowings 12.6 percent and change in reserves shared 2.4 percent. (*Source: Economic Survey 2066, MOF*)

Revenue mobilization, foreign grants and loan, domestic borrowings and change in cash reserves are used as fiscal instruments for financing government expenditures. When compared to the fiscal year 2064/65, revenue mobilization in 2065/66 grew by 33.3 percent to Rs. 143.47 billion. In the fiscal year 2064/65, revenue collection had increased by 22.7 percent as compared to its preceding

fiscal year. The Government revenue had financed 66.7 percent of the total government expenditure in the fiscal year 2064/65 while this source contributed to 65.3 percent of the total expenditure in the fiscal year 2065/66. (*Source: Economic Survey 2066, MOF*)

Of the total revenue, shares of tax revenue and non-tax revenue in the fiscal year 2065/66 stood at 81.6 percent and 18.4 percent respectively. Such shares in the previous year were 79.1 percent and 20.9 percent respectively. (*Source: Economic Survey 2066, MOF*)

As per economic survey of Government of Nepal, in the fiscal year 2064/65 total tax revenue collection of Nepal government was Rs.85.15 billion which was increased to Rs.116.99 billion in fiscal year 2065/66, which has 37.39% growth rate. Out of total revenue collection, contribution of indirect taxes was 72.89% (Rs.62.07 billion) in the fiscal year 2064/65 and it was 69.41% (Rs.81.21 billion) on fiscal year 2065/66 as per revised estimates of FY 2065/66. Contribution of VAT on total indirect taxes was 48.08% (Rs.29.81 billion) in FY 2064/65 and it was 49.19% (Rs.39.95 billion) on FY 2065/66. (*Source: Economic Survey 2066, MOF*)

It shows that contribution of VAT on total indirect taxes collection is increasing however there are various challenges in this sector. Still many businesses are yet to be brought into bracket of VAT. Government of Nepal has proposed a wide reform on VAT administration through the budget of F/Y 2066/67 and has aimed high revenue mobilization. Government has also announced compulsory PAN taking program to all income earning individual, which will also help to create a mass campaign and awareness at public level regarding tax and revenue system. However, there are various challenges at grass root level to implement all the provisions of VAT and regulations properly. Still Nepalese people are not practiced to take VAT bill after purchasing goods and services. Under invoicing of imported goods and not issuing VAT bill to all VAT livable sales is the major problem on optimum collection of VAT. As a point of view of taxpayer, bureaucracy of Revenue department is very difficult to work with and not

friendly with taxpayers. It is always an issue that officials of revenue department are corrupted and they work only for money. Likewise still many problems are there for optimum level of output from the VAT system of Nepal and to make it one of the major contributors on revenue of the nation.

Every year we are facing the deficit budget and that made the imbalance in the expenditure. If income could not be made as targeted, obviously there is decrease in the expenditure. But it is important in which the expenditure decreases. The operating expense to meet daily activities is increasing. But social and development expenditure is in decreasing trend.

The main thing to check whether the economy is running perfect or not is measured by the balance in expenditure. After deducting general operating expenses from the revenue collected is to be saved for development activities but the decreasing budget for development activities reached at the climax in last fiscal year.

2.2 Review of Related Studies

2.2.1 Theoretical Review

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

Nepal cannot successfully and properly tear a curtain built from massive poverty, hunger, unemployment, socio-political and geographical constraints over 45 years of planned development. Nepal cannot succeed to score much better than the 2.4% growth rate of GNP, where as the country like Indonesia and South Korea can achieve satisfactory growth rate of 6% and 7.7% respectively.

There is a global trend of tax reform. In this way there were as many as 25 tax-reform program between 1984 to 1990 in major Asian developing countries and

this trend continued on Latin American, East Europe and Asia from 1990 to 1995. Relating the global trend of tax reforms, Nepal could not be independent of such changes but will certainly be influenced from such global changes. Considering this reality HMG decided to introduce VAT in Nepal.

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

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

It was introduced in 1997 but still many businessmen here in Nepal are not very clear on how this system works. Moreover this system requires proper recording of business transactions, which many firms lack. Existence of small traders in large proportion and their inability to comply with the requirement of VAT due to their low scale of operation, lack of accounting records, illiteracy and high compliance cost. The existence of open boarder and large amount of unauthorized trade from India to Nepal is a challenge for implementing VAT.

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

The review of the theoretical background of VAT is made with the coordination of the topics selected. Negative aspect that Nepal faced possible remedies that

were previously recommended and positive aspects that in future Nepal can grab are analyzed based on the past data.

2.2.2 Critical Aspects

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

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

Further Nepal's taxation system and administration is not conducive to business. There is not need to improve attitude and treatment of tax officials, which is a major reason that people hesitate to go to tax offices. The diverse interpretation of laws and regulations have added extra legal burden on the business community. As a result, the share of tax in national revenue generation has not been able to pick up compared to the contribution of non-tax revenue sources.

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

A country with a high income tax can be well off, if it has zero or tax to zero tariffs. Scandinavian countries are prosperous despite taxes on income exceeding 50 percent, since they all maintain minimal duties. How tariffs enable people to

become wealthy, even though income taxes may take away a substantial chunk of their money. High tariffs prevent people from becoming rich.

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

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

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

The government has been able to collect value added tax (VAT) more than the target but it has failed to meet the mark set for income tax until mid-May 2010.

This scenario contrasts the earlier trend of not meeting the VAT target while meeting that of the income tax in the last few years.

Overall VAT collection until Mid-May was Rs. 42.85 billion against the target of Rs. 40.96 billion which is an increase of 4.6 percent against the target.

The government aims to collect Rs. 51.56 billion in VAT this year (FY 2066/67). “At this rate, we hope we will be able to collect more than Rs. 53 billion,” said official of the Finance Ministry. The government had failed to meet the VAT target last year as it had been the case in the preceding few years.

Internal value added tax has also overshoot target after a gap of few years. The internal VAT collection rose 10 percent to Rs. 15.16 billion against the target of Rs. 13.81 billion. The government has plans to collect Rs. 17 billion as internal VAT.

The VAT collected at customs points is at par with the target but the overshooting of target in the internal front contributed to surpass overall VAT collection.

Official of IRD said the increase in the internal VAT was due to expanded tax base, easier and faster service, tax education and action against tax evaders in the recent times.

The government has declared the current fiscal a tax compliance year and aims to add 200,000 new taxpayers. The number of new taxpayers reached 120,000 until mid-May 2010 with the number of total taxpayers arriving at 475,000. Despite addition to the taxpayers’ number, income tax was collected only up to 96.57 percent of the target. The collection remained at Rs. 24.73 billion against the target of Rs. 25.75 billion.

The government aims to collect Rs. 36.29 billion in the current fiscal year. “We hope we will meet the target as many taxpayers pay outstanding taxes of previous quarters before the closure of the fiscal year,” (*Source: The Kathmandu Post, 6 June 2010*)

2.2.3 Singapore’s Successful Story

Singapore adopted VAT as an important part of a broad tax reform program. Since the high rate of the income tax has a negative impact on savings, investments, production, etc., currently all countries around the globe are reducing the rate and level of income tax. Hence, based on the global trend, in

order to decrease its dependency for revenue on income tax and make its economy more competitive in the global market, Singapore had to make adjustments on its income tax system. But in the context of reducing the rate of income tax, alternative sources for revenue generation had to be found and VAT was introduced so as to develop it as source of revenue for the future.

Singapore not only adopted VAT, but also simultaneously implemented various other tax reform measures. In 1994, the maximum limit for individual income tax was from 33% to 30% and accordingly the rates applicable for different brackets were also reduced. In the same year, the tax exemption limit was also increased from Singapore \$2,000 to \$3,000. The corporate income tax was also reduced from 30% to 27%. Similarly, a policy to reduce the property tax was reduced from 16% to 15%. Some facilities were also granted on house rents.

Similarly, some improvements were made in the tax based on goods and services and on its fee structure. In this context, the telephone fee was cancelled and converted into VAT and thus some relief provided.

The tax reform package implemented in the context of adapting VAT aimed to fulfill the following objectives:

-) Widen the tax base.
-) Simplify the tax system.
-) Make Singapore's economy more competitive.
-) Encourage savings, investments and productivity.
-) Establish a high economic growth rate etc.

Preparations made by Singapore in the context of VAT are indeed noteworthy. In 1993, a White Paper was issued to implement this tax system. Then on 26 February 1993, a bill for tax on goods and services was presented at the parliament. A selected committee of the parliament was formed to discuss of this. On 7 September 1993, the committee presented its report to the parliament. The parliament then passed the VAT Act on 12 October 1993. On 29 October, a

gazette was published stating that the Act would commence from 26 November 1993 and that the registration and tax collection would commence from 1 April 1994.

Singapore prepared about 36 taxpayer education materials in almost all the main languages and organized several seminars for potential taxpayers. The first seminar was organized for the members of the Institute of Certified Public Accountants of Singapore (ICPAS) on 19 April 1993. From that time up to 24 March 1994 (up to 3 days prior to the actual implementation of VAT), 380 seminars had been organized, involving a total of 45,000 participants. Even after the commencement of VAT on 1st April 1994, 34 seminars were held. Similarly, 600 discussion programs among various groups were also organized. In order to impart knowledge regarding various aspects of VAT and to make the taxpayers, particularly small businessmen, capable of fulfilling the formalities of VAT, training was provided to 3,700 businessmen. Telephone services in form of 'help lines' were also introduced and this provided services to almost 31,000 people.

The registration process for the purpose of this tax commences on 12 November 1993. Prior to this, a registration kit comprising of the application form, information regarding the application process, and other relevant information, together with a letter were distributed among 30,000 potential taxpayers. Reminder letters, up to three times, were sent to those who did not apply. Finally phone calls were made to those who had not registered till the final date of registration. Advertisements were posted on almost all the popular newspapers and magazines to reach out to all potential taxpayers.

To impart knowledge regarding the objectives and effects of this tax not only to the potential taxpayers but also the general public, 40 seminars were held, mostly on holidays. Similarly, with the objective of providing knowledge regarding VAT to the local people, seminars were organized among community workers, the local police and even school students.

The mass media was used widely. Wide publicity campaigns were carried out through the radio, television advertisements, discussion programs, stories and cartoons in various newspapers, magazines, posters, etc.

Since Singapore did not have experience in the field of sales tax, special arrangements were made for the first day of the implementation of this tax, i.e. on 1st April 1994. The government and officers involved in the administration of this tax regarded this day as special and there was both anxiety and curiosity as to what would happen on 1st April. Several questions were raised in minds of the revenue authority of Singapore – what will the business community do? Will the taxpayers know how to collect tax properly? Will the taxpayers be supportive or not? Will the consumers pay tax or not? Might there be conflict between the taxpayers and the consumers?

On that day, a group of individuals who had received special training had been prepared to provide telephone services. These individuals were primarily from the Goods and Service Tax Department, Singapore Consumers' Forum, Customs and Excise Department, and the Ministry of Industry and Commerce. These individuals had the capability to tackle well questions related to technical and commercial aspects as well as in relation to the principles of VAT and the protection of consumers' welfare. The total number of calls received on that day was 1,380.

Similarly, 30 mobile groups had been mobilized all over Singapore. Their job was to look into places where lots of consumers had gathered to relay the status to the Operation Command Centre. These groups were the eyes and ears of the Inland Revenue Department of Singapore that spread all over Singapore. These groups were also instructed to solve the problems within their means and in case of failure to do so were to report to the Operation Command Centre which would then send special officers.

All businesses transactions ran smoothly on that day and there were no jams in the ports as well. No difficulties were faced even in the business centers. The day remains normal as usual with no unusual incidents. In this relation, the

Finance Minister said that “It is fortunate that no untoward incident took place and that nobody was disappointed with VAT. This means that the preparations made so far to implement this tax have been successful.”

Thus VAT was implemented successfully in Singapore. A majority of Singapore’s population internalized this tax within a short span of time and it has now become a part of the lifestyle of the Singaporean people. There are various reasons responsible for the successful implementation of this tax in Singapore in a short time despite the lack of experience in relation to sales tax. In the process of VAT implementation, the slogan “Fairer tax and a brighter future” was put forward and it was accorded high priority even at the high-level political arena. Prime Minister Goh Chok Tong, the Deputy Prime Minister, the Finance Minister, the Ministry for Industry and Commerce and various other ministers defended VAT in one voice during various occasions. The Finance Minister, Dr. Richard Hu, and the Minister for Industry and Commerce, Mr. Dhanabalan, were engaged in passionately emphasizing the necessity of VAT for the economic development of Singapore. This gradually helped fade out the objections made against VAT.

The reason behind Singapore’s successful VAT implementation is also its high level preparation. For good preparations, along with other factors, a large group of officials who have a clear understanding of the concept of VAT and who are reform oriented, inspired, and enthusiastic workers are also required. A Nepali team had visited Singapore to study VAT and when a member informed the Singapore Revenue Authority that Nepal was making preparation to introduce VAT, an official asked “how many sleepless nights have you spent because of VAT?” This shows the level of commitment and responsibility that the officials felt and hence the VAT implementation of Singapore is a success story today.

Thus, it is not easy to establish a new system in a magic way. But there are so many challenges to be tackled for the successful implementation in Nepal. The lesson we learned from the Singapore may be a milestone for the future success of VAT. Still we can do a lot of changes but should start today. Tomorrow will

be too late. The whole responsibility goes to Inland Revenue Department since it not only administers VAT but also income tax, excise duty and other non tax revenue as well. The Department is given the major responsibility of managing more than 70% of the total revenue of the nation. Therefore, in success and failure of the nation's fiscal system, this administration has a major role to play. The major challenge facing this new administration is whether to expand and make more systematic and reform oriented activities that took place in the context of the preparation and implementation of VAT. The programs such as establishment and development of the concept of self assessment, organization of the taxpayers education programs, function-based organizational structure, employee training, internal monitoring etc., should be organized as soon as possible (*Khadka, 2001*).

2.3 Literature in the Context of Nepal

2.3.1 Review of Relevant Books

Book entitled published in 2003 "*Value Added Tax in Nepal: Theory and Practice*" is written by Chandra Mani Adhikari deals with the theoretical concept of VAT which includes historical background, objectives, merit and demerit of VAT introduction of VAT system in Nepal, different terminologies associated with VAT, Tax administration system and legal provision made for the VAT implementation in Nepal and Value Added Tax Rule 1997 and Value Added Tax Act 1996. (*Adhikari, 2003*)

Mr. Puspa Raj Kandel, published a text book entitled, "**Tax Laws and Tax Planning in Nepal**" in 2004. The book was designed to fulfill the needs of MBS level under Tribhuvan University. This book was very useful to the students and teachers to know the legal provision of the Income Tax Act 2058. The book has attached acts, rules related to Value Added Tax and income tax. (*Kandel, 2004*)

Mr. Surendra Keshar Amatya, Dr. Bihari Binod Pokharel and Mr. Rewanta Kumar Dahal published a book entitled "*Taxation in Nepal (Income Tax, Property Tax & Value Added Tax)*" in 2004. This book makes an in-depth approach to the study of income tax, property tax and VAT in Nepal in order to

meet the specific requirements of the students studying taxation. This book includes legal provisions of Income Tax Act 2058 and VAT 2052. Not only theoretical but also numerical problems of income tax and value added tax are shrewdly presented in this book. (*Amatya, Pokharel & Dahal: 2004*)

In 2006, the book named, “**Tax Laws and Tax Planning**” by Mr. Ishwor Bhattarai and Mr. Girija Prasad Koirala describes the Income Tax System in depth. This book includes the separate chapter of Value Added Tax. It describes VAT practice in Nepal with several theoretical as well as with examples. This book specifically designed for the study of MBS 2nd year under Tribhuvan University. However, the book has not mention about the legal provisions. (*Bhattarai and Koirala: 2006*)

2.3.2 Review of Relevant Thesis

In Nepal VAT was introduced on 16 November 1997. This tax was levied in place of the import-manufacturing level sales tax, hotel tax, contract tax and entertainment tax. A total of 2045 firms were registered under the sales tax at the time of the introduction of VAT. They were required to be converted into VAT registrants by 16 November 1997. But there are so many obstacles and hindrances in the path of its development. During the course of its development various experts and researchers express their view regarding the problems and future prospects of VAT. This chapter includes the summary of many theses given by the students.

Ghimire, Lalmani (1998) in his thesis “**Value Added Tax: Key Issues in Nepal**” explains great importance for the effective implementation of VAT administrative capability in Nepal. Organizational structure, audit and inspection system, reward and punishment, political intervention, selection of skilled and experienced manpower are needed to improve for effective implementation of VAT. VAT is considered as a broad tax and potential advantages of it can be attained fully if the tax extended though retail level. He also finds some difficulties in implementation of VAT in Nepal such as rate structure, small traders in large proportion, lack of accounting records, illiteracy

and high compliance cost etc. Strong administrative and educational programme, technical data base system, combination of various revenue offices, high level VAT implementation terms etc are essential prerequisites of the successful implementation of VAT in Nepal. (*Ghimire: 1998*)

Bista, Rup Bahadur (1999) in his thesis “**Need of VAT for Nepal for several reasons**”. They are effective revenue mobilization, industrial development, strong administration, transparency and avoiding all tax loopholes. VAT helps to reduce the resource gap by broadening the tax base and mobilizing additional resource by controlling tax leakage, smuggling, unofficial trade and corruption through transparency and account based cross- checking. In his research, the major findings were about a VAT being account based, invoice based and record based; it checks the tax loopholes such as under valuation, on- recording and unauthorized trade. It discourages such issues and problems existed in the sales tax system. (*Bista: 1999*)

Dhakal, Bishnu Hari (2000) in his thesis, “**Nepalese Tax Structure**” has analyzed the Nepalese tax structure along with the basic emphasis and historical background and potential revenue of VAT in Nepal. The increasing trend of the resources gap of Nepal is forcing the country to debt-trap situation. Domestic resource mobilization through the properly designed tax system is the best way to uplift the situation .In this process, Nepal has adopted the destination based, consumption type VAT operated by the tax-credit methods. VAT encourages investment, supports economic growth and keeps price stable. Exceptions and zero rating reduced the regressively of VAT however it makes the complex. The study found that VAT is unable to complete the existing sales tax mainly due to the minimum use of invoices by sellers and as well having no interest to obtain invoices by purchasers. Elasticity and buoyancy Nepalese tax system are very low. Further, they are decreasing in recent years. VAT more attractive from the theoretical as well as empirical aspects. Hence, the introduction of the VAT is not the fulfillment of the requirement and VAT system itself has a great need of reforming in the

Nepalese context. (*Dhakal: 2000*)

Laudari, Raju (2001) in his thesis “*Analyses the problems and prospects of VAT in Nepal*” concludes that major problems associated with the VAT system to business houses are account keeping and billing. Weakness of VAT administration are lack of motivation service minded attitude and dishonesty in VAT officers. VAT system is the best and advanced fiscal tool in theoretical sense could not yielding the expected returns in Nepal because of lack of strong and honest tax administration, lack of co-ordination between tax collectors and tax payers and lack of strong political commitment etc. The VAT was well received and also welcomed by the business community. One year experiment showed that the operation was reasonably satisfactory. For its success, there were several reasons to meet, such as careful planning of tax structure and administration, close co-operation between the government and business sector, extensive publishing program, co-coordinated reform in purchased tax and income tax and selection of competent persons in the key positions. There were several things that can be taken as suggestion from Trinidad and Tobago for the introducing and operation of VAT in other developing countries as well. (*Laudari: 2001*)

Chaudhari, Raju (2001) in his thesis, “*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. (*Chaudhari: 2001*)

Karki, Babu Ram (2003) in the thesis “*Revenue Mobilisation through Value Added Tax in Nepal*” explained that the strong commitment from grassroots level to the top level is prerequisite to make VAT success, which seems lack in

Nepalese tax environment. An efficient, strong and fair administration is the most crucial for the proper implementation of VAT. But the VAT administration is still weak, traditional, corrupted and even physical infrastructures are not available properly. Even if the VAT system is bad on the computerized system, the data arrangement is not so good. It is necessary to develop and expand the networking of data box and information system at all levels. Therefore, it is necessary to promote it in tax system so that the existing problems such as under invoicing, non issuance of bills, and enforcement of law would be automatically solved. (Karki: 2003)

Gnawali, Sanjaya (2004) opined in his thesis “*Value Added Tax Contribution to Government Revenue: An Analysis in the content of Nepal*” that the revenue collection through VAT is not satisfactory in Nepal. VAT system, which was attempted to establish as a main source of revenue is problematic due to the weak billing system, under invoicing has remained as another major problem. The number of VAT exempted goods and services, and its impact in revenue is still large. An administrative competency seems to be weakening slowly. (Gnawali: 2004)

Uprety, Damber Prasad (2004) in his thesis work entitled “*Value Added Tax: Performance and prospects*” explained that it is not the matter of rejection of VAT but the implementation aspect of VAT must be managed and enhanced. VAT regime is extremely challenging in a burgeoning economy like Nepal where, with long open border, a large segment of the economy is yet to be magnetized. Resistance from the business community, ignorance of general people and the lack of full support and commitments from the politicians and government officials forced the authority responsible for implementing VAT to make compromises on various aspect of VAT which has weakened the process of its implementation right from the beginning. The culture of doing business without maintaining proper books of accounts or maintaining multiple sets of books of accounts have made implementation of VAT difficult. (Uprety: 2004)

Shakya, Alok Jyoti (2005) in his thesis “*Structure and Responsiveness of Nepalese Tax System*” disclosed that the low elasticity of the majority of the individual taxes must be explained in terms of their low tax –to – base elasticity, which indicates lack of efficient administration and progressive taxation. The most significant tax reform majors adopted by Nepal government after the restoration of democracy is the implementation of broad- based VAT in 1997 and its quite satisfactory performance. To some extent, VAT has been successful to develop a stable source of revenue through broadening the tax base. Further, he reported that the performance of non tax revenue is also quite satisfactory. On the other hand, the performances of majority of other taxes are poor and reflect ad hoc policy to achieve immediate revenue yield. (Shakya: 2005)

Pandak, Prabin (2006) in his thesis entitled “*An Overview of Tax System in Nepal: A Study of VAT*” has described that existing threshold of Rs. 2 million and provision of tax refund are two possible way of tax evasion. It seems that existing exemption has a broad coverage however some exemptions are unavoidable due to administrative complexity and equity aspect. So, exemptions should be minimized gradually. (Pandak: 2006)

Neupane, Nabin (2006) in his thesis, “**Resource Mobilization through Value Added Tax in Nepal**” has examined historical background of VAT and analyze mobilization of revenue through VAT. He has also provided the bird eye view of the practicing scenario of VAT in the foreign countries. He concludes that VAT is most scientific innovation and modern in sales tax family. The collection of revenue is always moral than the regular expenditure in each and every fiscal year. Tax administration has to begin its program package very strictly and immediately to register the traders who are supposed to get registered in the VAT in order to control the leakage of revenue and tax evasion so that the number of the tax payers would increase and hence the revenue collection would also increase.

According to him, implementation of VAT as a tax reform system is not enough to collect more revenue .Though attempt was made to inform the public about

the some non-VAT including commodities through the public media of communication. But as a result, the businessmen raised the price of daily consumption goods and in the other hand, government could neither reduce price nor punish those businessmen against such acts. He has given some recommendation on increasing the boundary of VAT instead of increasing the rates; also the concentration should be given to bring use of billing system and consumer should be made educated regarding the aspects and benefits of VAT. So, there should be Co-ordination between Government, taxpayer and tax administration to achieve better result. (*Neupane: 2006*)

Joshi, Asistha (2009) in his thesis entitled “*Current practical issues on VAT System*” has described that the ultimate goal of every country of this world including Nepal is to get better economic development and to ensure the rapid rate of economic growth. To get the pace of economic development, it is essential to have sufficient revenue generation, particularly revenue collection through taxation is a primary source and it plays the great role for development of nation's economy. In which the indirect tax has occupied two-third place of total tax revenue.

Recently, developing as well as developed countries have focused their attention on tax reforming with standardized and improved system. In this regard, Value Added Tax has been a centre point of attraction and Nepal too adopted this and implemented the VAT system in 1997.

After the implementation of VAT system, contact tax, hotel tax, sales tax and entertainment taxes have been replaced by it. It was not easy for government to implement VAT; there were lots of debates, discussion and interaction on VAT. But at the present context, looking at the contribution of these replaced tax in tax revenue and gross domestic product of the contribution, it's generally increasing before, the implementation of VAT. (*Joshi: 2009*)

Wagle, Mahesh (2010) in his thesis entitled “*A Study on Contemporary Issues on VAT System of Nepal*” has described that the after implantation of VAT in Nepal and promulgate the VAT Act, there has been legal changes made; rates

were increased for the effectiveness of VAT but still there are many problems, hurdles ahead to simply the whole system. He also carried out on to review the some new changes (e.g. Tax Plate, E-TDS and compulsory sales register) made on Business sector by the revenue administration. According to his field survey, level of awareness of the accountant, businessman paying VAT is at low level on some provision of VAT Act. He recommended that VAT areas should be increased, proper co-ordination between IRD & MoF, Taxpayer, customers who are ignoring the VAT system should be given proper knowledge about VAT and its benefits, Revenue administration may draft a policy to collect the arrear of VAT may be like Tax settlement committee and should be implemented with honesty, for improving billing condition, regular supervision, audits and investigation applied. Threshold of VAT should be decreased substantially. (Wagle: 2010)

2.3.3 Review of Relevant Articles, Journal and Workshop

Nepal Chamber of Commerce also made a study to analyze the possible effects of VAT in Nepalese economy in 1997. Dr. Puspa Raj Karnikar heading the team. The main findings of the study report was as follows:-

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

The study report suggested for a partial VAT on some commodities. It was in favor of phase wise implementation of VAT. The study analyses negative impact of VAT neglecting its positive impact. (Source: Nepal Chamber of Commerce, 1997)

Dr. Roop Jyoti (Former Finance Minister) in an article “*Analysis and suggestions on VAT*” (2001) conclude that under the VAT system a self enforcing environment is created where one tax payers ensures compliance by the previous tax payer. Honest tax payers are able to conduct their business in a simple and proper manner. This is one of biggest positive aspects of VAT. But, many are experiencing problems in the implementation of VAT in the trading sector. This is not because of any weakness or defect in the legal aspects of VAT but due to the lack of effective implementation of VAT in the right manner.

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

) Lack of invoicing or invoicing with the correct value.

) Lack of effective implementation of the VAT threshold. (Khadka, 2001a)

Mr. Lene Bendix (Chief Technical advisor at the VAT project 2001) an articles. “*4 years of value added tax*” conclude that. There were a lot of constraints and difficulties in introducing and implementing VAT in Nepal. The first two years of VAT were very turbulent. Despite this, VAT was introduced and survived because of the efforts of a small group of extremely dedicated, motivated and hard working people. Since its establishment in 1997, the VAT administration had been improving gradually until the early summer of 2001. The merger between the former VAT Department and the former Department of Taxation into the Inland Revenue Department took place in April 2001. This made it very difficult to keep focus on various important activities and decision that needed to be carried out and to continue the VAT implementation process by the new Inland Revenue Department (IRD). Some difficulties were expected after the merger and some of the problems have already been solved still lots of challenges are left to be resolved. (Khadka, 2001a)

Mr. Mahesh Acharya (Former Finance Minister). In his views published on book “*4 years of implementation of VAT*” (2001) conclude that, for Nepal’s development through modern tax system, successful and extensive implementation of VAT is compulsory need. VAT is a self-policing system that records business transaction from the level of manufactures to the consumers. The smuggling and revenue leakage from the border areas will be controlled. For the success of VAT, employees of the Internal Revenue administration to be alert towards showing trustworthiness and skill in the tax assessment and in collection process. Revenue can be mobilized better through skill and simplicity rather than by punishment. (*Khadka, 2001a*)

Mr. Pashupati Shamsheer J.B.R. (Member of Parliament of lower house). In his views published on “*4 years of implementation of VAT*” (2001) conclude that, Revenue plays an important role in the country’s development and tax is the primary source of revenue mobilization. Finding new source of revenue as a VAT was a timely action. This tax reduces the possibility of leakage by maintaining two accounts and also crates an environment of fair competition amongst the industrialists and businessmen. There are complaints from industrialist and businessman such types of weakness must be corrected in order to make VAT effective. To support the economic development and to make this tax effective it is necessary to solicit the co-operation of industrialists and businessmen. Similarly to make VAT successful it is necessary to raise the level of awareness of the consumers. (*Khadka, 2001a*)

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

“A Study of taxpayer’s satisfaction level in Nepal” was carried out jointly by the Inland Revenue Department (Ministry of Finance) and the German Technical Cooperation (GTZ) on August 2010. The survey’s purpose was to determine the satisfaction level of Nepalese taxpayers regarding existing tax policy, the quality of services and tax documents, tax procedures and administrative mechanisms, and the overall performance of the tax administration.

The majority of the sampled taxpayers stated that people should pay taxes and deserve to be penalized if they fail to do so. Only one third of the respondents were satisfied with the delivery of public services in the fields of the security, electricity, supply, drinking water and social benefits, whereas about 50 percent of the respondents were satisfied with the services in the telecommunication, transportation and education sectors. Less than 40 percent were satisfied with the quality of the services of IROs (except for location and accessibility) in spite of the perception that services during the past seven years have improved.

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

The most important source of information on tax issues are newspapers. Regarding the availability of information and the comprehensibility of the printed documents, three out of four were satisfied for income and other taxes, and four out of five for VAT. With reference to the contents and coverage of the documents, over 83 percent were satisfied.

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

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

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

General Comments and suggestions of Taxpayers

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

-) Don't put the entire burden on registered taxpayers. Those, who are not registered as yet, should also be brought into the net.
-) Provide relief to the taxpayers from visiting the IROs frequently.
-) Officials in the taxpayer section need to be very competent and informative.
-) Staff members in IROs should always understand taxpayers as their customers and not as milking cows.
-) Put PAN numbers of all registered taxpayers in the website of the Department.
-) Why do all large taxpayers need to go to Kathmandu? Can't this be arranged locally?
-) An effective complaint logging system should be established.
-) There is no major complaint regarding the tax policy and Tax Acts of the government, but there are problems in their implementation practices.
-) There is no problem for officials of Chamber of Commerce and Industries in dealing with IRO officials, but for ordinary people it is not easy.
-) Tax rates should be progressive.
-) There should be one and the same tax policy for all and there should not be any discrimination.
-) Tax rate for small business stalls is high compared to big business houses, so reduce the rates for the small business enterprises.
-) There is no clear tax policy in the case of educational institutions.
-) Communication on tax policy and practices need to be increased.
-) The staff members should behave impartially.

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

(Source: A study on Taxpayers' Satisfaction Level in Nepal, 2010, RAS)

2.3.5 Recent Improvements Made

Review on Finance Ordinance 2006

The finance ordinance released and approved on 10 January 2006 has given basis to the government's vision of increasing revenue collection by strengthening the Value Added Tax (VAT) system.

According to government officials, the average custom rate has been slashed to 8 percent from the existing 9.6 percent. "Customs rates have been adjusted mainly for third country imports, which won't adversely affect the competitiveness of domestic industries".

Customs rates have been lowered on some third-country manufactured two-wheelers, electronic goods, television sets, musical equipment and power generating sets, among others, added the source.

Ordinance, however, hasn't laid out any policies and programs to compensate for possible loss of customs revenue due to the adjustment.

The tariff cut would cost the state coffers Rs 1.70 billion in estimated customs mobilization for the current fiscal year, the ordinance has also made some minor changes in income tax. The state minister argues that the reduction in customs rates was essential to discourage undervaluation of imported goods, which, according to him, is a major obstacle in the effective implementation of VAT.

Officials have also strongly argued that lower customs rates would encourage importers to use formal channels, which in turn would contribute to higher

revenue mobilization. Effective implementation of VAT along with encouragement of the use of formal channels for imports will easily make up for possible loss of revenue, argues the state minister.

Former State Minister Dr. Roop Jyoti claimed that the revision in finance ordinance would control smuggling and under invoicing, as those who carry out transactions upto Rs. 20,00,000 yearly have to be registered under VAT. It would end unhealthy practices among the business enterprises. With new initiatives in VAT, self enforcement mechanism would be encouraged and which would increase the number of taxpayers from the retail level. (With new provisions in place, customs cheating could be checked that means increasing of revenue to the national coffer as predicted which is around Rs.1.28 billion from customs tariff reduction. The tariff reduction would help the people as a whole)

- Vat imposed on freight and transport is criticized as it would discourage import in a greater extent.
- VAT being imposed at the rate of 13% for service business carried out by foreign employment service providers has been abolished. However from now 2% excise on the invoice amount would be imposed. That excise duty will be used to buy insurance policy of up to Rs. 5,00,000 for the security of people going on foreign employment.
- Vat on raw material and packing material imported or purchased by pharmaceutical industries abolished.
- 5% excise duty imposed on health services by abolishing 13% VAT previously levied.
- VAT on woolen carpets and weaving, washing, spinning and dyeing of woolen yarn for producing woolen carpet exempted.
- Partial VAT exemption on mustard oil abolished.
- VAT exemption on cotton yarn, cotton clothing has been withdrawn.

With a view to giving relief to consumers by making consumers goods cheaper through the reduction of custom duty and controlling smuggling with new

adjustments (reduction) in import tariff, the country would loss about 1.28 billion in national revenue annually. However, Vat being enforced strongly, smuggling and under invoicing would be discouraged that would help to compensate for the revenue loss.

2.4 Research Gap

Due to the lack of seriousness in the research work (especially in case of thesis), output could not address the objective of study. The researcher was flabbergasted that research work is used only for formal completion of final year thesis. Most of the theses are based on secondary data only, which makes the errors repeated and no more contribution. This research work is based (not completely but major part) on primary data, which is updated to recently changed situations. The data collected is diversified to major three category of the society i.e., Businessmen, consumers and experts. This is done with objective to find out the problems from different eyes. Secondly, the analysis of data presented is done with consideration of conditional state of respondents. Ex- Among 30 consumers, some were bachelor or degree level educated, some are S.L.C. or less than that, some from highly sophisticated family who enters only to departmental stores and some were street buyers. This diversity could not be analysed only from the statistical data collected from questionnaire.

This study has focused about the impact of VAT on Government Revenue and the basic problems associated with VAT collection. No study has been made previously at this aspect. So this study will be fruitful to those interested Persons, Parties, Students, Teachers, Businessmen and Government for academically as well as policy perspectives.

CHAPTER III

RESEARCH METHODOLOGY

3.1 Rationale of Selection of the Study Area

The research should be done covering the whole nation, as this is the main agenda for the development of nation being a major source of revenue. The time and finance constraints of the researcher, this could not be possible to cover the whole nation. Therefore, Kathmandu valley is considered as the Universe. But some of the data are collected outside valley to and some are based on the newspapers as well. Kathmandu valley contains major three districts- Kathmandu, Lalitpur and Bhaktapur. The latest data of 2066 Asadh shows that out of 69,653 of registered business over the country; 29,232 (41.97%) in Kathmandu including LTO, 4,170 (5.99%) in Lalitpur, and 2,809 (4.03%) is in Bhaktapur (*Source: Annual report FY 2065/66, IRD*). That's why the Universe comprises 51.99% of total available data. It is assumed that where there is more business, there are more consumers too. As policy maker to businessmen and high class consumer to low class consumer inhabited here, the selected area is the best area. The category (Experts, Businessmen and Consumers) wise respondent is selected using random sampling method

3.2 Research Design

The research design is mainly based on descriptive studies but primary data have objective of exploratory studies as well. For this research small-scale field survey questionnaire is used for information gathering. Field surveys emphasizes on personal interviews. A case study (Singapore's successful story of implementation of VAT, efforts she made is presented in detail in Review of Literature) is also given place to investigate the reasons of our failure/weaknesses of the VAT implementation.

The research is planned to be conducted based on primary data. Data from secondary sources are also collected in some extent to make the report more

fruitful. To collect primary data, Quantitative survey (Questionnaire) is used. Only straight questionnaire may hide the true secrets behind the curtains, therefore cross check is applied. The following sections explain more about how research is designed.

Table: 4
Flash View of Research Design and Data Analysis

Universe/Population	KTM Valley (Kathmandu, Lalitpur and Bhaktapur)
Method of Selection of Interviewee	Systematic Random Selection Technique
Types of Respondent	Consumers, Businessmen and Experts
No of Respondents	Consumers – 30
	Businessmen – 20
	Experts – 10
Method of Data Analysis	Qualitative, Quantitative and Group discussion
Types of Research Design	Descriptive and Exploratory
Tolls used for Data Analysis	Percentage, Correlation and Trend Analysis

3.3 Nature and sources of data

3.3.1 Review of secondary data

Secondary data needed for study is collected from following sources:

- 1) Published and unpublished report articles and thesis on the concerned subject.
- 2) Publications and annual reports of Internal Revenue Department (IRD).
- 3) Various books written by tax officers and scholars.
- 4) Publication of Nepal Rastra Bank
- 5) Various publications of central bureau of statistics.
- 6) Related articles and journals.

3.3.2 Primary data collection technique

Questionnaires are developed based upon the research questions and interviews were conducted to the randomly selected respondents. Three separate

questionnaires were prepared for administrative experts, businessmen and consumers. Opinion and information are also collected from discussion (FGD) and interaction with colleagues, experts, policy makers and other intellectuals.

Data table is prepared from the questionnaire collected and then analysed by using statistical tools. Data collected from questionnaire is supported in some cases by secondary data. Cross analysis is made seriously considering the probability of misleading of data.

3.4 Sampling strategy and selection of respondents

Simple Random Sampling is applied for the staffs of Tax Offices and Tax Administration. While selecting different clusters and respondents for questionnaire, purposive sampling technique is applied. Consumers and businessmen are two different parts of our research as different questionnaire are prepared to them. Clusters are selected without bias from businessmen of different parts of the Kathmandu, Lalitpur and Bhaktapur Districts (Universe) as well as from consumers of these three districts. In total 30 consumers, 20 businessmen and 10 experts (includes both tax officers, tax auditors and other experts) were randomly selected and taken as respondents.

The hypothesis behind this study is that the Government could not effectively apply the VAT system of tax collection. There are so many weaknesses from the part of government, businessmen and consumers. If the government fined the core idea of being unsuccessful in the effective implementation of VAT, she could improve the regulation process then VAT will lay a golden egg.

3.5 Method of data collection

Secondary data were collected using the above mentioned tools. Primary data were collected by using the questionnaire. Following primary data collection techniques were used during the research.

3.5.1 Interview schedule

Semi-structured interview schedule was conducted with the selected respondents. To make the interview effective, convenient time and place for

respondent was selected. 30 consumers, 20 businessmen and 10 administrative experts, which include both tax officers, tax auditors and other experts, were randomly selected for interviews.

3.5.2 Focus Group Discussion (FGD)

Opinion and information are also collected from group discussion and interaction with colleagues, experts, policy makers and other intellectuals.

3.6 Data processing and analysis

Data collected through questionnaire was tabulated and analysed. Relevant data from secondary sources, observation and focus group discussion were processed and used to complete the findings from interview. Data collected from primary and secondary sources are analysed using tools like percentage, correlation and trend. The regression equation $Y = a + bt$ (where a =constant variable, b =slope and t =time or no.of year) is used to find out the future trend.

3.7 Reliability and validity of the data

Since both the quantitative and qualitative tools are applied, there are high possibilities of getting reliable data. Besides this triangulation of information collected through questionnaire also help to make data more reliable and valid. Percentage, regression and trend are used as analytical tools which may be incomplete for data analysis. Limitations may arise, as it could not represent the whole of our country as the samples are taken in Kathmandu, Lalitpur and Bhaktapur only. The people of these three districts are more aware and educated than of other parts of our country. So there is possibility of getting fictitious data, which could not represent the whole of Nepal and probably could not access the real objective of the research work. This is due to the lack of financial assistance and time required for the research.

CHAPTER IV

ANALYSIS AND PRESENTATION OF DATA

4.1 Analysis & Presentation of Secondary Data

Revenue mobilization is the major source of government expenditure. Taxation is one of the key internal sources of total government revenues.. However, trend of revenue mobilization has remained satisfactory in recent years. To maintain this, there is a challenge to control tax leakages after identifying the possible leakage areas, and increase the revenue mobilization specially the VAT and income tax, which are the major instruments of tax revenue. Since, there is a need to enhance work efficiency, effectiveness and professionalism of revenue administration, a strong challenge has been there to make necessary arrangements for achieving desired results.

The Government expenditure in FY2065/66 totaled Rs. 213.58 billion. Among the sources of financing the expenditure in FY2065/66 revenue mobilization contributed 66.59%. Of the total revenue, shares of tax revenue and non-tax revenue in FY2065/66 are 82.27% & 17.73%. (*Data of FY 2065/66 is revised estimate, taken from annex budget speech 2066, MOF*)

4.1.1 Tax Revenue Structure in Nepal

Tax is compulsory contribution by the tax payer to the government. Taxation is main source of income of the government excluding foreign aid. In the fiscal trend of Nepal, tax revenue structure is a combination of two tax elite. They are namely direct tax and indirect tax. The table presented in nest page shows that the trend of tax revenue has been increasing.

Table: 5
Total Tax Revenue Structure

Rs. in 000

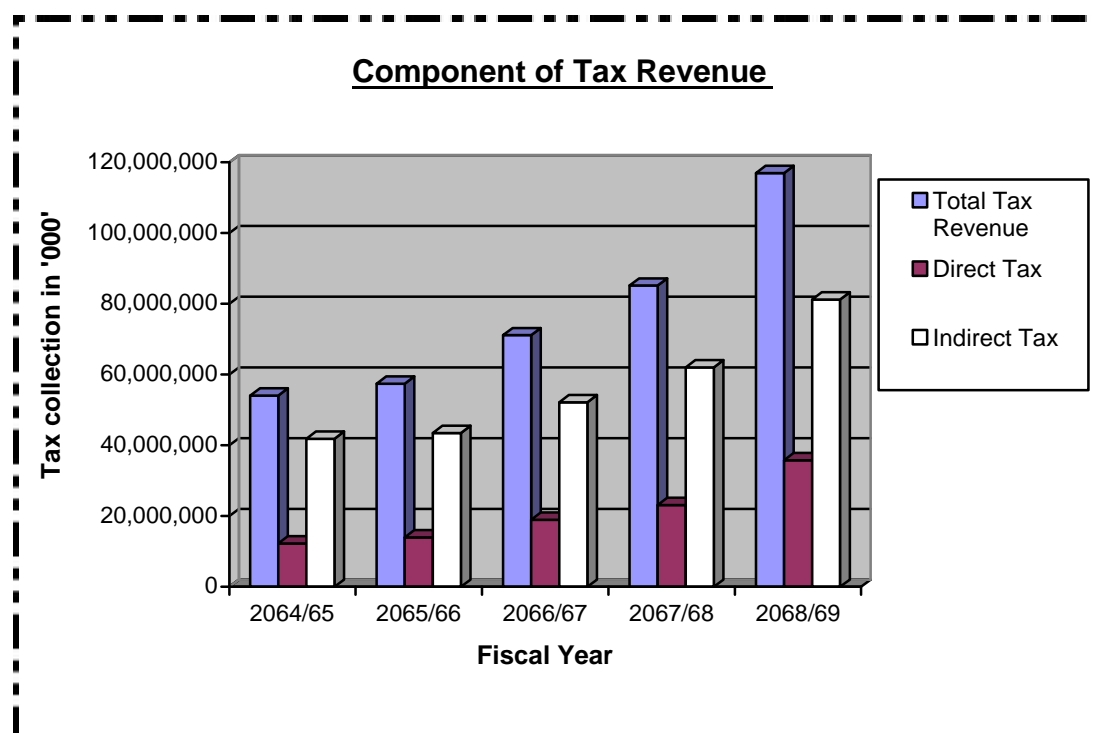
Fiscal Year	Total Tax Revenue	Direct tax		Indirect tax	
		Amount	% as total Rev.	Amount	% as total Re
2064/65	54,104,779	12,265,398	22.67	41,839,38	77.33
2065/66	57,426,935	13,961,476	24.31	43,465,51	75.69
2066/67	71,126,728	18,980,298	26.69	52,146,43	73.31
2067/68	85,155,458	23,087,759	27.11	62,067,69	72.89
2068/69	116,996,653	35,787,477	30.59	81,209,17	69.41

*Revised Estimate of FY 2065/66

Source: Annex of Budget Speech, MOF

Tax revenue increased by 37.39 percent in FY 2068/69 compared to that of the previous fiscal year. Such revenue had increased by 19.7 percent in FY 2067/68 compared to its preceding fiscal year. Of the total tax revenue in FY 2068/69, the share of customs duty was 22.08 percent while the share of tax on production and consumption of goods and services was 47.33 percent. Likewise, the share of land revenue and registration was 7.04 percent and that of income, profit, and property tax was 23.55 percent.

Figure: 2



Total tax revenue for the FY 2068/69 is in increasing trend, where tax revenue grew in FY 2065/66, FY 2066/67, FY 2067/68 & FY 2065/66 by 6.14%, 23.86%, 19.72% & 37.39% respectively. Of the total tax revenue, direct tax is in increasing trend while indirect tax is in decreasing trend. In total tax revenue, share of direct tax in FY 2064/65 FY 2065/66 FY 2066/67, FY 2067/68 & FY 2068/69 are 22.67%, 24.34%, 26.69%, 27.11% & 30.59% respectively. On the other hand, share of indirect tax in FY 2064/65, FY 2065/66, FY 2066/67, FY 2067/68 & FY 2068/69 are 77.33%, 75.69%, 73.31%, 72.89% & 69.41% respectively.

Table: 6
Component of Indirect
Tax

Rs. in 000

Fiscal Year	Indirect Tax				As % of indirect tax		
	Custom and other	VAT	Excise duty	Total	% of Custom Duty	% of VAT	% of excise duty
2064/65	15,701,555	18,885,400	6,445,909	43,465,519	36.12	43.45	14.83
2065/66	15,343,676	21,613,043	6,506,940	43,465,519	35.30	49.72	14.97
2066/67	16,707,644	26,095,599	9,343,187	52,146,430	32.04	50.04	17.92
2067/68	21,062,421	29,815,703	11,189,575	62,067,699	33.93	48.04	18.03
2068/69	25,829,493	39,947,480	15,416,958	81,209,176	31.81	49.19	18.98

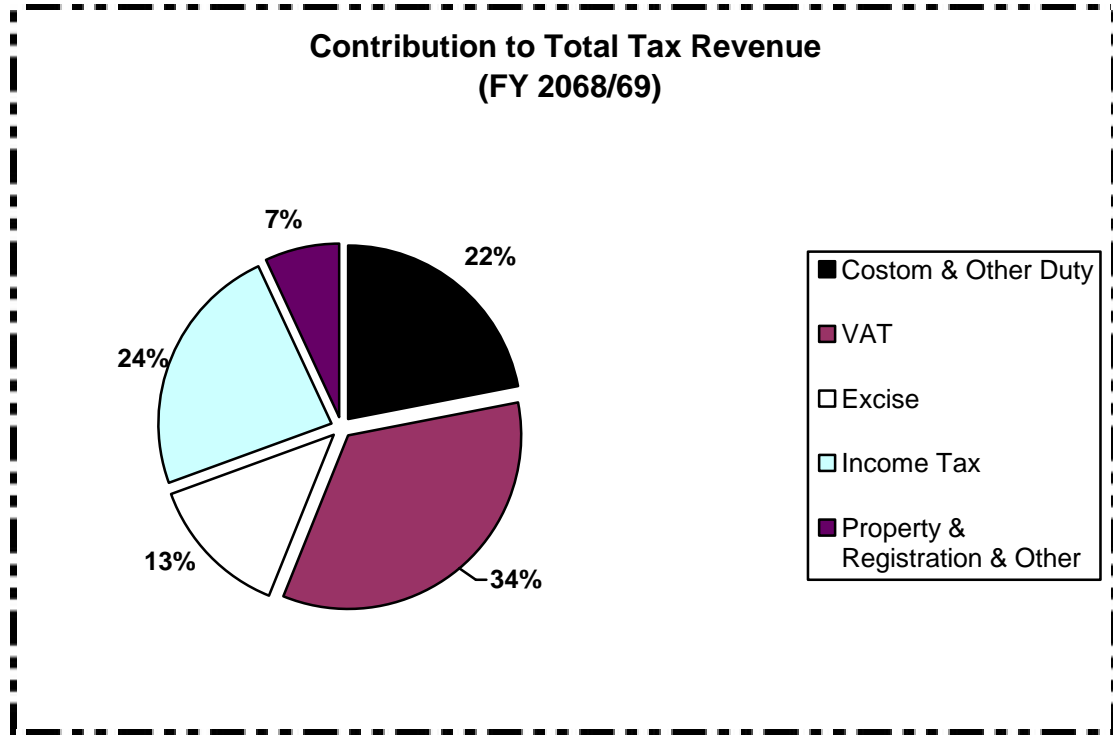
**Revised Estimate of FY 2065/66*

Source: Annex of Budget Speech, MOF

Customs revenue grew by 22.63 percent in the fiscal year 2068/69 as compared to its preceding fiscal year while VAT rose by 33.98 percent and Excise Duty rose by 37.78 percent. Of the customs revenue, revenue from imports increased by 28.8 percent while that from exports rose notably by 78.7 percent, and Indian excise refund increased by 7.1 percent in the fiscal year 2068/69

Contribution to Tax Revenue:

Figure: 3



The above chart shows that VAT only contributed 34% of the total Tax Revenue collection. The second by income tax contribution which is 24 and third one is custom & other duty which contributes 22%. The contribution of excise duty is 13% & tax on house, land & other property is 7%.

4.1.2 Internal Revenue Collection (Inland Revenue Collection)

In FY 2068/69 Rs.85.66 billion tax revenue (Income Tax, VAT, and Excise Duty & Vehicle Tax) collected which is 99% of target achievement and grew 39% than last year. Inland Revenue Department contribution to the total revenue of Government of Nepal is Rs.85.66 billion which share is 59.26% and grew by 0.50% than last year. Inland Revenue Department had contributed 8.86% on GDP.

Table: 7
Internal Revenue Collection-Trend

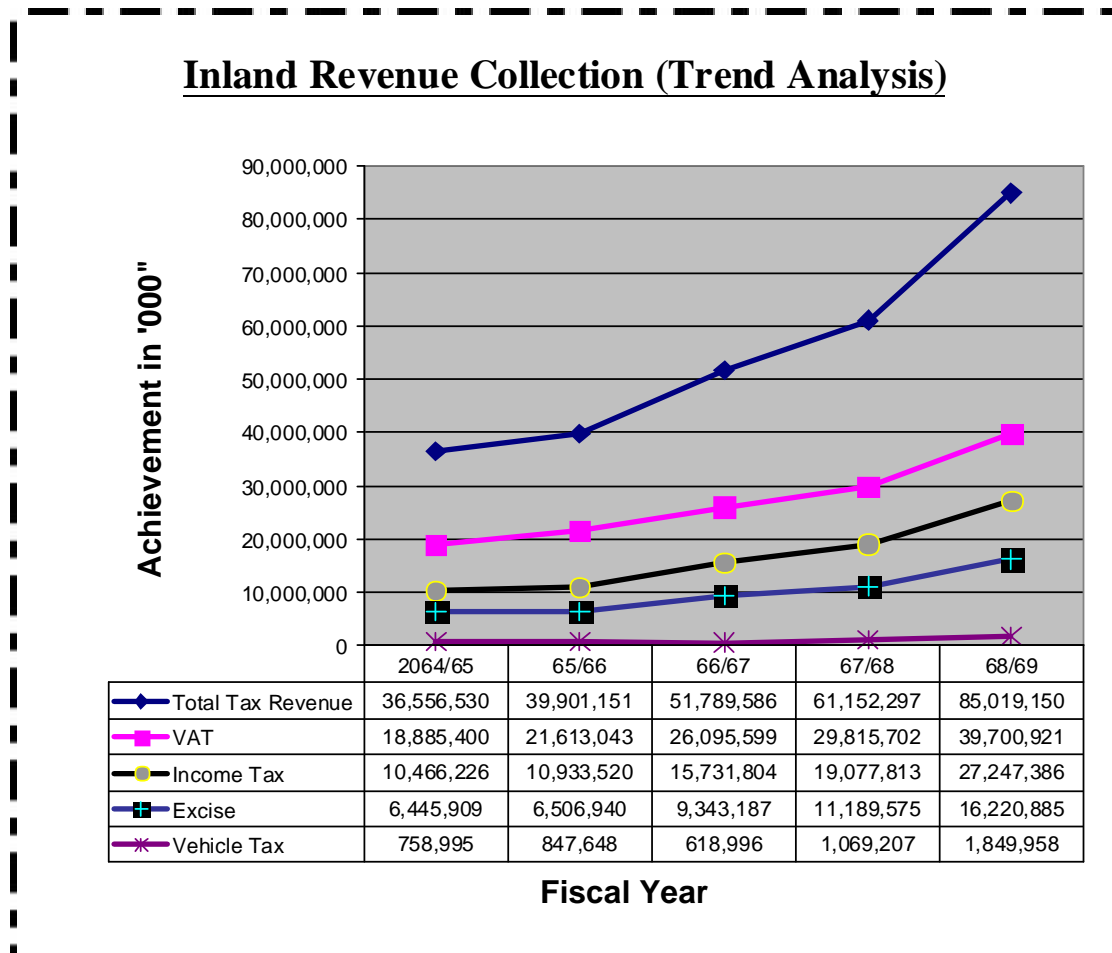
Rs. In '000'

<i>Budgeted In FY</i>					
FY	064/65	065/66	066/67	067/68	068/69
Tax Revenue	35,200,000	44,300,000	48,817,000	58126800	85,660,000
VAT	16,950,000	23,650,000	26,463,000	29651900	41,000,000
Income Tax	10,500,000	11,800,000	12,710,500	16869200	27,087,000
Excise	7,000,000	7,950,000	8,637,500	10523200	14,073,000
Vehicle Tax	750,000	900,000	1,006,000	1082500	3,500,000
<i>Actual In FY</i>					
	064/65	065/66	066/67	067/68	068/69
Tax Revenue	36,556,530	39,901,151	51,852,586	6,1152,297	85,019,150
VAT	18,885,400	21,613,043	26,095,599	29,815,702	39,700,921
Excise	6,445,909	6,506,940	9,343,187	11,189,575	16,220,885
Income Tax	10,466,226	10,933,520	15,731,804	19,077,813	27,247,386
Vehicle Tax	758,995	847,648	618,996	1,069,207	1,849,958
Increment %	18.20	9.16	30.00	18.64	39.00

Source: Annual Report FY 2068/69, IRD

The data presented in the above table is presented separately in the following trend analysis graph.

Figure: 4

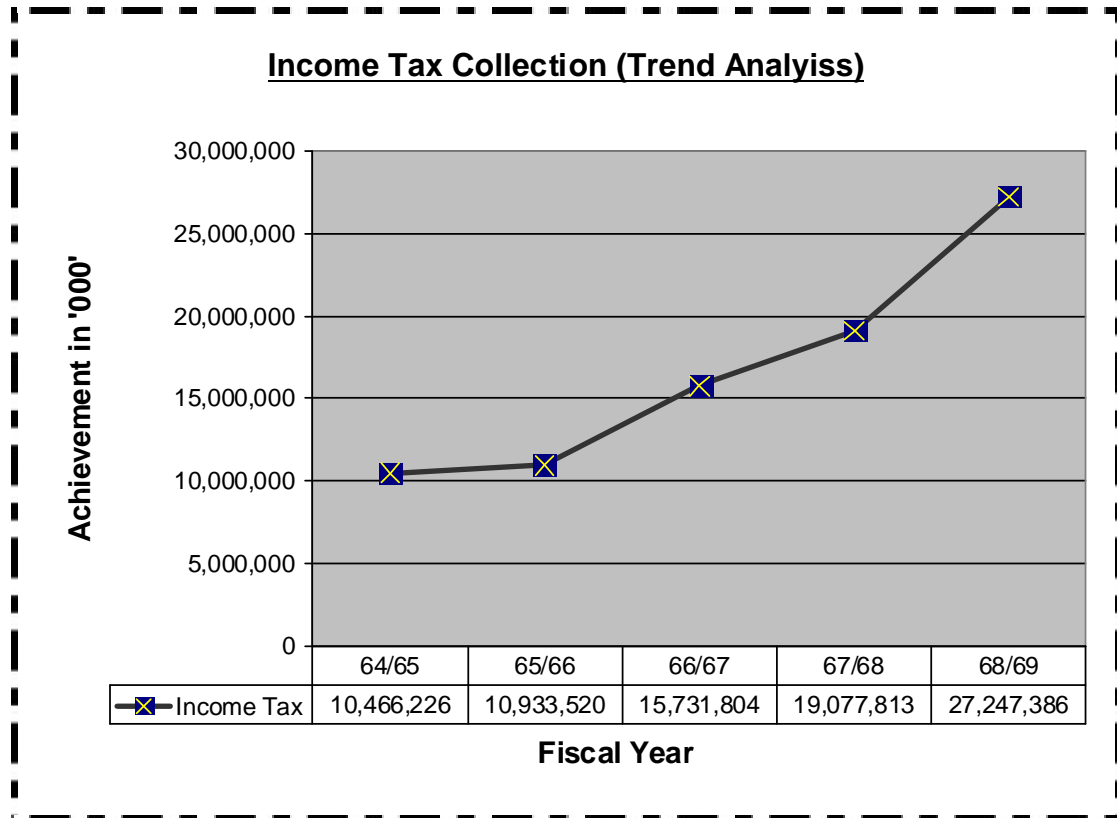


Among four types of tax, VAT contributes the highest value and followed by Income Tax, Excise and Vehicle Tax. Total tax revenue growth rate was decrease in FY 065/66 but in FY 066/67 it increases by 30% which is a positive symptom but in FY 067/68/ growth rate is decreased as compared to previous FY growth rate. It can be expected that the future collection will drastically improved as our country is going to resolve the current conflict and war, which is true and above figure prove it because in FY 068/69 growth rate of tax collection is increased by 39%.

As above trend line of Tax Revenue collection by IRD is increasing trend. All segments of Tax Revenue; Income Tax, VAT, Excise and Vehicle taxes are also in increasing trend.

Among these four types of tax, VAT and Income Tax are presented separately in the following figures.

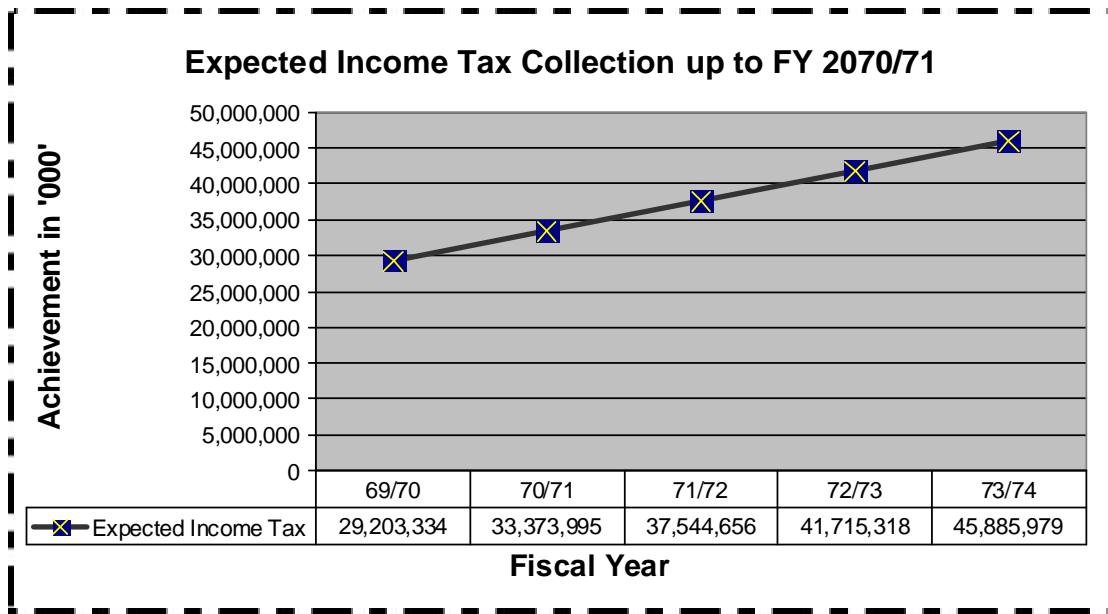
Figure: 5



Income tax collection trendline is in increasing trend. However, in FY 0625/66, income tax collection is increased but with slow growth rate, from FY 066/67, pace of growth rate is increased. There is a positive sign from the FY 064/65 and increases to 10.47 billion to 27.25 billion in the FY 068/69. Growth rate of income tax collection in FY 064/65 is 10% while in FY065/66 it shrink to 4.46% and it was enormously increased in FY 066/67 by 43.89% while in FY 067/68 it is grown by 21.27% and in FY 068/69 it is grown by 42.82%. The government should give great attention in this matter why income tax growth rate is very fluctuating?

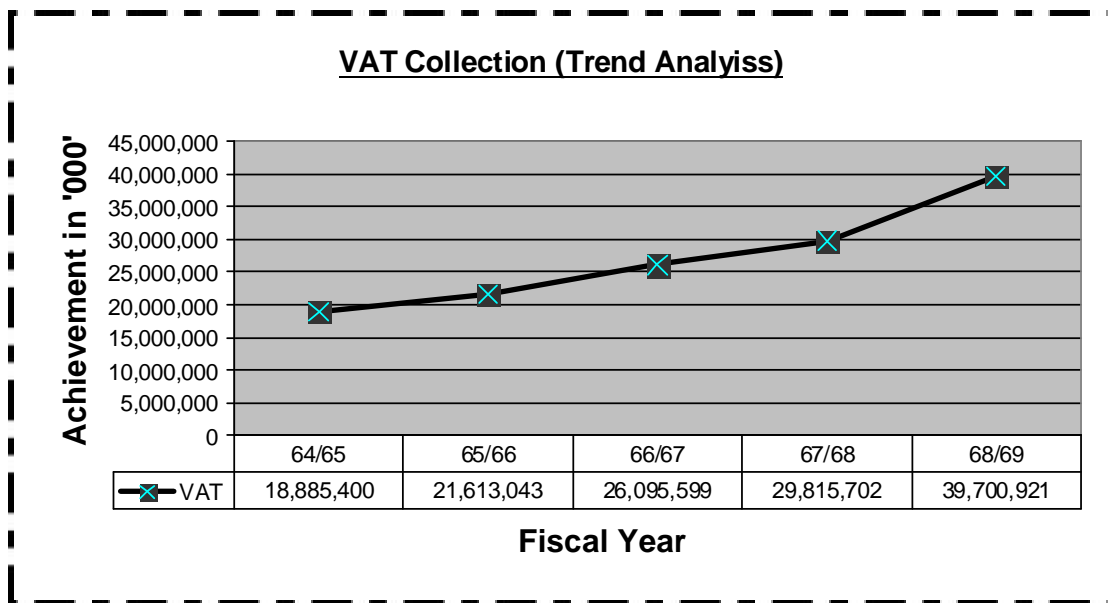
The expected income tax collection up to FY2070/71 is presented in the next page.

Figure: 6



Expected income tax collection in the FY 2073/74 will be reached to Rs. 45.89 billion.

Figure: 7

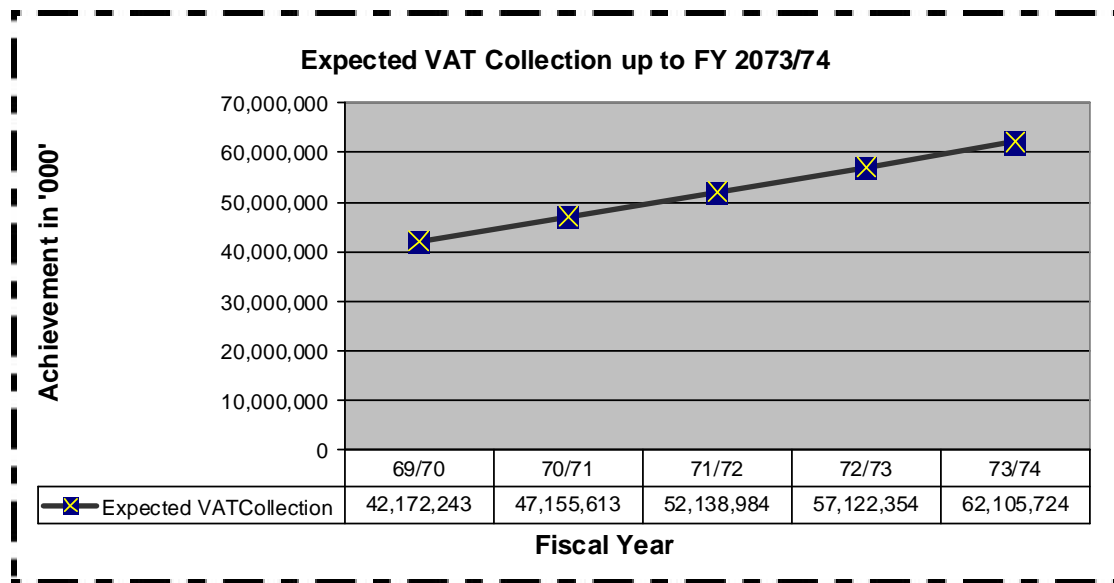


VAT collection is increasing regularly from FY 064/65 to FY 068/69 as it is increased from 18.89 billion to 39.70 billion the growth rate is fluctuating, where in FY 064/65 growth rate is 30.43%, in FY 065/66- 14.44%, in FY 066/67- 20.74%, in FY 067/68- 14.26% and in FY 068/69- 33.15%. But this does not indicate the improvement in our system. There are so many other reasons which

contribute in the increment in total VAT collection. The other things such as increase in no. of tax registrants (it is also about to doubled in this period.-see Table 29) and increase in business volume plays a great role.

The expected VAT collection up to FY2070/71 is presented below.

Figure:8



The Expected VAT collection in FY 2073/74 would be Rs. 62.11 billion if VAT increases in the same trend as of past five years. But the increment should be more than this as there would be more suitable environment for the growth of trade and services.

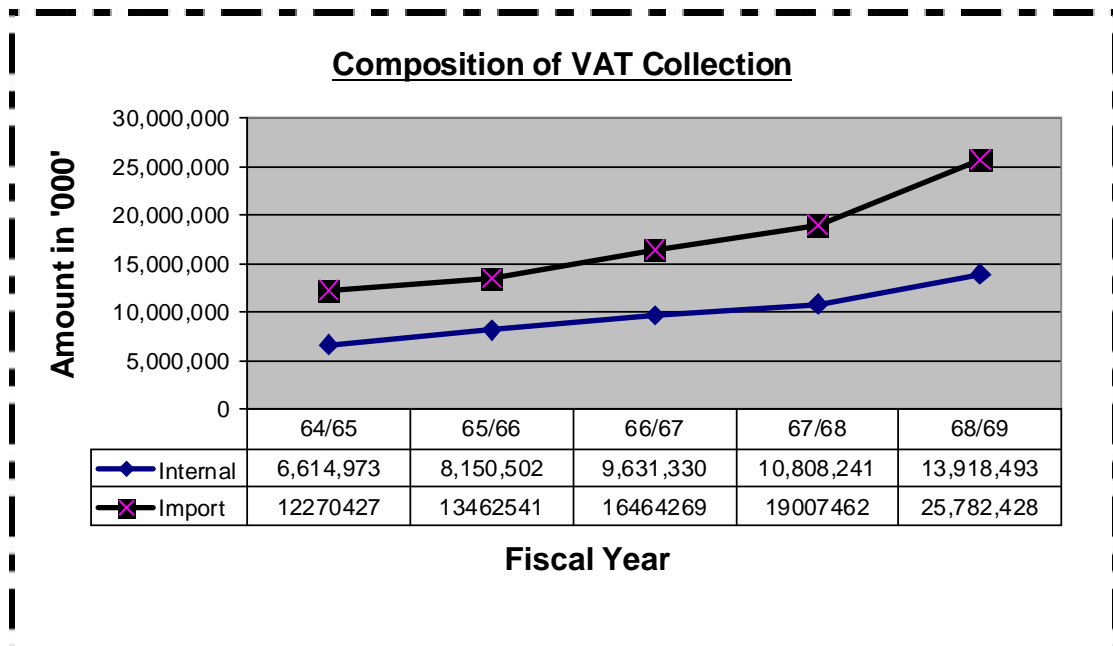
4.1.3 VAT Collection: Internal and Import

Table: 8
VAT Collection: Internal & Import

<i>in '000'</i>					
FY	064/65	065/66	066/67	067/68	068/69
VAT Collection	18,885,400	21,613,043	26,095,599	29,815,703	39,700,921
Internal	6,614,973	8,150,502	9,631,330	10,808,241	13,918,493
Import	12,270,427	13,462,541	16,464,269	19,007,462	25,782,428
Internal/Import Ratio	35:61	38:62	37:63	36:64	35:65
Increment %	30.43	14.44	20.74	14.26	33.15

Source: Annual Report FY 2065/66, IRD

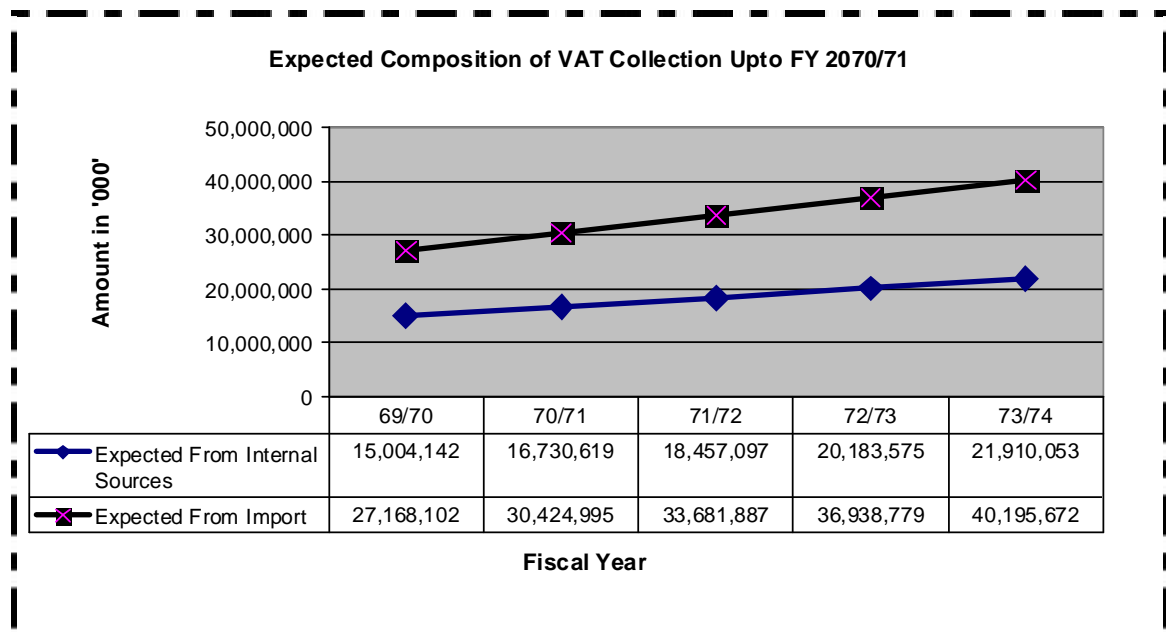
Figure: 9



The above table shows the data of VAT collection from internal trade and VAT collection from importing goods to abroad. VAT collection from Import is more than the collection from internal sources. The ratio of collection from internal sources and import is almost all constant from FY 2064/65 to FY 2068/69. The trend is still optimistic as it is increasing till 2068/69.

The expected VAT collection up to FY2073/74 is presented below.

Figure: 10



Expected VAT collection from internal sources is not satisfactory compared to import. More import is not good for the country's development so our government should be very aware to this composition. If we are able to produce more in our own country we can save foreign currency, increase employment, expand infrastructure and finally we can generate a huge amount of tax within the boundary.

4.1.4 Office wise Registration Status

Table: 9

Office wise Registration Status on VAT as of 2069 Asadh End

Office Code	Inland Revenue Office	Total Registration
11	BHADRAPUR	2131
12	BIRATNAGAR	3250
13	DHARAN	1854
14	JANAKPUR	1857
15	LAHAN	1729
16	SIMARA	1193
17	BIRGUNJ	3386
18	HETAUDA	1341
19	BHARATPUR	1868
20	DHANGADHI	1883
21	MAHENDRANAGAR	1099
22	POKHARA	3564
23	LALITPUR	4170
24	BHAIRAHAWA	3322
25	KATHMANDU-3	10327
26	NEPALGUNJ	2873
27	KATHMANDU-1	11917
28	KATHMANDU-2	6645
29	BHAKTAPUR	2809
30	KRISHNANAGAR	724
51	DANG	1368
52	LTO	343
Total Taxpayers		69653

Source: Annual Report 2068/69

The above data represent the VAT registrants in different location within the country. Kathmandu is divided in three parts i.e. KTM 1, KTM 2 and KTM 3 and VAT registrants in this region are greater than any other region of the

country. 42% of the total registrants are in this region only. Other major regions are Lalitpur, Pokhara, Bhairahawa, Birgunj, Biratnager, Bhaktapur and Nepalgunj.

4.1.5 VAT Registrants, Information Filers and Non Filers

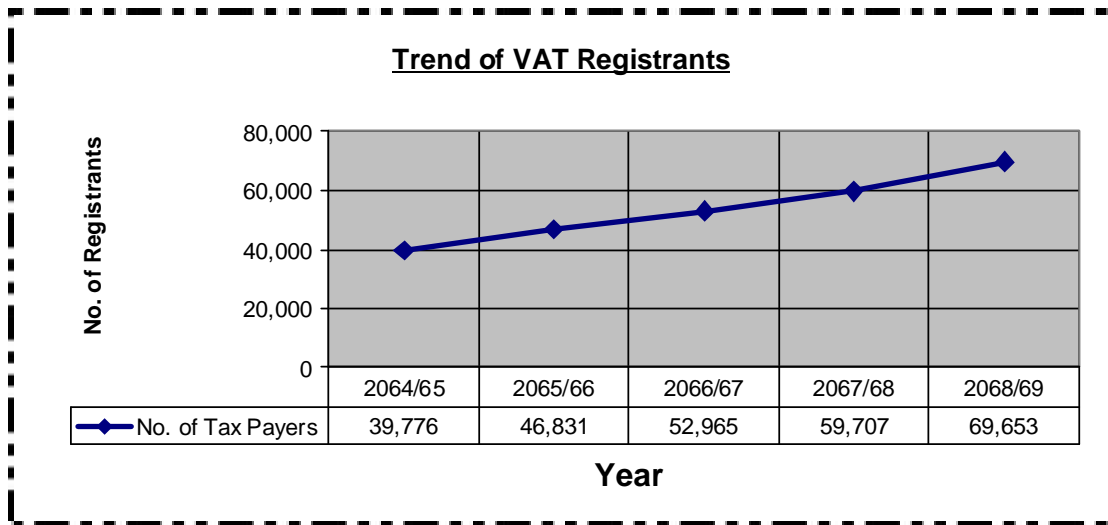
Table: 10
VAT Registrants, Information Filers & Non Filers

Year	2064/65 Ashad	2065/66 Ashad	2066/67 Ashad	2067/68 Ashad	2068/69 Ashad
1. No. of Tax Payers	39,776	46,831	52,965	59,707	69,653
No. of tax payer growth rate %	16.39	17.74	13.10	12.73	16.66
2. Information Filers	28,525	33,633	36,457	40,139	45,085
%	71.71	71.82	68.83	67.23	64.73
Dr. Information	9,478	10,449	11,457	12,052	13,491
%	33.23	31.07	31.43	30.03	29.92
Cr. Information	10,260	12,882	13,594	15,050	16,952
%	35.97	38.30	37.29	37.49	37.60
Zero Information	8,271	10,139	11,044	12,779	14,371
%	29	30.15	30.29	31.84	31.88
Suspended Information	516	163	362	258	271
%	1.81	0.48	0.99	0.64	0.61
3. Information Non Filers	8,492	13,198	7,098	9,050	13,040
%	21.35	28.18	13.40	15.16	18.72
4. Cancellation	30	36	31	150	175
5. Business Closed	445	647	793	863	1,024

Source: Annual Report FY 2068/69 IRD

The above table represents the data from various aspects. The data mainly focuses on the trend analysis of VAT registrants, Information filers & non-filers, Cancellation etc. are represented separately in the following figures.

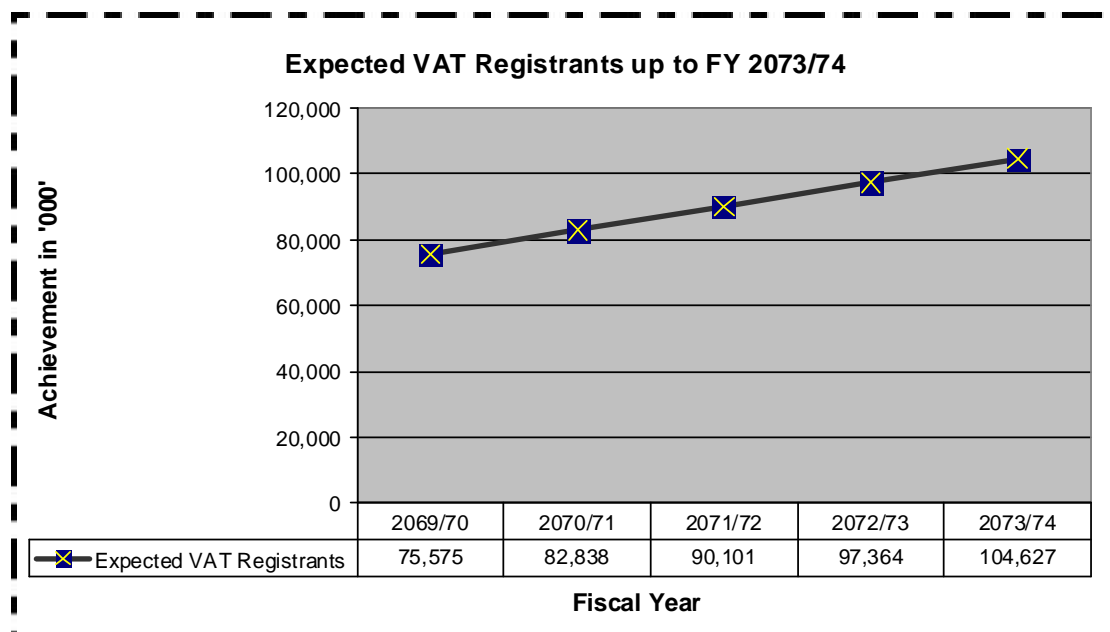
Figure: 11



The trend of VAT registration is continuously increasing from FY 2064/65 to 2068/69. At the end of Ashad 2064 it was 39,776 and reached to 69,653 at the end of Ashad 2069. But the growth percentage is fluctuating between 13% to 17%. Though the total no. of tax payers is increasing it is not sufficient to meet the government's need. To increase the VAT collection; the no. of tax payers should be increased faster than in the previous year. VAT should cover more and more businessmen in its mainstream.

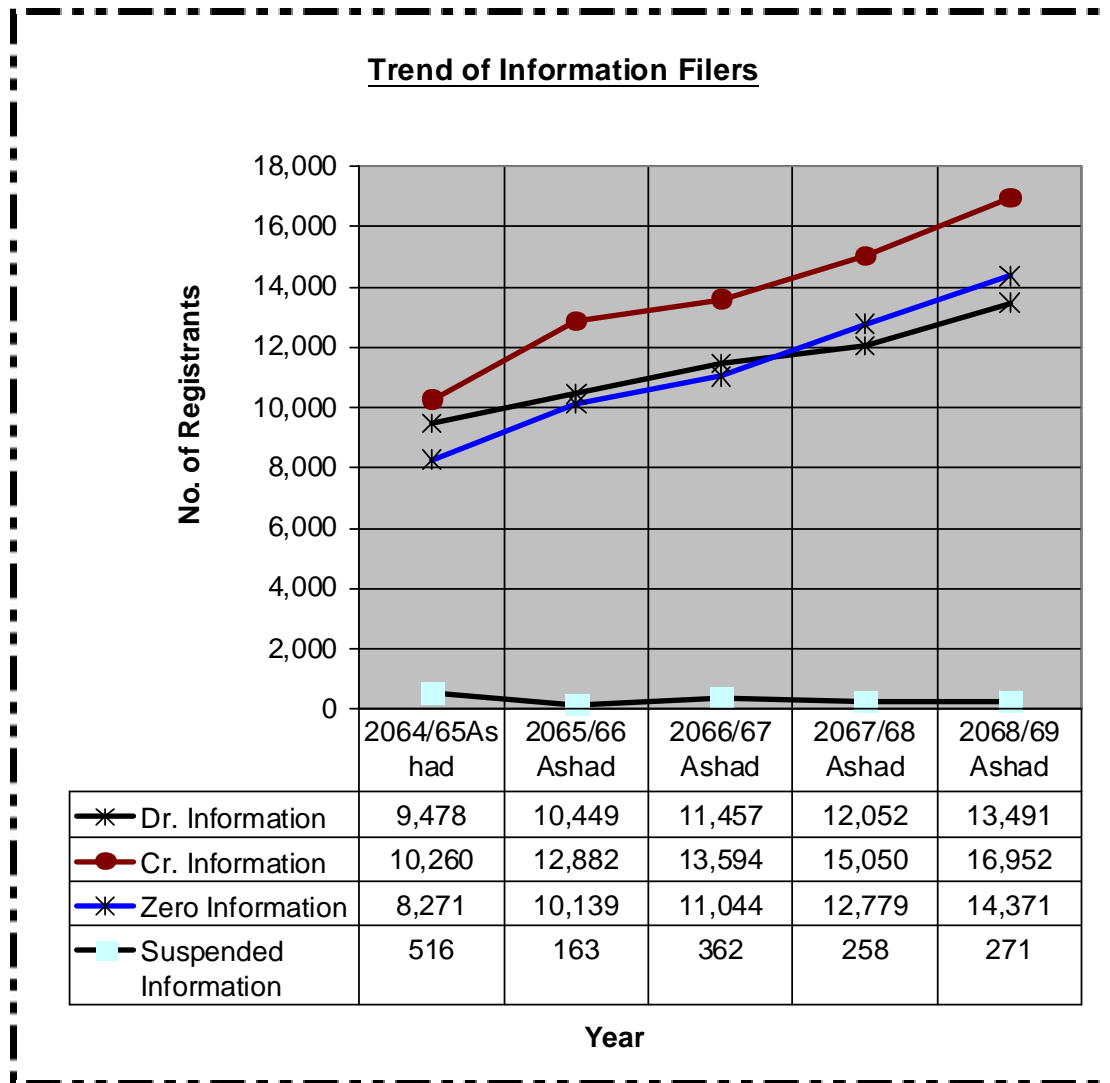
The expected VAT registrant up to FY2073/74 is presented below.

Figure: 12



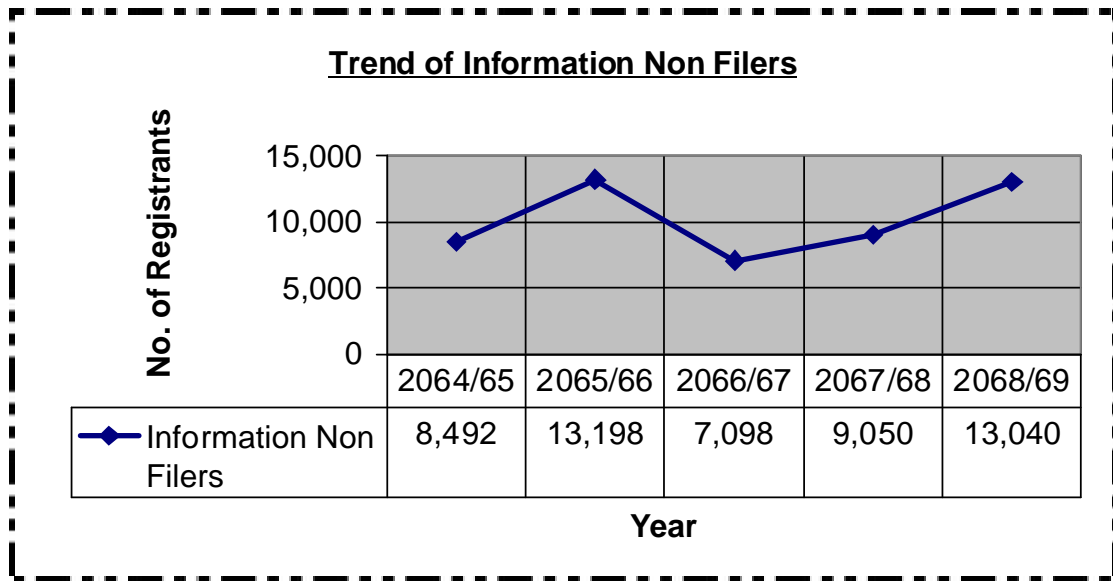
The no. of VAT registrants would be 104,627 till the end of Ashad 2073 if the same trend of increment is followed in the coming years. The government should try to increase the no of registrants by creating a suitable environment for business development.

Figure: 13



The trend of information filers shows that there is positive sign in Dr and Cr information filers are increasing but it is sad to increase the zero information filers.

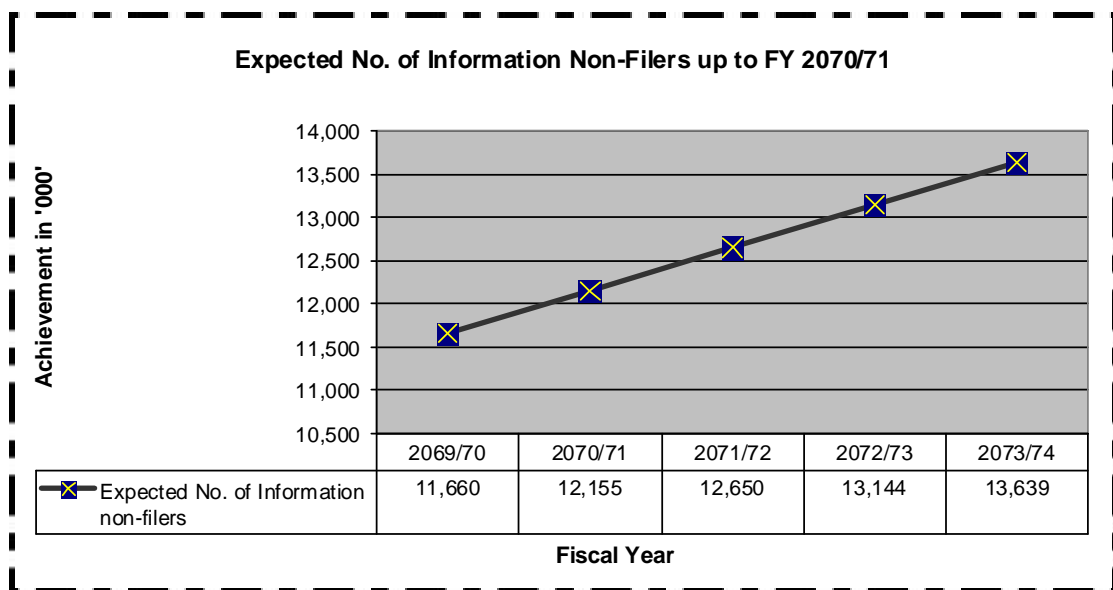
Figure: 14



The above data shows the trend of information non-filers. It is not good symptom to increase the information non-filers, as it is a sign of business recession. The Nepal Government should be very sincere in the improvement of political situation and in conflict management to make the economic depression recovered.

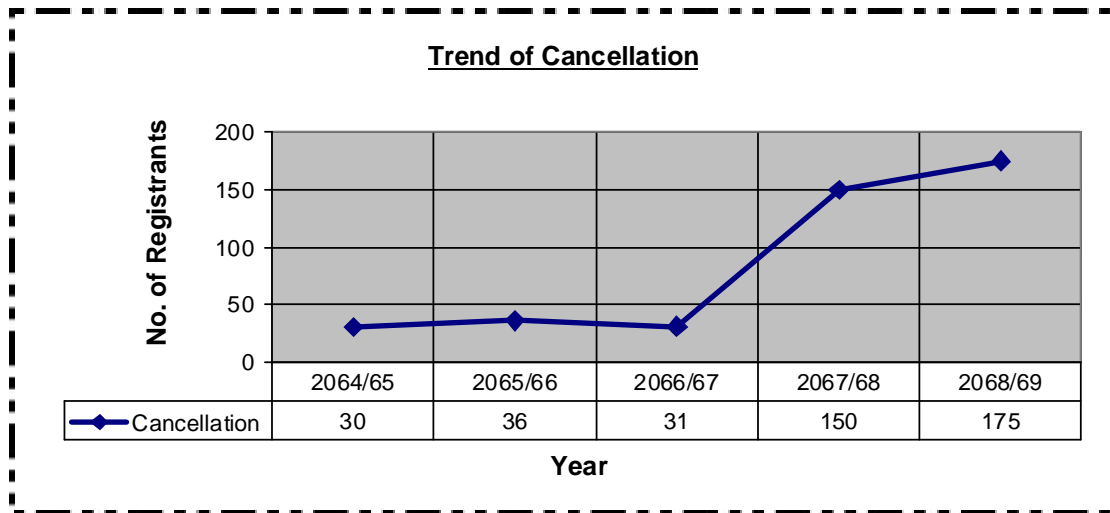
The expected no. of information non-filers up to FY 2073/74 is presented below.

Figure: 15



Expected no. of information non filers would reach to 13,639 in the next five years if the same increment pattern is followed. Government should be sincere on this and try to reduce this trend by finding the cause of increment in no. of non-filers.

Figure: 16

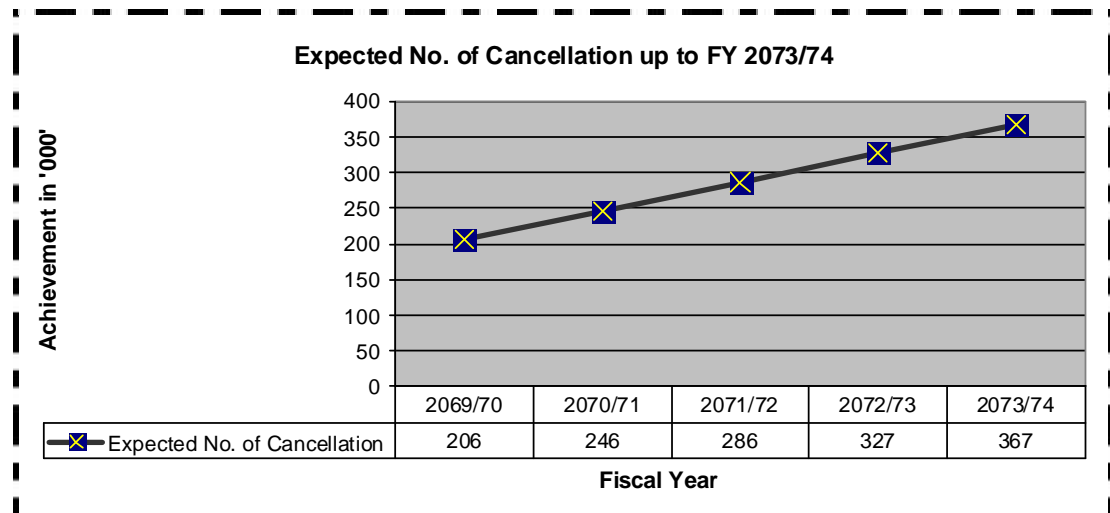


The no. of cancellation is increasing from FY 2064/65 to FY 2068/69 as it reaches to 175 from 30 but in FY 2066/67 it suddenly decreased to 31 from 36 in FY 2065/66.

The trend of cancellation is suddenly increased in the FY 2067/68 where it was 31 in FY 2066/67 to reach 150.

The expected no. of cancellation up to FY 2073/74 is presented below.

Figure: 17



The trend of cancellation is increased upto FY 2073/74. While analyzing the trend the expected no of cancellation up to FY 2073/74/ would be 367.

4.1.6 Impact of VAT on Government Revenue –Correlation Analysis

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

Table: 11

Vat and Revenue Collection

in Rs.000

Year(FY)	VAT Collection	Revenue Collection
2064/65	18,885,400	36,556,530
2065/66	21,613,043	39,901,151
2066/67	26,095,599	51,789,586
2067/68	29,815,702	61,152,297
2068/69	39,700,921	85,019,150

Source: Annual Report FY 2068/69 IRD

Correlation coefficient $r = +0.9983$

The correlation between these two series of data is +0.9983 which shows positive correlation between two variables. Or, VAT and Government revenue is highly associated therefore the increase in VAT will increase the collection of Government revenue and vice versa. The positive correlation means increase in Government revenue is an effect on increase in VAT.

Now, it is very important to understand that VAT which comprises 47% in government revenue and having highly positive correlation (+0.9983) is a backbone of current revenue collection portfolio. Its development and improvement will surely be beneficial for the whole nation, no doubt. Therefore

the previously concluded problems from field survey should be seriously thought and applied to improve the VAT collection system.

4.2 Analysis & Presentation of Primary Data

4.2.1 Knowledge about VAT.

Though the government used various tools for the improvement of VAT, it is still in the shadow. So there is a huge need to aware those stakeholders for the smooth functioning of this tax system.

But there are only a few people who are familiar with the actual meaning of this term. Today most people have the misconception that all types of tax is VAT; be it the income tax deducted at source or any type of fees. Even the educated community, university students, teachers and the ones studying related subjects or planning its curriculum have not been able to grasp a comprehensive understanding of its principle and practical aspects.

Not only in the diploma–level curriculum but also in the degree-level curriculum there is only one optional subject related to tax of a total 100 marks. The main objective of this curriculum is to produce tax experts but out of the total 100 credit hours, 50 credit hours allotted to income tax; 40 credit hours are for tax planning and 10 hours for VAT this shows how little importance has been given to VAT in this curriculum as well; out of total 100 credit hours only 10 credit hours i.e. only 10% have been allotted to VAT.

However, it is sad to say that the main institutions responsible for producing the country's human resource have not shown genuine interest in this. The high-level education is very far away from the nation's agenda.

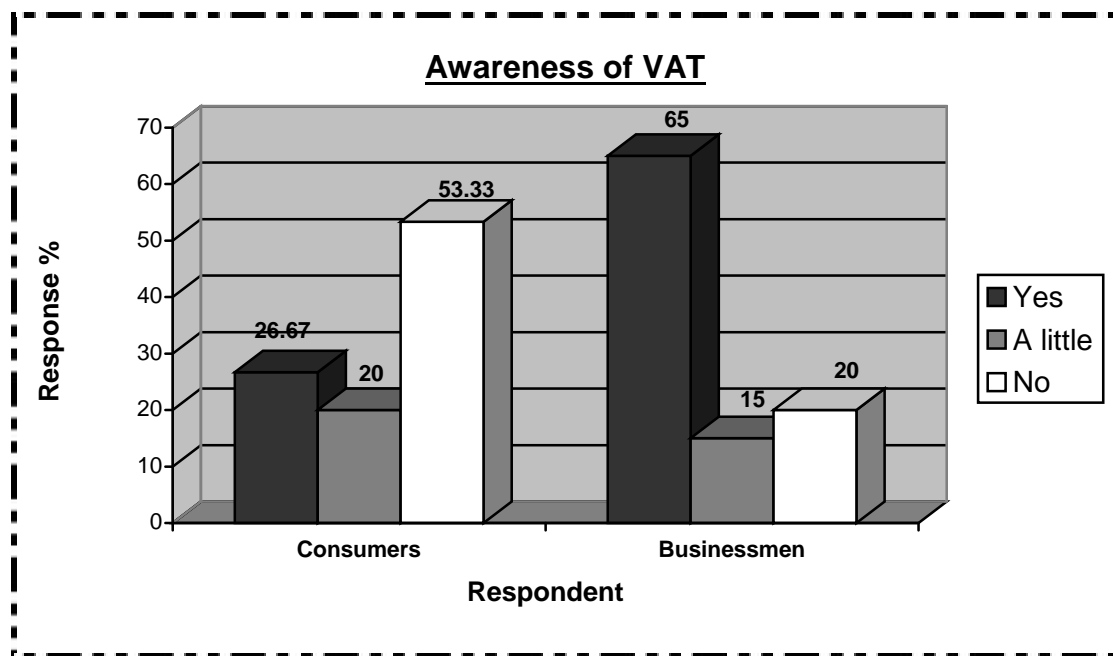
Knowledge of VAT is a most important question because unless and until the businessmen and consumers are aware enough to this subject, the implementation would be weak. The following table shows the awareness gained by consumers and businessmen in present situation. Here is the response given by consumers and businessmen on the question asked "*Do you know about VAT system of tax collection?*"

Table: 12
Knowledge/Awareness about VAT

Respondent Type	Response	No. of Respondent	%
Consumers N = 30	Yes	8	26.67
	A little	6	20
	No	16	53.33
Businessmen N = 20	Yes	13	65
	A little	3	15
	No	4	20

Source: Field Survey

Figure: 18



Out of the total 30, only 8 i.e., 26.67% consumers and out of 20 only 13, i.e., 65 % businessmen say 'yes' which is very low as to be required. Those saying 'yes' also could not give satisfactory answer. Respondent saying 'A Little' are also treated as saying 'NO' because the answer is almost not satisfactory. This indicates that awareness regarding VAT is very low. So the urgent need is to start the awareness campaign to the overall public and potential businessperson. The survey being conducted mostly in urban areas the respondents are assumed as more educated and more aware.

4.2.2 Why businessmen register on VAT?

This question is asked to find out the reason why businesses should be registered on VAT of among the various reasons which force the businesspersons to go to the tax office. This would help the planner to find out the best and easy way for the businesspersons to register on VAT. On question asked to businessmen '*why you register your business on VAT*', the following response is found.

Table: 13
Why businessmen register on VAT

Respondent Type	Response	No. of Respondent	%
Businessmen N = 20	Due to legal compulsion.	17	85%
	Can't issue bills of more than Rs.10,000/- if not registered on VAT.	8	40%
	To help the government in revenue collection.	2	10%

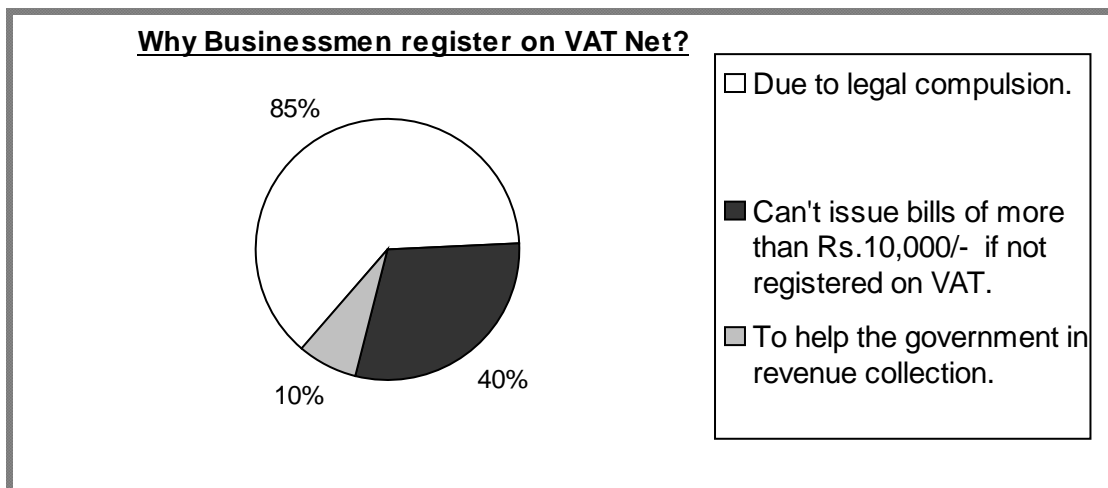
Source: Field Survey

The responses of the businessmen are ranked as per their preferences as follows:

-) Due to legal compulsion.
-) Can't issue bills of more than Rs.10,000/- if not registered on VAT.
-) To help the government in revenue collection.

The data in the table shows that 85% businessmen register their venture under VAT net due to legal compulsion as 85% businessmen marked on Legal Compulsion. Since the need of the VAT registration should be self-initiated, the trend should be developed for self-motivation for registration. The sad news is that only 10 percent (only 2 businessmen among 20) want to help the government. And 35% have their personal problem of business as they could not issue bills of more than rs.10,000/- if not register on VAT.

Figure: 19



4.2.3. Problems on VAT registration (Pre and post registration)

It is very crucial that the process of VAT registration should be easy and encouraging. Despite that, there are so many obstacles and problems during registration process and after registration too. To solve the problems of businesspersons is a main responsibility of government for the smooth functioning of the system.

Table: 14
Problems on Pre and Post registration on VAT

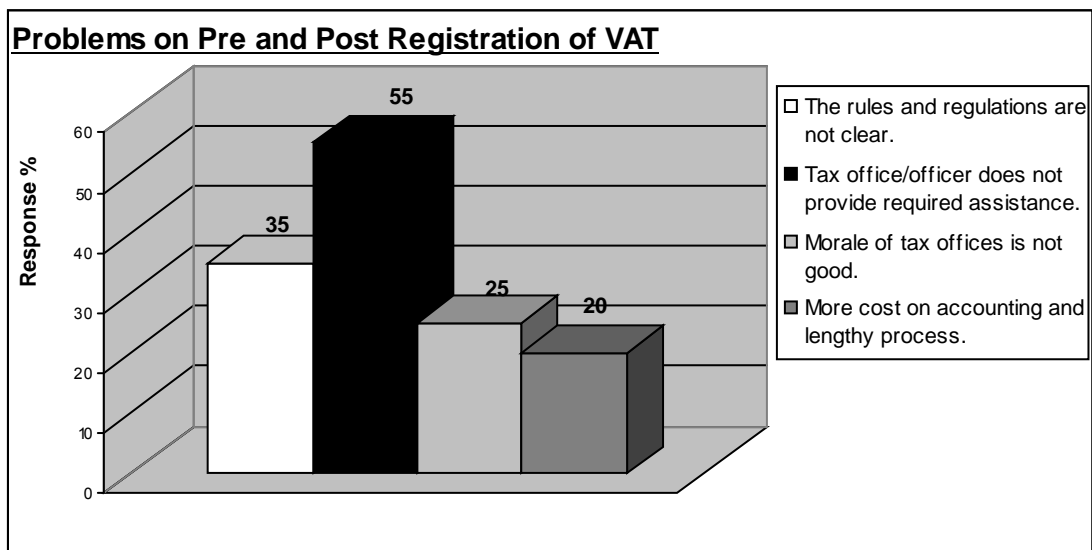
Respondent Type	Response	No. of Respondent	%
Businessmen N = 20	The rules and regulations are not clear.	7	35
	Tax office does not provide required assistance.	11	55
	Morale of tax offices is not good.	5	25
	More cost on accounting and lengthy process.	4	20

Source: Field Survey

The businessmen's problems on before and after registration on VAT are ranked here as per their preferences.

-) Tax office does not provide required assistance.
-) The rules and regulations are not clear.
-) Morale of tax offices is not good.
-) More cost on accounting and lengthy process.

Figure: 20



The major problems that businessmen are facing under VAT registration process and post registration is very crucial question as this is important for the motivation of businessmen. The findings in the above table and chart shows that the Tax Office could not provide required assistance to the business ventures. On the question asked '*What are the problems you faced pre and post registration on VAT*', to 20 businessmen 55% (11 businessmen) said that tax offices do not provide required assistance. 25% businessman thinks that the tax officers want bribe even for small mistake. Therefore the corruption is still widespread. 35% businessmen said that the rules and regulation are not clear. Therefore government should correct the system wherever is possible and give training as well as incentive for the tax officers. Government should also punish hard to those who are abusing their authority for vested interest.

4.2.4. Is present VAT rate appropriate?

Government increased the VAT rate to 13% from 10% last year. This is done to increase the tax revenue in the national coffer. But the impact is not good enough as compared to expected. Therefore, government revised some provisions in the recent financial ordinance 2006. So, it is important to know whether the current rate of VAT is O.K. or not. If not what should be done?

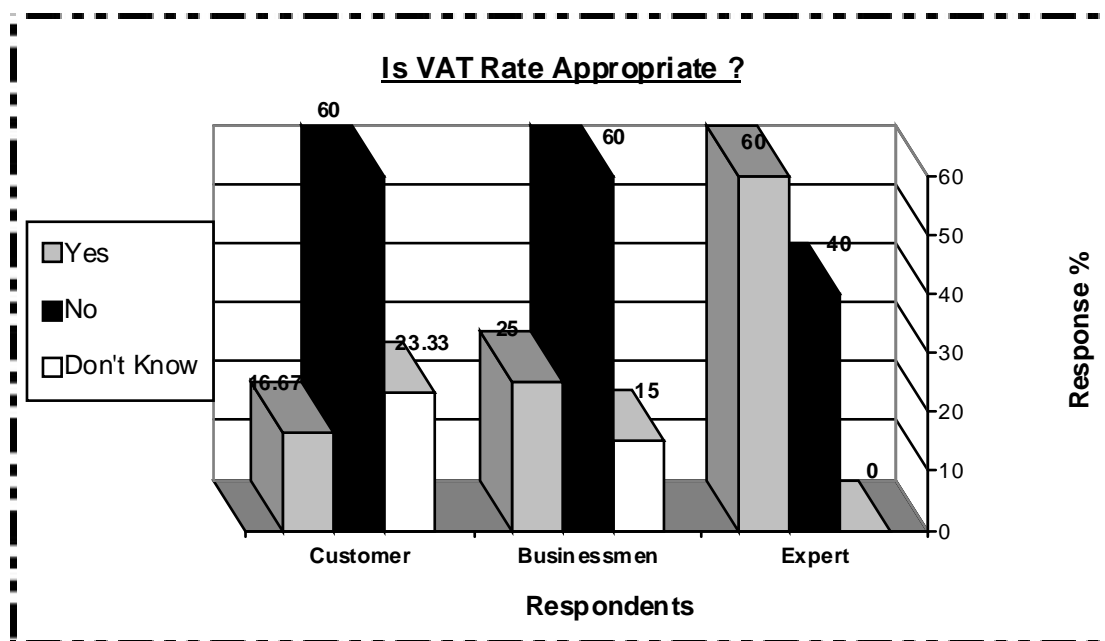
Table: 15
Is Present VAT rate appropriate?

Respondent Type	Response	No. of Respondent	%
Consumers N = 30	Yes	5	16.67
	No	18	60
	Don't Know	7	23.33
Businessmen N = 20	Yes	5	25
	No	12	60
	Don't Know	3	15
Expert N = 10	Yes	6	60

Source: Field Survey

The Above table shows the result found on asking the question "If the current VAT rate is appropriate or not?" and the result shows that the rate is not good and it should be changed. 60% Consumers, 60% Businessmen and 40% Experts have their view on the not appropriateness of VAT rate. This represent that the Government should be very much serious on fixing the rate and it should soon address on the need of the market. The experts who think the rate is not good have feeling – in country like ours where income of people is very low, tariff should be minimum.

Figure: 21



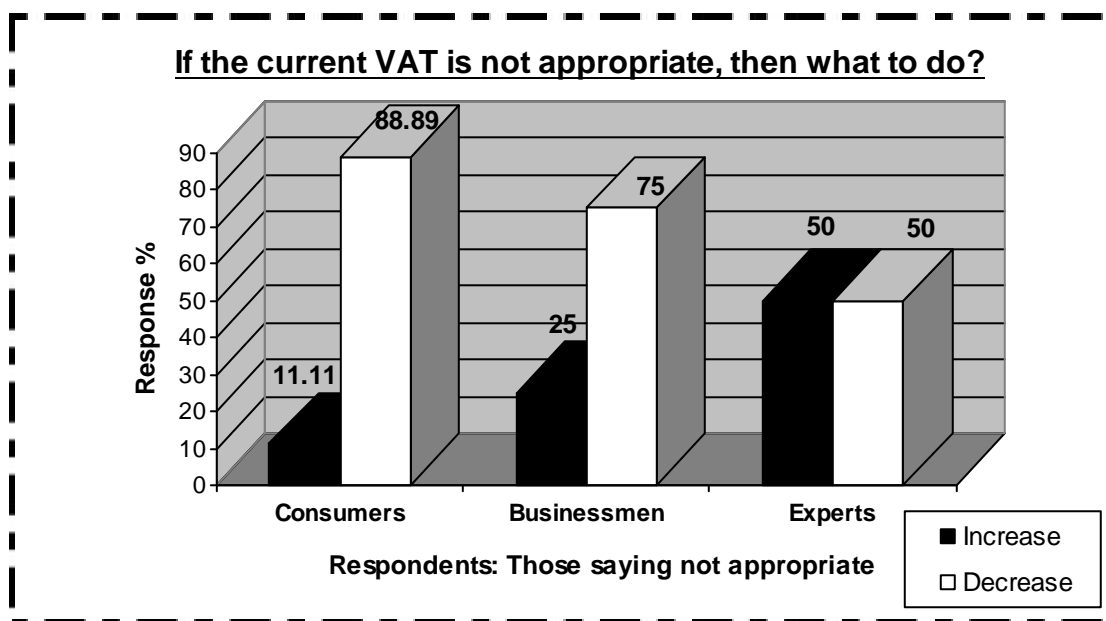
If 'NO' what to do?

Table: 16
If present VAT rate is not appropriate then “What to do?”

Respondent Type	Response	No. of Res.	%
Consumers N = 12	Increase	2	11.11
	Decrease	16	88.89
Businessmen N = 8	Increase	2	25
	Decrease	6	75
Expert N = 5	Increase	2	50
	Decrease	2	50

Source: Field Survey

Figure: 22



Those saying VAT rate is not appropriate were asked, "What should government then do?" 88.89% Consumers, 75% Businessmen and 50% Experts agree on reducing the rate as it directly affects the purchasing power of the consumers.

4.2.5. What should government do to make VAT effective and transparent?

The factors such as custom valuation not being based on actual price, lack of tendency to execute fair business amongst the businessmen, taxpayers not used to paying taxes, inability of the revenue administration to make the audit systematic and reliable, instability and insincerity of the government may be the main reasons for this system not being as successful as in other countries.

The condition to get invoices in the market is still not easy. But invoices are the main basis not only for VAT but also for income tax and customs duty. Now income tax is based on the accounts maintained for VAT, similarly, in connection with the implementation of VAT, the old valuation system regarding customs duty has been replaced with the transaction value system. Under the VAT system, even if the tax is evaded at the customs point by reducing the import value, it will be recovered at a later stage.

If there are so many problems from the very beginning to the 13th year of its implementation, it is now time to correct. Still there are lots of things to be checked and corrected. The change needed and the step that should follow by the government may be different for different people within the stakeholder. Various stakeholders of the society, towards the taxation policy of the government, give their view in different ways. Here is the summary of the list that people think government should do in the near future.

Table: 17
What should Government do?-Consumers

Respondent Type	Response	No. of Respondent	%
Consumers N = 30	1. Decrease VAT rate.	15	50
	2. Discourage corruption.	13	43.33
	3. Increase public awareness.	22	73.33
	4. Monitoring should be improved.	11	36.67
	5. Control custom point.	9	30
	6. Rules and regulation should be strong.	10	33.33
	7. Tax audit should be made each year.	5	16.67
	8. Make every trader compulsory on VAT registration.	12	40

Source: Field Survey

Consumers' view on what should Government do to make VAT system effective and transparent is ranked as per their preferences and found as follows:

-) Increase public awareness.
-) Decrease VAT rate.

-) Discourage corruption.
-) Make every trader compulsory on VAT registration.
-) Monitoring should be improved.
-) Rules and regulation should be strong.
-) Control custom point.
-) Tax audit should be made each year.

Table: 18
What should Government do?-Businessmen

Respondent Type	Response	No. of Respondent	%
Businessmen N = 20	1. Decrease VAT rate.	15	75
	2. Discourage corruption.	16	80
	3. Increase public awareness.	14	70
	4. Monitoring should be improved.	5	25
	5. Control custom point.	10	50
	6. Rules and regulation should be strong.	3	15
	7. Tax audit should be made each year.	1	5
	8. Make every trader compulsory on VAT registration.	2	10

Source: Field Survey

Businessmen's view on what should Government do to make VAT system effective and transparent is ranked as per their preferences and found as follows:

-) Discourage corruption.
-) Decrease VAT rate.
-) Increase public awareness.
-) Control custom point.
-) Monitoring should be improved.
-) Rules and regulation should be strong.
-) Make every trader compulsory on VAT registration.
-) Tax audit should be made each year.

Table: 19
What should Government do?-Experts

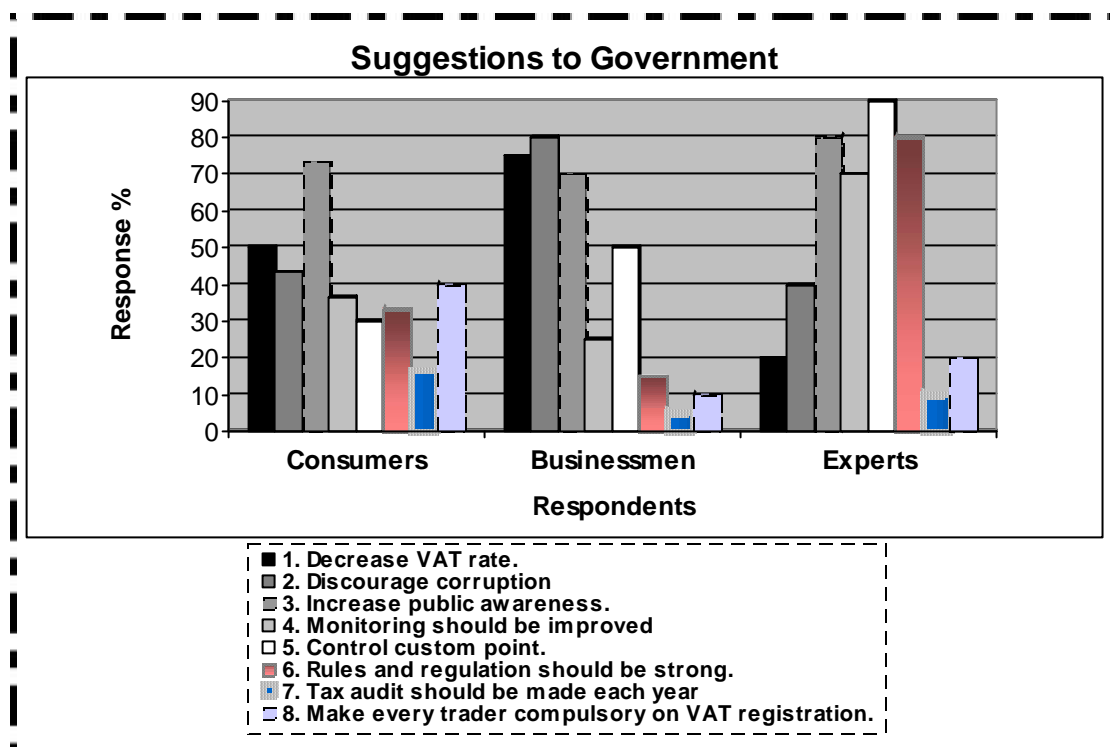
Respondent Type	Response	No. of Respondent	%
Expert N = 10	1. Decrease VAT rate.	2	20
	2. Discourage corruption.	4	40
	3. Increase public awareness.	8	80
	4. Monitoring should be improved.	7	70
	5. Control custom point.	9	90
	6. Rules and regulation should be strong.	8	80
	7. Tax audit should be made each year.	1	10
	8. Make every trader compulsory on VAT registration.	2	20

Source: Field Survey

Experts' view on what should Government do to make VAT system effective and transparent is ranked as per their preferences and found as follows:

-) Control custom point.
-) Increase public awareness.
-) Rules and regulation should be strong.
-) Monitoring should be improved.
-) Discourage corruption.
-) Decrease VAT rate.
-) Make every trader compulsory on VAT registration.
-) Tax audit should be made each year.

Figure: 23



So many times government is changing tax policies to make the system more effective and transparent. But the efforts are gone in vain as it could not change the weaknesses of the system. This happens because of various weaknesses. Therefore I prepared this question to find out the real problems from the consumers and businessmen's point of view. On the question asked to consumers, businessmen and experts '*What the government should do to make the tax system more transparent and effective*', 73.33% consumers, 70% businessmen and 80% experts say that the public awareness is necessary. 50% consumers and 75% businessmen request the government to reduce the rate. Another important finding is corruption control. 43.33% consumers and 80% businessmen and 40% experts agree on corruption control. The amazing result is that tax officers themselves told to control the corruption though the blame is to them being corrupted. 36.67% consumers and 70% experts agree on improvement of monitoring system. The previous result found that the low custom valuation and unauthorized trade is a major problem on successful implementation of VAT system. This is also noticed in this research work as 50% businessmen and 90% experts told to control the custom point for the

smooth functioning of the system. Experts also emphasize on the systematic and strong rules and regulations.

4.2.6. Is VAT better than previous tax system?

VAT is good or not than previous tax system of the government is important to know a VAT curtails various famous forms of tax such as sales tax, entertainment tax, hotel tax etc. The community asks this question to businessmen assuming that one reason behind VAT's unsuccessful is its unacceptance.

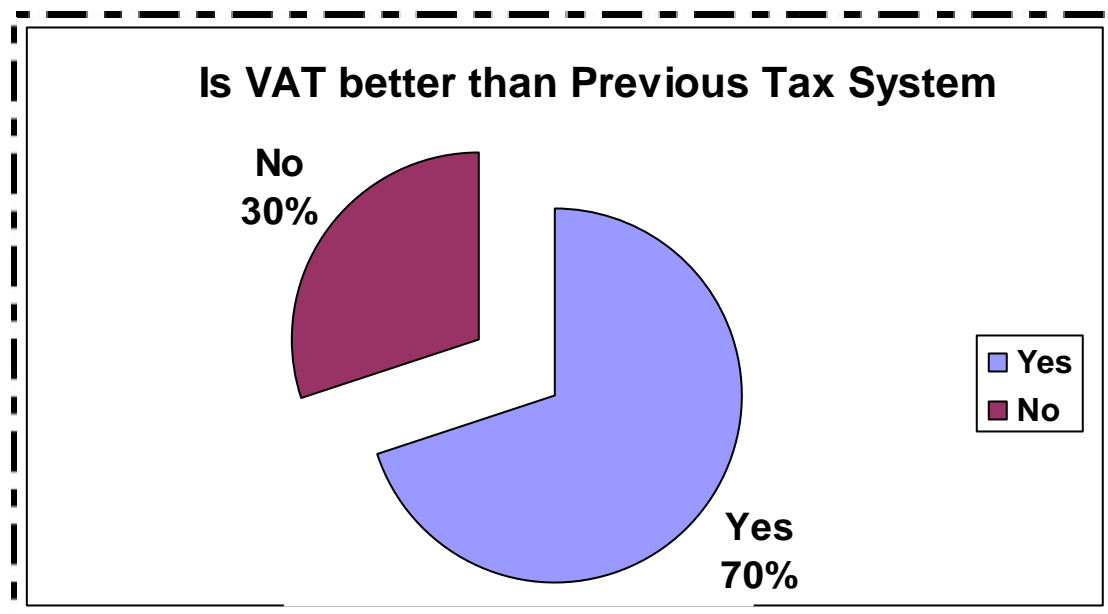
Table: 20
Is VAT better than previous tax system?

Respondent Type	Response	No. of Respondent	%
Businessmen N = 20	Yes	14	70
	No	6	30

Source: Field Survey

On the question asked to businessmen '*if the VAT better than the previous tax system*', 70% say Yes and only 30% say No. This shows that the people like this system. But previous question already emphasizes on the improvement of this system on various points for the overall improvement.

Figure: 24



4.2.7. What are the difficulties you faced with maintaining required books?

Another problem of VAT is its accounting system. Though current accounting system is good, businessmen are not aware enough behind the reason why these types of accounting are needed? There are at least three types of VAT collection method. Among them consumer type VAT is assumed well in the context of Nepal and applied.

Table: 21
What are the difficulties in maintaining books?

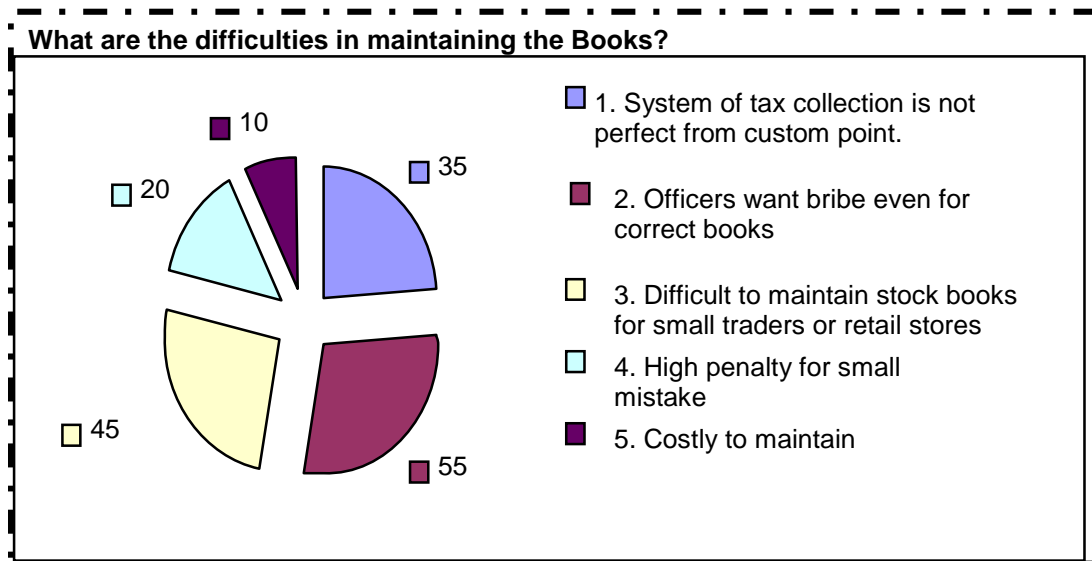
Respondent Type	Response	No. of Respondent	%
Businessmen N = 20	1. System of tax collection is not perfect from custom point.	7	35
	2. Officers want bribe even for correct books.	11	55
	3. Difficult to maintain stock books for small traders or retail stores.	9	45
	4. High penalty for small mistake.	4	20
	5. Costly to maintain.	2	10

Source: Field Survey

Businessmen's view about the difficulties faced on maintaining the required books are ranked below as per their preference.

-) Officers want bribe even for correct books.
-) Difficult to maintain stock books for small traders or retail stores.
-) System of tax collection is not perfect from custom point.
-) High penalty for small mistake.
-) Costly to maintain.

Figure: 25



The above table shows that the major problems that businessmen faced on maintaining the books. 55% businessmen told that officers want bribe for small mistake rather than correcting the mistake and suggest for the improvement. Similarly 45% agree that small traders could not maintain all the required books as stock books are almost impossible to maintain for the small retailer shops. 35% has view that the system of tax collection is breakdown from the custom point. This create many problems on maintaining the books as they could not get the real bill for purchase which makes them bound to issue false bill or not issue bills.

4.2.8. Issue of bills on every purchase and sales.

The main backbone of VAT system is billing system. The main problem identified by various previous studies is fall under weak billing system. Most of the sales and purchases are not billed and in billed that are in low price- called low invoicing. Therefore this affects the whole system of taxation. Here also effort is made to identify the current situation of perfect invoicing.

An analysis of the result of the past showed that the ratio of revenue to the GDP was 9 to 11% before the implementation of VAT has not gone beyond 15%. Even the tendency of tax evasion has not declined after the implementation of VAT. There is feeling that tax evasion has increased because

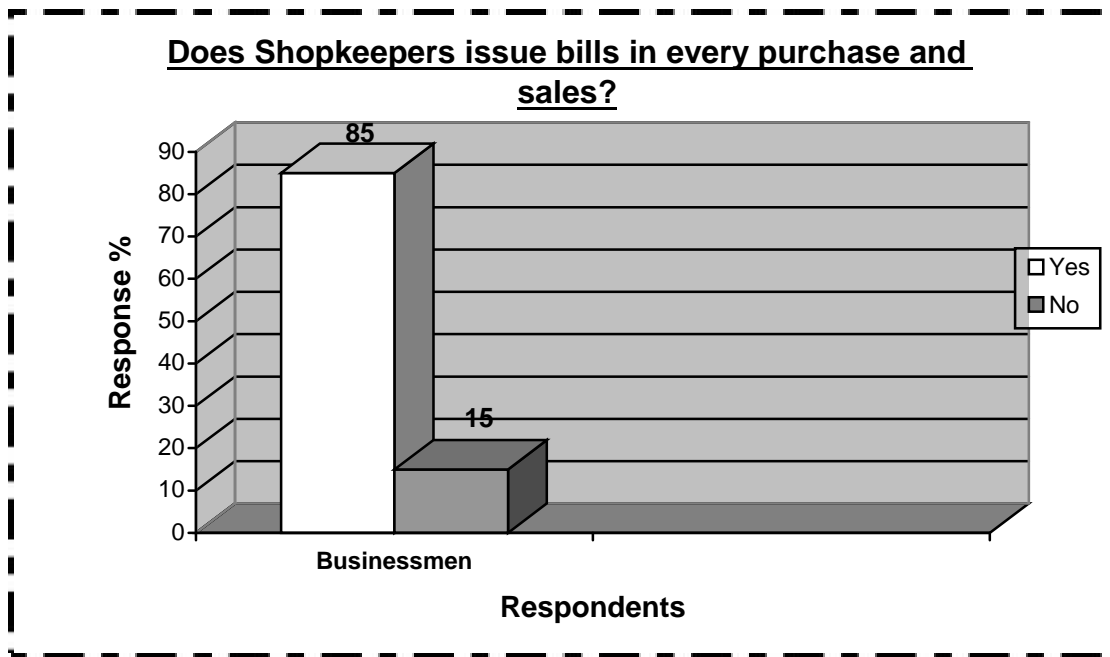
VAT and Income tax can both be evaded if a vender is able to issue false invoices during sales and hence the tendency to issue invoices has further declined. The inability to get purchase invoices from the businessmen while purchasing goods from the market proves this point. On the question asked, *"Do you issue (VAT) invoices in every sales"* the following result is found.

Table: 22
Does shopkeepers issue in every purchase and sales?

Respondent Type	Response	No. of Respondent	%
Businessmen N = 20	Yes	17	85
	No	3	15

Source: Field Survey

Figure: 26



Looking at the data we can easily say that the trend of issuing invoices is still weak. Only 85% shopkeepers issue invoices in their sales. Even those who issue invoices in their sales are mostly fixed priced shop and departmental stores, many of the businessman told that price is determined by bargaining and customers do not ask about the bill. Therefore we can easily conclude the weakness on this part of the VAT's backbone. And thus need a huge change to develop the trend of issuing invoices.

4.2.9. Ratio of percentage asking for VAT bills.

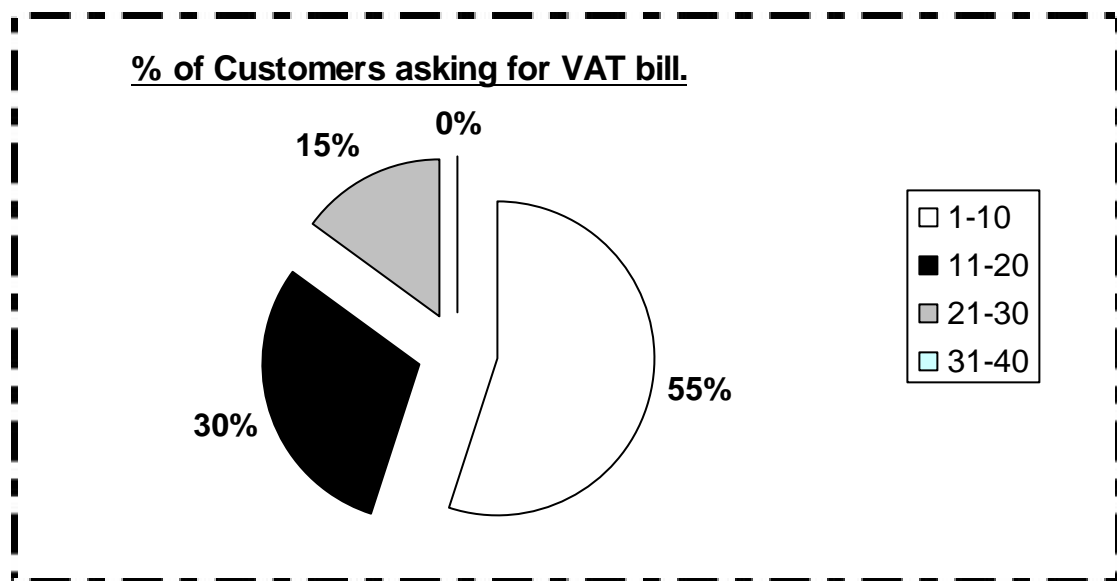
The main reason of this is the lack publicity and effective monitoring in the implementation of VAT the main glitch has been in terms of the lack of public awareness. Until a time when a situation is created where the consumer himself/herself is self motivated to ask for an invoice, it will be very difficult to apply this system for smooth functioning as we thought.

Table: 23
Ratios of Consumers asking for VAT bills

Respondent Type	Response (% of Customers)	No. of Respondent	%
Businessmen N = 20	1-10	11	55
	11-20	6	30
	21-30	3	15
	31-40	0	0

Source: Field Survey

Figure: 27



The data shows that consumers asking VAT bill is very low. Businessmen had experience that consumers are afraid of the increment in price due to VAT bill. 55% businessmen said that less than 10% consumers ask for VAT bill. And 30% businessmen said that consumers asking for bill is below 20% and remaining nominal part of the businessmen has experience that below 30% consumers ask for VAT bill. This data shows that 70% consumers do not ask for VAT bill.

4.2.10. Does VAT increase the price of commodities?

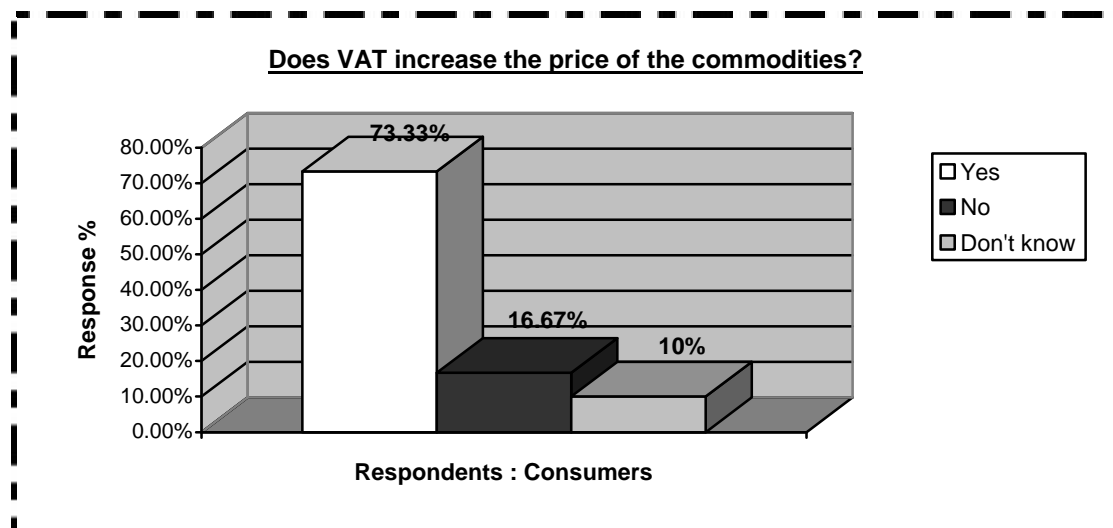
It is found in the previous research also that consumers do not ask for invoices while making purchase due to afraid of increase in the price of goods and services. Every one wants to pay less which is the nature of consumers worldwide. By not taking invoice if the goods is found cheaper then why to take bill is a common thought.

Table: 24
Does VAT increases the price of commodities?

Respondent Type	Response	No. of Respondent	% of Consumers
Consumers N = 30	Yes	22	73.33
	No	5	16.67
	Don't know	3	10

Source: Field Survey

Figure: 28



One of the important findings of this research is to know why consumer hesitate to take bill or afraid of taking bills. 73.33% Consumers thought that VAT increases the price of the commodities. But the major problem is not from the side of consumers but from the side of the businessmen. They purchase goods and do not get bills and same trend followed. In this survey I found that the fixed priced shop and departmental stores do not face this problem much as there is no trend of bargaining on price. VAT is already added in the price and therefore consumers also do not say anything about the VAT and increment in price.

4.2.11. Do you ask for bills while making purchases?

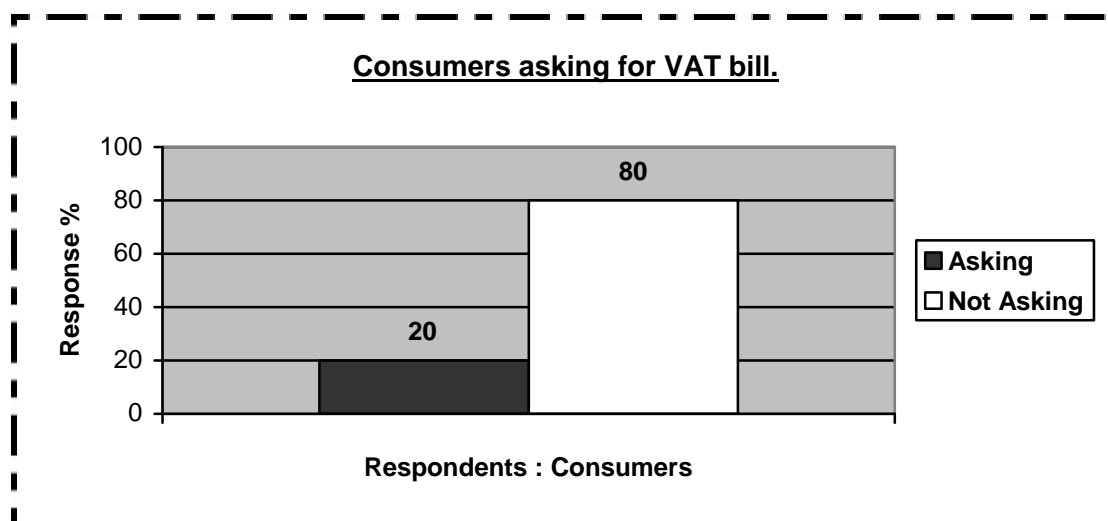
Although the invoices are a very important component, the flow of VAT invoices in the market has not been very effective. No matter how much we state the VAT is a tax based on invoices, there is only one fact – most often invoices are not available in the market and even if available the shopkeepers directly state that “if you want an invoice then you have to pay 13% extra”. The consumers of course look at his/her price benefit and there will hardly be any consumer who wishes to pay 13% extra and get a VAT invoice. Moreover, under invoicing is practiced in a majority of large wholesale and production points and in imports. The practice is always to give and take invoices that state amounts that are always less than what is actually paid. This not only minimizes the VAT collection at this point, but once the goods reach the retail he/she will also not issue actual invoices and hence VAT gets evaded even at retail point. Since the VAT accounts provide basis for income tax assessment under billing also result in decline income tax liability.

Table: 25
How many consumers ask for VAT bills while making purchases?

Respondent Type	Response	No. of Respondent	% of Consumers
Consumers N = 30	Yes	6	20
	No	24	80

Source: Field Survey

Figure: 29



On the above question (*do you ask for bills while making Purchase?*) asked to the 30 consumers, only 20% consumers ask for bills and 80% (24 Consumers) do not ask for bills. This indicates that the consumers are not conscious in taking the bills. They afraid of something that encourages them not to take bills. We so many times earlier explain that the main backbone of VAT system is billing system. Each bill is equivalent to a bank cheque for government in taxing purpose. Therefore I tried to find out the reason why they hesitate to take bills or why they don't understand the importance of VAT bills? On the question asked to 80% consumers who do not take bills while making purchases, the following result is found.

Why you don't want bills. (For those 24 consumers saying 'NO')

Table: 26
Reasons for not asking for Bills?

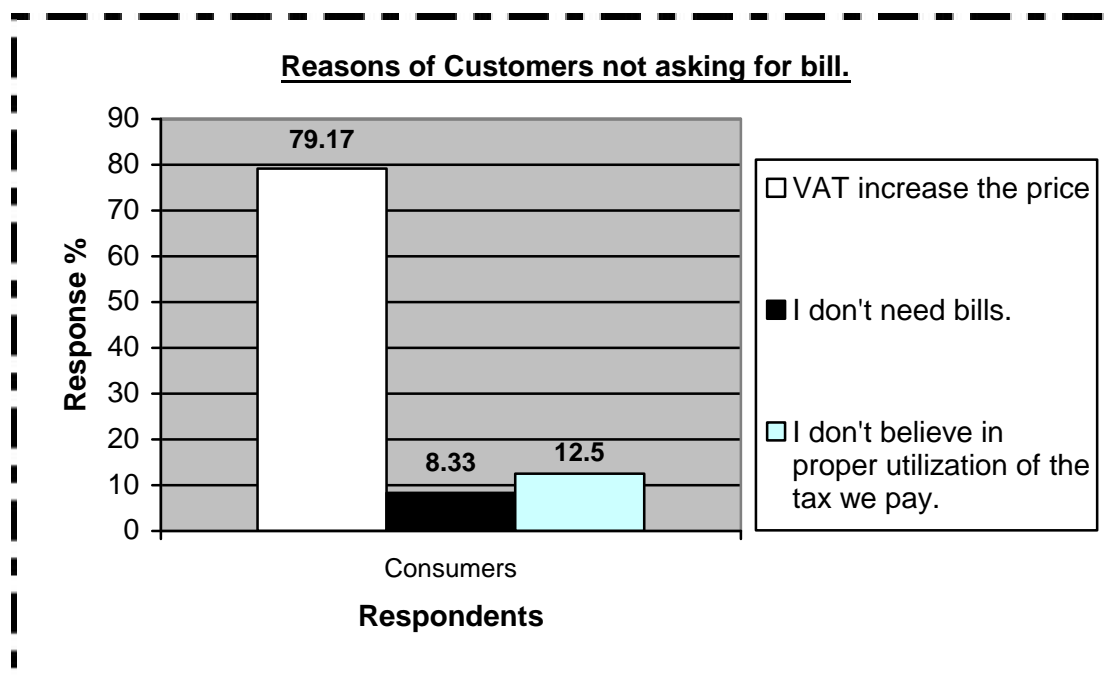
Respondent Type	Response	No. of Respondent	% of Consumers
Consumers N = 24	VAT increases the price.	19	79.17
	I don't need bills.	2	8.33
	I don't believe in proper utilization of the tax we pay.	3	12.50

Source: Field Survey

The above question is very important because one of the main problems previous identified is that consumers hesitate to take bill. Why they hesitate to take bills is ranked below as per consumers' preference is presented below.

-) VAT increases the price.
-) I don't believe in proper utilization of the tax we pay.
-) I don't need bills.

Figure: 30



As the same result of question no. 10, consumers have feeling that VAT increases the price of commodities. Among those consumers who do not take bills, 79.17% afraid of immediate price increment. Only 8.33% said that they don't need bills and 12.50% consumers said that they don't believe in proper utilization of the tax they paid. Therefore there is an urgent need to improve the wrong feeling of consumers and convince them that VAT does not increase the price but it is already added to the sales price. Though this is correct theoretically, practical difficulties are another part which is very difficult to correct. As already discussed in the Q. no.10, under invoicing is practiced in a majority of large wholesale and production points and in imports. The practice is always to give and take invoices that state amounts that are always less than what is actually paid. This not only minimizes the VAT collection at this point, but once the goods reaches the retail level he/she will also not issue actual invoices and hence VAT gets evaded even at retail point. Therefore the need for improvement is not in the side of consumers but from the government's control mechanism to the trade (both internal and external).

Does the seller make the bill equal to the amount we pay? (For those 6 consumers saying 'YES')

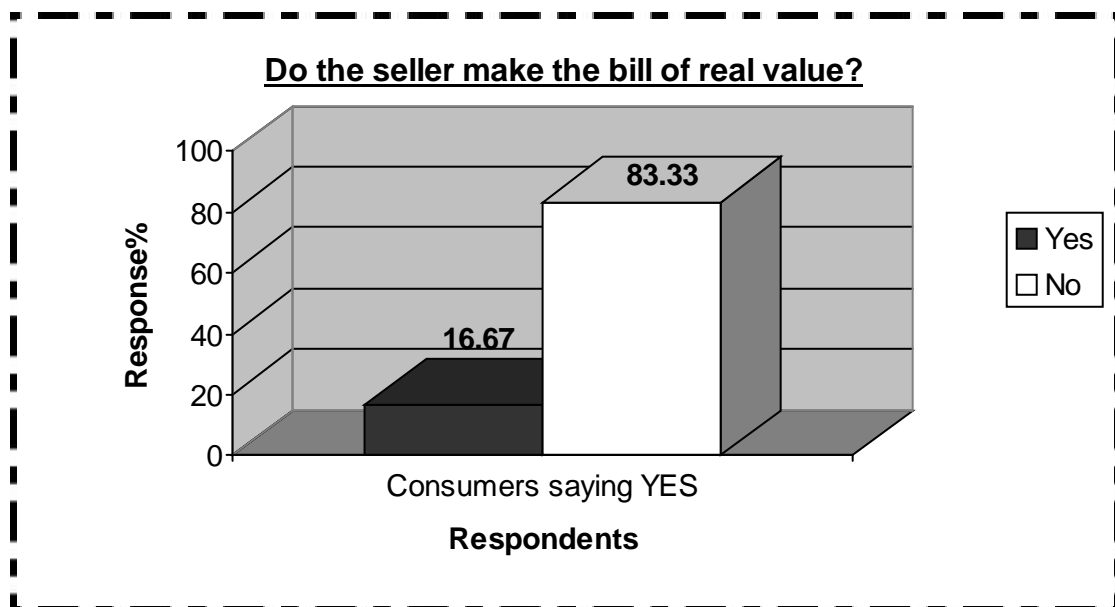
Table: 27
Do the sellers make bill equal to the amount we pay?

Respondent Type	Response	No. of Respondent	% of Consumers
Consumers N = 6	Yes	1	16.67
	No	5	83.33

Source: Field Survey

Even though consumers ask for VAT bills seller do not make the bill equal to the amount that consumers paid. In most of the cases the VAT bill is less than the actual price paid. The main reason behind this is under valuation of goods in the custom points. The retail level traders are also bound to not issue or undervalued the invoice. Among those consumers who ask for VAT bills, 83.33% have experience that the bill price is not equal as they paid.

Figure: 31



4.2.12. Choice of shop.

The serious consideration was not given to the impact that smuggling from the long open borders with India and China would have and no steps were taken to address this. There was no official study on kind of goods that come from these borders, especially the southern borders, and how these get distribution in the

Nepali market and no steps were taken for the control. Chinese goods are now dominating the Nepalese market, as those products from china are comparatively cheaper than imported from other countries and produced here. On the contrary, it was left up to VAT as a major control mechanism rather than the other way round. The transactions in these shops were increased due to which VAT was sidelined. The tax administration was not even able to penetrate this system into the market due to which no one felt the presence of VAT.

This question is therefore very crucial to analyze the consumers' consciousness about paying the taxes carefully. Unless the consumers' behaviors do not change to go to the VAT registered shop, this system could not work properly.

Table: 28
Consumer's choice for shops

Respondent Type	Response	No. of Respondent	% of Consumers
Consumers N = 30	VAT registered.	3	10
	Non VAT registered.	6	16.67
	Any one.	31	73.33

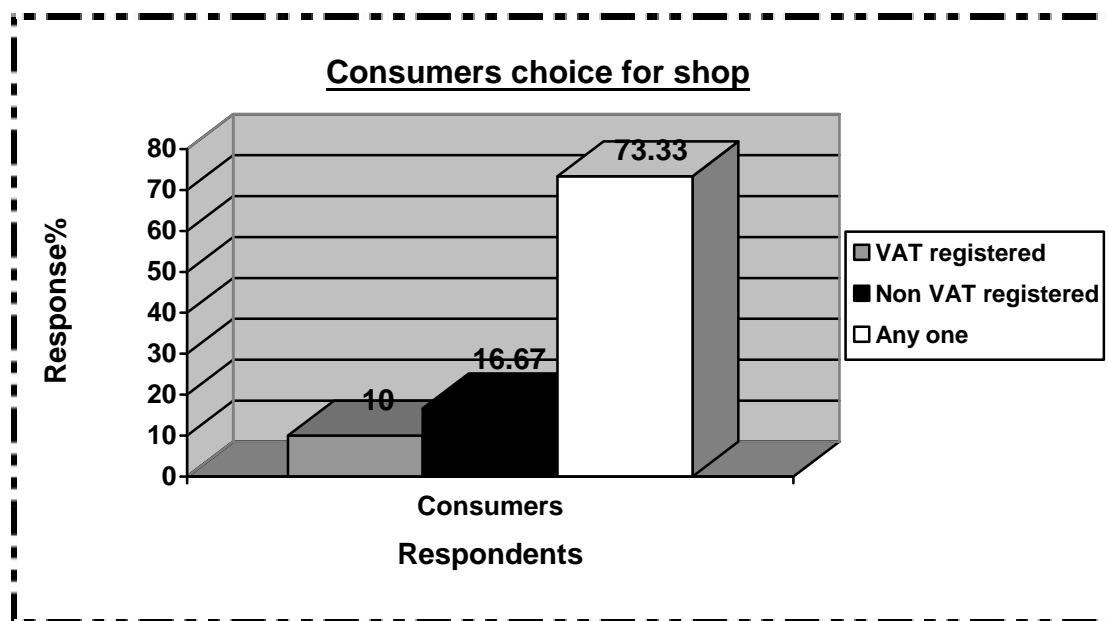
Source: Field Survey

In what types of shop consumers generally prefer to go is ranked below as per their choice.

-) Any one
-) Non VAT registered.
-) VAT registered.

The above table shows the very unconsciousness of the consumers on choosing the shop. 73.33% consumers have no choice of shop or they go for shopping to any type of shop they meet.

Figure: 32



4.2.13. Why Nepal has adopted VAT system?

Table: 29
Why Nepal has adopted VAT System?

Respondent Type	Response	No. of Respondent	% of Consumers
Expert N = 10	1. To make tax system more effective and transparent.	7	70
	2. Other developed countries follow this system.	5	50
	3. This is the latest tax system.	1	10
	4. To avoid double taxation.	3	30

Source: Field Survey

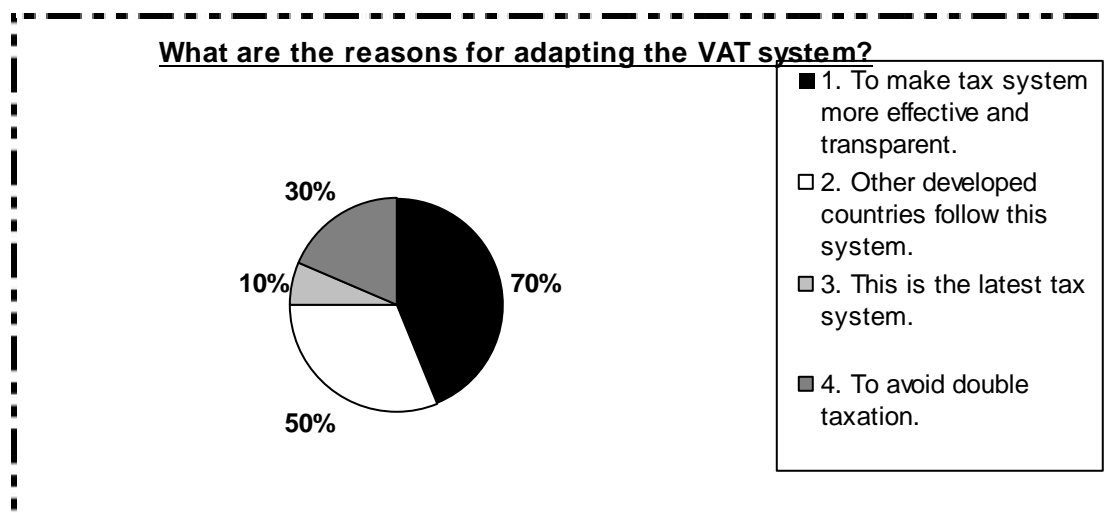
Experts view about why Nepal has adopted VAT system of tax collection is presented here as per their preference.

-) To make tax system more effective and transparent.
-) Other developed countries follow this system.
-) To avoid double taxation.
-) This is the latest tax system.

Even though VAT system is applied to make the tax system more effective and transparent, the result could not be achieved as per desired. About 70% experts

and tax officers agree that VAT system is applied to make tax system more effective and transparent. This also avoids the cascading effect of taxation. 50% agree that other developed countries followed the system so we also follow the same trend.

Figure: 33



4.2.14. Why threshold limit is set to Rs. 2 Million?

Table: 30
Why threshold limit is set to Rs. 2 million

Respondent Type	Response	No. of Respondent	% of Consumers
Expert N = 10	1. Difficult to administer all small taxpayers.	8	80
	2. Disability of small traders to keep accounts.	5	50
	3. Retailer could not issue bills of each and every item.	7	70
	4. To make tax system easier.	4	40

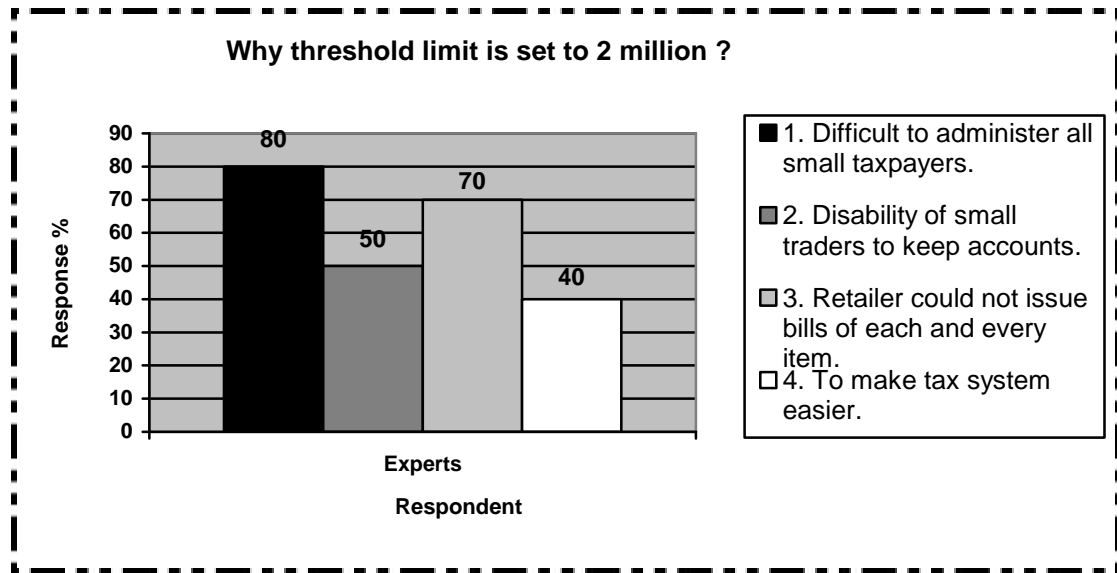
Source: Field Survey

Experts' saying on why threshold limit is set to 2 million is ranked below as per their preference.

-) Difficult to administer all small taxpayers.
-) Retailer could not issue bills of each and every item.
-) Disability of small traders to keep accounts.
-) To make tax system easier.

This question is asked to know if the threshold limit is one of the reasons of VAT's leakages or not. There is a saying that – VAT can be controlled to some extent if the threshold limit is ignored and all the traders whether big or small should be register on VAT Net.

Figure: 34



The finding of the research indicates mainly to points that 'why threshold limit is necessary'. Firstly, the small traders could not be administering effectively and secondly, retailer could not issue bills of each and every item due to the nature of the business. First got vote of 80% and second 70% among the Experts.

4.2.15. What are the possible loopholes?

Table: 31
What are the possible loopholes?

Respondent Type	Response	No. of Respondent	% of Consumers
Expert N = 10	1. Zero rating.	1	10
	2. Threshold limit.	7	70
	3. Tax refund system.	2	20
	4. VAT exempting goods and services.	4	40
	5. Low valuation in custom point.	10	100
	6. Corrupted TO's and administration.	3	30

Source: Field Survey

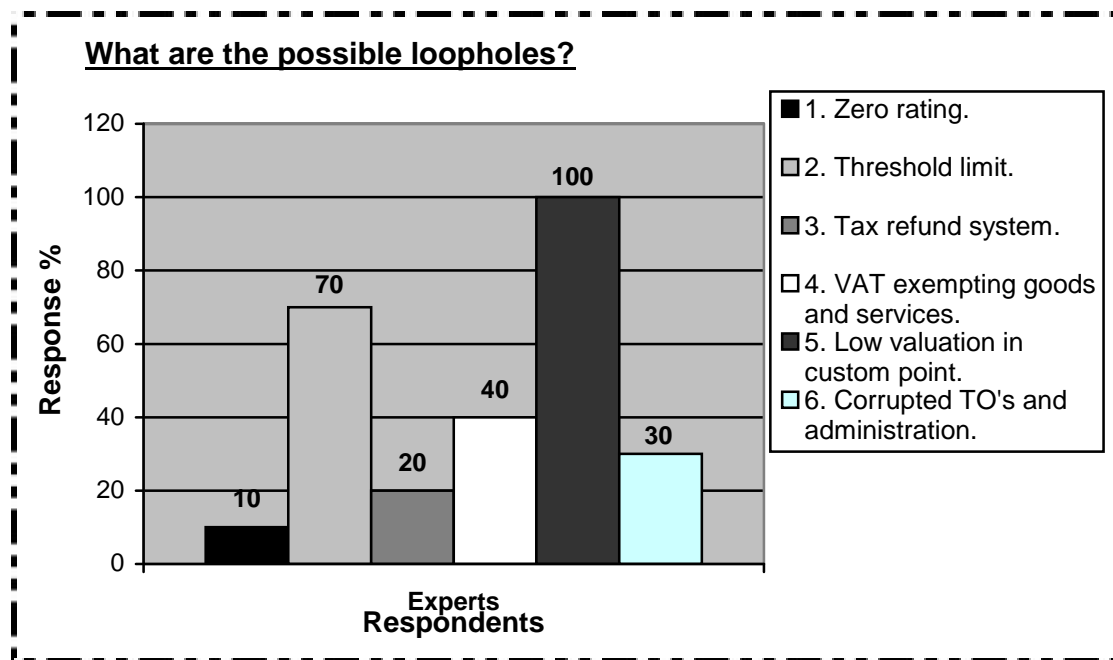
The major loopholes of VAT system are presented below as per the rank made from experts' view.

-) Low valuation in custom point.
-) Threshold limit.
-) VAT exempting goods and services.
-) Corrupted TO's and administration.
-) Tax refund system.
-) Zero rating.

It is found from the study that the major problem of VAT's leakages is an unofficial trade from the southern and northern boarders. Under valuation of goods is rampant which cause problems from the very initial stage of VAT. Once the problems started in the chain of VAT, it affects the whole system.

The above table shows that 100% experts agree on under valuation of goods in the boarder is one of the causes of VAT leakages. And 70 % experts have feeling that threshold limit is another part which open the door for VAT evasion. Unless and until these two holes are not tightened the successful implementation of the VAT in Nepal would be a dream.

Figure: 35



4.3 Major Findings

1. Very few people are aware about the VAT system. 53% Consumers and 20% businessmen don't know about VAT. Those saying they know about VAT system and its impact could not give satisfactory answer. So awareness regarding VAT on general public should be improved. Consumers have fear that VAT increases the price of goods and services they consumed
2. Major problems associated with VAT system to business houses are account keeping and billing. Weakness of VAT administration are lack of motivation, service minded attitude and dishonesty in VAT officers.
3. It is found from the study that the major problem of VAT's leakages is an unofficial trade from the southern and northern borders. Under valuation of goods is rampant which cause problems from the very initial stage of the VAT. Once the problems started in the chain of VAT, it affects the whole system. According to VAT, if less tax is paid the tax credit latter will also be less and taxpayers are discouraged from indulging in under invoicing.
4. One of the reasons why VAT is not successful in Nepal is due to vested interest in different layer of administration system. During the survey the researcher was asked time to time that only the staffs having good connection with political parties are posted in revenue department. In many case he/she pay a large sum of money to go to that department and moreover, the businessmen pay a large donation during election.
5. The research found that 85% shopkeepers (see pg. no.76) issue invoices in their sales. Even those who issue invoices in their sales are mostly fixed priced shop and departmental stores. Therefore we can easily conclude the weakness.
6. Existence of small traders in large proportion, lack of accounting records, illiteracy and high compliance cost, open boarder with Indian market etc which create a question for successful implementation of VAT. Very large number of small tax payers' with no record keeping and issuing invoices are major problem facing by Nepalese Tax system.

7. The customers do not have habit of asking for invoices while making purchases. Whereas, VAT is a system which is totally based on the accounting. Under VAT system all transactions need to be recorded through invoices. But in our country where businesses have been running in a traditional fashion, the implementation of VAT system will enforce additional burden of issuing invoices, paying and collecting taxes and the additional responsibility of maintaining accurate accounts and presenting it to the tax office.

8. The government appointed 'tax helpers' urging the businessman to support the government by 'taking and giving' bills of right value during the time of former FM Roop Jyoti. But they could not do any more significant changes in the prevailing system. When the researcher asked the businessmen about the tax helpers they have a common voice that the tax helpers has only an attitude of gaining something rather than making the system better and to find weaknesses for correction of the system.

9. It is very important to understand that VAT which comprises 59.26% in government revenue and having highly positive correlation (+0.9983) is a backbone of current revenue collection portfolio. Its development and improvement will surely be beneficial for the whole nation, no doubt.

Findings at a Glance

-) Custom valuation not being based on actual price.
-) Lack of tendency of not issuing invoices and not asking for invoices.
-) Lack of tendency to execute fair business amongst the businessmen.
-) Inability of the revenue administration to make the audit systematic and reliable.
-) Corruption is widespread.
-) The consumers have feeling that not taking the invoice is saving the cost.

CHAPTER V

SUMMARY, CONCLUSION & RECOMMENDATION

5.1 SUMMARY

VAT is a modern and scientific tax system. It is a tax of the 21st century since it is highly developed and refined. It is a tax that suits the present speed of knowledge, development and skill. Moreover, it is concerned with the present context of liberalization, privatization and globalization. It is easily adaptable with the open economy of present day. It is a tax that is transparent and has an in-built system of self-control. There can be no difference of opinion on the above facts.

It was introduced in 1997 but still many businessmen here in Nepal are not very clear on how this system works. Moreover this system requires proper recording of business transactions, which many firms lack. Existence of small traders in large proportion and their inability to comply with the requirement of VAT due to their low scale of operation, lack of accounting records, illiteracy and high compliance cost. The existence of open boarder and large amount of unauthorized trade from India to Nepal is a challenge for implementing VAT. While full implementation of the value added tax is one area that may have an immediate pay off, more broad based tax reform are necessary to integrate the VAT with income and customs tax administration to produce a more buoyant and responsive tax system.

At the early stage of VAT implementation, government has made a great effort to make VAT more effective and productive. However, VAT was subject of a strict opposition from the business community in the period of introduction later there were some correction in VAT rules and regulation, then slowly business community accepted the system and further demanded it to extend though the retail level.

In the traditional tax system, each tax was independent by itself. While importing goods from abroad, the customs duty and the income tax to be paid on

this basis did not have a straight connection. In other words, the transaction papers used for customs purpose would not be used for income tax. The same was true for all taxes. Due to this there is many possibilities of revenue leakages. It has a special system where a person trying to deceive tax will be caught in either one of the levels. Therefore, the trend of evading taxes would be discouraged.

Despite of all this features of VAT system, it could not be implemented perfectly. The government was not able to effectively enforce the acts and regulations of the tax system and it was not able to take it seriously among the taxpayers and the consumers. Therefore the expected revenue could not be collected from this system. The factors such as custom valuation not being based on actual price, lack of tendency of not issuing invoices and not asking invoices, lack of tendency to execute fair business amongst the businessmen, taxpayers not used to paying taxes, inability of the revenue administration to make the audit systematic and reliable, instability and insincerity of the government may be the main reasons for this system not being as successful as in other countries. Lack of awareness regarding this system amongst the taxpayers, tax administration and the general public is another main reason of the problem.

We live in a time of widespread publicity of 21st century. But in the context of VAT publicity has been at the speed of a tortoise. It cannot be said that nothing has been done but whatsoever has been done is not enough and has not proven its outcome. It has been said that spending 10% of the earning in advertisement is a standard practice. If we all consider VAT to be the primary source for revenue mobilization then commensurate time, effort and costs should be expanded on it.

VAT is collected mainly in the city areas. The institutional set-up and the aims of revenue also imply that it has targeted the city areas most. Hence, it appears appropriate to prepare an increase publicity campaigns based on radio, TV, FM programs that are popular in the cities as well as in the whole country. Though the main business centers are located in the city areas, consumers come to a

particular shop from the 75 districts of the country. Similarly, immediate campaigns should be undertaken to place attractive hoarding boards in strategic locations of the cities with messages regarding VAT invoices and by placing inspiring messages in the popular newspapers and magazines. Public awareness campaign should be undertaken in such a way that whether a consumer goes, whether at home or market place, they encounter with VAT messages and remind them to take invoices. The campaign should as much effective as it could stamp on consumers' mind that they should not purchase anything without an invoice.

We are very far away to educating our child. Out of 160 total credit hours allotted in diploma level, only 5%, i.e. 8 credit hours have been allotted for VAT whereas 15 credit hours for property tax, 127 credit hours for income tax and 10 credit hours for sales tax have been allotted. But VAT which is to be developed as main basis for the tax system gets only 8 credit hours. Not only in the diploma-level curriculum but also in the degree-level curriculum 50 credit hours allotted to income tax; 40 credit hours are for tax planning and only 10 hours for VAT. This shows how little importance has been given to VAT in this curriculum.

The preparation made by Singapore in the context of VAT is indeed noteworthy. In order to impart knowledge regarding various aspects of VAT and to make the taxpayers, particularly small businessmen, capable of fulfilling the formalities of VAT, training was provided to 3,700 businessmen. Telephone services in form of 'help lines' were also introduced and this provided services to almost 31,000 people. Finally phone calls were made to those who had not registered till the final date of registration. Advertisements were posted on almost all the popular newspapers and magazines to reach out to all potential taxpayers. The mass media was used widely. Wide publicity campaigns were carried out through the radio, television advertisements, discussion programs, stories and cartoons in various newspapers, magazines, posters, etc.

The economic development of any nation depends on availability of resources and the resource development depends upon countries income. The source of revenue is income tax, custom duties and VAT. The only tax system that is popular worldwide is VAT. All industrialist and traders should register under VAT to increase the revenue source of the country to build our nation ourselves. Why should we always depends on foreign aid and spread our hands and ask for donation ad alms? It is drop by drop that a jar get filled and hence lets us all get together and do what we can do to make our nation self dependent. Businessman can make a major contribution by issuing invoice keeping accurate and proper accounts. VAT office should provide help by maintaining a supportive attitude. The consumer should be more alert and demanding in terms of asking for and taking invoice. The experience of China indicates that in order for VAT to be effective it should be implemented fully not partially.

One-way, there are hindrances in development movements due to the running political conflict and war. And another way, the sources for development is also narrowing. The development activities in rural areas opens door for employment as well as utilise local resources which lead to increase the earning capacity of local people. But this cycle is being disabled in last few years.

In coming days, the government should balance this expenditure through ceiling on general expenditure and especially on security expenditure. To increase security expenditure on unplanned way is to decrease the development expenditure. The cycle of income of general public revenue collection and poverty alleviation also need continuation to development activities.

Government by reducing taxes on various commodities has tried to promote import and at the same time has tried to curb the smuggling also. Though at present, it is difficult to deal with the large number of people wanting to be registered into VAT, the government is appointing 'tax helpers' urging the businessman to support the government by 'taking and giving' bills of right value.

The problem is not so much in manufacturing but in trading. The government should be aware of it. Unless illegal trading through the open border with India is addressed, we cannot adopt a magical solution. The government should have a two tier VAT system. For items with custom duty of more than 5%, VAT should be less. This will allow the tax department to enforce proper declaration of valuation at the customs points. Alternatively the duty rate should be brought to 5% allowing VAT to remain the same. This will ensure transparency in transaction. All types of businesses whether small or big should be brought under tax not to increase revenue but for better performance. The government should understand that people's income does not keep on increasing on a constant rate during economic recessions. That may generate less revenue which tax officials failed to understand. Leakage is one of the serious problems inflicting the tax system. The government needs to introduce strong measures for stemming the rot and make sure they are implemented. It is better to broaden the tax net than to put additional taxes on exiting customers. Due to falling revenues from exports, VAT has become more important. The government, however, should not raise the VAT rate, but concentrate on efficiently implementing it.

5.2 CONCLUSION

The term 'Value Added' refers to the value added to goods and services by a step in the chain of original purchase, manufacture or other enhancement and retail. Thus Value Added Tax basically means the tax liability to be levied on the Value Added by an organization at each stage of its producing goods and rendering services.

The praxis of VAT is that it is a broad based form of indirect tax family in the nature of multipoint sales tax (exports being zero rated) on final consumption of goods or services. It is ultimately borne by the consumer although it is collected at every stage of production, distribution and sales. A tax credit is granted at each stage for tax paid earlier in the chain of transfer/sale of goods and services until it reaches the ultimate consumer.

VAT is a self-policing and transparent system of taxation reducing the scope for tax evasion wherein the tax administration is highly automated. Under VAT, the ideology is to allow full credit that is set off taxes paid on purchase. So the manufacturers should not consider any taxes paid in his purchases as part his purchase price, and accordingly while fixing his sale price, no component of tax will get included in the same. This will avoid tax upon tax.

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

The tax administration is yet to be taxpayer friendly while resolving 'practical difficulties' of entrepreneurs and traders. Frequent changes in policies and unrestricted reassessment system have created a lot of confusion, which in turn has been an impediment during implementation. The VAT Act has been amended seven times in the course of eight years. But there are still a number of clauses and sub-clauses which need change or modification. The government

effort has remained at only paying lip service and it has failed to implement its commitment too.

Further Nepal's taxation system and administration is not conducive to business. There is need to improve attitude and treatment of tax officials, which is a major reason that people hesitate to go to tax offices. The diverse interpretation of laws and regulations have added extra legal burden on the business community. As a result, the share of tax in national revenue generation has not been able to pick up compared to the contribution of non-tax revenue sources.

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

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

Therefore, there is urgent need for taking immediate action by Nepal Government in developing and implementing effective tax reform and policy measures as recommended.

5.3 RECOMMENDATION

Nepal has been undergoing through server fiscal crises due to limited sources of revenue and increasing Government expenditures. The trend of past few years shows unbalance revenue expenditure gap. The country is heading toward debt trap situation. The implementation of VAT through tax reform program could not solve the economic challenge yet. To establish this tax on a completely successful scale and to make it a major part of country's internal resources requires much bigger efforts than what we are doing now. The following measures are recommended for successful implementation of VAT and to get the desired result.

- ✓ A collection strategy needs to be developed and implemented effectively in order to collect the increasing amounts of arrear. To improve billing condition in the market needs regular supervision, audits and investigation.
- ✓ The proper co-ordination among various Government departments involved in revenue collection must be maintained. Computer networking system should be established in all the custom points with department. It is necessary to simplify tax procedure and reform tax administration.
- ✓ The tax administration should be fully computerized and ensure faster, simpler and reliable procedures for the taxpayers. Various revenue organizations should unify and make one unit in order to make tax administration simpler, transparent and effective.
- ✓ Tax helper program should be monitored properly as there is a bad smell even in that young blood too. They should be guided properly. To decrease corruption, strong measures of carrot and stick should be applied.
- ✓ Perfect billing system should be established. Every trader should be made compulsory to register under VAT and use prescribed computer software so that taxpayers should not be able to delete the transaction once entered in computer.

- ✓ Amendment in VAT rate is necessary. The VAT rate and custom tariff should be reduced. From the equity consideration, it is better to differentiate the VAT rate with the higher rate on luxurious goods and lower rate on essential goods.
- ✓ The existing long open border is the main cause of smuggling and undervaluation in the border sides. So open borders should be systematized to a greater extent. Threshold and tax refunds are two possible gates for tax evasion. An effective and efficient tax auditing, investigation and monitoring system should be developed.
- ✓ In the campaign to increase public awareness, institutions that deal with the public should be involved. There are many examples worldwide of such institutions being used to establish VAT.
- ✓ Classes should be organized for high school students regarding VAT. Educating a child is like educating the whole family as today's child is the adult of tomorrow and hence the consumers.

If implemented properly, VAT would definitely help to increase revenue collection in Nepal. The present situation of VAT shows that the system could be improved by understanding and commitment at different layers of the society with government's commitment towards its political and administrative quality. Therefore the improvements to be made in each layers of the society are specifically presented below.

5.3.1 What should the Administration and Government do?

1. The administration must take a big heart with support by the Finance Act and VAT Act to take legal action to those who break the rules.
2. Publicity and educational program must be made more effective.
3. Conducting link audit at all levels of business chain with emphasis on tax audit.
4. Fully and up-to-date update of price index of goods and services is necessary.

5. Compulsory application of the cash machine billing system.
6. Developing billing software and making it available freely to the vendors.
7. Making all traders compulsory to register on VAT net. So that the vendor could not misuse the facility given by threshold limit.

5.3.2 What should the Businessmen do?

The main backbone of the economic system is business community. It can change the whole system if become honest and responsible for the benefit and development of the country. I personally as a researcher request all the businessmen to not to be influenced with the vested interest and do what we can do to society. Don't be competitive in tax evasion but to make business environment clean. This is the only way we can place our country in the economic map of the world. The following are the few points we should do now.

1. Be honest from today to the consumers, to the business ethics and to the country.
2. A notice saying "*please do not forget to take your invoice*" can be posted at the cash counter.
3. Habit of quoting the price inclusive of VAT should be developed.
4. Do not offer bribe to the corrupt employees for the immediate benefit.
5. Start giving invoices that denote correct price and the correct transaction and force the buyer to take invoice.

5.3.3 What should the Consumers do?

As a good citizen it is our responsibility to develop a good system for financial reform. We could not make such policies in this context but we could contribute a lot to make a civilized society. Let us build a habit of taking invoices and make the best use of our hard-earned money. Stop being cheated.

1. Ask for an invoice which is our natural right.

2. By not taking the invoice we are not free from the liability of paying VAT. There will be another huge tax waiting for us to pay in future.
3. Appropriate goods can only be found after taking the invoice. If an invoice is requested, the seller is afraid and he/she will not be able to lie.
4. Try to know whatever we can grasp with our knowledge. Ask to those who are professional in this subject.

With the above analysis it is clear that the problem of discussed subject could not be solved with only one effort. A community is made up of groups of people and if you and I start developing this habit at a personal level, the trend will develop automatically. The combined effort of all businessmen, consumers, civil society and the government is equally important. For this purpose, various suggestions have been recommended which are concerned with various communities of our society. The list of suggestion is only a short list for immediate action. The continuous and long term effort is necessary for the complete solution of the deep rooted problem. There is always room for improvements in an open society and market economy. Therefore, there are possibilities for future improvements learned through our mistakes. The problem can be completely solved with the trial and error basis only. So, let us give importance to the improvements that need to be made today and secure the opportunities for tomorrow through an economy based on an open market system.

This topic is not only related with the revenue collection but also related to the preservation of our entire open market and ultimately for the development of the country. We can not blame for others for our own mistake and weaknesses. Until and unless a system of issuing bills/invoices in a correct manner can be established in the market, the collection of VAT and the entire revenue collection will be at risk. As the contribution of the VAT to the total revenue collection of this year in the data of Asadh 2066 is 59.26%. Revenue policies are not only implemented for immediate revenue collection but are also directed towards long-term well being and development of the economy. In this context,

our duty is to be fully committed towards developing a self-generated system of the process of giving and taking invoices. If we cannot fulfill this responsibility from this day, we will not only be unsuccessful but the future of our economy would be in great danger. At this moment of great change in political history, we should be the great leader of the financial reform.

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Appendix -1

Questionnaire for Consumers

A. General Information:

Questionnaire No:.....

Date:.....

Name of the Interviewer:.....

B. Information of Respondent:

Name of the Consumer:.....

Age: Sex: Education.....

Address:.....

C. Survey Questionnaire:

1. Do you know about VAT system of tax collection?

Yes A little No

if 'yes' or "a little" then ask about conceptual knowledge of VAT

.....

.....

2. Is present VAT rate appropriate?

Yes No I don't know

if no, what should be done?

Increase (ignore 'b') Decrease (ignore 'a')

(a) if 'increase' what is the proposed rate

(b) If 'decrease' what is the proposed rate

Why do you want to reduce the rate? (If 'b')

It decreases the price of goods and services.

Tax burden is reduced.

Increase the demand of goods as price decreases.

Other specify.....

3. Is the recent increment of VAT rate to 13% reasonable?

Yes No

if no, what the government should do?

Increase service charge and render good service to the public.

Depend more on foreign assistance.

Open new companies to earn more profit to increase revenue collection.

Making the revenue collection system more effective and more transparent.

Other specify.....

I don't know

4. Does the VAT increase the price of commodity compared to the previous tax system?

Yes No I don't know Conditional

5. Do you ask for VAT bill while making purchase?

Yes No

if no, why don't you ask?

(More than one can be ticked)

I don't need bill.

Seller don't give / I don't ask.

I don't believe in proper utilization of the tax we pay.

VAT bill increases the price of goods.

Other.....

if yes, do the seller make the bill equal to the amount you pay?

Yes No

6. If you are given a choice to go on VAT registered shop and non- registered shop, where do you go for shopping?

VAT registered shop Non VAT registered shop Any one

if 'Non VAT registered shop', why so..

VAT makes price of goods higher.

I don't need VAT bill.

I don't know.

**7. What the government should do to control tax leakages and to make VAT system more effective and transparent? (More than one can be ticked)-
Ranked Basis**

Decrease tax rate.

Discourage corruption by increasing salary of tax officer, giving more social pressure and making strong rules against source unidentified income.

Decrease corruption by making strong rules and regulations like higher penalty.

Increase public awareness through various programs.

Monitoring the effectiveness of VAT regularly.

Control the custom point for low valuation of goods.

Make every trader compulsory to register on VAT (ignore threshold limit).

Discard VAT and apply the traditional tax system.

Harder punishment to the tax officers if found abuse of authority and attractive prize package to loyal and committed officers.

I don't know.

THANK YOU FOR YOUR VALUABLE TIME.

Appendix -2

Questionnaire for Businessmen registered with VAT

A. General Information:

Questionnaire No:.....

Date:.....

Name of the Interviewer:.....

B. Information of Respondent:

Name of the Respondent:.....

Age: Sex: Education.....

Business Type:

Distributor Wholesaler Retail Stores Hotel

Travel and Tourism Producing company (Factory)

Other Specify.....

C. Survey Questionnaire:

1. When did you register your Business with 'VAT'?

Specify date.....

2. Why did you register your business with VAT? (More than one can be ticked)

Due to Government compulsion.

We cant issue bill of more than 10,000/- if we don't register on VAT.

To increase/expand the market share.

To help the government in revenue collection.

To fulfill social responsibility.

Others specify

3. Do you know about VAT system of tax collection?

Yes A little No

if 'yes' or "a little" then ask (or write) about conceptual knowledge of VAT

.....
...

4. What are the major problems that you faced registering your business with VAT? (More than one can be ticked)-Ranked Basis

The rules and regulations are not clear.

The tax office does not provide the required assistance and support.

Paying and refunding of VAT is not clear.

Cost of maintaining specified accounting system.

Advance payment of 2.5% of declared stock must be paid if the existing business is registered with VAT.

I don't know.

Others, specify.....

5. Is present VAT rate appropriate?

Yes No I don't know

if no, what should be done?

Increase (ignore 'b') Decrease (ignore 'a')

(a) if 'increase' What is the proposed rate(go to 6)

(b) If 'decrease' What is the proposed rate

Why do you want to reduce the rate?(if 'b')

It decreases the price of goods and services.

We get benefit on stock. (increase in refundable tax credit)

Easy to expand business (consumers purchase more).

Others specify.....

6. Is the recent increment of VAT rate to 13% reasonable?

Yes No

if no, what the government should do to collect more revenue?

(More than one can be ticked)

Increase service charge and render good service to the public.

Depend more on foreign assistance.

Open new companies to earn more profit to increase revenue collection.

Making the revenue collection system more effective and more transparent.

Other specify.....

I don't know

7. Is VAT system effective?

Yes No

8. What should the government do to make VAT system more effective and transparent? (More than one can be ticked)

Decrease tax rate.

Decrease leakages of tax revenue by making strong rules and regulations.

Increase public awareness through various programs.

Monitoring the effectiveness of VAT regularly.

Harder punishment to the tax officers if found abuse of authority and attractive prize package to loyal and committed officers.

Control the custom point for low valuation of goods.

Make every trader compulsory to register on VAT (ignore threshold limit).

Discourage corruption by increasing salary of tax officer, giving more social pressure and making strong rules against source unidentified income.

Tax audit should be done each year. (now doing once in a 4 years.)

Discard VAT and apply the traditional tax system

I don't know.

9. Is VAT better compared to previous sales tax, entertainment tax and hotel tax?

Yes No

10. What are the books of account to be prepared for VAT? (Tick on only one).

1. Sales book and purchase book.
2. Sales book, purchase book, debtors' book and creditors' book.
3. Debtors' book and creditors' book.
4. Sales book, purchase book, debtors' book and creditors' book and Stock book.

11. Did you maintain all the required books?

Yes No

12. What are the difficulties you face with maintaining the books?

(More than one can be ticked)

- Higher penalty. (10,000 even for a small mistake while maintaining)
- Costly to maintain.
- System of tax collection is disabled from the point of origin. (Custom)
- Officers want bribe even if our accounts are clear and we prepared the books in proper way.
- Consumers do not take bills so we need to issue dummy bills.
- Difficult to maintain stock books for retail shop for small and frequent items sold.

13. Do you issue (VAT) invoices in every sales''

Yes No

14. Did you receive (VAT) invoices in every purchase?

Yes No

15. Generally what is the percentage of customer who asks for VAT bill?

.....

THANK YOU FOR YOUR VALUABLE TIME.

Appendix-3

Questionnaire for Administrative experts

A. General Information:

Questionnaire No:

Date:

Name of the Interviewer:

B. Survey Questionnaire:

1. Could you explain the VAT system of Tax collection in Nepal?

.....
.....

2. Why Nepal has adopted VAT system curtailing previous sales tax, entertainment tax and hotel tax? (More than one can be ticked)

To make tax system more efficient and transparent.

To minimize loopholes.

Because other developed countries follow this system.

To avoid double taxation (cascading of pyramiding effect).

To increase tax revenue.

Others

specify.....

3. Why threshold limit is fixed to Rs. 20,00,000/- sales?

It is not possible to administer all the small traders in tax brackets.

Disability of small traders to keep books of accounts.

Exempting the small traders from tax brackets.

Retailer seller could not issue bill of each and every small items.

To make tax system easier.

Others

specify.....

4. Do the businessmen pay their VAT timely?

Most of

About 50%

Less than 50%

5. What are the possible loopholes to evade from VAT?

(More than one can be ticked)

Zero rating.

Threshold limit.

Tax refund system.

VAT exempting goods and services.

Low valuation at custom point.

Lack of regular monitoring.

Corrupted administration and tax officers.

Others

specify.....

6. What are the challenges to execute VAT in Nepal?

(More than one can be ticked)-Ranked Basis

- Lack of consumer awareness.
- Weak tax administration.
- Lack of cooperation from businessmen.
- Complex process. (not simple)
- Closing of business is more difficult.
- Lack of honesty in business culture.
- Other specify.....

7. What are the efforts made by the government to control the tax evasion?

(More than one can be ticked)

- Consumer awareness programmes.
- Cross/random checking.
- Making tax administration and system more clear.
- Others specify

8. What the government should do to control tax leakages and to make VAT system more effective and transparent?

(More than one can be ticked)-Ranked Basis

- Tax audit should be done each year.
- Control the custom point for low valuation of goods.
- The government should update the price of listed goods as per the market rate.
- Make every trader compulsory to register on VAT (ignore threshold limit).
- Give training to the tax officers to find out the leakages.
- Discourage corruption by increasing salary of tax officer, giving more social pressure and making strong rules against source unidentified income.
- Harder punishment to the tax officers if found abuse of authority and attractive prize package to loyal and committed officers.
- Other specify.....

9. Is the recent increment of VAT rate to 13% reasonable?

Yes No

if no, what the government should do to increase revenue?

(More than one can be ticked)

- Increase service charge and render good service to the public.
- Depend more on foreign assistance.
- Open new companies to earn more profit to increase revenue collection.
- Making the revenue collection system more effective and more transparent.
- Other specify.....

THANK YOU FOR YOUR VAULUABLE TIME.

Appendix -4

Calculation of Expected Income Tax Collection up to FY 2070/71 using Microsoft Excel worksheet with TREND Function.

Original Data:

Rs. in 000

FY	Year(x)	Value(y)
2064/65	1	10,466,226
2065/66	2	10,933,520
2066/67	3	15,731,804
2067/68	4	19,077,813
2068/69	5	27,247,386

Expected Income Tax Collection:

Rs. in 000

2069/70	29,203,334
2070/71	33,373,995
2071/72	37,544,656
2072/73	41,715,318
2073/74	45,885,979

Calculation of Expected VAT Collection up to FY 2073/74 using Microsoft Excel worksheet with TREND Function.

Original Data:

Rs. in 000

FY	Year(x)	Value(y)
2064/65	1	18,885,400
2065/66	2	21,613,043
2066/67	3	26,095,599
2067/68	4	29,815,702
2068/69	5	39,700,921

Expected VAT Collection:

Rs. in 000

2069/70	42,172,243
2070/71	47,155,613
2071/72	52,138,984
2072/73	57,122,354
2073/74	62,105,724

Calculation of Expected Composition of VAT-Internal Sources and Import up to FY 2070/71 using Microsoft Excel worksheet with TREND Function.

Original Data:

Rs. in 000

FY	Year(x)	Internal Sources	Import
		Value(y)	Value(y)
2069/70	1	6,614,973	12,270,427
2070/71	2	8,150,502	13,462,541
2071/72	3	9,631,330	16,464,269
2072/73	4	10,808,241	19,007,462
2073/74	5	13,918,493	25,782,428

Expected Composition of VAT-Internal Sources & Import:

FY	Internal Sources	Import
2069/70	15,004,142	27,168,102
2070/71	16,730,619	30,424,995
2071/72	18,457,097	33,681,887
2072/73	20,183,575	36,938,779
2073/74	21,910,053	40,195,672

Calculation of Expected VAT Registrants up to FY 2070/71 using Microsoft Excel worksheet with TREND Function.

Original Data:

	Year(x)	Value(y)
2064/65	1	39,776
2065/66	2	46,831
2066/67	3	52,965
2067/68	4	59,707
2068/69	5	69,653

Expected VAT Registrants:

2069/70	75,757
2070/71	82,838
2071/72	90,101
2072/73	97,364
2073/74	104,627

Calculation of Expected Information Non-Filers up to FY 2070/71 using Microsoft Excel worksheet with TREND Function.

Original Data:

FY	Year(x)	Value(y)
2064/65	1	8,492
2065/66	2	13,198
2066/67	3	7,098
2067/68	4	9,050
2068/69	5	13,040

Expected Information Non-Filers:

2069/70	11,660
2070/71	12,155
2071/72	12,650
2072/73	13,144
2073/74	13,639

Calculation of Expected no. of Cancellation up to FY 2065/66 using Microsoft Excel worksheet with TREND Function.

Original Data:

FY	Year(x)	Value(y)
2064/65	1	30
2065/66	2	36
2066/67	3	31
2067/68	4	150
2068/69	5	175

Expected no. of Cancellation:

2069/70	206
2070/71	246
2071/72	286
2072/73	327
2073/74	367

Appendix -5

Calculation of Correlation between VAT and Government Revenue using Microsoft Excel worksheet with CORREL Function.

Original Data:

Vat and Revenue Collection

in Rs.000

Year(FY)	VAT Collection	Revenue Collection
2064/65	18,885,400	36,556,530
2065/66	21,613,043	39,901,151
2066/67	26,095,599	51,789,586
2067/68	29,815,702	61,152,297
2068/69	39,700,921	85,019,150

Correlation Coefficient $r = +0.9983$

Correlation of Government Revenue with VAT is highly positive. Which means there is high degree of association between VAT and Government Revenue.

