

**TAX REFORMS IN NEPAL:
A STUDY OF NEPALESE VALUE ADDED TAX SYSTEM**

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RECOMMENDATION

This is to certify that the Thesis

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A STUDY OF NEPALESE VALUE ADDED TAX SYSTEM

It has been prepared as approved by this Department in the prescribed format of the Faculty of Management. This Thesis is forwarded for examination.

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DECLARATION

I hereby declare that the work reported in this thesis entitled “**TAX REFORMS IN NEPAL: A STUDY OF NEPALESE VALUE ADDED TAX SYSTEM**” submitted to Central Department of Management, Faculty of Management, Tribhuvan University is my original work. It is done in the form of partial fulfillment of the requirement for the Master’s Degree in Business Studies (MBS) under the supervision of **Prof. Dr. Upendra Koirala**.

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ABBREVIATIONS

| | |
|---------|--|
| C.VAT | Consumption Type Value Added Tax |
| DANIDA | Danish International Development Agency |
| DG | Director General |
| e.g. | For example |
| EC | European Community |
| EEC | European Economic Community |
| Fig. | Figure |
| FY | Fiscal Year |
| GDI | Gross Domestic Income |
| GDP | Gross Domestic Product |
| GON | Government of Nepal |
| GST | Goods & Service Tax |
| HIID | Harvard Institute for International Development |
| i.e. | That is |
| I.VAT | Income Type Value Added Tax |
| IRD | Inland Revenue Department |
| MBS | Master of Business Studies |
| MIS | Management Information System |
| MOD VAT | Modified Value Added Tax |
| MOF | Ministry of Finance |
| MST | Multi-stage Sales Tax (also Manufacture Level Sales Tax) |
| No. | Number |
| NRB | Nepal Rastra Bank |
| PAN | Permanent Account Number |
| P-VAT | Product Type Value Added Tax |

| | |
|-------|--|
| Rs. | Rupees |
| RST | Retail Level Sales Tax |
| SAARC | South Asian Association for Regional Co-operation |
| TPIN | Tax Payer's Identification Number |
| TR | Total Revenue |
| TXR | Total Tax Revenue |
| UML | United Marxist Leninist (Communist Party of Nepal) |
| USAID | United States Agency for International Development |
| VAT | Value Added Tax |
| viz. | Videlicet |
| vs. | Versus |
| WST | Wholesale Level Sales Tax |
| WTO | World Trade Organization |

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

1.1.1 Introduction to Tax

Economic development has been one of the most popular slogans in almost all the developing countries all over the world. Similarly, achievement of high rate of economic growth rate, reduction of income disparities and poverty and improvement of living standard of people are some development strategies towards which most of the government efforts have been directed in developing countries.

It is known that government needs more revenue mobilization for overall economic development and state welfare. Besides this, for meeting day-today expenditure, the government also requires some sources of income which is called revenue.

The role of revenue in the development of a country is not less important than the role of oxygen for the existence of human body. In this context, a government needs to mobilize a lot of internal resources to fulfill its responsibility towards its nation and people. In the developing country like Nepal, there is a necessity for raising a larger volume of funds for the development and administration expenses.

The revenue collection is a challenging task in itself which demands increasing necessity of regular expenditure in general and development expenditure in particular. However, resource mobilization is very low compelling the government to rely heavily on foreign assistance. Development expenditure has been dependent almost entirely on the foreign aid. External assistance is uncertain, precarious, inconvenient and not conducive to the healthy and overall development should there be heavy dependence on it. The foreign aids are not bad for economic development of the nation. But the experience of the most of the developing countries shows that there are negative effects of increasing international grants and loans to finance the public development activities. Thus the government should depend on its own resources for generating revenue in order to finance these regular and development activities.

The government can collect revenue from taxable and non taxable sources. Tax is a key source for revenue generation and mobilization. Different persons have defined taxation in different ways. In this respect, it would be better to take the definition

given by Prof. Seligman. In his words, “Tax is the compulsory contribution from a person to the government to defray expenses incurred in the common interest of all without reference to special benefit conferred.” From the definition given above, it can be said that firstly, a 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. The taxpayer does not have any right to receive the direct benefit from the tax paid. Due to this compulsory nature, people have expressed different views in satirical way about the taxation. In this respect, some say “Nothing is certain in this world but death and taxes”, some say “Death and taxes are both certain ... but death is not annual”; while others say “Death means stopping to pay tax”. Here, it should be noted that all compulsory payments are not taxes. For example, fines and fees are also compulsory payments without having direct benefit to the payer but they are not taxes because the objective is not to collect revenue but to curb certain types of offences. Secondly, the taxpayer cannot receive any quid pro quo for the payment of tax. The taxpayer does not receive equivalent benefit from the government. A tax is not a price paid by one for which he can claim for goods and services. The charge of price for goods and services by public authority is not a tax. Thirdly, the tax is paid to the government for running it. Fourthly, the amount is spent for common interest of the people. The tax is collected from haves and basically, spent for the interest of have-nots in the society. Fifthly, a natural or an artificial person pays the tax. (Kandel, 2004:3)

In conclusion, it can be said that a tax is a liability to pay an amount to the state on account of the fact that the assesses have income of a minimum amount from certain specified sources or that they own certain tangible or intangible property or that they carry on certain economic activities or they consume certain goods and services which have been chosen for taxation. (Kandel, 2004:3)

Taxes are major fiscal policy instruments and important government policy tools have an important role in increasing the rate of capital formation and thereby a high rate of economic growth can be achieved. Increase in taxes may be directed to increase in saving through the postponement of consumption. The increase in saving means a higher volume of resource is available for making useful and productive investments. Taxation may also play a dual role. On the one hand, it may be used to make the maximum volume of resource available to public sector. On the other hand, taxation may be used to promote useful investment in the private sector and to prevent the

resource from being dissipated over speculative and unproductive investment as well as over lavish and luxurious consumption. Thus, taxes in developing countries serve as the severe means of raising revenue. Therefore, Taxation may be utilized by the government as an effective tool for giving incentive to the proper growth of saving, investment and gross domestic product. But, in Nepal the tax policy is mostly guided towards the revenue generation.

1.1.1.1 Classification of Tax

There are so many effects of taxation; no single tax is completely perfect. Consequently, there must be a structure of taxation, combining a number of taxes, which the government can vary from time to time according to changes in emphasis on different objectives.

Depending on the methods of payment of taxes, taxes can be classified into two major categories, viz. direct taxes and indirect taxes.

A. Direct Taxes

Under direct taxes the person makes payment direct to the revenue authorities – the Inland Revenue Department (IRD) or the local authority. In the words of Dr. Dalton, “A direct tax is really paid by the person on whom it is legally imposed”. (Dhakal, 2001:2) Usually each individual’s tax liability is assessed separately. Some examples of direct taxes are briefly described below individually.

i. Income Tax

Under income tax, taxable income, which is subject to a basic tax rate, is arrived at after allowing deductions depending on circumstances from chargeable incomes. For natural person, taxable income is derived by deducting allowable deductions depending on marital status and other personal circumstances from admissible incomes and is subject to a basic rate with increasing rates above Rs. 160000.

ii. Corporate Tax

Tax imposed on income of corporate bodies is called corporate tax. All profits, whether distributed or not, are taxed. A part is transferred to shareholders and deducted in advance when the dividend is paid.

iii. Capital Gain Tax

A tax is levied on any capital gain when an asset is disposed of. These assets are land, buildings, long term investments, etc. Owner-occupied houses, cars, National Saving Certificates and goods and chattels worth less than a limit are excluded, and losses may be offset against gains.

iv. Capital Transfer Tax

Capital transfer tax applies to lifetime gifts as well as legacies.

v. Other Taxes

These consist of stamp duties (payable on financial contracts), vehicle tax, property tax, house and land tax etc.

Direct taxes yield more than two-thirds of total revenue. Their great merit is that being progressive and assessed according to the individual's circumstances; they ensure that the heaviest burdens are placed on the broadest backs. Their progressive character also gives additional weight to their role as built-in-stabilizers.

B. Indirect Taxes

Indirect taxes on goods and services are so called because the revenue authority (the Department of Customs/Excise) collects them from the seller, who, as far as possible, passes the burden on to the consumer by including the duty in the final selling price of the good. In the words of Dr. Dalton, "An indirect tax is imposed on one person but paid partly or wholly by another". (Dhakal, 2001:4). In other words, such tax is levied on one person who does not bear it from his/her own income. Instead, the tax liability is transferred by collecting it from customers by adding it to the price of goods or services.

The Indirect taxes may be:

i. Customs Duty

As per Section 2 (c) of Custom Duty Act 2019, customs duty means the customs duty payable at rates prescribed by Nepal Law from time to time on exports or imports.

ii. Excise Duty

As per Section 3 of the Excise Duty Act 2058, excise duty is charged on import and production of those goods and services, which are specifically mentioned in the schedule forming part of the Act. Those goods or services not covered by the Schedule are free from the boundary of the Act.

iii. Value Added Tax (VAT)

Value Added Tax is one of the indirect taxes which constitute the main topic and focus of the present research as well. What is VAT and how it is levied forms the main concern of the subject. So, this section obviously does not need any description in that the introductory description follows in the next section below.

1.1.1.2 Objectives of Tax

Tax is a permanent instrument for collecting revenues. It is a major source of revenue in developed world and has been appearing as an important source of revenue in the developing world like Nepal as well. It has been an instrument of social and economic policy for the government. However, the objective of taxation has been different for different periods. In ancient times, its objective was to strengthen the muscle of the state by raising more revenues for mobilizing these in security to an individual and society from violence, invasion, injustice and maintaining public institutions which can never be for the interest of an individual.

In modern days, the objective of tax is shifted from the security perspective to the economic development. The modern objective of taxation is not only to main peace and security, but also to conduct development activities.

From the above facts, we can enumerate the objectives of tax as given below:

- To raise revenue for ensuring resource mobilization
- To distribute equally wealth and income in the society
- To encourage the production of certain products
- To encourage employment
- To Boosting up the economy
- To contribute to the enforcement of government policy
- To remove regional disparities and imbalances. (Bhattarai & Koirala, 2010)

1.1.2 Value Added Tax

In the least developed countries like Nepal, the role of indirect tax is seen to be more important. Of the Indirect taxes, VAT is probably the best tax system and the most important innovation of the second half of the twentieth century, which is considered as an effective means to collect revenue as a reformed sales tax of indirect tax system. 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.

VAT is intended to be levied or charged whenever there is some value addition to raw material. The taxpayers on the other hand, will get credit for the amount of tax paid off at the stages of procurement. The value added tax system has proven to be effective in avoiding problems that normally might arise out of the double taxation of goods and services.

The lesson learnt of tax reforms in developing countries proves that VAT is the most important choice and ingredient of tax reform. It may be adopted by a developing country with no difficulty and is an important instrument for the mobilization of internal resources and the pressure of VAT on economic activities is minimal or not at all. The tax reform and adoption of a VAT, is therefore, essentially connected with the efforts of many underdeveloped countries to achieve the goal of economic development.

1.2 Focus of the Study

Nepal has adopted VAT since 1st Marga 2054 BS (November 16, 1997). In the present situation of Nepal, tax reform and adoption of VAT as a substitute of existing sales taxes is expected to improve the Nepal's tax system in various ways. The sales tax system is very narrowly based and less productive. It is also putting much pressure on economic activities by its distorted character. By contrast, VAT would broaden the tax base and increase the revenue elasticity. Hence the main focus of the study is to

find out how VAT is superior to sales tax and what is its share in the GDP (Gross Domestic Product), thereby showing a substantial change between the two periods i.e. before implementation of VAT and after its implementation. The study also critically assesses the administration of VAT in Nepal, analyzing the lapses and problems with necessary measures for improvement.

1.3 Statement of the Problem

In every country, the government collects its revenues through different sources. Out of which, taxes contribute a significant amount in the public revenues. The government mobilizes its revenues through budget in development activities for the public welfare and interests.

Nepal is an underdeveloped and one of the poorest countries in the world. It has low per capita income and more than one third people of the nation are living under the poverty line. The economic development and prosperity is very low. Foreign dependency and internal leakages has made government think for another option which is expected to increase the revenue. Moreover, fiscal deficit has been increasing due to the continuously growing expenditure and the low revenue performance in Nepal. In addition, the country has also been facing the increasing burden of foreign loan.

In Nepalese economic environment, how is VAT faring is the main concern here. There are several research questions which are given below:

- a) Is VAT superior to sales tax?
- b) Is present administration system of VAT sufficient to satisfy the need of the nation?
- c) Is there any significant change being observed in the revenue collection after implementation of VAT?
- d) How can VAT be made the backbone of Nepalese tax system?
- e) What is the practicing scenario of VAT in Nepal and what are the key problems of VAT implementation and possible correction measures?

1.4 Objectives of the Study

The main objective of this study is to ponder into theoretical knowledge of VAT and to analyze the practical aspects of the implementation of VAT in Nepalese context. The general objective of the study is to examine the various issues relating to VAT

and to provide useful views as well as suggestion. In this perspective, the specific objectives of the study are:

1. To explore the practice scenario of VAT in Nepal.
2. To analyze the effectiveness and problems of VAT in Nepal.
3. To find out the contribution of VAT in GDP, total revenue and tax revenue.
4. To identify the major problems of the effective implementation and suggest possible correction measures.

1.5 Significance of the Study

The scope of the study is to explore the practical scenario of VAT. In addition, it also finds out the contribution of VAT to Gross Domestic Product with the help of data since the VAT was implemented in Nepal. Moreover this study reveals comparative position of revenue yield before and after the VAT was implemented in Nepal. This will evaluate the effectiveness and shortcomings of VAT in Nepal. Another objective of this research is to find out the problem of effective VAT implementation and its possible correction measures. So the research is significant in the sense that its thorough study may facilitate the government making policy and solving the implementation problems and VAT relate issues. It may be helpful for the businessmen and the consumers as well who are still lost amid the confusion about the proper implication of VAT. They will also keep themselves informed about the current condition of VAT implementation in Nepal. It will help other researchers as well who are interested in doing research in this particular topic “VAT in Nepal”.

1.6 Limitations of the Study

The study has very limited area of investigation. It is only a part and partial analysis of the corpus of Tax system. The comprehensive study of the tax system is not possible in this research work due to its certain deadline for completion. The history of VAT is not so long in Nepal. When talking about VAT, it implicitly concerns the corpus of the taxation like income tax and others, but this study would not go that far. The information and data were collected from the IRD office, MOF and other concerned offices. Most of the data were taken from Economic Survey: 2010/2011. Due to time and resource limitation mainly secondary date were used in this study. So, it is largely dependent on the reliability of secondary data. The literature on VAT

is inadequate and scattered. These all constraints have limited the boundary of the study. Despite such limitations, the attempt has been made to make it profitable.

- (a) This study has been concentrated about the study of Value Added Tax in Nepal.
- (b) It is not a complete study of the whole tax system in Nepal.
- (c) Mainly secondary data has been used.
- (d) The views of respondents are collected only in the Kathmandu Valley.
- (e) Due to time and resource constraints, this study extends up to the period of 2010/2011 only.
- (f) Limited business organization, tax office, experts and the consumers are consulted to collect primary data

1.7 Organization of the Study

This study is divided into five chapters. Prior to the body of the thesis, several pages of preliminary materials such as title page, Viva-voce sheet, Recommendation, Declaration of the researcher, Acknowledgements, Table of contents, List of tables, List of figures and Abbreviations used have been included.

The first chapter is introduction which includes background of the study, brief description about Value Added Tax, statement of the problem, objectives of the study, needs and significance of the study, and limitations of the study.

The second chapter is the review of related literature which includes concept of Value Added Tax, Historical Background of VAT in Nepal, Legal Provision for VAT and Review of Related Previous Studies.

The third chapter is research methodology. This chapter includes the detail framework of the study, such as research method of population and sample, variable, research design, data collection procedure and presentation and analysis tools and techniques.

The fourth chapter comprises data presentation & analysis of data. In this chapter the primary and secondary data collected from various sources have been presented in a systematic format: such as tables, charts, and figures. These collected data have been analyzed by using different mathematical, statistical and analytical tools. In addition to that, the major findings of the study have been presented.

The fifth or the last chapter is concerned with the output of the study in the form of summary, conclusion and recommendation. This chapter consists of summary of the major findings of the study, concluding it with major recommendations and suggestions for future improvement and betterment of VAT in Nepal from both administrative and revenue perspective which may be a good reference to the VAT administrators, consumers, students, researchers and other professionals in the field of taxation in general and VAT in particular.

At the end of the study, bibliography and appendices have also been incorporated.

CHAPTER TWO

CONCEPTUAL BACKGROUND AND REVIEW OF LITERATURE

2.1 Conceptual Framework

2.1.1 Introduction to Value Added Tax (VAT)

Value Added Tax (VAT) is the most recent innovation in the field of taxation. Actually, VAT is considered as one of the most important tax reforms of the second half of twentieth century. It is a scientific tax system, which was first introduced in France in 1954. VAT is a family member of indirect tax. Indirect tax is called primary because the real burden of tax under this type can be shifted forward to the consumers. In other words, it is not borne directly by the person who pays it. As long as the real burden of the tax can be shifted forward, it is indirect.

Different experts and institutions have attempted to give the meaning of VAT. According to Ishwar Bhattarai and Girja Prasad Koirala, VAT is a general consumption tax assessed to the value added to goods and services. It is a general tax that applies in principle, to all commercial activities invoicing the production and distribution of goods and the provision of services. It is a consumption tax because it is borne ultimately by the final consumer. It is not a charge on companies. It is charged as a percentage of prices, which means that the actual tax burden is visible at each stage in the production and distribution chain. It is an indirect tax, in that the tax is collected from someone other than the person who actually bears the cost of the tax (namely the seller rather than the consumer) as VAT intended as a tax on consumption, exports (which are, by definition, consumed abroad) are usually not subject to VAT (Bhattarai and koirala, 2010).

According to Rup Bahadur khadka, Value Added Tax is not an additional tax but has replaced taxes such as sales tax, hotel tax, contract tax, and entertainment tax that use to be levied on the sale of goods and services (Khadka, 1997).

According to Wikipedia website,

A Value Added Tax (VAT) is a form of consumption tax from the perspective of the buyer, it is a tax on the purchase price from that the seller, it is a tax only on the value added to a product, material, or service, from an accounting point of view, by this stage of its manufacture or distribution. The manufacture remits to the government,

the difference between these two amount and relations the rest for themselves to offset the taxes they had previously paid on the inputs.

According to Economy Watch Website:

Value Added tax (VAT) is an indirect tax which is imposed on goods and services at each stage of production, starting from raw materials to final product. VAT is levied on the value additions at different stage of production. VAT is widely applied in the European countries. However, now a number of countries across the globe have adopted this system.

VAT, also known as goods and services tax or GST proves to be beneficial for the government. Implementation of this tax system, government can raise revenues invisibly, where the tax is not shown on the bill paid by the buyer. VAT is different from sales tax in various aspects. While sales tax in to be paid on the total value of the goods and services, VAT in levied on exchange of the product, so that consumers do not have to carry the total cost of tax. However VAT is generally not applied on export goods to avoid double taxation on the final product. However, if VAT is charged on export goods, the tax amount is usually refunded to the tax payer.

From the above definitions, it can be summarized that:

VAT applies to supplies of goods and services for consideration other than exempt goods by taxable person. VAT shall be charge on any supply of goods and services. VAT is tax on trading transaction the real VAT payer is the consumer not the producer.

- The VAT is a broad based tax as it covers the value added to each commodity by a form during all stage of production and distribution. It is a modern tax system to improve the collection of taxes, to increase efficiency and to reduce tax evasion. It is also regarded as the backbone of income tax system.
- VAT is levied on value added at each stage of production and distribution activities. The stage may be import, export, manufacturing, wholesaling and retailing.
- VAT is levied in the final price of the supply.
- VAT is indirect tax. However it is not new form of taxation. It is improve and modified form of traditional sales tax.

- It is believed to improve the collection of taxes, to increase efficiency and to lessen tax evasion.

In summary, the Value Added Tax system is designed to address various problems associated with the conventional sales tax system. It is a broad-based tax it is also covers the value added to each commodity by a firm during all stages of production and distribution.

It is a modern tax system to improve the collection of taxes, to increase efficiency and to lessen tax evasion. It is also regarded as the backbone of income tax system in Nepal. (IRD, 2011). As clarified by Chandramani Adhikari, it is also an improved and reformed sales tax (Adhikari, 2003). In sales tax, there is no provision for input tax credit, which means that the end consumer may pay tax on an input that has been already taxed previously. This is known as cascading and leads to increases consumer tax and price levels, which increases the rate of evasion and can be detrimental to economic growth. In contrast, the VAT that has been levied in the previous level can be deducted while paying taxes on the later levels. It has a special system where a person trying to deceive tax will be caught on either one of the subsequent levels. Therefore, the trend of tax evasion is highly discouraged.

2.1.2 Types of VAT

VAT has different types. They are categorized on several bases. The most important of them is the classification of VAT on the base of its treatment to capital goods. The VAT has typically classified in to three variants according to the way the capital goods are treated. They are:

A. Consumption Type VAT (C-VAT)

All capital goods purchased from other firms, in the year purchase are excluded 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 relived from tax while imports are taxed, the base of this tax becomes identical to the base of retails sales tax on consumer goods and services.

Nepal has adopted a consumption type multistage VAT system. Under this system, tax 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.

Consumption Type VAT = Gross Domestic Product – Cost Intermediate Goods – Cost of Capital Goods

B. Income Type VAT (I-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.

Income Type VAT = Gross Receipt – Cost Intermediate Goods – Depreciation

C. Gross Domestic Product Type VAT (P – 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.

GDP Type VAT = Gross Receipt – Cost of Intermediate Goods

2.1.3 Methods of Computation of VAT

There are three basic methods by which VAT can be calculated. They are:

- A. Tax credit method
- B. Subtraction method
- C. Addition method

The first two methods, tax credit method and subtraction methods are frequently used while addition method is rarely used.

A. Credit Method

Under this method, tax is imposed on total value of sales and tax payers are allowed to deduct from their suppliers and pass on to them. As compared to subtraction method, which deducts purchases from sales and levies tax on the difference, tax on purchases is subtracted from the tax as invoice method. (Bhattarai and koirala, 2010). Since the Value Added (VA) is sale value (SV) minus cost of purchased inputs (CPI) a given tax rate, say (t) the tax revenue (T) will be –

$$T = t.SV - t.CPI$$

The following example may help understand the credit method in better way. Let's suppose an importer imported a washing machine for Rs. 30,000.00. VAT was paid on its import. This product passes through three stages before reaching to final consumer. The value added (profit) by each businessman on the cost price are: import – 30%, manufacturer – 50%, wholesaler – 20% and retailer – 10%. The VAT is calculated in the following table with all the given information.

Table - 2.1

Calculation of VAT Under the Credit Method (in Rs.)

| Stages | CPI – VAT | Added Value | S.V – VAT | VAT@13% | SV+ VAT | VAT |
|----------------------------|-----------|-------------|-----------|---------|---------|------|
| Imported washing machine | 30000 | - | - | 3900 | - | 3900 |
| importer to manufacture | 30000 | 9000 | 39000 | 5070 | 44070 | 1170 |
| manufacturer to wholesaler | 39000 | 19500 | 58500 | 7605 | 66105 | 2535 |
| wholesaler to retailer | 58500 | 11700 | 70200 | 9126 | 79326 | 1521 |
| retailer to costumer | 70200 | 7020 | 77220 | 10039 | 87259 | 913 |

B. Subtraction Method

Under this method, each merchant's tax liability is computed by applying the applicable VAT rate to the difference between his/her total sales (inclusive of the VAT element in his purchase price). Hence, unlike the credit method, the amount of VAT connected with a taxable transaction is not required to be explicitly stated on the associated invoice (Howell, 1995). This method is appropriate for the consumption variant of VAT. The tax revenue under this method can be calculated by using this formula:

$$T = t (SV - CPI)$$

Table -2.2

Calculation of VAT Under Subtraction Method (in Rs.)

| Phases of production and distribution | Net purchase price (CPI) | Net sales (SV) | Value added (SV – CPI) | VAT@13% |
|--|---------------------------------|-----------------------|-------------------------------|----------------|
| Raw materials producer | - | 4000.00 | 4000.00 | 520.00 |
| Producer | 4000.00 | 5500.00 | 1500.00 | 195.00 |
| Wholesaler | 5500.00 | 6800.00 | 1300.00 | 169.00 |
| Retailer | 6800.00 | 7500.00 | 700.00 | 91.00 |
| Total | 16300.00 | 23800 | 6500.00 | 975.00 |

C. Addition Method

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

2.1.4 Principles of VAT

There are two principles for levying VAT.

A. Original 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 revenue loss. It also discourages the exports either directly or indirectly.

B. 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 all imports while exports are relieved from VAT by means 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.

2.1.5 History and Development of VAT

Tax is collected by government to meet the need of budget. Among the various types of tax, the sales tax is one of the major sources. VAT is the most scientific system of sales tax. In the early days, the tax from the consumption and production is collected as sales tax. But now, it is almost completely replaced by the VAT. The concept of VAT was introduced in 1919 by Dr. Wilhem Von Sieman in Germany. This concept was brought to replace the 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 multi stage tax is reduced instead of the implementation of VAT. In 1921, the America was implementing the corporate income tax. Pro.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. France, the first implementer of VAT, extended it to the retail level for the first time. And Germany also adopted VAT in the same year. In 1969, the countries like Netherlands and Sweden also adopted VAT in their countries. In 1970, 1971 and 1973, Luxembourg, Belgium and Ireland introduced the VAT respectively.

In Asia, Vietnam was the first country to introduce this most scientific tax system. The country adopted VAT in 1973. The trend being VAT popular was increasing all over the world. In 1977, 1984, 1985, 1986, South Korea, China, Indonesia and Taiwan introduced VAT respectively. Similarly, VAT was introduced by Philippine in 1988, Japan in 1989, Thailand in 1992 and Singapore in 1994. In SAARC region, Pakistan was the first adaptor of VAT. It implemented VAT in 1990. 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. But some state did not adopt of VAT for political reasons. Majority of the state embraced VAT, states like Andhra Pradesh and Maharastra taking the lead. The Empowered Committee, constituted by Government of India, provided the basic framework for uniform VAT laws in the states but due to the federal nature of Indian constitution, States do have a liberty to set their own valuations for the VAT levied in their own territory. India introduced the full VAT in some prescribed regions of the country on April 1, 2005. Around 130 countries have introduced VAT system across the world. The list below shows the chronology in which VAT was implemented in different countries.

Table-2.3**Implementation of VAT in Different Countries in the Chronological Order**

| year | Countries that have Started Adopting VAT |
|-------------|--|
| 1954 | France |
| 1960 | Ivory Coast |
| 1961 | Senegal |
| 1967 | Brazil, Denmark |
| 1968 | Germany, Uruguay |
| 1969 | Netherland, Sweden |
| 1970 | Ecuador, Luxemburg, Norway |
| 1971 | Belgium |
| 1972 | Ireland |
| 1973 | Austria, Bolivia, Italy, United Kingdom, Vietnam |
| 1974 | Argentina, Chile, Colombia, Cost Rica, Nicaragua |
| 1976 | Honduras, Israel, Peru |
| 1977 | South Korea, Panama |
| 1980 | Mexico |
| 1982 | Haiti |
| 1983 | Dominican Republic, Guatemala |
| 1984 | Republic of China |
| 1985 | Indonesia, Turkey |

| | |
|------|---|
| 1986 | Morocco, Newzeland, Nigeria, Portugal, Spain, Taiwan |
| 1987 | Grenada, Greece |
| 1988 | Hungary, Philippines, Tunisia |
| 1989 | Japan, Malawi |
| 1990 | Iceland, Kenya, Pakistan, Trended, and Tobago |
| 1991 | Bangladesh, Berlin, Canada, Jamaica, Mali, Algeria, South Africa, Armenia, Azerbaijan, Cyprus, EL Salvador, Fiji, Kazakhstan, |
| 1992 | Tajikistan, Belorussia, Kyrgyzstan Russia, Thailand, Turkmenistan, Ukraine, Uzbekistan, Moldova |
| 1993 | Bulgaria, Finland, Lithuania, Singapore, Western Samoa, Madagascar, Niger |
| 1994 | Burkina Faso, Czech Republic, Paraguay, Poland, Romania, Georgia Slovak Republic, Venezuela |
| 1995 | Gabon, Ghana, Switzerland, Zambia, Malta, Latvia, Liechtenstein, Mauritania |
| 1996 | Albania ,Belize, Guinea, Uganda, |
| 1997 | Barbados, Congo, Nepal |
| 1998 | Croatia, Mongolia, Srilanka, Tanzania Vanuatu Surinam , French poly Nosier |
| 1999 | Cambodia, Cameron, Mozambique, Netherlands, Papua New Guinea, Slovenia, New jersey |
| 2000 | Australia, Chad, Macedonia, Namibia, Sudan |
| 2001 | Botswana, Rwanda |

| | |
|------|---------|
| 2002 | Lebanon |
| 2005 | India |

(Source: The VAT Project Office (Revenue Administration Support), IRD, IRD/DANIDA, 2001.)

* India has implemented modified VAT system since 1986. This system is not exactly a VAT system.

2.1.6 Reason for the Increasing Popularity of VAT

Although VAT has been first adopted just about half century ago, as compared to other traditional tax system, it gained its momentum in little time. It is a precondition to have adopted VAT for any European countries to become a member of EEC. This precondition plays a vital role in the popularization of VAT.

VAT does not bring any unintended and undesirable effects in the methods of production and distribution or in consumption. That is why it is natural with respect to the choice of method of production and distribution. Since the tax is levied only on the value. It is efficient too. Added at each stage in the system, tax liability remains the same regardless of the system of depend on the rate of tax and on the total value added (i. e. the final price) of the commodity but not on the number of states through which it has passed.

This VAT does not affect the preference of the consumer. VAT is neutral with respect to consumer's choice. VAT does not affect the relative price. Consequently, there is no need for the consumer to shift from one commodity to the other as responsive to tax. It also avoids probable distortions of the optimum allocation of resources.

VAT is charged equally on all goods Therefore, it is more equitable in the sense that it falls equally on all goods and gathers a different proportion of value added at various stages.

Exports are commonly relieved from taxation in order to maintain the competitive power of domestic manufactures in the international market. This promotes exports is refunded to exporters. It is comparatively easier to refund the exact amount of tax levied on exports under VAT.

Under VAT system especially when the invoice method is adopted, the exact amount of tax can be shifted forward to the consumer. Another reason for the growing popularity of VAT is that this tax avoids the problem of cascading or pyramiding.

There is tremendous scope for increasing the revenue from VAT. It offers greater revenue potentiality as compared to other forms of sales taxes. VAT is an improved version of sales tax, which has the virtue of mobilizing substantial amount of revenue.

VAT is favorable from the administrative point of view also. VAT is favored on the ground that as the base of this tax is broad; a relatively low rate reduces the possibility of tax evasion. Since the tax burden is distributed among a large number of taxpayers under the VAT system, it does not put a heavy burden on a taxpayer and hence avoids the chance of considerable tax evasion.

In summary, VAT is a modern and transparent tax. It is less distorted and more revenue productive. That is why this tax has become a popular topic for tax reform and has been spreading all over the world since the late 1960s. The attractiveness for VAT across the nation has proved that it is preferred not merely for raising revenue but also its avoiding multiple distortions as created by other forms of sales tax. In the process of economic liberalization and globalization, VAT makes the tax system flexible and the bracket widen. All this indicates that the VAT is the tax system of the present day.

2.2 VAT in Nepal

2.2.1 History and Development of VAT in Nepal

In the eighties, various countries, to maintain a sound macroeconomic policy, adopted various types of reform programs. This program was in swing in 1990's. As the adoption of reform program was at the heart of worldwide policies. Nepal was no exception. The Nepalese government revealed its intention for the adoption of various reform programs to promote market oriented economy in the Eighth Plan (1990-1995) document. In a process to reform tax policy, it has mentioned that some time in the mid-plan period a VAT will be introduced in the country. Before that VAT was completely unknown word to the general people of Nepal. After a restoration of democracy in 1992/93, a two-tier sales tax system was in function at that period.

Under this system dealers and distribution of nine-selected items were required to register for sales tax purpose and collect tax on their sales. It was extended further to

five more items in 1993/94. Only the amount of tax paid to manufactures was allowed to credit. Further, sole distribution or agents of the foreign firm or companies and their wholesalers were also required to register for the purpose of collection of sales tax.

As a part of its liberal economic policy, the government of Nepal asked donors to study the VAT system. Finally a VAT task force was created in the Sales Tax and Excise Department in 1993. United States Agency for International Development (USAID) and Consultancy Assistance for Economic Reform for International Development (HIID) started the study in order to makes the necessary preparation for the introduction of VAT. The task force was fully devoted to accomplishing preparatory work. It prepared the draft for VAT legislation, organization, staffing and exemptions. Due to political instability and frequent changes in the priority for the implementation of VAT, the task force could not continue its job. At the time of creation of task force, the Nepali congress was in absolute majority in the parliament.

A mid-term poll changed the political scenario. The United Marxist-Leninist (UML) party created a minority government whereas the Nepali congress became the opposition party. The government led by UML could not reveal its positive attitude towards the implementation of VAT. In the contrary, the two-tier sales tax was declared to be removed in its 1994/95 budget. This negative step hurt the donor agencies and consequently the USAID suspended its support and Harvard Institute for International Development's experts returned. The VAT task force was dismantled.

Soon after the verdict of the Supreme Court to re-install the dissolved parliament, a coalition government led by Nepali congress, formed and it showed as earlier, a firm commitment to introduce VAT in its F/Y 1996/97 budget. The USAID resumed its support but its allocated for the study of VAT had already been transferred to other projects. Again, scarcity of fund is realized by the government and search of the donor who can provide the necessary fund and technical assistance for the implementation of VAT. After all, the DANIDA supported the VAT project. It is continuously supporting till now.

As a part of preparatory work, the VAT Act was passed in 1996 by the parliament. The government in 1997 approved VAT Regulations. In the same year, the department of sales Tax and Excise were renamed as the Department of Value Added

Tax (VAT). After a year, the Ministry of Finance approved nine volumes of manuals. Furthermore, VAT Taskforce organized a various discussion and interaction program related to VAT in different parts of the country. Various introductory brochures were published and distributed to the potential taxpayers, businessmen and the administrative staffs.

The VAT was initially scheduled to be effective from July 1997. The government was planned to register the potential taxpayer in VAT from this period. In support of VAT, the government decided to rationalize the tax structure by educating the rate of income tax, sales tax and custom duties in advance. The VAT was to replace the Hotel Tax, the entertainment Tax and the Contract Tax. For this purpose the VAT task force was preparing its work in accordance with the schedule. Meanwhile the private sector of business field opposed the government policy on adoption of VAT. Nepal Chamber of Commerce held a nationwide discussion program among traders, businessmen, industrialists and their representative association in March 1997 to collect the attitude towards the introduction of VAT in Nepal. Most of the business community showed their dislike to the VAT which was scheduled to be operated from two month later.

Business persons protested the decision of the adopting of VAT with the slogan "No VAT" issue of VAT resulting in a conflict between the government and the private sector. Confrontation continued for a long time. Accepting the increasing pressure of business sector, finally the government decided to postpone the date of application for four months. The government also announced the date for the VAT to be effective from November 16, 1997. With a view to facilitating the functioning of VAT the government made an arrangement in the budget for F/Y 1997/98 to convert the Hotel tax into the Sales tax. The rate of the sales tax reduced from 15 percent to 10 percent. Further the rate and the slab of income tax and customs duty were also lowered. The government took a heavy revenue risk by curtailing the rate and structures of various taxes without prior demand of the taxpayers.

Whatever reasons were laid for the postponement of the effective date of VAT, the preparatory team got a very valuable time for the preparation of VAT. The government and its associated body tried to convince the business community in favor of VAT. It was really a very hard work to implant VAT without the dull cooperation of business community. The VAT project, Ministry of Finance as well as Department

of VAT devoted the extended period of making friendly relations by providing more training, information campaign meetings, talk program and interaction program between different groups of people.

In the mean time the business group was also divided into two groups. Industrialist was in favor of VAT whereas the trading group was against it. Despite heavy protest by the trading group, the government implemented the VAT from the scheduled date of November 16, 1997.

Even after the adoption of VAT the days were not as easy as expected. Trading businessmen were completely against the VAT whereas industrialists were in favor of it with heavy concession on various taxes. The government announced all the concessions without prior plan in budget speech four month before the date of VAT implementation, which could not motivate the businessmen. On the one hand the businessmen enjoyed the privilege provided by the government for the successful enforcement of VAT, on the other they continued to protest against VAT.

Political situation was also volatile. The government was in a pressure to quit. As usual, the businessmen were against VAT. Industrialists were in favor of further concession in tax regime that was against the principle of VAT. VAT administrators were not fully aware of its system. Due to various reasons VAT could not function as expected. The business community demanded the continuation of all exemptions and incentives granted under the sales tax system.

Businessmen were also very angry at the function of octroi, a local tax. FNCCI, an apex body of private sector, decided on February 4, 1998 that they would not sit for negotiations with the government regarding the implementation of VAT unless the government scrapped out octroi.

On March 1998, the government and the private sector reached an agreement regarding the modalities of the implementation of VAT. Exemption of industrial machinery and tractors, soft behave towards the retailer, acceptance of the bill value in import point, set up a committee in order to review the VAT law and establishment of permanent revenue board where the main agreement. Since most of the agreed points were not activated the businessmen again began to oppose VAT. A series of discussion took place before the presentation for the F/Y 1998/99 budget. The demands of Businessmen were increasing considering the volatile situation of the

political party. The government requested for the agreement but the businessmen rejected the proposal and did not sign in agreement. Even though the government addressed few issues that were asked by the businessmen, Finance Bill 1998 incorporated following changes.

- The threshold was increased from Rs. 1 million to Rs. 2 million.
- Cottage industry got relief from the registration in VAT.
- A special arrangement to be provided to settle the old stock of businessmen.
- The rate of interest was reduced to 15 percent from 18 percent.
- The rate of penalty of the late filing of return fixed at 0.1 percent per day instead of 100 percent.
- Tax offices were empowered to issue a tax assessment if tax payer cannot justify the reason for under invoicing.
- Firms, companies and industries are required to issue serially numbered invoice with their names and addresses. The VAT administration may inspect, with prior approval of the DG of the VAT Department, the books of accounts of unregistered vendors in connection with VAT, and may penalize if the books of accounts are not maintained properly.
- A list of exempted items increased.

Despite above mentioned provision, the government also announced the several measures in the field of income tax, customs duty and revenue investigation with a view to rationalize the tax in accordance with VAT principle. Provision of some curative measures provided for the simplification of tax collection irritated businessmen more than were attracted towards it. They continue to oppose the VAT system vigorously.

Finally both parties agreed not to implement the provisions provided by the Finance Act until they reached an agreement. Ultimately, both parties agreed on 39 points on September 1998. Most of the agreement was in connection with the further exemptions and concessions in various fields VAT as well as to the taxes. Few of them were in adverse direction of VAT principle.

VAT administration had allocated a TPIN (taxpayer identification Number) consisting of nine digits to registered taxpayer with a view to process data in computer. It was developed as per international standard. Last ninth digit was for checking the

accuracy of the number, which is called check number. All the records of taxpayer are stored in the computer in database format. As the computer processed all the data of taxpayer, it has become an integral part of VAT administration. Before that all the records were kept manually.

In accordance with the purpose of integrating VAT and Tax department into one department from coming year a provision was made in Finance Act, 1999 that “A PAN (Permanent Account Number) was allocated to the registrant of income tax from the next fiscal year”. For this purpose a Taxpayer service center established under the department of Tax. PAN was also similar to TPIN. Those tax payers who have already received the TPIN were converted to PAN with same number. The service of this center was only confined to nine offices of Kathmandu valley.

Issuance of PAN was accessed to all tax payers of the country from December 16, 1999 after the establishment of Inland Revenue Department (IRD). For the simplification of management of date, a database computer system has been developed since the inception of VAT in Nepal.

With a view to provide all the services from the same window and to make effective mobilization of internal resource, the government decided to integrate the Department of VAT and department of Tax. The department of VAT merged into department of Tax on April, 2000. Through the budget speech for F/Y 2001/02, the government announced to establish “Inland Revenue Department” from July 2000.

Before the merger, there were 17 offices under the VAT Department and 41 offices under the Tax Department. To over the whole kingdom of Nepal, all those offices merged together and established 21 offices on the basis of including geographical region, number of taxpayer, taxpayer services and potentially of tax collection. Out of them, four offices were classified into “A” class, tow into “B” lass, five into “C” class, five into “D” class and Five into “E” class. Officials and staffs wee reorganized according to its work load. The newly established department will administer the following taxes from the same window.

1. Income tax (individual and corporate income tax, Remuneration income tax, interest tax, house rent tax.)
2. Value added tax.
3. Non-tax (dividend, principal and interest payment, royalty, charges and fees)

4. Other related charges and fees related to excisable goods.

VAT has been justified in the light of government fiscal imbalances and need for extra revenue mobilization through an efficient tax system. The Government of Nepal has increased VAT to 13% from 10% effective from Magh 1, 2061.

2.2.2 Basic Features of Nepalese VAT System

The following are the main features of the Nepalese VAT system.

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

2.2.3 Coverage of VAT in Nepal

VAT is a tax on goods and services consumed in Nepal. The tax is based on the principle that each producer or distributor adds value, in some way, to the materials they have purchased and it is this added value that is taxed at each stage of the production and distribution. The coverage of VAT in Nepal is based on transfer, sales, supply, import and export of goods and services except some special provisions. It is levied on the value added at each stage of the production or distribution. Every persons or firms or companies, who are involved in such transaction liable to pay and collect tax. The actual coverage is structured by the standard and zero rates as well as tax exempted provisions. In other words, tax coverage is guided by tax invoice system. VAT is administered by invoice method.

2.2.3.1 Standard Rated Areas

Nepal has adopted “Inclusive Basket System” which means board-based tax coverage. Under this system all transactions regarding transfer, sales, supply, imports and exports of goods and services, where value added exists are taxable, except some special provisions. The Value Added Tax Act 1995 has made provision for exempted goods and services under special law. Unless this provision, all the value added economic transactions are taxable and tax is collected at the rate of 13 percent. This is called standard rated area.

2.2.3.2 Zero Rated Areas

Under the VAT systems some goods and services are, or may be, taxed at zero-rate. The objective of this zero rate is to relieve some goods and services from taxation working under regular VAT system and net for the purpose of promoting and encouraging export and maintaining diplomatic behaviors. Under this, purchaser is allowed to credit the tax paid on inputs or purchase in concern. However, one has to maintain all records regarding VAT. The VAT is meant to apply only to the consumption of goods and services in Nepal. Supplies made in Nepal that are exported are taxable at zero-rate. Exporters are allowed to claim input tax credits for VAT paid or payable on purchases of goods and services relating to their commercial activities. Exports taxed at zero percent include exports of both goods and services. (Detailed in Appendix – III)

2.2.3.3 Exempted Goods and Services

Exemption simply suggests to an exclusion of a certain kinds of business transaction or a person from the tax net. If the objective of the government is to make me vendor free from the responsibility for registering and paying tax, but to keep some tax on the final purchaser, exemption is a suitable measure. If it is desirable to keep certain goods or services or transactions outside the tax net, then they should be exempt from VAT, exempt transactions are not subject to tax out no credit is allowed for tax paid on inputs. Exemption, thus, implies tile exclusion of certain goods and services from the tax jurisdiction. For example, if exports are exempt, exporters are not required to register under VAT. They do not need to collect VAT on their output and cannot claim for input tax credit.

Exemption of goods and services are granted on different grounds. Goods and services of basic needs are exempted on the ground of social welfare to maintain the equity norms. Similarly, some goods and services are exempted with the view of administrative simplicity. It is better not to bring the unorganized small vendors and scattered business firms into VAT. Again, the exemption technique is applied for selected goods and services to encourage their investment and production.

In Nepal, several goods and services are exempt on administrative and social ground. The list of exempted goods and services from VAT is presented below.

- Basic agriculture products
- Goods of basic needs
- live animals and animal products agriculture inputs
- Medicine, medical and similar health services
- Education
- Books, Newspaper etc
- Artistic and cultural goods and services, caring services
- personal or professional services
- Land and Building
- Betting, casinos, lotteries (Detailed in Appendix – II)

2.2.4 Tax Administration

In general the prime goals of VAT administration are to promote voluntary compliance and to promote the VAT revenue by effective, efficient and economic way. Identification of tax payers, tax registration, processing of returns, tax audit, assessments, collection, credit, refund and control of stop filers are main functional areas of tax administration. In the Nepalese periphery, Ministry of Finance is the main responsible body for collecting financial resources and managing the public expenditure. Department of Customs, Revenue Administration Training Centre, Department of Revenue Investigation and Inland Revenue Department are the wings of Ministry of Finance. Previously the VAT was administered by Department of Value Added Tax. By 2001- 2002, the government merged the Department of Taxation and the Department of Value Added Tax and named it “Inland Revenue Department (IRD). IRD is currently responsible for the administration of the taxes like Income Taxes, Corporate Taxes, Value Added Tax, Excises and certain fees and

duties like Entertainment fee, Film Development Fee, Tourism Development Fee, Liquor control duty, Smoking liquor duty, special fee, etc. Likewise the department is also responsible for monitoring the non-tax revenue of the Government. This Department is located in the Kathmandu Valley. Under IRD there are 21 Inland Revenue Offices through the country. These offices and department jointly administer the VAT as well as income taxes. The Government of Nepal has the authority to appoint Tax officers in required numbers. Similarly, the jurisdiction of a Tax officer should also be prescribed by the Government. All the tax officials are the civil servants under the revenue service. Thus, IRD is the authority to mobilize inland revenues including VAT.

The IRD has functional organizational structure. From operational point of view it has been divided into two wings. One is policy related and other is operational wing. The operational wing contains six functional works and these are taxpayer service, tax audit, investigation, collection, tax refund and others. Similarly policy related wing contains the sections related to personnel administration. The Government of Nepal may delegate tax administration related authority to other government officer. Similarly the VAT Act has provided the authority to the Government to define the jurisdiction of tax officers. Thus the department carries out the functions such as tax administration, making tax policy, tax treaty and International taxation, review and appeal related tax matters, advance ruling, tax enforcement and investigation, tax audit, tax refund, excise and liquor administration, tax payer services. (Adhikari, 2003)

2.2.4.1 Registration (VAT Act 2052: Sec 10)

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

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

As a government agent for the purpose of the VAT collection, the obligations of the VAT registrant are as follows.

- Submit VAT return and pay the collected VAT amount within the 25th day of the following month.

- Provide tax invoice to their customer.
- Maintain purchase and sales book separately for the VAT purpose.
- Keep their VAT record for a period of 6 years.
- Inform the IRD office of changes to the business including new address, telephone number or a reorganization of a partnership within 15 days.
- Put their certificate of registration in the premises where customers may easily see and read it.
- Allow tax officers to enter the business to examine the business records and the stock on hand.

Most business will required only minor modifications to their record keeping. In order to complete his VAT return a taxpayer will need to ensure that his books in records provide:

- The amount of VAT paid on purchases.
- The amount of VAT collected on sales.
- A method of distinguishing between taxable and exempt sales.
- The time the goods and service were supplied and
- Evidences that goods were exported, if any

2.2.4.2 Deregistration (VAT Act 2052: Sec 11)

A VAT registration may be cancelled by anyone whose total taxable sales for consecutive calendar quarters is not more than Rs. 2000000 and who has been registered for a full fiscal year or by persons who no longer have commercial activities. Regarding the cancellation of registration the VAT act has mentioned the following conditions:

- If the organization is closed or transferred or collapse in case of corporate body.
- If the business is running under proprietorship with the owner dead.
- If the partnership is dissolved.
- If the distributor or producer stops selling or producing taxable goods and services.
- If the business was registered by m mistake.

Regarding the cancellation, the tax officer collects the tax on the capital and others goods that tax credit facility has been taken by taxpayer previously. The categories falling under this ground neither are required to collect VAT nor allowed to claim a refund of the VAT that they have in producing their goods and services for sale. (Adhikari, 2003)

2.2.4.3 Accounting (VAT Regulation Act 1996)

The effectiveness of VAT depends on the VAT accounting system. It should neither contain unnecessary details nor is inadequate so that it cannot provide appropriate and useful information. The VAT accounting should be information-based as well as less costly. The accounting in VAT consists in the process of maintaining purchase, sales book, VAT account and stock. Thus Purchase and Sales books are the main part of VAT accounting. The Purchase book contains such information as TPIN, the supplier's name with TPIN, The customer's name with TPIN. Similarly in the sales book date, invoice number, name and number of the supplier, purchase price and taxable price of the import, taxable value and the amounts of VAT should be recorded. The Purchase book is a certified register. The registrants should maintain or record all the purchases during the period, all the goods and services either taxable or non-taxable appearing in separate columns. Likewise, the sales book is another main part of VAT accounting. It should be posted on the basis of sales invoices chronologically showing the amount of standard and zero-rated sales amount and the tax amount. At the end of tax period it should be totaled while mentioning the amounts in the VAT account. The VAT account is monthly summary showing the sources of the figures used in the VAT return. In order to complete the VAT return, a taxpayer should need to ensure that the amount of VAT paid on purchase, the amount of VAT collected on sales, a method of distinguishing between taxable and exempt sales, the time of goods and services supplied and proof that goods were exported. (Adhikari, 2003)

2.2.4.4 VAT Invoices (VAT Regulation Act 1996)

Every registrant is required to issue a tax invoice to the recipient in supplying any goods and services. The specimen of an invoice has been prescribed in schedule 5 and 6 of VAT regulation 1997. it is necessary to mention seller's PAN, buyers PAN whether it is registered in VAT or not, address of sellers and buyers, date of

transaction, date of invoice issue, description and price of goods and VAT amount on the tax invoice issue, description and price of goods and VAT amount on the tax invoice. The invoice must be issued in sequential order for the starting of every fiscal year. A minimum of three copies of each invoice must be raised. First copy must be provided to purchase mentioning tax invoice.

Only retailers are facilitating to issue abbreviated invoice with prior approval of tax officer. It is not necessary to mention details in abbreviated invoice as shown in tax invoice. It can't be issued for transaction exceeding Rs. 5000 including VAT. It also must be issued in sequential order. It shall be the duty of a registered person to provide a tax invoice who asks for. A recipient who receives and abbreviated tax invoice shall not be allowed to edit the input tax. In an abbreviated tax invoice, tax is calculated by multiplying the sales value by rate of tax divide by adding 100 to rate of tax.

2.2.4.5 Return Filing (Sec 18)

VAT is based on self-assessment system. Tax payer himself calculations all taxes.

Every registered taxpayer required submitting the return to a tax officer within twenty-five days after the close of tax period. Such return all have to be submitted whether or not a taxable transaction was carried out in that tax period. Failure to submit return in specified time is penalized.

2.2.4.6 VAT Collection

The producers and suppliers are the agents for tax collection on behalf of the Department or VAT administration. Usually they collect VAT on sales and deposit the collected amount after crediting the tax (if any amount remains) in prescribed public treasury account. Tax should be collected in selling price that comprises the costs related to transportation and distribution expenses as well as profit. Excise duty, custom and other tax except income taxes are also included under the selling price. But the trade discount and trade commission are not included. A person who is not registrant is not entitled to collect tax. The collection of VAT is not the responsibility only of the business community but also of the Revenue Offices. In Nepalese context, if the taxpayer fails to deposit collected tax by regular system, the tax officer may implement various methods and measures to collect the tax arrears. These methods they may employ are as follows:

- Deducting the tax from the refundable tax amount
- Possessing the taxpayer's fixed and current account
- Auctioning the property own by the taxpayer.
- Deducting from the bank account
- Deducting from the amount payable to taxpayers by Government offices or
- Government owned enterprises.
- Deducting from the amount payable by the third person with the prior approval of the taxpayer.
- Blocking the taxpayers' export-import business. (Adhikari, 2003)

2.2.4.7 Tax Credit

VAT is grounded on tax credit method. All the tax paid on purchase of goods and Services, including assets, stationery and other expenses, related to business are allowed to credit full amount from the output tax collected on sales. There are some good, which is very difficult to ascertain whether stated in rule 41(1), tax may not be deducted in respect to the following goods and services.

- Beverages;
- Alcohol or alcohol mixed beverages such as liquors and beers;
- Petrol;
- Entertainment expenses.

Some goods are used for the both purposes of the business and personal use. Tax paid to the following goods may be deducted on the following proportions.

- On all aircraft, 40 percent of purchase value;
- On automobiles (any motor vehicle with three or more wheels used on a road for carriage of passenger, 40 percent of purchase value);
- On computer, 60 percent of purchase value;

2.2.4.8 Assessment

VAT is self assessed tax. Taxpayers assessed their liability themselves. They are self allowed to get credit tax paid on purchase. Self-assessment system is developed in the assumption does not satisfy. Taxpayer may assess wrongly o may fail to pay correct tax. To correct this situation there is a provision of management tax assessment,

which is done by the tax officials. Following criteria has been fixed for management tax assessment.

- (a) If tax is not fields
- (b) If tax return is filed lately
- (c) If tax return contains incomplete information or
- (d) If tax official has reason to believe the tax is not genuine.

2.2.4.9 Refund

Excess of input tax over output tax in any tax period can be adjusted in the following tax period by carrying forward to next period or can claim for refund to the tax office. Two major criteria have been fixed in VAT law for the claim of refund by taxpayer. IT is allowed to claim either by regular export basis or by regular six months credit basis. Exporter having more than fifty percent export to total sales is treated as regular exporters. There is also a separate provision of refund for the diplomat and foreign aided projects. They are allowed to claim refund immediately.

2.2.4.10 MIS (Management Information System)

The tax system should be backed by good and effective information technology which must be taxpayers friendly and conducive to the tax administration as well. A scientific information system provides highly sophisticated and standardized services to the tax payers, providing them with needed and adequate information at the right time and also to the management and the decision makers. To meet this very purpose, a separate department called “Information Technology Section (IT Section), is separately installed. Management Information System (MIS) does the following functions:

- Processing of tax application form and related information.
- Updating the taxpayers’ individual accounts.
- Entering, Processing and preservation of the central data. Preparing of master record in database format regarding tax collection, refund, Tax credit, registration, de-registration and the business closure.
- Managing of integrated information between department and field offices.
- Managing and preservation of data and information for a long period.

The IRD posts the data in taxpayers' account and sends the result to the related Revenue offices. The information of taxpayer is kept confidential according to VAT Act. DANIDA VAT Project has contributed a lot to systematization of the MIS in Nepal. (Adhikari, 2003)

2.2.4.11 Appeal

A taxpayer may file an appeal to the Revenue Tribunal within 35 days against tax assessment or penalty charged by a tax officer or an order by the Director General relating to the suspension of this place of transaction. A provision of appeal to director general has also been included in first amendment in VAT act as a choice to taxpayer. Before filing the appeal the taxpayer must deposit the disputed amount of the assessed tax due the rest of the amount of the tax due plus the whole amount of the fine shall have to be deposited or a bank guarantee of the same has to be provided.

2.2.4.12 Offences and Penalties

In the VAT Act, there is a special provision for the offences and penalties too. The registrant is liable to fine or a penalty, if he fails to use the registration number or does not clearly display his registration certificate, fails to file a return, does not issue invoices, fails to keep an up-to-date account of transaction, obstruct the visit by tax officer, prepare false accounts and invoices or attempts to evade tax. According to VAT Act, action is taken in case of the following:

- Non-registration (those falling under taxable criteria)
- Non filers or stop filers
- Who has tax due/arrears
- Who has no VAT accounts and records as prescribed by the Law.

The Act also has the provision of punishment to tax officers. If the tax officer is found to have made the assessment quite negligently or maliciously, the Director General has a full authority to take action against such a culprit.

2.2.4.13 Rewards

According to VAT Act, if a person provides information with solid evidence showing that a tax payer has evaded or attempted to evade all or some portions of tax, he will be rewarded with the amount equal to 20% of the amount of tax collected on that

basis of such information. The Director General (DG) himself is responsible for rewarding the informants.

2.3 Review of Related Studies

Since the period of introduction of income tax in Nepal, many individuals as well as some institutions have made efforts on study of taxation for finding the ways for the improvement of income taxation. Many books, research reports and articles have been written and published in this respect. The researcher had consulted books, theses and some articles concerning with income taxation during the thesis writing. Some of them are presented in brief below.

2.3.1 Review of Books

The Value Added Tax does not have a long history even in the global context; admittedly, there are not as much literatures available on this topic as other forms of tax system. So in other words, very few studies have been done on this particular topic with special reference to Nepal. An attempt, thereby, has been made to review the theory of tax reform as well as the recent literature on VAT.

The book *Nepalma Mulya Abhibridhhi Kar: Siddhanta ra Byabahaar* is collection of different articles published in various newspapers and written by Dr. Rup Bahadur Khadka during 2051/54. The main objective of this book is to bring public awareness regarding the implementation of VAT. It cites the examples of India, China and Bangladesh where Vat had been already introduced. It has made an attempt to justify the rational for introducing VAT in Nepal. The legal, procedural and structural aspects of VAT are also covered in the book. The success story of Singapore and the failure story of Ghana and implication to Nepal are delineated in the study.

In the book *Kardatako Guide* by Shakti Prasad Pandit (2053), Mr. Pandit gives the glimpses of different forms of taxes and their provision. He tries to make aware about the general terminology of Vat and its application in Nepal. He clearly defines the every term of Vat that is associated with VAT system and the procedure that business community has to follow if falls under the threshold.

Another book entitled "*Value Added Tax in Nepal: Theory and Practice (2003)*" is written by Chandra Mani Adhikari which comprises of three chapters the first chapter deals with theoretical concept of VAT which includes historical background, objectives, merit and demerit of VAT. The second chapter comprises practice of

Nepalese VAT which deals with introduction of VAT system in Nepal, different terminologies associated with VAT, Tax administration system and legal provision made for the VAT implementation in Nepal. The third chapter consists of different model question of TU on VAT, specimen of VAT related forms and Accounts and Value Added Tax Rule 1997 and Value Added Tax Act 1996.

Puspa Raj Kandel published a text book entitled ***“Tax Laws & Tax Planning in Nepal”*** in 2004. The book was designed to fulfill the needs of MBS and BBS levels under T.U. This book was very useful to the students and teachers to know the legal provisions of Income Tax Act 2058. The book has attached unofficial translation of the tax laws – both Acts and Rules – related to value added tax and income tax. This book was more informative rather than analytical.

In 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)”***. This book was specifically designed for the students of Bachelor of Business Studies (BBS) 3rd years under Tribhuvan University. Unlike other books available on this subject, this book makes an in-depth approach to the study of income tax, property tax and value added tax in Nepal in order to meet the specific requirements of those students who are studying taxation as a concentration/elective subject at BBS 3rd year. This book was very useful to know the legal provisions of Income Tax Act 2058 and Value added Tax Act 2052. Theoretical aspects as well as numerical problems of income tax and value added tax are shrewdly presented in this book. However the book was failed to analyze legal provisions with numerical examples on the topic of income taxation of insurance business.

The book named ***“Tax Laws and Tax Planning”*** written by Mr. Ishwor Bhattarai and Mr. Girija Prasad Koirala published in 2010 described the income tax system in depth. This book includes the separate chapter on Value Added Tax. It describes VAT practices in Nepal with several theoretical aspects and numerical examples. This book was specifically designed for the students of MBS 2nd years under Tribhuvan University. However, the book was failed to mention legal provisions with examples regarding taxation of income from insurance business in detail.

2.3.2 Review of Journals and Articles

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 finding of the study report was as follow:

- 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 the negative impact of VAT and neglecting its positive impact. (Source: Nepal Chamber of commerce, 1997)

VAT Refund System (The Kathmandu Post: 2002) - The article published in the November 15, 2002 issue made a point that Nepalese industrialist and business did not have any faith in the VAT refund system before four or five years. Most of them used to say that it would be impossible to institutionalize a refund system in Nepal. While refund is one of the important features of Vat system, it was a big challenge for those who were involved in designing the Nepalese VAT system to create a refund mechanism that can be implemented smoothly under the Nepalese circumstances. The possibility of refund arises when the tax paid by a taxpayer on his purchase/imports exceeds the tax collected on his output. Tax refund is granted after verifying the export declaration forms, letter of credits/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. In the absence of these conditions, refund mechanism is likely to be grossly misused by the taxpayers, which does not become sustainable. International experience indicates that provided refund without verification of export and payment of input tax. So, these countries later on stopped granting refunds even to the genuine exporters. In order to avoid such situation, the system of verification has been introduced in Nepal.

On the other hand, refund mechanism has been misused by the tax official in those countries which made full audit mandatory for the refund. This is because resources allocated for audit generally limited. But in case of Nepal problem of allocating budget and realizing the long term process of budget and approving refund , a system of refund directly through the VAT revenue collected on imports has been introduced. It was a dream of the designers of the refund system to implement it in a proper and effective manner in real life. In the first year of introduction of VAT, no one claimed for the refund. After publicity regarding the tax refund system the trust of taxpayers gradually increased and claimed for refund. VAT refund figure indicated that the refund system is becoming increasingly effective in real life but there is still long way to go.

"A study of taxpayer's satisfaction level in Nepal – August 2010"

"A study of tax payers satisfaction level Nepal" was carried out jointly by the Inland Revenue Department (Ministry of Finance) and the German Technical Co – operation (GTC) on august 2010. The survey's purpose was 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 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 respondents were satisfied with the delivery of public services in the field 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 the IROs (Except for location and accessibility) in spite of the perception that services during the post seven years have improved.

The majority of the respondents were reasonably satisfied with the tax procedures and administrative mechanisms, except with tax refunds. Four out of five respondents have observed 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 the 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 past 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 be provide additional budgetary room in the long run. However, better reputation van only be achieved if citizens feel significant improvements in the services delivery. A part 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.

(Sources: A study on Taxpayers satisfaction Level in Nepal, 2010, RAS)

2.3.3 Review of Previous Research and Dissertations

There are quite a few dissertations relating to Value Added Tax Nepal undertaken by various individuals and some institutions. Some of them are reviewed below:

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 the lack of efficient administration and progressive taxation. The most significant tax reform 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)

The unpublished dissertation entitled "*Resource Mobilization through ValueAdded Tax in Nepal*" undertaken by **Neupane, Pawan Kumar in 2006** has the basic objective to examine historical background of Value Added Tax and to analyze mobilization of revenue through VAT. Mr. Neupane also provided the bird eye view of the practicing scenario of VAT in the foreign countries. He conducted a research

applying secondary data to analyze simple ratio and also use of observation method. He concluded that VAT 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 to control tax evasion so that the number of the taxpayers would increase and hence the revenue collection would also increase exponentially. He complains that in Nepal, after the implementation of VAT, the government has hardly paid any attention to the consumers. He gave several reasons behind this. According to him, after the implementation of VAT, attempt was made to inform the public about some non-VAT including commodities through the public means of communications like radio, television and newspapers, but it could not prove effective.

As a result, the consumers are on the other hand, as he argues, the businessmen opposing the VAT had raised the prices of daily consumption goods like rice, vegetable etc, which had added future burden to the consumers. The government, he observed, could neither reduce the price nor punish those businessmen against such act. Instead, the government compromised with those businessmen. These are some of the grievances articulated by Neupane in the conclusion of the thesis, but he also gives some recommendations. His constructive recommendations were 1. The boundary of Value Added Tax (VAT) should be increased instead of increasing the rate of VAT in order to increase the tax amount under VAT, 2. The concentration must be given to bring the use of billing in all trading concern, 3. The most important one, the consumer should be comprehensively educated about the nature and beneficial aspects of VAT. (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 ensure the rapid rate of economic growth. To get the pace of economic development, it is essential of 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 taxes 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 implementation of VAT in Nepal and promulgate the VAT Act, there has been legal changes made; rates were increased for the effectiveness of VAT but still there are many problem. He also carried out on reviewing 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. the recommended that VAT areas should be increased proper co – ordination between IRD and MOF, taxpayers, 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 honestly, for improving billing condition, regular supervision, audits and investigation applied. Threshold of VAT should be decreased substantially. (Wagle: 2010)

Basnet, Hem Chandra (2011), in his dissertation, "*VAT present status and future Prospects in Nepal*" by suing the analytical and explanatory research design and having the objective to as the present status and future prospect of VAT and its effects on various aspects of economy, has concluded that the implementation of VAT in Nepal would have very poor results than expected due to poor planning and poor implementation. But VAT implementation has been becoming more and more effective and VAT net has been spreading and revenue collection is on the constant rise establishing it firmly in Nepal. It is expected that positive impact can be seen in tax collection as code of conduct announced recently includes all the required ingredients, such as, utilization of tax revenue, respecting the taxpayers, simplification

in the service and improvement in the behavior of the tax administrators. Moreover, he recommended that tax related newspapers, pamphlets, radio, television etc. Interview programs with professors, researchers, tax experts, and economists should be conducted and published through advertising media. Similarly the students at school campus level curriculum should include tax education and social obligation of paying tax. Border should be effectively controlled to prevent the illegal trade. There should be a broader tax adjustment checking and highway checking should be practical effectively to prevent any kind of illegal trade. The accounting should be transparent and VAT officers should control auditing as far as possible. (Basnet: 2011)

Tamang, Santosh (2012), in his dissertation, "*VAT in Nepal: An Analysis of its problems and prospects*" having the objective to review historical background of VAT, to examine the structure of VAT in Nepal, to observe the contribution of VAT to resource mobilization and to analyze the existing problems of VAT in Nepal through the primary and secondary data and information, has concluded that the main problems for business houses are account keeping and billing and the weakness of VAT administration are lack of motivation and service minded attitude among tax officials lack of honesty in VAT officers.

Though from the theoretical point of view it is sure that VAT system is the best and advanced fiscal tool, its effect in the context of Nepal is not as expected because of the lack of strong and honest tax administer, lack of motivation and service minded attitude among the tax officials, lack of the cooperation of business community, lack of strong coordination between tax collectors and tax payers, lack of strong political commitment and weak public consciousness. He has further recommended some suggestion for better solution of these problems. Tax related information should be published regularly. Interview programs with professor, researchers, tax experts, and economists should be conducted and published through advertising media. Often escape away from actual custom duty, as under valuation of the goods has been a tradition. Thus to overcome these problems, the government either has to collect the custom duty of the actual price of the goods or it has to fix the actual price of the goods in the market. Enforcement should be effective through more audits, investigation and collection visits and integrated approach to total tax system should be introduced for successful implementation of VAT. (Tamang: 2012)

CHAPTER THREE

RESEARCH METHODOLOGY

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

3.1 Research Design

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

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

3.2 Population and Sample

The population for this study was comprised of Tax Administrators, Experts Business persons and Customers. In order to fulfill the objectives of the study, 45 samples from the population in the Kathmandu Valley were carefully selected. The respondents were divided into three groups. The following table shows the groups of respondents and the size of samples.

Table-3.1

Group of Respondents and Sample Size

| S. N. | Group of Respondents | Sample Size |
|--------------|-----------------------------|--------------------|
| 1. | Tax Administrators/ Exports | 10 |
| 2. | Business Persons | 20 |
| 3 | Customers | 15 |
| | Total | 45 |

3.3 Nature and Sources of Data

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

A. Primary Sources

The primary data were collected through following techniques

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

B. Secondary Sources

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

- a) Published and unpublished reports, articles and dissertations on the concerned subject.
- b) Published documents of National Planning Commission.

- c) Publication and annual report of Inland Revenue Department (IRD).
- d) Different publication of Central Bureau of Statistics.
- e) Publications of Nepal Rastra Bank.
- f) Various books written by tax officers and scholars.
- g) Publications, Budget Speeches and Economic Survey of various fiscal year of Ministry of Finance, the Government of Nepal.
- h) Newspapers, such as, Gorkhapatra, The Rising Nepal, Kantipur Daily, and so on.
- i) Publications of various VAT Department.
- j) Websites, etc.

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

3.4 Data Analysis Procedure

The useful data and information are collected from various reliable sources. These data and information are firstly processed for tabulation and analysis purpose. Available data are tabulated into separate tables and format as per requirements of the subject matter. Tabulated data are analyzed by using simple statistical tool such as average; percentage etc. and they have been presented and analyzed in descriptive way. Graphs, Charts and diagrams are also presented to interpret visually the findings of the study.

3.5 Data Presentation and Analysis Tools

As data analysis is very important task to the researcher, researcher must be very careful to use the tools to analyze the data, while choosing the tools; researcher must choose the best one as it can show the clear picture of the data and its finding.

In order to analyze and interpret the collective data after necessary adjustments various financial as well as statistical tools have been used. Brief explanations of such tools have been presented below:-

- a) Table method:- Various tables are formulated to tabulate the data. A matter table is also presented in the appendix.
- b) Simple percentages:- it is the most popular tool to analyze the data in research work. As it is easy to understand the data in the percentage form most of the data in the research work are used in the percentage form.

- c) Simple average:- it also next popular tool in data analysis work, which gives the information about the data in average.
- d) Graphs, Charts and diagram:- these tools are used for visually description of the data, trend line, bar diagrams are used for the purpose. It helps to understand about the data easily to everyone even to the uneducated people.
- e) Correlation:- correlation may be defined as the degree of linear relationship between two or more variable, two variables are said to be correlated when the change in the value of one variable is accompanied by the change of another variables. Correlation analysis is defined as the statistical technique which measures the variable, which is lie between ± 1 . If the value of correlation \textcircled{r} is near to +1, this relationship is said to be perfectly positively correlated and vice-versa. We can compute the correlation simply by using method.

$$r = \frac{N \sum XY - \sum X \cdot \sum Y}{\sqrt{N \sum X^2 - (\sum X)^2} \sqrt{N \sum Y^2 - (\sum Y)^2}}$$

Where, N = No. of Observation

X = Variables, Y = Variable

CHAPTER FOUR

PRESENTATION AND ANALYSIS OF DATA

4.1 Structure of Nepalese Tax System

The main objective of taxation is to maintain the economic stability and social justice through equal distribution of wealth. In this way tax structure stands as a mirror of the fiscal policy instruments. The taxable capacity of government as well as ability of people to pay tax is the major factor of designing the tax structure. For the underdeveloped countries like Nepal the role of taxation in the process of economic development is considerably significant. In this respect, the tax structure has vital role in development.

Tax system was informal during early Shah Period; it was bounded by traditional land tax and other fines etc. In Rana period, taxes were levied on agricultural income from forest and mines, business etc. However the specific tax system and trend of revenue collection was commenced with the budget speech of 1951 but, which are limited to traditional sectors.

Income tax was introduced from fiscal year 1959/60 and sales tax, contract tax, house and rent tax in 1965/66. Tax reform programs and implementation of new tax system were continuous in Nepalese tax structure. In this way the government introduced VAT from 1997.

4.2 Need for Reforms on Present Tax System in Nepal

The tax reform exercise has been the most important and technically the most exciting component of the reform programmer in the fiscal sector.

Arguments put forward in favor of reforms in Nepalese tax system are:-

- To enhance more revenue needs.
- To enable tax administration.
- To fulfill the increasing resource gap.
- To face the problem of continuing and raising difficulties.
- Tax reform is inevitable for liberal and competitive economy.
- To increase productive efficiency.

4.3 VAT as a Tax Reformer in Nepal: A Study on its Theoretical Importance

Nepal is a small country with different society, different people, and different religions and different geographical constructions. Value Added tax is a kind of reformed and modified tax system, which has been held in the country few years ago for supplement of the tax, hotel tax, entertainment tax etc. From the past experience, it proved the government of Nepal has been able to collect more tax than with the previous system (i.e. sales tax, hotel tax and entertainment tax). Lack of highly qualified and educated people, government of Nepal has been able to implement effectively this new tax system. The following arguments reveal VAT's timely importance in Nepal.

4.3.1 Control of the Corruption

First of all it is necessary to control the corruption from the country by implementing the customer awareness policy to collect the more revenue (tax) of the government. Lack of the education and effective management control system, the government of Nepal has not been able to collect more tax. For example, a businessman records his business transaction in the two different books of the accounts, i.e. the original and the duplicate one meant to be shown to the tax department. Due to this corruption, the appropriate (net) amount of the tax could never be collected. Hopefully this new system minimizes these kinds of fraudulent transactions.

4.3.2 Lack of Education

Nepal is not only the poor country but it is also lagging behind in education. Almost 65% of the people are literate. Business persons are not only the people to blame but the general customers also do not bother to ask for the bill. This is because of the lack of education. Consumers do not understand the importance of the bill and do not ask for it. So to collect the tax and control the funds people must be literate and give importance to billing system and the tax system as a whole.

4.3.3 Lack of Customers' Awareness

As described above, the people of Nepal are illiterate and do not know about the tax or the VAT system in particular. So, it is necessary to raise their awareness about the billing system, encouraging them to receive the bills after the product is purchased. By this funds would be collected, facilitating the development of the nation in the long run.

4.3.4 Collection of More Government Revenue

This new policy of tax system has changed each and every stage of business transactions (supplier, producer, distributor, wholesaler and the retailer). This new flexible policy of the transaction will definitely help the government to collect more revenue in fair and clean manner, eventually contributing to the development of the nation. This will ensure the increase of per capita income of the Nepalese people.

4.4 Revenue Structure of Nepal

The total revenue of government of Nepal is collected from tax and non-tax sectors. The tax revenue, which is compulsory sacrifice of the peoples, can divide into two components i.e. direct tax and indirect tax. Those revenues collected as income tax, land tax, property tax, etc are direct tax and those revenues collected as sales tax, value added tax (VAT), customs and contract tax etc are an indirect tax. Another sides, the government has received other kinds of revenues, e.g. postal service charge, fees fines and forfeiture etc are non-tax revenues. Non-tax revenue are not imposed specially views of revenue collection. In Nepalese economy amount of tax revenue is generally higher than that of non-tax revenue. In Nepal, the contribution of tax revenue used to be almost 80% and non-tax revenue almost 20%. The structure can see in the Table no. 4.1.

Table-4.1**Revenue Structure of Nepal**

(Rs. in million)

| Fiscal year | Total Revenue | Tax Revenue | | Non-Tax Revenue | |
|-------------|---------------|-------------|------------------------------|-----------------|------------------------------|
| | | Amount | % Compare with Total Revenue | Amount | % Compare with Total Revenue |
| 2001/2002 | 50445.6 | 39330.6 | 77.97 | 11115.0 | 22.03 |
| 2002/2003 | 56230.0 | 40896.0 | 72.73 | 13642.9 | 24.26 |
| 2003/2004 | 62331.0 | 48173.0 | 77.29 | 14158.0 | 22.71 |
| 2004/2005 | 70122.7 | 54104.7 | 77.16 | 16018.0 | 22.84 |
| 2005/2006 | 72282.1 | 57430.4 | 79.45 | 14851.5 | 20.55 |
| 2006/2007 | 87712.1 | 71126.7 | 81.9 | 16585.4 | 18.91 |
| 2007/2008 | 107622.5 | 85155.5 | 79.12 | 22467.0 | 20.88 |
| 2008/2009 | 143474.5 | 117051.09 | 81.58 | 26422.6 | 18.42 |
| 2009/2010 | 179945.8 | 156294.9 | 86.86 | 23650.9 | 13.14 |
| 2010/2011 | 199819.0 | 172777.6 | 86.47 | 27041.1 | 13.53 |

Source: Economic survey of various years, MOF

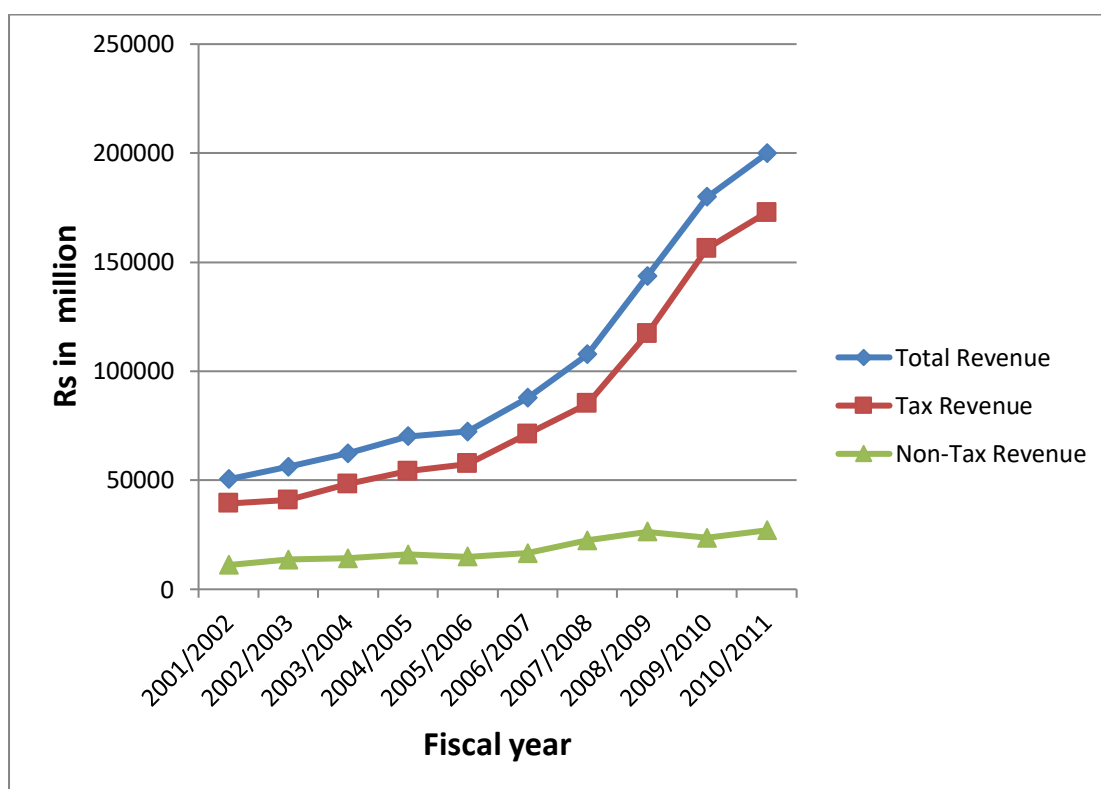
The composition of tax revenue and non- tax revenue in total revenue structure has been shown in above table. It can be seen that revenue collection trend in increasing trend. Since the fiscal year 2001/2 to the fiscal year 2010/11 the revenue has increased from Rs. 50445.6 million to Rs. 199819.0 million. Similarly tax revenue as well as non tax revenue is also increasing trend. Total tax revenue has increased from Rs.39330.6 million to Rs.172777.6 million in fiscal year 2001/02 to 2010/11. It is the main source of revenue collection. It has contributed very much in national revenue.

Similarly non- tax revenue has also increased from Rs.11115.0 million to 27041.1. But non tax revenue collection in 2005/06 has decreased to Rs.14851.7 million after than it was in the increasing trend.

The contribution of tax and non-tax revenue on total revenue is shown in the following trend line:

Figure - 4.1

Revenue Structure of Nepal



Above Figure shows three trends lines which are total revenue, tax revenue and non-tax revenue. It is clear that upper line is total revenue which is ascending upward. Middle is tax revenue it is higher than non tax revenue which is represented by lower line. So, total revenue is combination of tax and non- tax revenue.

4.4.1 Tax Revenue Structure of Nepal

Tax revenue is the main source of government revenue. Total tax revenue is divided broadly into Direct tax revenue and Indirect tax revenue. Direct tax revenue includes income tax, property tax, interest tax, gift tax, vehicle tax, expenditure tax, contract tax etc. whereas, Indirect tax revenue is composed of taxes like sales tax(VAT),

entertainment tax, passenger tax, hotel tax, import tax, export tax, excise duty etc. The following table shows the structure of total tax revenue.

Table-4.2
Tax Revenue Structure of Nepal

(Rs. in million)

| Fiscal year | Total Tax Revenue | Direct Tax | | Indirect Tax | |
|-------------|-------------------|------------|----------------------------------|--------------|----------------------------------|
| | | Amount | % Compare with Total Tax Revenue | Amount | % Compare with Total Tax Revenue |
| 2001/2002 | 39330.6 | 10597.5 | 26.94 | 28733.1 | 73.06 |
| 2002/2003 | 42586.9 | 10105.7 | 23.73 | 32481.2 | 79.42 |
| 2003/2004 | 48173.0 | 11912.6 | 24.73 | 36260.4 | 75.27 |
| 2004/2005 | 54104.7 | 13071.8 | 24.16 | 41032.9 | 75.84 |
| 2005/2006 | 57430.4 | 13968.1 | 24.32 | 43462.3 | 75.68 |
| 2006/2007 | 71126.7 | 18980.3 | 26.69 | 52146.4 | 73.31 |
| 2007/2008 | 85155.5 | 23087.7 | 27.11 | 62067.8 | 72.89 |
| 2008/2009 | 117051.9 | 34320.7 | 29.32 | 82731.2 | 70.68 |
| 2009/2010 | 156294.9 | 41746.4 | 26.71 | 114548.5 | 73.29 |
| 2010/2011 | 172777.6 | 41466.6 | 24.00 | 131311.0 | 76.00 |

Source: Economic Survey 2001/02 to 2010/11, yearly Report of IRD 2010/11.

The above table shows the increasing trend total revenue as well as its component i.e. direct and indirect tax. Direct tax has increased from 10597.5 million to Rs.41466.6 million from the fiscal year 2001/2002 to fiscal year 2010/2011. Similarly indirect tax has also increased from Rs.28733.1 million to Rs.131311.0 million from the fiscal year 2001/2002 to the fiscal year 2010/2011. The maximum contribution made by the

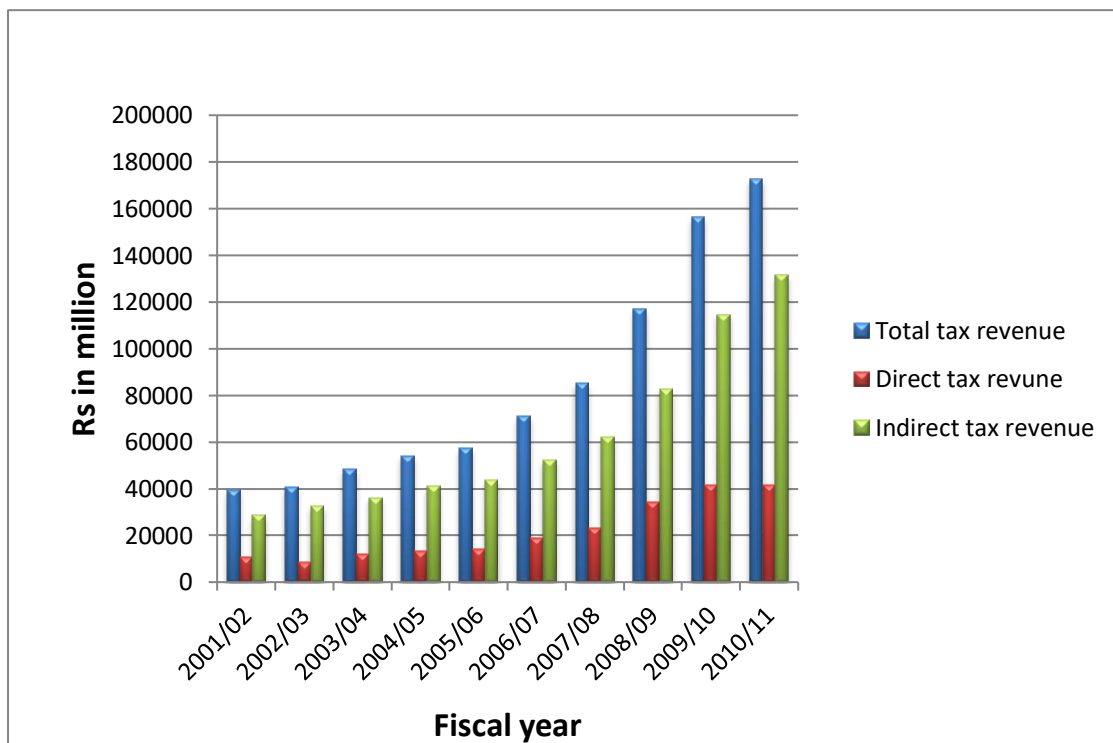
direct tax on total tax revenue is 29.32 % in the fiscal year 2008/2009 and indirect tax is 79.42% in the fiscal year 2002/2003. The increasing trend of direct tax revenue is constraint then indirect tax revenue. Indirect tax revenue increasing trend is much fluctuated then direct tax revenue.

Therefore, on the basis of available data for the study, contribution of direct tax is on increasing trend till F.Y. 2008/09 then decreasing and contribution of indirect tax is on decreasing trend from the F.Y. 2003/04 to 2010/11. These seem that government is trying to create good status of country among other country.

The contribution of direct and indirect tax revenue on the total tax revenue is shown in the following bar diagram:

Figure-4.2

Tax Revenue Structure of Nepal



From the above figure, it is clarify that the completely Nepalese tax structure is dominated by indirect tax revenue on comparison with direct tax. Indirect taxation with a dominant role in tax structure, it is not good symptom of economic development because in the developed country direct tax would be highest portion than indirect tax. It is not happening for few years but every year, indirect tax is always one step front than direct tax. In the fiscal year 2010/11 the share of direct tax

is Rs.41466.6 million and of indirect tax is Rs 131311.0 million, which is 24% and 76% respectively, shared of the total tax revenue.

4.4 Revenue Collection from VAT

VAT is an indirect tax; it contributes some portion in total revenue. The revenue from VAT is collected under the heading of tax on consumption and product of goods and services. The revenue collection from VAT in different fiscal year is presented in the table below.

Table-4.3
Revenue Collection from VAT

(Rs in million)

| Fiscal year | Revenue Collection from VAT | Percentage Change |
|--------------------|------------------------------------|--------------------------|
| 2001/2002 | 12267.3 | - |
| 2002/2003 | 13459.7 | 9.72 |
| 2003/2004 | 14478.9 | 7.57 |
| 2004/2005 | 18885.4 | 30.43 |
| 2005/2006 | 21610.7 | 14.43 |
| 2006/2007 | 26095.6 | 20.75 |
| 2007/2008 | 29815.7 | 14.26 |
| 2008/2009 | 39700.9 | 33.15 |
| 2009/2010 | 54920.9 | 38.34 |
| 2010/2011 | 61663.6 | 12.28 |

Source: Economic survey of various years, MOF

Above table shows the increasing trend of revenue collection from VAT. In fiscal year 2010/2011 Rs.61663.6 million was collected from VAT. Regarding percentage

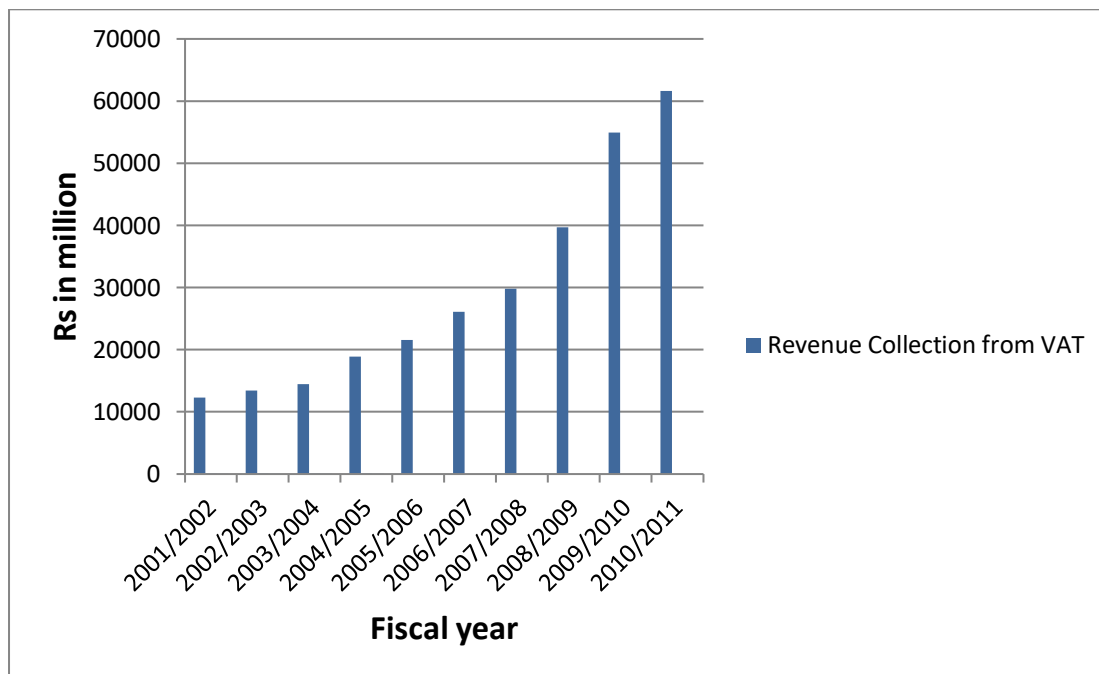
change amount it is not some ratio in every year it has increased in higher percentage like in the fiscal year 2009/2010 i.e. 38.34 percent.

The data can be shown in following diagram.

Figure-4.3

Revenue Collection from VAT

(Rs. in million)



Above figure also shows that the revenue collection trend from VAT is in the increasing trend. In the year 2009/2010 there is maximum increase in revenue collection by VAT. This shows that VAT is getting popularity in our country Nepal.

4.4.3 Contribution of VAT to Total Revenue

Total revenue includes tax and non-tax revenue. The contribution of VAT to total revenue has been shown in table below:

Table-4.4**Contribution of VAT to Total Revenue**

(Rs in million)

| Fiscal Year | Total Revenue | Revenue Collection from VAT | % of VAT Revenue to Total Revenue |
|--------------------|----------------------|------------------------------------|--|
| 2001/2002 | 50445.5 | 12267.3 | 24.32 |
| 2002/2003 | 56230.0 | 13459.7 | 23.94 |
| 2003/2004 | 62331.0 | 14478.9 | 23.23 |
| 2004/2005 | 70122.7 | 18885.4 | 26.93 |
| 2005/2006 | 72282.1 | 21610.7 | 29.90 |
| 2006/2007 | 87712.1 | 26095.6 | 29.75 |
| 2007/2008 | 107622.5 | 29815.7 | 27.70 |
| 2008/2009 | 143474.5 | 39700.9 | 27.67 |
| 2009/2010 | 179945.8 | 54920.9 | 30.52 |
| 2010/2011 | 199819.0 | 61663.6 | 30.86 |

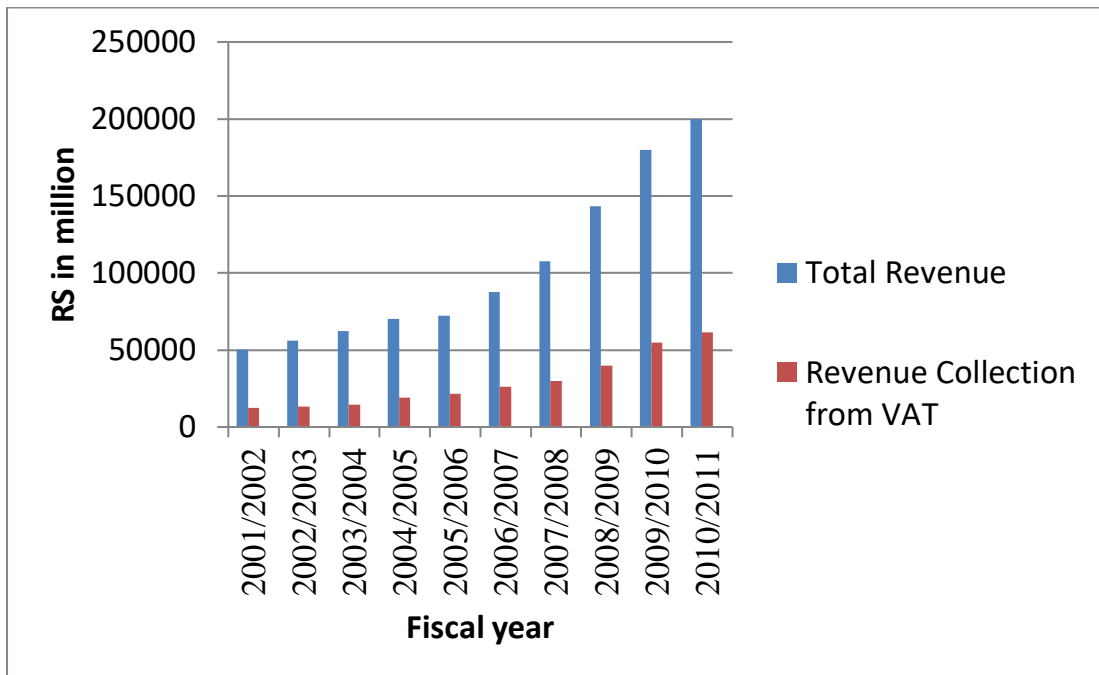
Source: Economic survey of various years, MOF

Above table shows that VAT has maximum contribution in fiscal year 2010/2011 which is about 30.86 percent and minimum in the fiscal year 2003/2004 which is about 23.23 percent.

Above data can be shown in multiple bar diagram which is as follow:

Figure 4.4

Contribution of VAT to Total Revenue



Above diagram shows that with the increase in the total revenue.VAT revenue is increasing only on difference is that sometime it is more and sometime it is less. In the fiscal year 2010/2011 there is maximum contribution of VAT revenue on total revenue in comparison to the other fiscal year.

4.4.4 Contribution of VAT to Total Tax Revenue

Tax revenue includes direct and indirect tax. VAT is indirect tax revenue. VAT will automatically contribute in the tax revenue. How much VAT has contributed to tax revenue is shown below:

Table-4.5**Contribution of VAT to Total Tax Revenue**

(Rs. in million)

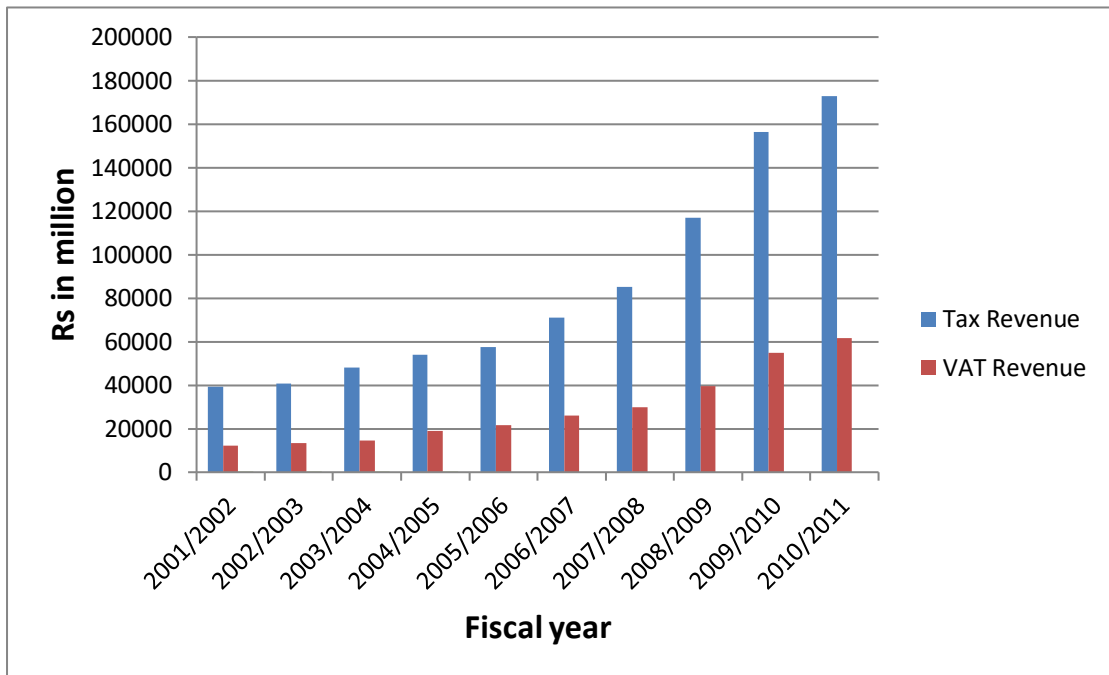
| Fiscal year | Tax Revenue | VAT Revenue | Percentage of VAT |
|--------------------|--------------------|--------------------|--------------------------|
| 2001/2002 | 39330.6 | 12267.3 | 31.19 |
| 2002/2003 | 40896.0 | 13459.7 | 32.91 |
| 2003/2004 | 48173.0 | 14478.9 | 30.05 |
| 2004/2005 | 54104.7 | 18885.4 | 34.91 |
| 2005/2006 | 57430.4 | 21610.7 | 37.63 |
| 2006/2007 | 71126.7 | 26095.6 | 36.69 |
| 2007/2008 | 85155.5 | 29815.7 | 35.01 |
| 2008/2009 | 117051.09 | 39700.9 | 33.92 |
| 2009/2010 | 156294.9 | 54920.9 | 35.14 |
| 2010/2011 | 172777.6 | 61663.6 | 35.69 |

Source: Economic survey of various years, MOF

Above table shows that there is maximum contribution of VAT revenue on tax revenue in the fiscal year 2005/2006 which is about 37.63% and minimum is the 30.05% in the fiscal year 2003/2004. Above data can be shown in multiple bar diagram which is as follows:

Figure 4.5

Contribution of VAT to Total Tax Revenue



Above diagram shows that with the increase in tax revenue. Contribution of VAT on tax revenue is not in equal it is fluctuated. There is the maximum contribution of VAT on tax revenue in the fiscal year 2005/2006 which is 37.63 percent.

4.4.5 Contribution of VAT to Indirect Tax Revenue

Indirect tax includes customs, excise on industrial products and value added tax. So VAT will automatically have certain percentage of share in indirect tax revenue. The percentage of contribution of VAT revenue to indirect tax revenue in difference fiscal years of our country is as follow:

Table-4.6**Contribution of VAT to Indirect Tax Revenue**

(Rs. in million)

| Fiscal year | VAT Revenue | Total Indirect Tax Revenue | Percentage of VAT |
|--------------------|--------------------|-----------------------------------|--------------------------|
| 2001/2002 | 12267.3 | 28733.1 | 42.69 |
| 2002/2003 | 13459.7 | 32481.2 | 41.44 |
| 2003/2004 | 14478.9 | 36260.4 | 39.93 |
| 2004/2005 | 18885.4 | 41032.9 | 46.02 |
| 2005/2006 | 21610.7 | 43462.3 | 49.72 |
| 2006/2007 | 26095.6 | 52146.4 | 50.04 |
| 2007/2008 | 29815.7 | 62067.8 | 48.04 |
| 2008/2009 | 39700.9 | 82731.2 | 47.99 |
| 2009/2010 | 54920.9 | 114548.5 | 47.95 |
| 2010/2011 | 61663.6 | 131311.0 | 46.96 |

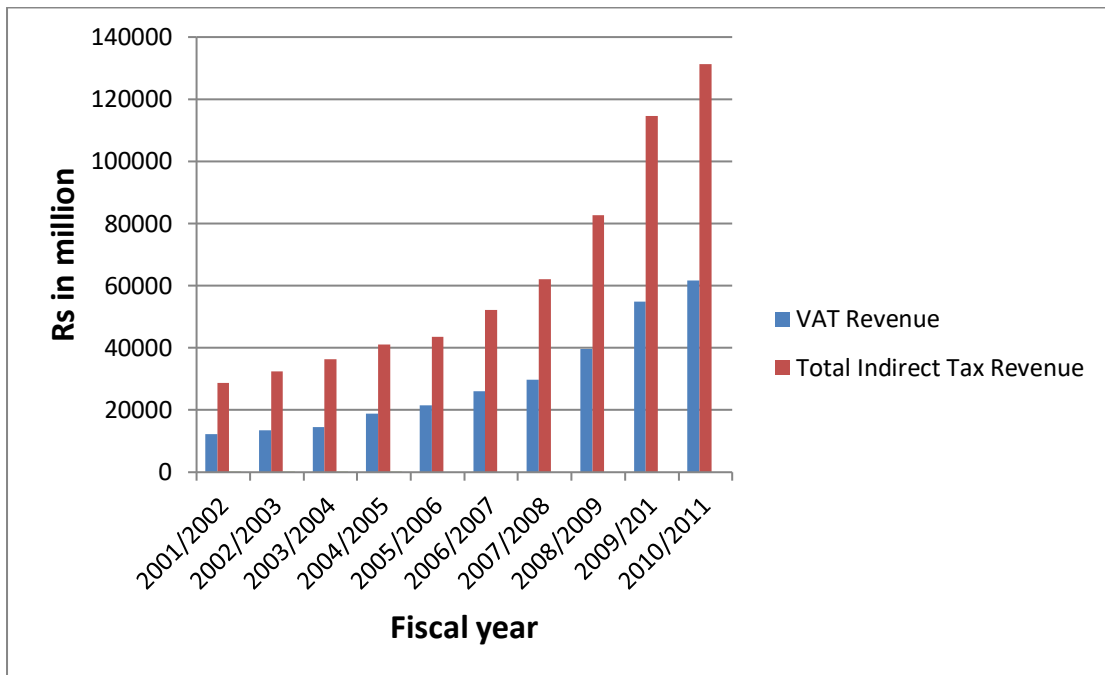
Source: Economic survey of various years, MOF

According to above table, there is maximum contribution of VAT in indirect tax revenue in the fiscal year 2006/2007 to 50.04 and minimum in the fiscal year 2003/2004 i.e. above 39.93 percent. It shows that the contribution of VAT on indirect tax revenue is an average 46.08 percent. Its percentage of share on indirect tax revenue is not same.

On showing the above data in multiple bar diagram, it seems as follows:

Figure-4.6

Contribution of VAT to Indirect Tax Revenue



Above diagram shows the contribution of VAT on indirect tax revenue in different fiscal year. It shows that there is maximum contribution of VAT on indirect tax revenue in the fiscal year 2006/2007, with the increase in indirect tax.

4.4.6 Contribution of VAT to GDP

The contribution of VAT in Gross Domestic Production is presented in the following table.

Table-4.7**Contribution of VAT to GDP**

(Rs. in million)

| Fiscal year | GDP | VAT Revenue | % of VAT Revenue |
|--------------------|------------|--------------------|-------------------------|
| 2001/2002 | 430396.6 | 12267.3 | 2.85 |
| 2002/2003 | 460325.3 | 13459.7 | 2.92 |
| 2003/2004 | 500699.1 | 14478.9 | 2.89 |
| 2004/2005 | 548484.7 | 18885.4 | 3.44 |
| 2005/2006 | 611088.5 | 21610.7 | 3.54 |
| 2006/2007 | 675484.0 | 26095.6 | 3.86 |
| 2007/2008 | 820814.0 | 29815.7 | 3.63 |
| 2008/2009 | 909528.0 | 39700.9 | 4.37 |
| 2009/2010 | 1083415.0 | 54920.9 | 5.07 |
| 2010/2011 | 1246423.0 | 61663.6 | 4.95 |

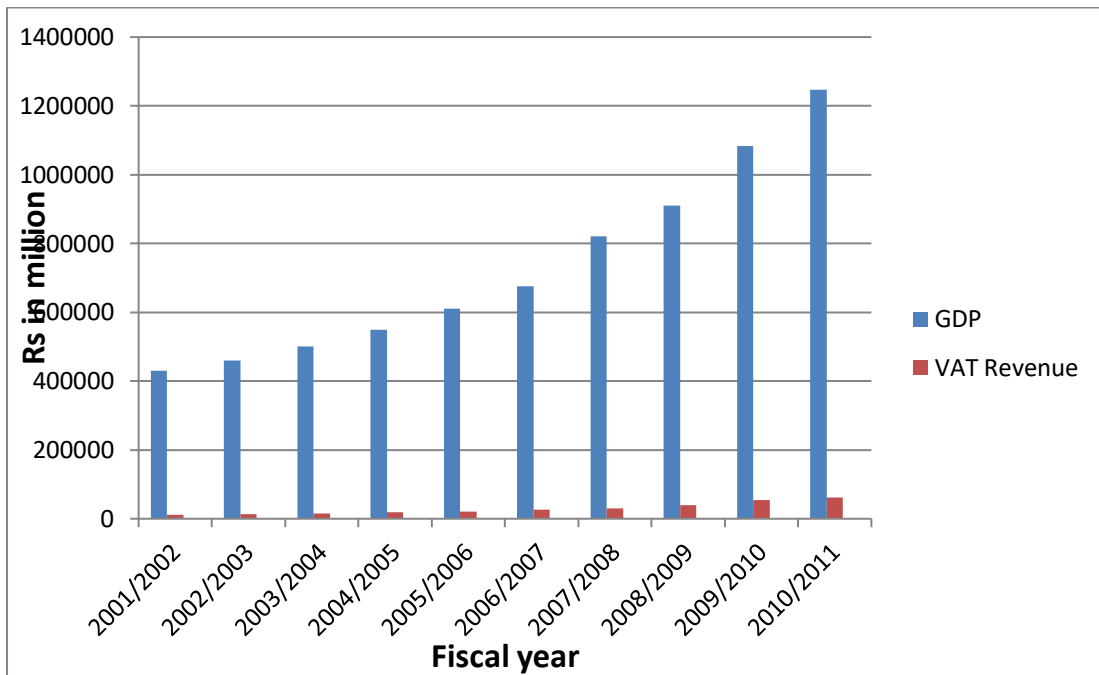
Source: Economic survey of various years, MOF

From the above table it is clear that the percent of VAT revenue in GDP is nominal in Nepal. The VAT/GDP ratio was 2.85 percent in fiscal year 2001/2002 and such contribution never cross 5.37 percent during 10 years. In fiscal year 2007/2008, VAT contributed to GDP was only 3.63 percent and reached in 4.37 percent in fiscal year 2008/2009. After this year such contribution started to increased and reached 5.07 in fiscal year 2009/2010 but it was decreased in the fiscal year 2010/2011, VAT contribution to GDP only 4.95 percent.

On showing the above data in multiple bar diagram, it seems as follows:

Figure-4.7

Contribution of VAT to GDP



4.4.7 Structure of VAT in F.Y. 2009/10 and F.Y. 2010/11

VAT is a modern tax system to improve the collection of taxes; it is also regarded as the backbone of income tax system because VAT contributes maximum revenue to indirect tax revenue in Nepal. Here, composition of VAT in FY 2009/10 (actual) and FY 2010/11(actual) are given in the following table:-

Table 4.8**Collection of Value Added Tax from Different Sources in F.Y. 2009/10 and 2010/11**

(Rs. in thousands)

| Symbol No. | Item | Fiscal year 2009/10(actual) | % | Fiscal year 2010/11(actual) | % |
|-------------------|---------------------------|------------------------------------|----------|------------------------------------|----------|
| 1.1.02.10 | Value Added Tax | 54920856 | 100 | 61692838 | 100 |
| 1.1.02.11 | Production | 6016916 | 10.96 | 6768301 | 10.97 |
| 1.1.02.12 | Import | 34541025 | 62.89 | 39306573 | 63.71 |
| 1.1.02.13 | Selling and distribution | 3299200 | 6.01 | 4251741 | 6.89 |
| 1.1.02.14 | Contract and consultation | 2192455 | 3.99 | 3115281 | 5.05 |
| 1.1.02.15 | Tourism | 2221398 | 4.04 | 1116897 | 1.81 |
| 1.1.02.19 | Other service | 6649862 | 12.11 | 7134051 | 11.56 |

Source: Budget speech of 209/10 and 2010/11, ministry of finance, Nepal government.

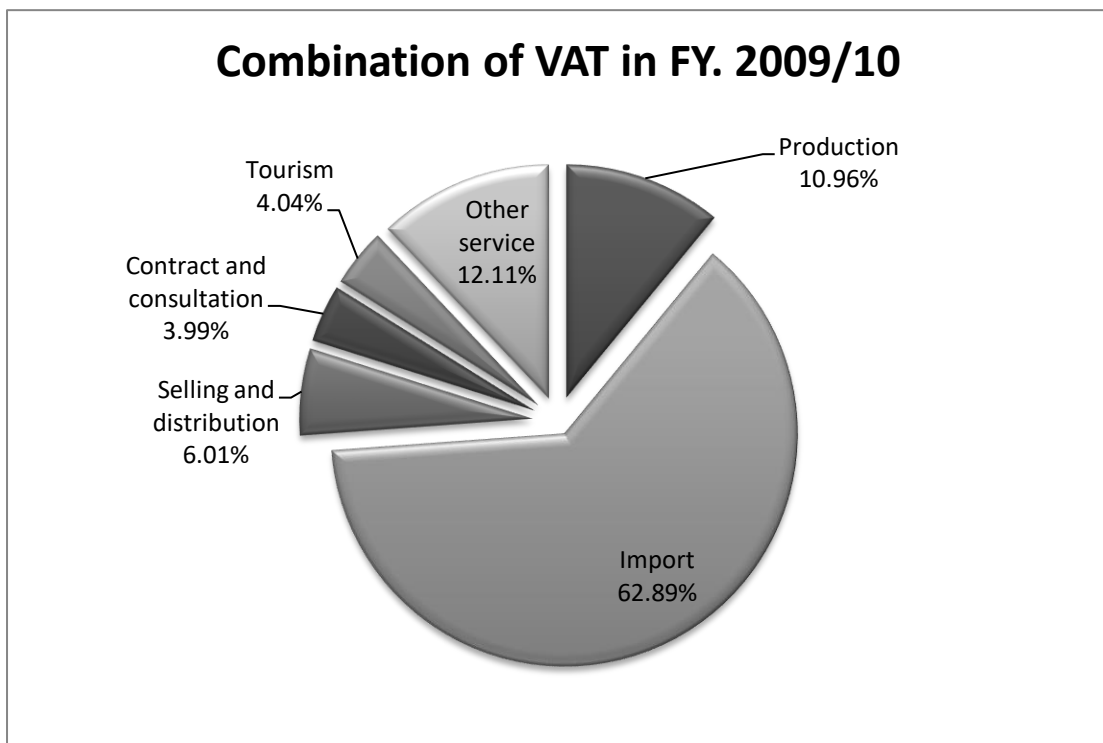
Above table shows that total collection of VAT amount in F.Y. 2010/11 is greater than in F.Y. 2009/10. So, it is cleared that VAT is in increasing trend. Above table also shows that the import is the major source of VAT. In F.Y. 2009/10, its contribution is 62.89% amounting Rs. 34541025 thousands and in F.Y. 2010/11 its contribution is 63.71% amounting Rs. 39306573 thousands. The contribution of production is the second position of VAT. Production contribution in F.Y. 2009/10 is Rs. 6016916 thousands and in F.Y. 2010/11, its contribution is Rs. 6768310 thousands respectively.

On the other hand, other services take the third position to contribution of VAT. Its contribution is Rs. 6649862 thousands in F.Y. 2009/10 and Rs. 7134051 thousands in F.Y. 2010/11 respectively.

Again, selling and distribution takes fourth position to contribution of VAT. Its contribution were in F.Y. 2009/10 is Rs. 3299200 thousands and in F.Y. 2010/11 is Rs. 4251741 thousands respectively. Similarly, contract and consultation contribution were in F.Y. 2009/10 is Rs. 2192455 thousands and in F.Y. 2010/11 is Rs. 3115281 thousands respectively. At last tourism sector contribution is very low; its contribution is Rs. 2221398 thousand in F.Y. 2009/10 and Rs.1116897 thousands in F.Y. .2010/11 respectively.

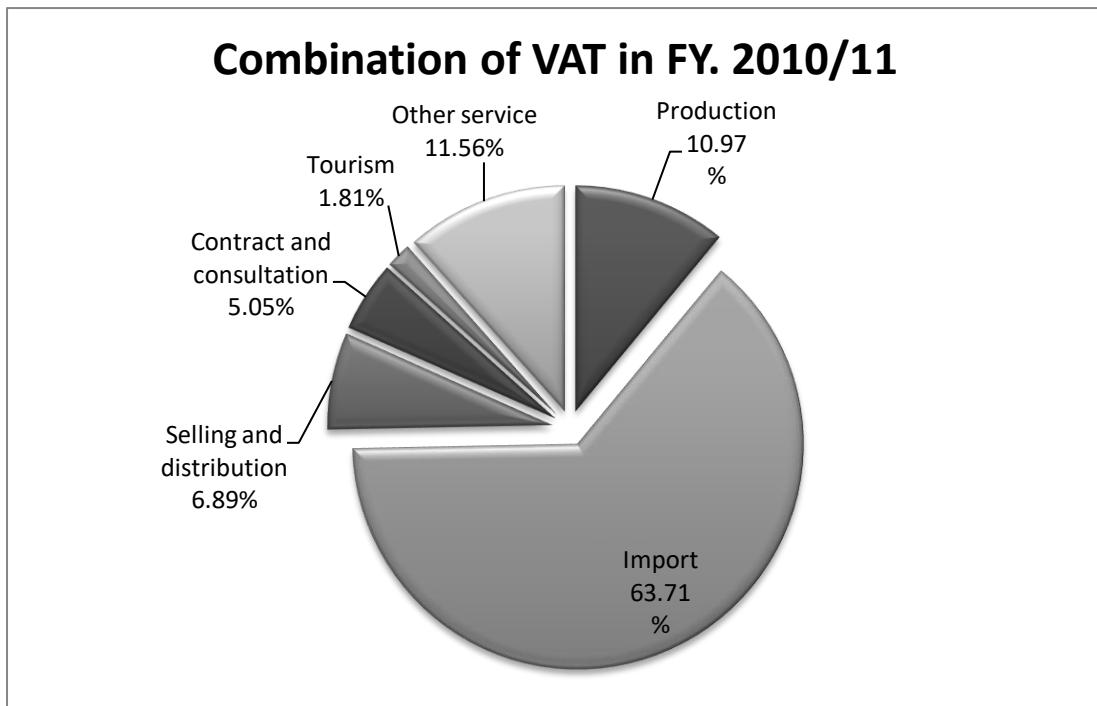
It can be presented to pie chart as given below:-

Figure 4.8 (a)



Above pie-chart shows the combination of VAT in F.Y. 2009/10. This pie-chart shows that maximum area occupied by the import, 62.89%. Similarly, others service covered 12.11%, production 10.96, selling and distribution 6.01%, tourism 4.04% and contract and consultation takes very low space, which is only 3.99%.

Figure 4.8 (b)



Above pie-chart shows the combination of VAT in F.Y. 2010/11. This pie-chart's maximum space covered by import, which is 63.71%, that means import is the main source of VAT. Similarly, other service, Production, Selling and distribution, contract and consultation takes; 11.56%, 10.97%, 6.89%, 5.05% and 1.81% area of this pie-chart respectively.

4.5 Empirical Evaluation

Various empirical studies conducted before and after implement of VAT in Nepal. Many experts' views that this system has been implemented effectively as expected. In the earlier period of VAT implementation, there was lack of skilled and trained manpower; administration structure wasn't set up properly. But currently different informative programs, seminars were held in order to give knowledge about VAT. As a result now business community seems to be in flavor of VAT. All the traders having taxable capacity and include into the tax net. In such situation empirical study is done to know the views of different fields on different aspects of VAT.

For the purpose of survey questionnaire was prepared to know the opinion of the various person. The questionnaire was distributed to 60 respondents but only 45 respondents gave their views about it. The data collection from questionnaire and analysis of them are presented below in following way

4.5.1 Views on VAT as an Appropriate Mean of Raising the Government Revenue

In the concept of Nepal where government expenditure is always increasing but revenue collection is not increasing as required to finance the government expenditure. It is necessary to know whether VAT is as appropriate means of raising fund or not appropriateness regarding its revenue collection can be shown in the following table:

Table-4.9

Views on VAT as an Appropriate Means of Raising Government Revenue

| Respondents | Yes | | No | | Total |
|------------------|--------|-------|--------|-------|-------|
| | Number | % | Number | % | |
| Tax Exports | 10 | 100 | - | - | 10 |
| Business persons | 19 | 95 | 1 | 5 | 20 |
| Customers | 13 | 86.67 | 2 | 13.33 | 15 |
| Total | 42 | 93.33 | 3 | 6.67 | 45 |

Source: Opinion survey

From the study it is clear that almost all the respondent i.e. 93.33% respondents agreed that VAT as an appropriate means of raising government revenue. 100% of tax exports, 95% business persons, and 86.67% customers take VAT as an appropriate means of raising government revenue where as 5% business person and 13.33 % customer viewed against the issue.

4.5.2 VAT Education

VAT is newly introduced scientific tax system so everybody should be educated about it. About VAT education, few people are aware of this term. Customers believe that VAT will increase the price of the goods and services so they don't want to be even educated about it. Businessmen are also against it as they also lack the proper

knowledge about VAT. So VAT should be the topic of discussion and matter of concern for the successful implementation. The following feedback has been collected from the survey:

Table-4.10

Effective Media for VAT Education

| Respondents Alternatives | Tax Exports | | Business Persons | | Customers | | Total | |
|-----------------------------|-------------|-----|---------------------|-----|-----------|-------|-------|-------|
| | No | % | No | % | No | % | No | % |
| Radio/TV | 2 | 20 | 12 | 60 | 5 | 33.33 | 19 | 42.22 |
| Newspaper | 5 | 50 | 3 | 15 | 7 | 46.67 | 15 | 33.33 |
| Booklets/ pamphlets | - | - | 2 | 10 | 1 | 6.66 | 3 | 6.67 |
| Wall Painting/ Banner | 2 | 20 | 1 | 5 | 1 | 6.67 | 4 | 8.89 |
| Seminars | 1 | 10 | 2 | 10 | 1 | 6.67 | 4 | 8.89 |
| Total | 10 | 100 | 20 | 100 | 15 | 100 | 45 | 100 |

Source: Opinion Survey

The above table shows that 42.22% suggest radio and TV as the effective media as VAT education. Newspaper might be another source of education as suggested by 50% of Tax exports. About 6.67 suggest that booklets and pamphlets may be the best media for VAT education. This media proves to be ineffective, thereby must be replaced by other forms of media.

4.5.3 Views on Superiority of VAT to the Areas it has Replaced

VAT has replaced four taxes such as sales tax, entertainment tax, hotel tax and contract tax. VAT is being preferred by many countries of world is superior over sales tax and others because of effective revenue mobilization ability to tackle the all tax evasion wide tax base, transparent, VAT is considered superior to the areas it has replaced. The survey result on this aspect is summarized in the table below:

Table-4.11**Views on Superiority of VAT**

| Respondents Alternatives | Tax Experts | | Business Persons | | Customers | | Total | |
|---|--------------------|----------|-------------------------|----------|------------------|----------|--------------|----------|
| | No. | % | No. | % | No. | % | No. | % |
| Yes | 10 | 100 | 17 | 85 | 11 | 73.33 | 38 | 84.44 |
| No | - | - | 3 | 15 | 4 | 26.67 | 7 | 15.56 |
| Total | 10 | 100 | 20 | 100 | 15 | 100 | 45 | 100 |

Source: Opinion survey

According to the field survey 84.44% of respondents provided their view on superiority of VAT to the areas it has replaced. Out of which 100% tax exports, 85% businessmen and 73.33% customers views that the VAT is superior. But 15.56% of respondents are opposite of its superiority of VAT to the area it has replaced. The outcome proofs that VAT is superior the areas it has replaced.

4.5.4 Habit of Taking Bills on Purchase

The customers are found to have neglected taking or ever asking for the bills after they have purchased goods or services. Likewise, the salespersons also don't bother to provide them with any bills. VAT calls for the issuance of the bills. So, this habit can be taken as the critical problem for the smooth implementation VAT system. Even if some give bills, guaranteed that are proper ones or are not fake ones. The respondents gave following variegated answer when asked about this.

Table-4.12**Habit of Taking Bills on Purchase**

| Respondents Alternatives | Tax Experts | | Business Persons | | Customers | | Total | |
|---|--------------------|----------|-------------------------|----------|------------------|----------|--------------|----------|
| | No. | % | No. | % | No. | % | No. | % |
| Yes, on every purchase | 5 | 50 | 5 | 25 | 1 | 6.67 | 11 | 24.44 |
| Yes ,on most of the purchase | 5 | 50 | 13 | 65 | 2 | 13.33 | 20 | 44.44 |
| Yes, but not regular | - | - | 2 | 10 | 10 | 66.67 | 12 | 26.67 |
| No, I never get any bill | - | - | - | - | 2 | 13.33 | 2 | 4.5 |
| Total | 10 | 100 | 20 | 100 | 15 | 100 | 45 | 100 |

Source: Opinion survey

Table 4.12 shows that 50% of tax experts 65% of businessmen and 13.33% of customers have the habit of taking bills on most of their purchase. In total 24.44% of people take bills on every of their purchases. About 26.67% of people have the habit of taking bills but are not so serious about it so they are not regular about picking up bills on their purchases. 4.5% of people complain that they are not given any bill when they buy goods and services. It is a liability of every salesman to produce the bill whereas demand for bills is the lawful right of every customer.

4.5.5 Views on Rising Price due to VAT System

In the stage of VAT implementation there was a strong opposition from the business community regarding the possibility of rise in price of commodities due to VAT system. There was also voice from different people on price rising as commodities.

Consumers also complain that act of VAT. Here an investigation has been made to get the information the respondents to find out whether there will rise in the price due to VAT system.

Table-4.13

Views on Rising Price due to VAT System

| Respondents Alternatives | Tax Exports | | Business Persons | | Customers | | Total | |
|---|--------------------|----------|-------------------------|----------|------------------|----------|--------------|----------|
| | No. | % | No. | % | No. | % | No. | % |
| Yes | 1 | 10 | 7 | 35 | 3 | 20 | 11 | 24.44 |
| No | 9 | 90 | 11 | 55 | 10 | 66.67 | 30 | 66.67 |
| I don't know | - | - | 2 | 10 | 2 | 13.33 | 4 | 8.89 |
| Total | 10 | 100 | 20 | 100 | 15 | 100 | 45 | 100 |

Source: Opinion survey

From the opinion survey, 66.67% respondents conclude against the views that there is rise in price due to VAT system. 24.44% respondents claim that there is a rise in price where as 8.89% respondents are unconcern about it. 90% of tax exports, 55% businessmen and 66.67% customers argue that there is no raise in price due to VAT system. According to survey 10% businessmen and 13.33% customers have no idea about this question.

4.5.6 Views on Opposing of VAT

For the earlier period to VAT implication government have faced the many problems. The business communities are opposing VAT due to no clear knowledge about VAT. So that they are against the VAT and they are running away from VAT. Most of the businessmen are doing business without maintaining the books of account or maintaining multiple set of books of account that has made implementation of VAT difficult. Businessmen are cheating with VAT and trying to not issuing bill at the time of sales. An opinion survey was also performed in this regard. The description of respondent from the person has shown in the following table:

Table-4.14**Views on opposing of VAT**

| Respondents Alternatives | Tax Experts | | Business persons | | Customers | | Total | |
|---|--------------------|----------|-------------------------|----------|------------------|----------|--------------|----------|
| | No. | % | No. | % | No. | % | No. | % |
| Lack of knowledge | 4 | 40 | 6 | 30 | 7 | 46.67 | 17 | 37.78 |
| Extra burden | - | - | 4 | 20 | 3 | 20 | 7 | 15.56 |
| Lack of accounting | 1 | 10 | 2 | 10 | 2 | 13.33 | 5 | 11.11 |
| Lack of co-operation | 2 | 20 | 3 | 15 | 1 | 6.67 | 6 | 13.33 |
| Lack of public awareness | 3 | 30 | 5 | 25 | 2 | 13.33 | 10 | 22.22 |
| Total | 10 | 100 | 20 | 100 | 15 | 100 | 45 | 100 |

Source: Opinion survey

The above table shows the different views of the respondents why people are opposing or against VAT. Out of 45, 17 respondents' i.e.37.78% has responded about lack of knowledge of VAT. 15.56 % responded that it is an extra burden of tax. 11.11%, 13.33% and 22.22% has responded about lack of accounting, lack of co-operation and lack of public awareness respectively.

4.5.7 Problems in the Process of VAT Implementation

Tax payers and tax collector both have to be conscious because VAT is new and advanced tax system experienced but it is still a matter of challenge especially in the case of implementation. The respondents were asked for their views to explore the problems that the implementation aspect is facing. The view of the respondents about the problems in the process of VAT implementation is shown in following table:

Table-4.15

Problems in the Process of VAT Implementation

| Alternatives | No. of Respondents | Ranking Percentage | Ranking Position |
|---------------------|---------------------------|---------------------------|-------------------------|
| Registration | 14 | 31.11 | II |
| Collection | 10 | 22.22 | III |
| Tax refund | 16 | 35.56 | I |
| Miscellaneous | 5 | 11.11 | IV |
| Total | 45 | 100 | - |

Source: Opinion survey

The above table shows that 35.56% respondents focused on the problem tax refund process, 31.11% respondents focused on the problem of registration process. likewise 22.22% respondents focused on the problems of collection process and 11.11% respondents focused on miscellaneous problems like dishonest in both sides (tax payers and tax collector), weak regulations, problems on issue of original bill, inefficiency of VAT administration in tax auditing etc.

4.5.8 Most Important Factors for Effectiveness of VAT in Nepal

In order to know the most important factor for effectiveness of VAT in revenue collection in Nepal, respondents were request to express their view about the most important factor for effective of VAT in Nepal. The view of the respondents is shown in the following table.

Table-4.16

Most Important Factor for Effectiveness of VAT in Nepal

| S.N. | Alternatives | No. of Respondents | Ranking percentage | Ranking Position |
|-------------|--------------------------|---------------------------|---------------------------|-------------------------|
| 1 | Honest Tax Officers | 10 | 22.22 | II |
| 2 | Honest Tax payers | 6 | 13.33 | V |
| 3 | Clear Act and rules | 12 | 26.67 | I |
| 4 | Effective administration | 8 | 17.78 | IV |
| 5 | Tax education | 9 | 20 | III |
| Total | | 45 | 100 | - |

Source: Opinion survey

The above table shows that 26.67% respondent focused on need of clear act, rules and regulation for effectiveness of VAT. There after 22.22% respondents focused on honest tax officers, 20% respondents focused on effective VAT education, 17.78% respondents focused on effective VAT administration and 13.33% respondents focused on honest tax payers. So it can be concluded that clear act, rules, regulation are the most important factors for effectiveness of VAT in revenue collection in Nepal.

4.5.9 Measure of Established VAT as Major Sources of Revenue

VAT is the most popular taxation system. VAT can be as a major source of public revenue, when the tax administration will be effective and efficient. The respondents were asked for their views toward the measure to established VAT as the major source of revenue which is shown in the following table:

Table-4.17

Measure of Established VAT as the Major Sources of Revenue

| S.N. | Alternatives | No. of Respondents | Ranking Percentage | Ranking position |
|-------------|---|---------------------------|---------------------------|-------------------------|
| 1 | More trained and qualified manpower | 15 | 33.33 | II |
| 2 | Minimize personal contract with tax payers | 4 | 8.89 | IV |
| 3 | Computerized system for the payment of VAT | 21 | 46.67 | I |
| 4 | Collection of VAT should be given to private sector | 5 | 11.11 | III |
| Total | | 45 | 100 | |

Source: Opinion survey

The above table shows that 46.67% respondents focused on need of computerized system for the payment of VAT to establish VAT as a major source of revenue. Likewise 33.33% respondents focused on the need of more trained and qualified manpower .11.11% respondents focused on need of private sectors participation in collection of VAT. 8.89% respondents focused on to minimize personal contract with the tax payers.

4.5.10 Problem Faced After Introduction of VAT System

VAT system was introduced in 1997. However the concept of this tax system in Nepal was introduced in 1997. The respondents were asked for their views towards the problem faced after introduction of VAT system, which is shown in following table:

Table-4.18**Problems Faced After Introduction of VAT System**

| S.N. | Alternatives | No. of Respondents | Ranking Percentage | Ranking Position |
|-------------|----------------------------------|---------------------------|---------------------------|-------------------------|
| 1 | Problem in accounting system | 3 | 6.67 | VI |
| 2 | Increase in complain cost | 9 | 20 | II |
| 3 | Problems in tax refund | 2 | 4.44 | VII |
| 4 | Problems in administration | 12 | 26.67 | I |
| 5 | Decrease in competitive capacity | 8 | 17.78 | III |
| 6 | Problems in trade and transit | 6 | 13.33 | IV |
| 7 | Problem in credit transaction | 5 | 11.11 | V |
| Total | | 45 | 100 | |

Source: Opinion survey

Above table shows that 26.67% respondents focused on problems in administration after introduction of VAT system. Likewise 20% respondents focused on increase in complain cost. 17.78% respondents focused on decrease in competitive capacity. 13.33% respondents focused on problems in trade and transit. 11.11% respondents focused on problems in credit transaction. 6.67% respondents focused on problems of accounting system and 4.44% focused on problems tax refund process.

4.5.11 Future of VAT

VAT is advantages to the revenue mobilization by the international experience, not only this experience; the VAT system is also different than others type of taxing system like example of Vietnam. It is introduced in Asia in 1973 but it was replaced in short time. So Nepal has applying VAT system since in 1997 but cannot be saying as to the possible results and effects until its effective implementation. So in this

context a field survey was held as "Do you think VAT will effective in future? The following table shows the outcome of survey.

Table-4.19
Effectiveness of VAT in Future

| Respondents Alternatives | Tax Exports | | Business Persons | | Customers | | Total | |
|-----------------------------|-------------|-----|---------------------|-----|-----------|-------|-------|-------|
| | No. | % | No. | % | No. | % | No. | % |
| Yes | 9 | 90 | 13 | 65 | 6 | 40 | 28 | 62.22 |
| No | 1 | 10 | 4 | 20 | 4 | 26.67 | 9 | 20 |
| I don't know | - | - | 3 | 15 | 5 | 33.33 | 8 | 17.78 |
| Total | 10 | 100 | 20 | 100 | 15 | 100 | 45 | 100 |

Source: Opinion survey

According to survey 90% tax exports are optimistic about the future of VAT. Likewise 65% business person and 40% customers are optimistic about the future of VAT.

4.5.12 Suggestion from the Respondents

To know the other important factors for effectiveness of VAT a question was asked "Do you have any suggestion for the effectiveness of VAT in revenue collection in Nepal?" The respondents are as follow:

- The Inland Revenue Department should make offer to educate the tax payers and tax personnel.
- Reward and punishment system should be implemented without any partiality.
- Development checks and balance system.
- Effective tax management, training and seminar to the tax personnel.

4.6 Major Findings of the Study

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

1. The VAT was introduced on November 16, 1997 in Nepal.
2. VAT replaces the old sales tax, contract tax, hotel tax and entertainment tax. It has been designed to collect the same revenue as the four taxes it replaced.
3. Till the date of 29th of Poush 2061 the rate of VAT was 10%. The government increased the rate to 13% from Magh 1, 2061 BS.
4. Collecting the revenue from VAT is the responsibility of Inland Revenue Department (IRD).
5. The VAT system is governed by the Value Added Tax Act, 2052 Value Added Tax Rules, 2053 which are being amended by the government in time to time.
6. Currently there are 23 different offices of IRD which collect the revenue in all over the country.
7. Value Added Tax is collected at every stage of production and distribution of any goods and services except some provision for exempted goods and services.
8. In Nepalese the amount of tax revenue is higher than that of non-tax revenue. In the fiscal year 2010/2011, percentage of tax revenue to total revenue is 86.47% whereas percentage of non-tax revenue to total revenue is 13.53%.
9. The contribution of direct tax revenue on total tax revenue is very low than the contribution of indirect tax on it. In the fiscal year 2010/2011 the contribution of direct tax is 24% and the contribution of indirect tax is 76%.
10. During the study period in an average contribution of VAT revenue in total revenue is above 27.48%.
11. The tax revenue is one of the major sources of revenue of government. The average percentage of contribution in total tax revenue during the study period is above 34.31%.
12. The contribution of VAT on indirect tax revenue is an average 46.08%.
13. The relationship between tax and GDP is known as VAT/ GDP ratio. This is an indication of the utilization of taxes i.e. capacity. The VAT/GDP ratio is comparatively lower. The average VAT/ GDP ratio of 10 years from fiscal year 2001/2002 to 2010/2011 is 3.75%.
14. Import is the major source of VAT. In fiscal year 2009/2010, its contribution is 62.89% amounting Rs.34541025 thousands and fiscal year 2010/2011, its contribution is 63.71% amounting Rs. 39306573 thousands.

15. A large amount of government revenue comes from taxation. More than 80% of government revenue comes from taxation whereas the contribution of non-tax revenue is less than 20% in Nepalese tax structure. The contribution of tax revenues was expected to increase after the implementation of VAT. But implementation of VAT did not increase the contribution of tax revenue on total revenue significantly.
16. There is little knowledge about VAT to taxpayers and low public consciousness level in Nepal. To educate tax payers and all the concerned bodies, educational programmed has to be lunched in an effective way. But whatever programmer has been underway is not sufficient to create its impact on price. Most of the respondents suggest that radio/TV might be best media to educate taxpayers and consumers. Newspaper might be another good alternative.
17. Survey shows that 93.33% respondents agreed that VAT as an appropriate means of rising government revenue.
18. Only few members of consumers have habit of taking bills on their purchases. Consumers have no habit to take bill on their purchase. This implies that there is very low public awareness and consciousness level towards VAT. The percentage of customers demanding bills on their purchase is very low. This might be the cause of ignorance and no habit of taking bills.
19. Almost 70% respondents conclude against the view that is rise in price due VAT system.
20. Survey shows that 35.56% respondents focused on problems of tax refund process and 31.11% respondents focused on problems of registration.
21. Survey shows that most of the respondents focused on the needs of clear Act, Rules and Regulation for effectiveness of VAT.
22. The future of VAT is progressive and optimistic.
23. Open border is the main problem for effectiveness of VAT on revenue collection.
24. Respondents are suggested to achieve effectiveness of VAT in revenue collection from this ways; Reward and punishment system should be implemented without any partiality, effective tax management and training and seminar to the tax personnel etc.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

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

5.1 Summary

VAT is introduced in Nepal to generate more revenue by widening and boarding the tax base since it covers the value added to each commodity by a firm during all stages of production and distribution. From its beginning in 1997 to the current date the VAT system in Nepal has witnessed different scenarios.

In this study I have attempted to analyze the practice of VAT in Nepal, its revenue collection trend for past ten fiscal years. The share of VAT revenue to different tax heads is analyzed. Empirical analyses have been done with the help of 10 years data (i.e. from the fiscal year 2001/2002 to 2010/2011) and questionnaire developed by the researcher. This study is divided into five chapters. Prior to the body of the thesis, several pages of preliminary materials such as title page, viva-voce sheet, Recommendation, Declaration of the researcher, Acknowledgement, Table of contents, List of tables, List of figures and Abbreviations used have been included. Major chapters of this study are as follows:-

Chapter One: Introduction

Chapter Two: Review of Literature

Chapter Three: Research Methodology

Chapter Four: Presentation and Analysis of Data

Chapter Five: Summary, Conclusion and Recommendation

The first chapter begins with the brief background of the study, i.e., the introduction to Taxation itself, its types and all relevant information about Taxation which is essential for having some understanding about VAT, the main topic. The chapter also goes on to discuss the main focus of the study, research questions, objective of the study, significance, limitations and organization of the study. Therefore this chapter

presents the outline of the study highlighting its main aims and the reasons for carrying out the research.

In the second chapter, theoretical framework of VAT has been discussed. This chapter includes introduction to VAT, types of VAT, methods of computation of VAT, Origin vs. destination principle as dual principles of VAT, historical development of VAT around the globe and in Nepal, Coverage of VAT in Nepal and Tax administration also. Likewise in the resume of earlier studies, related materials like books, dissertations and journals have been reviewed.

The third chapter briefly explained the research design, nature and sources of data and the statistical procedure and tools which have been used to conduct the research.

The fourth chapter is the main body of the research work which has two main sections viz. presentation and analysis of data, and major findings of the study. This chapter begins with the need for reforms on the present tax system in Nepal, the reform in Tax being the VAT. Its importance was also studied. The study then moves on to examine the trend preceding and following the implementation of VAT in Nepal. The sample survey of 45 concerned people consisting of tax exports, Businessmen and customers was conducted to throw light on the administration system of Nepal. About 13 questions were asked them about the various issues relating to VAT in Nepal. The study also discusses the revenue collection from VAT, composition of VAT revenue, share of VAT revenue to GDP, to Total Revenue and to Total Tax revenue. The chapter then studies the future trend of GDP/VAT ratio. After all these studies were made, the study came up with major findings which were also included in this chapter.

The fifth and final chapter contains the summary of the four earlier chapters. This chapter also has conclusion of the research and attempted to offer various suggestions and recommendations for the enhancement and betterment of VAT in Nepal.

5.2 Conclusion

The ultimate goal of the underdeveloped countries like Nepal is to achieve the economic development and ensure the rapid rate of economic growth. It calls for a huge amount of investment in economic overheads and other development activities for which taxation is undoubtedly a primary source of Inland Revenue for the

government. Taxation may be considered as a basic tool in the path of economic development for the underdeveloped countries.

Recently, developing as well as developed countries in the world have increasingly focused their attention towards reforming the tax system by standardizing and improving the poorly designed tax structure in order to mobilize high volume of resources for the development purposes and make the economy healthy, efficient and self sufficient to a larger extent. In this regard, VAT has become a point of attraction for about 130 countries in the world including Nepal. Existed sales tax along with contract tax, entertainment tax and hotel tax were replaced by VAT since 1997 in Nepal. VAT was initially expected to have a high revenue yield due to its broader coverage and basis. Elimination economic distortions caused by tax system, elimination of cascading and pyramiding effects, creation of the competitive business environment, strengthening foreign trade etc, as it were, are other features of VAT theoretically, expected to be fulfilled in the real practice.

It was not easy for the Nepalese government to implement VAT easily as there were many objections and complaints from the business community. But after some dialogue and negotiations, the government was able to implement it to the satisfaction of all. However, there are several issues in the applicability of VAT in Nepal. One of the key issues is administrative capability and situation which definitely are of great importance for the effective implementation of VAT in Nepal. Actually VAT was introduced in Nepal in an ambitious hope to increase the revenue and particularly stop the leakage made through other forms of taxes. But history has shown that the government has already tried many reforms in the field of taxation but no alternative have effectively materialized because it lacked proper planning and in other words leading to administrative failure. Indeed, this is true in the case of VAT also, Nepalese businessmen are generally found to avoid the frequent contacts with the tax officials because they are widely known for unofficial benefits. Even in the administrative area, there is a widespread corruption. From the survey, it is clear that it is difficult for the customers to get the job done by officials without sufficiently bribing them. So, for the government, administrative capability and transparency are the serious concerns. In order to make VAT applicable, following things should be considered:

- Administrative power and credibility
- Tax payer identification

- Registration and educational program
- Incentives for small traders
- Co-ordination with private sector
- Feasibility of refund system
- Electronic media

Public awareness is very low. The salesmen are not used to issuing bills and the consumers to receiving them. Undervaluation and smuggling of goods are mostly found. The problem seems to be aggravated by the government's increasing the VAT rate to 13% which immensely discourages the customer in demanding bills on their purchases. Truly, recent increment in VAT rate has a fairly negative influence on general people. Their viewpoint is to broaden the tax base instead of increasing the tax rate. Tax rate has been increased time and again for nothing, but this does not get reflected in real revenue mobilizations. Rates should be continued for a long time for transparency and must be incorporated in VAT Act itself. So, the government has to pay serious heed in increasing the tax base instead of increasing the tax rates. International experience tells us that the gradual lowering of duties or tax rate is an effective tool in achieving the desired goals rather than increasing it.

Periodical policy has also been obstacles for its speedy enforcement, and a major hurdle that has hurt revenue generation. Excise duty is an important source for VAT, but it has not been effectively administered. Custom officials are more worried on customs duty than VAT collection. Widespread leakages are normal practices due to lack of professionalism, integrity, technically competent, and international orientation. Tax auditors have been auditing without basic knowledge and academic background. As it's weakly enforced, many sectors are out of tax net. Taxpayers complain that the procedures are complicated and time consuming during the decision-making process.

However, if the nation is to march fast enough to keep pace with the momentum of development and political change; it must come out with a new inventory of concepts and strategies as opposed to the old stereotyped ones. It is a well known fact that the industrialization of Japan, Hong Kong and South Korea was possible because of their tax policies. So under the changed system in the country, a tax system definitely could play a crucial role in course of nation-building. Sweeping and radical reforms on VAT

system with a comprehensive incentive package based on VAT concept would help the economy boom.

A bold vision, evolutionary leadership, efficient bureaucrats, honest taxpayers plus collectors and graft-free society are the invisible infrastructures required. The Inland Revenue Department must come up with a forward-moving process, concrete action plan and policies to cope with the global challenges in order to accelerate the reform process.

5.3 Recommendations

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

1. A proper co-ordination between IRD and MOF should be established. Unpractical Acts, Rules and Regulations should be amended. VAT laws needs to review on the basis of experience gained so far VAT laws should be effectively implemented.
2. Unproductive, corrupted, inefficient staff lacking practical and specialized training is a serious problem. So, providing training to such staff is highly essential.
3. The tax administration should be very watchful to prevent any kind of malpractice, fraud and tax evasion. Utmost care should be taken to prevent any kind of bribing and corruption. Tax officials should effectively be monitored.
4. Taxpayers, customers are clearly ignoring the VAT system and taking it for granted. They have lack of proper knowledge about computation of tax liability, taking invoice or bill on their purchases. So, emphasis should be given in educating the tax payers. The issuance of proper bill for every taxable sells must be made mandatory.
5. The success of VAT system is not only the success of the IRD, but also the success of nation as a whole. The role of general media, radio, TV, newspaper plays an important one. Emphasis should be given on mass media. Awareness towards VAT system should be created among general public, nongovernmental and government organization.

6. Computer system and networking program through online service must be developed and linked so as to make the work simple and easy. Computer links between tax officers and custom offices should be maintained.
7. Government has been providing tax refund facility to business organization and foreign diplomacy and foreign aided project. Tax refund is one of the sources of tax leakage. Therefore, tax authority should manage tax refund facility properly.
8. Research and investigation should be conducted on various issues, such as the effect of VAT on price, economic growth, investment and measures for solving VAT problems should be recommended by the expert group. VAT law needs to be reviewed on the basis of experience gained so far.
9. The accounting system should be transparent. Taxpayers should be encouraged to register their business voluntarily. Instead of forcefully coercing tax payers, providing various facilities to them can increase VAT compliance. The tax administration can select genuine business persons and reward them.
10. Border should be effectively controlled to prevent the illegal trade. Warehouse and highways checking should be done effectively to prevent any kind of illegal trade.
11. VAT collection on import is remarkably higher than domestic production. Government should take effective steps to encourage domestic production.
12. Lots of efforts should be made to reestablish a functionally well-organized organization where the tasks are carried out in a modern, effective, efficient, transparent and service-minded manner.
13. Most of the national economic activities are dependent upon agriculture and large portion of GDP coming from agricultural sector remains out of the tax net. Thus VAT should also be levied on agriculture sector with sufficient exception for generating more tax revenue. This will increase VAT/GDP ratio.
14. Most of the taxpayers are not satisfied with VAT administrators. They always have complaints against the administrators who do their jobs rather slowly, harassing the customers unnecessarily. The work that is to be finished today is postponed for the next day. This is their habit. Therefore it is suggested that tax administrators should be consumer-focused and result oriented.

15. VAT rule for luxurious goods should be increased and daily consuming goods should be reduced.
16. In the present Nepalese environment there exists instability of political situation, so government should create an effective environment, strong political commitment for effective revenue collection from VAT.
17. Lastly, the periodic information about VAT is now available on the website as well. For the researcher this is a great privilege. But the websites are not updated and doesn't have the older reports. So the website must be updated from time to time and must be kept up-to-date. And all backup copies of the old (old fiscal years') annual reports and Economic surveys must also be available on the website. This facilitates the researchers greatly and other concerned bodies, even the consumers, because for minor information, they would not have to frequent the Inland Revenue Department and Ministry of Finance.

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APPENIX – I

QUESTIONNAIRE

Dear Respondents,

I will be extremely obliged if you kindly help me to fulfill my objective of undertaking the research on "**Tax Reforms in Nepal: A Study of Nepalese Value Added Tax System**" by answering the following set of questions for dissertation required to the MBS course to be submitted to the Tribhuvan University. To analyze this research objective, I have enclosed herewith some questions, which are related with VAT problems. Your answer will be kept strictly confidential and will be used only for academic purpose.

Thank You!

Questionnaire

Name of the Respondents: _____

Office / Organization: _____

Designation: _____

Occupation: _____

Please tick (√) the answer of your choice or wherever appropriate put in order of preference from 1 to last number on the basis of alternatives. Number 1 stand for the most important and vice – versa.

1. Which media is effective for VAT education?

(a) Radio/TV

(b) Newspaper

(c) Booklets/pamphlets

(d) Wall painting/ Banner

(e) Seminars

2. Do you take the VAT as an appropriate mean of raising the Government Revenue?

(a) Yes (b) No

3. Is VAT more appropriate/ Superior to the areas it has replaced (such as hotel tax, entertainment tax and contract tax)?

(a) Yes (b) No

4. Do you take the bills on purchase?

(a) Yes, on every purchase (b) Yes, most of the purchase

(c) Yes, but not regular (d) No, I never get any bill

5. Will price rise due to VAT system?

(a) Yes (b) No (c) I don't know

6. Why people opposing or against VAT?

(a) Lack of knowledge (b) Extra burden

(c) Lack of accounting (d) Lack of co-operation

(e) Lack of public awareness

7. What kind of problems have arises in the process of VAT implementation in Nepal?

- (a) Registration (b) Collection (c) Tax refund
 (d) Other, please specify.....

8. Do you think that the revenue collection from VAT is satisfactory as it had been expected?

- (a) Yes (b) No (c) I don't know

9. What are the most important factors for effectiveness of VAT in revenue collection (please rank)

- (a) Honest tax officers
 (b) Honest tax payers
 (c) Clear Act, Rules and requisition
 (d) Effective and efficient administration
 (e) Tax education
 (f) Other, (please specify).....

10. To establish VAT as a major source of public revenue, what measures are needed?

(Please rank)

- (a) More trained and qualified officers
 (b) Minimize personal contact with tax payers
 (c) Computerized system for the payment of VAT
 (d) Collection of VAT should be given to private sector

11. What types of problem have you faced after introduction of VAT system?

(Please rank)

- (a) Problems in accounting system
 (b) Increase in compliance cost
 (c) Problem in tax refund
 (d) Problem in administration
 (e) Decrease in competitive capacity
 (f) Problem in trade and transit
 (g) Problem in credit transaction
 (h) Other (Please specify).....

12. Do you think that VAT will be more effective in future?

(a) Yes (b) No (c) I don't know

13. Do you have any other suggestion for the effectiveness of VAT in revenue collection in Nepal?

.....
.....
.....

Thank You!

APPENIX – II

LIST OF VAT EXEMPT GOODS AND SERRVICES

1. Basic Agriculture Products:

- a) Paddy-rice, wheat, maize, barley, pulse, flour and similar unprocessed food materials.
- b) Green and fresh vegetable, fresh fruits, fresh eggs and similar products (except used in hotel, restaurants, bars guest house, cafeteria and other similar organizations)
- c) Unprocessed cereals, (such as sugarcane, tea leaf, tobacco, cotton, cardamom, jute, oil, seeds, soybean)
- d) Herbs

2. Goods of Basic Needs:

- a) Piped water, including water supplied by tankers
- b) Fuel wood and coal
- c) Kerosene
- d) Salt

3. Live Animals and Animal Products:

- a) He goat, sheep, yak, he buffalo, bore, pigs, rabbit and similar other animals; their fresh milk and uncooked/unprocessed verities.
- b) Cows, she buffalo and she goat.
- c) Ducks, hens, cocks, turkey and similar other birds and their fresh meat, eggs and similar uncooked varieties.
- d) Fresh or dried fish (other than packed).

4. Agricultural Inputs:

- a) Seeds of any plants listed in Group 1
- b) Manure, fertilizer and soil conditioners
- c) Agriculture hand implements
- d) Pesticides, made mainly for use of crops
- e) Agriculture equipment, including tractors
- f) Post to provide water to chicken on poultry firm, box to keep chicken and crates and birds and animal feed

5. Medicine, Medical and similar Health services:

- a) Medical or surgical services provided by Government Institutions
- b) Human blood and products derived from human blood
- c) Human or animal organs or tissue for medical research.
- d) The supply services by person on the registers of veterinary surgeons and veterinary doctors.
- e) The supply of goods made for and suitable only for the use of disabled persons, X –ray film and oxygen gas to be used for treatment
- f) Raw materials purchased or imported by the drug industries to the extent approved by the Department of Drug Management

6. Education

- a) The provision of research in a school or university
- b) The provision, otherwise than for profit, or professional or vocational training or refresher training
- c) The provision of education in a school or university and supply of goods made in connection with such services

7. Books, Newspaper etc:

- a) Books, newspapers, newsletters and periodicals
- b) Newsprint

8. Artistic and Cultural Goods and Services, Carving Services:

- a) Painting, handicrafts, carving and related services
- b) Cultural programme
- c) Admission to libraries, archaeology, museums, zoos and botanical gardens

9. Passengers and Goods Transportation Services:

- a) Air transport. non- tourist passenger transaction (except cable car) and goods carrier (except transaction related to supply)

10. Personal or Professional Services:

- a) Personal services rendered by artists, sportsmen, authors, writers, designers, translators, and interpreters institutionally or individually

11. Other Goods and Services:

- a) Postal services
 - i. The services of conveyance of letters, money and postal packets by the post office
 - ii. The supply by the post office of any service in connection with the conveyance of letters, money and postal packets
 - iii. Postage stamps
- b) Financial and insurance services
- c) Bank notes and cheque books
 - i. The printing and issue of bank notes
 - ii. The supply of bank notes from outside the Kingdom of Nepal to the Kingdom of Nepal
 - iii. Cheque book
- d) Gold and silver
 - i. Gold, gold coins and gold ornaments
 - ii. Silver and silver coins (other than ornaments and goods made of silver)
- e) Electricity
- f) Raw wool
- g) Battery operated tempo, their chassis and battery
- h) Bio gas, solar power operated power generation plant and their main parts on the recommendation of the Alternative Energy Center
- i) Aero plane, Helicopter, Fire Brigade and Ambulance
- j) Jute goods
- k) Industrial machinery included in section 84 of customers tariff and subject to 5% tariff
- l) Woolen carpet & woolen carpet weaving, dying, washing, knitting
- m) Cotton and other synthesis sadi, Lungi, Dhoti, Gamcha
- n) Cotton yam
- o) Woolen yam to be used in hand knitting sweater (except artificial & acrylic) domestically
- p) Donated goods received for calamities or philan ihorpic purpose approved by Ministry of Finance

- q) personal goods imported which if free of tariff due to personal belongings, is the value added tax paid by cotton and match factory and industries producing rod and ingot using iron scrap as raw materials will refunded. However, to those industries which use 100 percent iron scrap as raw materials, will be refunded only 50 Percent of the VAT paid.
- r) Land and Building purchase and rent of land buildings(except the rental service provided by hotels, guest houses or similar organization)
- s) Belting, casinos, lotteries
 - i. The provision of any facilities for the placing of bets or the playing of games of chance
 - ii. Lottery

APPENIX III

RELATING TO SUB-SECTION (2) OF SECTION 7

ZERO RATED AREA

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