

CHAPTER: I

INTRODUCTION

1.1 Background:

Tax becomes the main source of revenue of the state. Value Added Tax is the latest innovation in the field of taxation. VAT is considered as the reform tax system of the 21st century, which has already been implemented popularly in more than 135 countries in the world. VAT is multi staged, commodity and services based tax which is levied on the value added of business at different stages of production and distribution. It is imposed on different stages. It imposed on value of goods and services. The value added tax is indirect tax depends upon consumer.

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

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

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

Tax is the largest source of public revenue of the modern governments. It is the internal source of national income. Tax is the legal duty of every citizen of a country

to pay honestly. In the present day, a government has to spend a lot of money to fulfill its responsibility towards its people. The responsibility may be either for security, for health, education or other developmental activities. To meet the growing public expenditure, the government has to manage its funds from internal as well as external sources. External sources of funds are foreign grant and loans. Such external sources are uncertain, inconvenient, and not good for healthy development if there is heavy dependent on them. It would be better to mobilize internal resources rather than expecting with beggar eyes to the donors. The experiences of developing countries show that there are negative results of increasing international aid and loan to finance the public development activities. As a result, their economic condition has gone down day by day. The government imposes tax on the people to repay the external debt, as a consequence of which the capacity or people to work to save decline.

In Nepal, **Value Added Tax (VAT)** was introduced on 16 Nov. 1997. This tax was levied in place of the Sales tax, Hotel Tax, Contract Tax and Entertainment Tax. However, it could not be implemented fully until the FY 1998/99 due to political instability and strong opposition from the business community.

VAT replaces the old sales Tax, Contract Tax, Hotel Tax and Entertainment Tax. It has been designed to collect the same revenue as four taxes it replaced. Since the collection of both customer's duties and income tax depends, to a great extent, upon the effectiveness of VAT, it is expected to help enhance revenue collection.

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 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.

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

There is a persistent increase in the number of VAT registrations. IT has crossed the 40000 mark. At the time of conversion from the then existing sales tax to VAT, a total

of 2045 taxpayers were converted as VAT registrants. As the taxpayers are increasing, the amount of revenue collection and the level of tax compliance are improving today.

Taxation is the biggest sources of public revenue of the modern governments. Tax is a kind of money of which it is the legal duty of every money of which it is the legal duty of every citizen of a country to pay honestly. In the present day a government has to spend a lot of money to fulfill its responsibility toward its people. The responsibility may be either for securing for health, education or other developmental activities. To meet the growing public expenditure, the government has to manage its funds from internal as well as external sources. External sources of funds are foreign grant and loans. Such external sources are uncertain inconvenient and not good for healthy development if there is heavy development on them. It is better to mobilize internal sources rather than experiences of developing countries show that there are negative results of increasing international aid and loan to finance the public development activities. As a result their economic contributions have gone down day by day. The government impose tax on the people to repay the external debt as a consequence of which the capacity or people to work to save decline.

Nepal is a predominantly agriculture base economy. The major portions of population live in village and most of them are below the poverty line. Being one of the poorest and least developed countries in the world, role of government is still vital to build up infrastructure, provides social services and alleviates abject poverty. Wide spread poverty rapid population growth, low income level of people, unemployment situation, lack of adequate infrastructure, dependency on foreign aid, unexploited resources, extreme disparity in the distribution of wealth and income, lack of adequate industries, adverse balance etc are the main characteristics of Nepalese economy. These are challenging problem, which demands increasing necessity of regular expenditure in general and development expenditure in particular.

Now a day, the prime concern of every nation is rapid economic development and being on of the developing countries, Nepal is not an exemption of this situation. In the present day world, economic development has been one of the formidable challenges for Nepal. Government revenue plays a vital role in the rapid economic development programmed to solve these challenging tasks. Government expenditure is

increasing day by day. For meeting day –to-day expenditure, government requires some sources of revenue. Revenue from a country may be from internal sources and external sources. Internal sources constitute tax and non-tax revenue and external sources includes foreign aids and loans. Such external sources are uncertain, inconvenient and not good for healthy development. Most dangerously it would give rise to the dependency syndrome, which is not healthy signal for any country. Thus it is better to mobilize internal resources rather than approaching to the beggar’s eye to the donors.

Taxation is the most effective and powerful tool reserved in the hands of the government of a country. The major objective of taxation is to make fund available for the economic development and economic and economic stability. A major part of government revenue comes from taxation. It constituted 75.74 percent of total revenue collected in fiscal year 2002/2003 while non-tax revenue constituted only 24.26 percent. Which show that, for the economic development of the country, internal resources mobilization is much better than external resources mobilization? It is better for developing countries to maximize revenue through domestic sources, which is much safer is much and fruitful as well. Taxation not only contributes in economic development and stability but also helps equal distribution of national income of the country. (Khadka, Rup B., 2000)

Value Added Tax (VAT) is a general consumption tax assessed on the value added to goods and services. In some countries, including Australia, Canada, New Zealand, and Singapore, this tax is known as “goods and service tax” or GST: and in Japan it is known as Consumption tax”. It is a general tax that applies, in principle, to all commercial activities involving the production and distribution of goods and the provision of services. It is a consumption tax because it is borne ultimately by the final consumers. 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 is intended as a tax on consumption, exports (which are, by definition, consumed abroad) are usually not subject to VAT or VAT is refunded. (Laudari, Rajan, 2010)

It is collected fractionally, via a system of deductions whereby taxable persons can deduct from their VAT liability the amount of tax they have paid to other taxable persons on purchase for their business activities. These mechanisms ensure that tax is neutral regardless of how many transactions are involved. In other words, it is a multi-stage tax, levied only on value added at each stage in the chain of production of goods and services with the provisions of a set-off for the tax paid at earlier stage in the chain. The objective is to avoid 'cascading, which can have a snowballing effect on prices. It is assumed that due to crosschecking in a multi-stage tax; tax evasion will be checked, resulting in higher revenues to the government. Value added tax falls under the general category of a consumption tax, meaning taxes on what people buy rather on their earning, savings, or investments.

VAT has also been referred to as a sort of sales tax, though its functions vary differently. Sales tax is imposed on the total retail price of the item sold, while VAT is imposed on the value added at each stage of production and distribution. And though more complicated than sales tax, value-added tax system has more checks against tax fraud because the tax is assessed at more than one point in the distribution process.

Over 130 countries worldwide have introduced VAT over the past three decades and Nepal is amongst the last few to introduce it. Nepal already had a system of sales tax collection wherein the taxes were collected at one point (first/last) from the transactions involving the sales of goods. VAT would, however, be collected in stages (installments) from one stage to another. The mechanism of VAT is such that, for goods that are imported and consumed in a particular stage, the first seller pays the first point tax, and the next seller pays tax only on the value-added done – leading to a total tax burden exactly equal, to the last point tax.

VAT is an indirect tax. It is an improved and modified form of sales tax. It is levied on value added of goods and services at each stage in the process of production and distribution chain. This stage can be import, manufacturing, wholesale and retail. Value added for a firm is sales value minus all expenditures on goods and services purchased from other firms. The value added can be obtained by adding payments to factors of production (wages, salaries, rent, interest and profit). This value added is the

base of VAT. Although VAT is eventually borne by the final consumer, it is collected at each stage of production and distribution chain.

To conclude, VAT has been the most essential ingredient of tax reform of developing countries because it is the most improved form of sales tax, which leads to revenue enhancement and economic efficiency. It is an important instrument for the internal resources mobilization. There is tremendous scope for increasing the revenue from VAT. The sound implementations of VAT will obviously increase its contribution to coming days. The tax reform with an adoption of VAT is, therefore, an essential connection with the efforts of many underdeveloping countries as one of the major elements of tax revenue sources to achieve the goal of acceleration of economic development.

1.2 Statement of Problem

Economic development is considered as a basic need for a welfare state to fulfill the aspiration of its people. But Nepal is a developing country facing development challenges to promote the life standard of its 42% of citizens living below the poverty line.

The world is now stepping toward the 21st century. But Nepal is still one of the poorest and least developed countries in the world. Despite more than four decades of planned development, the Nepalese economy is persistently suffering from general poverty and stagnation.

Like other developing countries in the world, Nepal has been suffering from resource constraints, massive poverty, rapid population growth, increasing unemployment, high dependency on agriculture, subsistence living standards and poor infrastructure. Unfortunately, the problems, instead of being solved, are rather deepening and worsening.

In Nepal, resource mobilization is still poor that does not cover the growing expenditure. Because of deficit financing and external loans, the economy has to face the resource gap; debt trap problem. It is widening continuously with the increment of total expenditure in respect to total revenue collection. It is shown in the following table:

Table:-1.1
Resource Gap in Nepal

Rs. in million

Fiscal Year	Expenditure	Revenue	Resource Gap	% Of Resource Gap
2004/05	80072.00	50445.40	29626.60	37.00
2005/06	84006.00	56229.70	27776.30	33.06
2006/07	89443.00	62311.00	27132.00	30.33
2007/08	102560.40	70021.00	32539.40	31.73
2008/09	110889.20	72282.00	38607.20	34.82
2009/10	131851.00	86135.20	45715.80	34.67

Source: Economic Survey 2009/10(GON, Ministry of Finance)

Above Table 1.1 shows that the scarcity of internal resource because of growing resource gap that existing in Nepalese economy, there's no alternative resolution to finance the additional expenditure except deficit Financing. Since 1965, Nepal has been attempting the deficit financing although its nature is inflationary. Each budget contributes enlarging its size in the Budget. So, we can conclude that its increasing trend is still continuous. Government expenditure is increasing day by day but there is no increasing in government revenues equivalently. Such unbalanced growth in revenue and expenditure has resulted in massive revenue expenditure gaps or budgetary deficit in the country. The major cause of persisting fiscal deficit in Nepalese economy is inadequate resources mobilization. It is the result of poorly designed tax structure. The design of tax in Nepal is poor and defective. The revenue instruments are always having very weak performance. Contribution of tax to the national revenue is low due to the above reasons. In other sense weak performance of tax is the root cause of low tax GDP ratio.

The ever increasing government expenditures and limited resources of the revenues have led the country to sever fiscal crisis over the years. Government expenditure is increasing while there is no 'equivalent' increasing in government revenue. Such unbalanced growths in revenue and expenditure have resulted in massive revenue expenditure gaps or budgetary deficit in the economy.

Nepal's lower revenue mobilization is due to the poorly designed and defective tax system where the taxes are less productive, less responsive and distribution. It is expected that VAT would be a major instrument to avoid deficit financing. In an attempt to reform the existing tax system, the government has planned to adopt a VAT in Nepalese tax system. In Nepalese tax structure, sales tax is found to suffer from very low tax base, cascading effect and distribution effect but VAT is considered as the best form of sales tax, with the merits of self policing, catch up effect, broad base etc. So there is the need of VAT in place of sales tax to mobilize up effect, broad base etc. So there is the need VAT in place of sales tax to mobilize initial resources through effective structure, which is also considered as the optimal solution of resources gap and dependency on foreign aid. In the earlier stage of introduction of VAT in Nepal, it has triggered a lot of debate among the businessmen and government regarding its good and bad effect. There have been arising various issues on design of vat, its administrative operation and applicability and its effect on different segments of society. A careful examination of these issues and imperative analysis is necessary to implement VAT successfully in coming days. So it is a time to evaluate the Nepalese VAT by identifying its present problems and analyzing future prospects, not only from theoretical aspect but also from the practical experience, which is the subject matter of this study.

1.3 Objective of the study

The general framework of the study is to examine the various problems and scanning the practices of VAT in Nepal and to suggest the useful alternatives solutions against the major issue. The major objectives of the study are.

- a. To examine the importance of VAT in revenue collection study.
- b. To review about theoretical aspect of VAT.
- c. To identify current problems and analyze future prospects of VAT
- d. To recommend for making VAT effective and efficient in coming days.
- e. To examine the contribution of VAT to revenue mobilization.

1.4 Significance of the study

Since there exists an acute resource gap in Nepal, Resource mobilization is a challenging function in different condition of a nation. Actually VAT is scientific system in the field of taxation. VAT may be the tools of mobilizing resources more

efficiently. The main focus of the study is related with topics of major issues and effective practices of VAT in Nepal. The concentration is made in this study to make awareness of general people toward VAT because most of the people are unconscious about VAT even today. The main reason of selection of this topic is to compute VAT with sales tax as presence and administrative development.

In Nepal, the coverage of income tax is very low. Very few people of the total population pay the income tax. There is a poor income tax habit of Nepalese people. There are a lot of researches on VAT conducted abroad as compared to Nepal. About ten years have been passed since VAT came into operation, but many Nepalese people are unknown about various aspect of it. VAT, being itself a complicated and modern tax system, more efforts should be made on actual circumstances. Theoretical and practical knowledge are required to implement VAT properly. So this study analyzes Nepal's VAT system with its problems and prospects with its revenue contribution. Because of this reason, the studies will directly beneficial policy maker, private sector, researchers and other general people. Policy maker will be able to identify the areas requiring improvement and for the proper implementation of VAT in Nepal. It will also provide a clear and knowledge to these persons who are interested and confused about VAT system. Similarly, it will be valuable reference to the scholars or researcher to conduct further similar research on VAT system. Recommended option will help to make the decision about effective implementation of VAT in Nepal. From such standpoint, the study deserves great significance.

1.5 Limitations of the Study

Some specific limitations of this study are as follows;

1. The extent of this study is based on the availability of reliable data and sufficient literature.
2. To make this study manageable in terms of budget and time bound is limit.
3. The sample size in the study is 50 and some of the respondents are found less acquaintance with Value Added Tax, so their responses may not be accurate. Further the probability of sampling error is there.
4. The study is confined within the prevailing acts and laws of the country.

These above limitation, no doubt, have some impact on quality of the study. But such impact will not affect usefulness of the study in a significant manner. In fact this study would provide a base for further study in the area of Value Added Tax in the country.

1.6 Scheme/Organization of the study

This study is divided into following five chapters. Each devoted to some aspects of the study of the Value Added Tax. The titles of each of these chapters are as follows;

Chapter I: Introduction

This chapter includes General background of the study, Statement of problem, Significance of study, Objectives of study, limitation of study and Chapter Scheme.

Chapter II: Literature Review

This chapter is connected with review of literature. The reading material of this chapter is conceptual review of related literatures. This chapter has also covered Concept of VAT, provision of VAT, An overview of VAT system, Methods of calculating VAT etc

Chapter III: Research methodology

This chapter is consists of research design, sources of data, data collection techniques, and analysis of data.

Chapter IV: Presentation and analysis of Data

This chapter includes Revenue collection through VAT, comparative contribution of VAT, trend of VAT collection, growth of VAT, Survey Result (in various aspects of VAT implementation) and major finding of the study.

Chapter V: Summary, Conclusion and Recommendation

This chapter covers summary of this study, conclusion of research findings and recommendation for effective implementation of VAT.

CHAPTER-II

CONCEPTUAL FRAMEWORK AND LITERATURE REVIEW

2.1 Theoretical Aspects of VAT

2.1.1 Introduction of VAT

Value Added Tax imposed on the value added to goods and services consumed in Nepal or exported outside. 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 chain. There is the presumption that VAT is shifted forward completely to the consumer.

Value Added Tax is newly developed modern and scientific tax system, which is recently innovated in the field of taxation. It is hybrid taxation from the retail level of sales tax. So vat is an advance form of sales tax. It has spread all over the world with in a short span of time. It has gained huge popularity in short period of time in a history of taxation.

In the field of taxation, VAT has been considered as an attractive alternative to indirect tax system. It has been emerging as a main element of the worldwide tax reforms although it is the youngest form of taxation innovated in the second half of the twentieth century.

Value added tax is a tax imposed on "value added" by a business firm a goods and services at the successive stage of production and distribution. Value added on a commodity or services is a simply the excess of sales value over purchases by business entity. The VAT is collected from seller on the basis of their value added at each stage of business process, thus the same value in never taxed twice and never produces cumulative effect.

VAT is now concept of collecting revenue. Each step of goods and services are levied to tax to tax on its added value. It covers the value added to each commodity by a firm during all stages of production and distributions and the vat is shifted forward completely to the ultimate users.

We can able to get a clear concept of VAT through an example. Consider the case of sugar production. A farmer produces sugarcane and sells it to the mille. Miller adds value in the process of changing sugarcane in to sugar. Value added of miller constitutes all expenditure including profit and miller sells his product i. e. sugar to the dealer, which in turn, sells it to the retailer with an increased value. Ultimately, sugar is sold to the consumers with some additional value. Thus, at each stage of production and distribution, value is added as turn total of all such added value exactly equals to the final sales value of The sugar.

The following table shows simple process of calculating VAT.

Table: - 2.1
Process of Calculating VAT

Channel Of distribution	Cost Price	Value Added	Selling Price excl. VAT	VAT @ 13%	Selling Price Incl. VAT	Vat to Govt.
Farmer	–	–	500	65	565	65
Farmer- Miller	500	100	600	78	678	13
Miller- Dealer	600	100	700	91	791	13
Dealer-Retailer	700	100	800	104	904	13
Retailer – Consumer	800	100	900	117	917	13
Total						117

Source: Arbitrarily estimated figures

From the above table, by using a VAT rate @ 13% the farmer pays of Rs.65 as VAT to the government. The miller collects VAT of Rs.78 on his sales but has an input tax credit of Rs.65 and thus remits Rs.13 to the government. Like wise, the dealer collects VAT of Rs.91 but deducts his inputs tax Rs.78 and remits the balance of Rs.13 to the government account. On the same way, retailer collects Rs.104 as VAT and remits Rs.13 to the government after deduct his input tax of Rs.91. at last, the consumer will pat Rs.117 (i.e. 65+13+13+13+13) from all stages.

VAT for a firm is nothing but its gross receipts from sales minus all expenditure, on goods and services purchased from other firms. In the production and distribution process, a firm buys materials from other firms. These materials may include principle raw materials, auxiliary raw materials, chemical, electricity and goods such as machinery, equipment, building, furniture and vehicles. The firm adds value to these purchased materials by processing or handling them with the help of its own factors of production such as labor, land, capital etc. This increase in the value of output over inputs is the value added by a firm to factors employed. This means that value added by a firm is equivalent to its payment of wages, salaries, rent and interest plus its profit and this value added is the base of VAT.

2.1.2 Origin and development of VAT

VAT is the youngest member of the sales tax family. The rise of VAT is an unparalleled tax phenomenon. Historically the VAT has its origin as an alternative to defective multistage turnover or cascade type of taxes. The VAT has also has been used to replace the single stage manufacturing, wholesale or retail level sales taxes. The concept of this tax in Germany in 1919 by a mission assigned to propose reforms in tax system of Japan under the chairman of professors Carl S. Stoup. Thus although the concept of this tax was evolved in Germany and a more detail from was prescribed for Japan on country adopted this tax system until 1953 up to that time, VAT remaindered a topic of academic decision.

VAT is the most recent innovation in the field of taxation. The concept of VAT was developed for the first time by Dr. Wilhelm V. Siemens in Germany in 1919. The concept of VAT was developed further in 1949 by a tax mission to Japan headed by Prof. Carl S. Shoup. The tax however, remained as only a topic of academic interest until 1953. In 1954, France introduced a VAT covering the industrial sector. The tax was, however, limited up to the wholesale level. By the end of 1960s, only eight countries including France Brazil, Germany, and the Netherlands Sweden etc. had introduced VAT. Since then, VAT has been introduced by at least one country each year and by now it has been adopted by more than 120 countries.

Vietnam ventured VAT for the first time in Asia in 1973 but it was replaced in short period. South Korea adopted VAT in 1977 and is continuing till this time. Therefore, it

is the leading country in Asian continent. In South Asia, Pakistan is the first country introducing VAT. It introduced VAT in 1990.

In this way, many rich and poor countries, developed and developing countries, small and big countries, socialist and capitalist countries have adopted VAT. In present situation more than 125 countries adopted VAT system and also have growing attention of other developed and developing countries.

2.1.3 Preparation of VAT in Nepal

In Nepal VAT preparation began in September 1993 when a VAT task force was created in order to make necessary preparation for the introduction of VAT. A VAT steering committee was also set up to evaluate and monitor VAT preparatory activities. The United States Agency for International Development (USAID) provided financial assistance in order to support the VAT preparation and implementation process in Nepal. Under this project, the technical assistance of the Hardware Institute for International Development (HIID) began in the fall of 1993. Members of the VAT task force and the HIID consultants worked together. USAID/HIID assistance was supposed to last August 1996.

However, a change of government took place in late 1994 when a minority government was formed. The new government did not show the same commitment in the beginning to implement VAT. Consequently, the USAID activity was suspended at the beginning of 1995. The new government, however, kept the idea of VAT alive. This government appointed a tax system review task force in order to review the overall tax system and tax administration. The task force strongly recommended VAT for the rationalization of the Nepalese tax system. There was again a change in the government in late 1995 when a new coalition government was formed. This government decided introducing VAT at the earliest date, As a result, the USAID/HIID technical assistance resumed in February 1996 for a period of about 8 months. The USAID/HIID assistance was later extended and continued until the end of September 1997. Assistance for the implementation of the VAT was continued beyond September 1997 through financing provided by the Danish Government. The assistance of DANIDA's, was originally meant for 2 years, but still coming up with high enthusiasm

2.1.4 Types of VAT

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

I. Consumption Type VAT

Under the consumption type VAT, all capital goods are purchased from other firms in the same year is allowed to deduct from sales value. While depreciation is not deducted from the tax base in the subsequent years. Since investment is relieved from taxation under this variant, the base of tax is consumption. As exports are relieved from tax while imports are taxed, the base of this tax becomes identical to the base of retail sales tax on consumer goods and services. Thus,

Consumption type = gross national product – gross investment = total consumption expenditure

II. Income Type VAT

Under this variant, capital goods purchased from other firms are not deducted from the tax base however, the depreciation in the subsequent years is allowed to deduct from the tax base. The tax falls both on consumption and net investment and the conceptual tax base of this variant is the national income. Thus, tax base under this variant includes consumption and net investment, which is equivalent to the net national product (NNP). Therefore, tax base is given as

Income type = gross national product – depreciation = net investment + consumption = net national product (NNP)

III. The gross national product Type VAT

The base for this type of Vat includes capital goods along with the value added on the other raw materials, semi manufactured goods etc., purchased from other firms. Hence under these variants, capital goods purchased from other are not allowed to deduct from sales while calculating the tax base. Thus, the base of VAT consists of

consumption and gross investment, which is equivalent to the gross national product (GNP).

Base of VAT = GNP = c+ ig

= Consumption + gross investment

2.1.5 Principle of VAT.

While considering the international trade, the principles of VAT have great significance. Whenever international trade between two countries is considered, cross boarder adjustment is necessary: in that case it is very useful to know these principles. There are two principles for levying VAT. They are origin principle and destination principle. Choice between these two principles largely depends on the goals and the policies of nation, accession of international trade computing methods and types of VAT.

In case of international trade, two serious alternatives appear while implementing VAT in any country. They are taxing all domestically produced goods including exported ones and exempting all imports or taxing all the imports and making exception for all exported goods and services to the foreign countries.

a) Origin Principle

Under origin principle, goods and services produced in a country are subject to tax at the place where they are produced or rendered, wherever they are consumed, and the goods and services imported from the abroad are beyond the tax base. Hence this principle is not the favor of imports and against exports where there is open broader and cross-country trade. Thus, this principle affects balance of payment of the country negatively specially for those who have a poor performance in the world economy. The principle could be followed, with appropriate changes, in the exchange rate, but countries are reluctant to attempt this approach.

As the country can enforce jurisdiction over firms located with in its jurisdiction, the principle is much simple and there would be no rebates on sales for delivery with in the common market countries, rather each country would give credit for tax imposed in the country of origin. Under such situation the origin principle has gaining more importance in EEC countries to achieve the ultimate objectives. Three methods subtraction, addition and tax credit, are all equally well adopted to use of single rate

origin principle. Value added tax with respect to exports; imports in contrast, are bound to present a difficult problem for the original principle if the tax credit method is used.

b) Destination Principle

Under this principle, all goods and services are taxed at the place where they are produced or rendered but the place where they are consumed. It includes at the imports in the tax net while exports are free from tax. As, the principle taxes imports and exempts exports, it will have favorable effects on the country's balance of payment. According to this principle, tax would be collected at importation and the firm would receive credit for this tax and a refund when the products are exported. This means tax levied on the importation of the basis raw materials, semimanufactured goods etc. Which are imported for the production in the domestic market will be refunded when the products is exported. Indeed, by principle no tax is collected upon importation at all, other than by the ultimate user. The broad results is that the relative ability of one country to another will be unaffected by a destination arrangement which treats imported and home prepared good. Thus, neutrality one of the essential features of the good taxation, is provided by the destination principle by means of no discrimination between imported and domestic products.

In conclusion, destination principle is more appropriate, for a country having consumption type of value added tax with the tax credit method of computation. Special benefit by this destination principle can attain by those countries who have open border and cross country trade, and less competent in the open market.

2.1.6 Design of VAT Law and VAT System

The VAT law was drafted in 1994. It was discussed in depth at several stages with in the VAT task force with the efforts of the low reform commission and thevarious business groups. It was review by the VAT steering committee. The draft was sent various business groups including the Federation of commerce and industry (FNCCI) and Nepal chamber of commerce for their comments. While this was a good beginning to seek the opinion of the private sector on the proposed VAT law before its approval by the parliament in written comments were received from the private sector on the draft VAT act.

The VAT regulations were drafted in July 1996. Like the VAT Act, the regulations were discussed at different stages. They were sent to the FNCCI for comments. As in the case of VAT act, no comments were received from the private sector on the VAT regulations. Cabinet approved the regulations on 27 January 1997.

The operational manual was initially drafted in 1996 and was finalized in the fall of 1997. HMG approved the operational manual on 21 September 1997. The manual has been prepared in volumes, covering all aspects of VAT from the law through investigation of offenses. They are: (i) organization and management (ii) charging and accounting for value added tax (iii) VAT registration (iv) collection and enforcement (v) payment of claims for refunds (vi) verification and audit (vii) fraud investigation (viii) the VAT computer system and (ix) VAT act and rules.

2.1.7 Methods of calculating VAT

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

I. Additional Method

Under this method value added is the total sum of the factor payments made by the business firms, which is equivalent to the gross income received by the factors of production. The tax base is computed by adding the payments made by the firms to factors of productions employed in turning out the product, such as wages, interest, rent, royalties and profits. Thus, VAT under additional method is the function of the total factor payment as given by:

$$\text{VAT} = f (\text{W}+\text{R}+\text{I}+\text{P})$$

Where,

W = wage,

R = rent

I = interest,

p = profit

II. Subtraction Method

Under this method value added is determined as net turnover which is obtained by subtracting the cost of materials from sales proceeds and the procedure was used in the Michigan VAT. Value added is obtained by subtracting purchase of produced goods from the figure of sales during the period, as given in the functional form by,

$$\text{VAT} = f (S_v - P_v)$$

Where,

S_v = Sales value

P_v = purchase value

This method of calculating VAT is suitable for the consumption variant of VAT. It is not well suited for discrimination among types of consumer goods but it needs not any adjustment to operate correctly for imports under the origin principle. Something also happens to the addition methods. However, under the destination principle, these principles, these both methods of direct calculation can not supply the information needed to compute precisely the export rebate or the import compensating tax when there is not uniform rate to all stages of value added of all goods and services.

III. Tax Credit Methods

Tax credit method is also known as the invoice method and uses an indirect subtraction technique to compute the tax liability. Value added as such never calculated at all. In this method, but the effect is exactly the same as if the figure was calculated and the tax rate applied. Since, the firm deducts the amount of the tax paid on its purchases during the period from the figure calculated by applying the tax rate to its figure of taxable sales for the period. Under this method taxpayers are allowed to subtract the taxes already paid by the supplier and passed on to them from the gross tax liability, which is levied on the total value of their sales. Thus, in contrast to the subtraction method, which deducts purchases from sales and levies taxes on the difference, tax on purchases is subtracted from the tax on sales under the tax credit method.

Hence net tax liability is given by:

$$\text{VAT} = f (\text{Outputs} - \text{Inputs})$$

Where,

Outputs = tax collection from sales

Inputs = tax paid on purchases

Among the above three method of computing VAT, the tax credit method is widely favored in the countries. The invoice method is used generally in European countries. The tax credit method is so superior to the other method in terms of application and enforcement as well as adaptability to various rates modification that is now universally employed. The methods of calculating VAT liability under the different methods are shown in the table below:

Table: - 2.2

Calculation of VAT liability by different methods (13% VAT)

Figures in Rs.

	Stage of production and distribution			Total
A. Addition method				
(a) Wages	15000	25000	10000	50000
(b) Rent	5000	3000	2000	10000
(c) Interest	3000	2500	1500	7000
(d) Profit	1000	1500	500	3000
(e) Value added (a+b+c+d)	24000	32000	14000	70000
(f) VAT liability (13% of e)	3120	4160	1820	9100
B. Subtract Method				
(a) Sales	40000	30000	30000	100000
(b) Purchases	30000	25000	25000	80000
(c) Value added (a-b)	10000	5000	5000	20000
(d) VAT liability (13% of c)	1300	650	650	2600
C. Tax credit method				
(a) Sales	60000	40000	25000	125000
(b) Tax on sales (@13%)	7800	5200	3250	16250
(c) Purchases	50000	35000	20000	105000
(d) Tax on purchases (@13%)	6500	4550	2600	13650
(e) Net VAT liability (b-d)	1300	650	650	2600

Note: All sales and purchases are exclusive of tax and the figures are assumed.

Among three methods, the tax credit method is much better than other. It has following major benefits over the other two types of VAT computation. (i) In the tax credit method, tax liability is attached to transaction that makes it legally and technically superior. (ii) Tax Collection is easy (iii) cross checking is possible, (iv) It provides the benefits catch up effect that makes under evaluation and tax evasion impossible (v) there will be no loss of revenue due to the exemptions granted to the small traders (vi) It never demands for the calculation of value-added total tax (vii) Liability entirely depends on the rate on the last stage, so rate differentiation is possible for the same revenue yields. Calculation of VAT liability under tax credit method is described in detail below:

Table: - 2.3

Calculation of VAT liabilities by tax credit method

(VAT rate 13%)

In Rs. thousand

Particular	Stages of production and distribution			
	Farmer	Manufacturer	Wholesaler	Retailer
Type of production	Sugarcane	Sugar	Sugar	Sugar
(a) Purchase	0	200	400	400
(b) VAT paid on purchase	0	26	52	58.5
(c) Sales value	200	400	450	510
(d) Gross VAT liability on sales (@ 13% on (d))	26	52	58.5	66.3
(e) Net VAT liability (d-b) or VAT paid in each stage	(26-0)=26	(52-26)=26	(58.5-52)=6.5	(66.3-58.5) = 7.8
Actual sales price	226	452	508.5	576.3

Note: Figure is estimated arbitrarily and both the sales and purchase value exclude tax liability.

Here, for the sake of simplicity, the purchase value of the farmer is assumed zero as shown in the table 2.3 Each seller calculates the gross tax liability by applying the given tax rate to his sales value and then gets net VAT liability by subtracting the amount of VAT liability paid by the seller at different stages equals to the gross VAT

liability on sales with the same VAT rate, so far as tax credit chain is not broken. Unlike the remaining two methods, there will be no change in total VAT liability by two methods in the tax credit method, there will be no change in total VAT liability by the rate differentiation in earlier stages.

2.1.8 Value Added Tax and Other Sales Taxes:

VAT is modern and scientific tax then other form of sales tax. VAT is compared with other form tax as follows:

2.1.8.1 Value Added Tax and Turnover Tax:

Turnover tax is a form of sales tax, which applies to the selling price of each point of sales. In this sense a turnover tax is the multiple stage cascade tax. This means the effective tax rate applies to all stage of production and distribution. This tax offers mainly to advantage: (a) A low tax necessity for given sum of revenue (ii) there is no complication of concession for various types of firms. Under this system tax evasion may arises because there is possibility of vertical integration. Such integration distorts the economy. This effect of tax is reducing economic efficiency which is the worst level of the tax.

A turnover tax further discriminates against the domestic product and imported goods. Imported goods need to pass less stages of transaction if the good are finished product. On the contrary domestic products need to pass mark stage and transaction. Turnover tax applies to the total volume of transaction of the product at each stage of production and distribution; it creates a strong incentive for reducing the economic activities at earlier stages like performing many activities of producing and distribution under a single roof. There will not be any incentives for integration in a VAT system, since the total amount of tax on the produce will be the production and distribution system and the taxable price is always equal to the final price of the product. Thus from the view point of neutrality VAT is so far superior to the turnover tax.

The turnover tax is comparatively easy to administer as it applies only on gross so that there is no need of tax credit. The double-checking and several provisions associate with the VAT create complicity however makes the tax system transparent, efficient and equitable.

Comparative easiness and simplicity also can be found in turnover tax in the viewpoint of tax compliance. But due to the self-enforcing feature of VAT, it is more attractive to check the tax evasion. An uneven burden is also created on various commodities by turnover tax and further the burden varies with the typical number of transaction through which a commodity passes on its way to the final consumer.

2.1.8.2 VAT and Manufacture's Sales Tax (MST)

Manufactures sales tax (MST) basically covers domestic manufacturing as well as imports. This is a single stage levy. In practice manufactures and importers are required to register for sales tax purpose. Generally this type of tax is applied on sales in case of domestic product and on the import value in the case of imported goods. These types of tax is favored in many developing countries in the sense that it more or less avoids the cascade evil and covers more organized entrepreneurs so as to make administration easy.

In contrast, VAT avoids cascading and pyramiding effects. It does not have a negative impose on negative impact on economic growth. The tax burden also falls stepwise under a VAT system, rather than at once in an import level of sales tax. The stepwise burden would not disport economic sectors. So, they will not encourage evading tax. But if, burden is laid down at once, a very high load will depress the entrepreneurs so as in creating the tax evasion. From the above discussion we can conclude that MST is non-neutral, limited in base and encouraging various difficulties with the culmination of tax evasion. VAT proves advantageous over MST, that it has broad coverage equipped with catch up effects, eliminating cascading and pyramiding and desirable in developing countries because it is distrusted roughly according to consumer expenditure. The main disadvantage, coherent to VAT, in comparison to MST, is the large number of taxpayer with poor record keeping. But it can be covered by means of improvement in administration.

2.1.8.3 VAT and Wholesale Level Sales Tax (WST)

Simply speaking, the wholesale level sales tax (WST) means the taxation on sales to retailers by wholesaler. In underdeveloped country, wholesalers are more organized than the producers and retailers. Thus it is easy to implementing in practice and more meritorious than MST in the sense that it covers value added by wholesalers.

Wholesaling goods are carried directly from producers or importers. But in many countries, there is no provision of separately registers. Making the provision of separate registered as domestic enterprises and imports can enlarge the volume of taxable base. Which makes WST more suitable too? As a theme WST can be levied in two ways i.e. WST impose on wholesale enterprise and accompanies with manufacturing or retail system. On the ground of revenue potentiality, Value added tax provides more revenue than WST but as compared with MST, wholesaling enterprises lie some how greater than MST compared to VAT. For the administrative formalities like calculating tax base cross checking and auditing, refund procedures etc are less under the WST system. Further more, WST is easy to handle since it needs only to watch on sales point of wholesalers. On the basis of this reasoning WST is argued to be superior. The inclusion of new items i.e. basic necessities would make VAT more vertically inequitable than MST and WST as it will be levied at uniform rate however, the imposition of VAT on services. Which the higher income group largely consumes would have opposite effect. Despite these few merits of WST, we cannot ignore the contradictory and bad effect of WST in practice, which puts the demerits of VAT, is shadow. If manufactures or importers encourage direct sell to retailers or consumers then the revenue will be nil. The problems should be more serious when for the two kinds of goods having same qualities and price whereas distribution process is different. Suppose one commodity (say A) supplied from producer to wholesaler and wholesaler to retailer successively but the other commodity (say B) is supplied directly from producer to retailer or to consumer, then definitely the price of 'B' becomes for below than 'A' due to the WST. In this case, the commodity 'B' cannot complete with 'A' in the market. Such a vast alternation compels the producer of commodity 'A' to close down his production. Thus WST is on neutral among the production and distribution process as well as consumer choices. But in contrast, it is notable that VAT does not create such discrimination because VAT is levied in every stage of business process.

Thus, WST encourages manufactures or importer to sell directly to the retailers so that product remains beyond the tax net. This results a loss in the revenue on the other hand, it discriminates against those products by means of competitive advantage, which bear the tax burden favoring those firms, and product, which do not bear the tax burden. In contrast, VAT does not create such discriminations since it is levied at

every stage of production and distribution and tax evasion is also more difficult. Thus VAT is neutral among the process of production and distribution.

2.1.8.4 VAT and Retailer's Sales Tax (RST)

VAT and RST are acceptable on theoretical grounds because both are identical in the sense of tax base. Both differ in tax collecting techniques in which VAT is collected at each stage of business process while RST is imposed only at the final stage. Each system provides the same and amount of revenue because total value added of final goods and services are same and both are principally the destination based consumption type.

From the administrative point of view RST seems to be simple as compared with VAT because their records and audit are sufficient on keeping the single stage. And the number of taxpayer remains more under VAT than RST. RST based on the suspension principal in which tax retailers are required to register for the sales tax purchase. Thus it is meant that the RST is levied only on the sales, which is registered to sale the consumer.

VAT and RST are vertically neutral with respect to production and distribution as total tax on a given commodity depends on the final price under both systems. On the other hand VAT and RST both are able to avoid the problem of cascading effects since there is no possibility to impose on tax. Both taxes avoid the problem of pyramiding since there seems no need to apply the mark-up on the tax amount levied at earlier stages. So, consumer price increase only by the amount of tax.

RST is more vulnerable to tax evasion than VAT. RST places a heavy burden only at the retail stage. Under this tax system, the whole tax is imposed at single stage (i.e. retail level). If a retailer does not file his return under the VAT, tax collection is dispersed over the whole production and distribution process. Thus the tax burden is distributed among a large number of taxpayer who feels it less burden

Some as compared to RST. VAT provides a self-policy mechanism, which is not available under RST VAT also provides a more complete audit trail than RST. As a

conclusion, we can say that VAT is more preferred in developing countries but it required efficient tax administration.

2.1.9 Operation of VAT

For effective implementation of VAT, the following provisions are needed:

I. Registration

This is the first step for the smoothly operation of VAT. The registration of firms subject to the tax is a master roll of taxpayers. In this process, all the venders having a taxable business turnover are compulsory registered on VAT. Any business enterprises that have not compulsion for registration, if they desire to register can register voluntarily. However, there is no compulsion to register for the small vendors who have an annual turnover below the threshold.

The registration procedure starts with a notice to the potential taxpayers through extensive publicity campaign. Then the registration forms and distributed so that the vender will fill up to be a formal member of the taxpayer under the VAT system. Then the registration form is returned back to the Inland Revenue Department and their coding is made. Thus registered taxpayers may be unknown about VAT in detail. So, an informative visits needs to be made and check detail whether the provided information by the taxpayers are correct or not.

Although all the venders having the transaction of taxable capacity may not be registered so it is almost essential to make a door-to-door check, especially in developing countries. The newly hired staff of inspectors and enforcement officers can be used for this purpose and strongly monitoring and supervision is also required. In the Nepalese VAT system small vendors having annual turnover below the threshold apply for voluntary registration and the Inland Revenue office.

If tax officer is satisfied about applicants may register them for VAT purpose. Like other registered venders, who are registered voluntarily will be able to claim back input tax paid on their purchases, to collect VAT on their sales, to hold the collected tax until the date of it payment to the concerned tax offices. The tax-registered vendors

should get a VAT registration certificate, which must be prominently displayed in the public area of his business.

It is being very difficult to know which of trader is legal taxpayers and liable to register under the VAT. There is no strong evidence to show that one should register and tax administration can't compel that one should register without any record. Trend of VAT registration in Nepal, is shown in table below:

Table: - 2.4
Trend of VAT Registration

Year	No. of VAT Registration	Increasing rate in (%)
2057 Ashad	4959	-
2058 Ashad	9082	82.64
2059 Ashad	17947	86.13
2060 Ashad	21093	17.53
2061 Ashad	25147	19.23
2062 Ashad	29872	18.78
2063 Ashad	34174	14.40
2064 Ashad	39776	16.39
2065 Ashad	59775	50.28
2066 Ashad	69653	16.52
2067 Ashad	82433	18.35
Average growth rate in 10 years		34.02

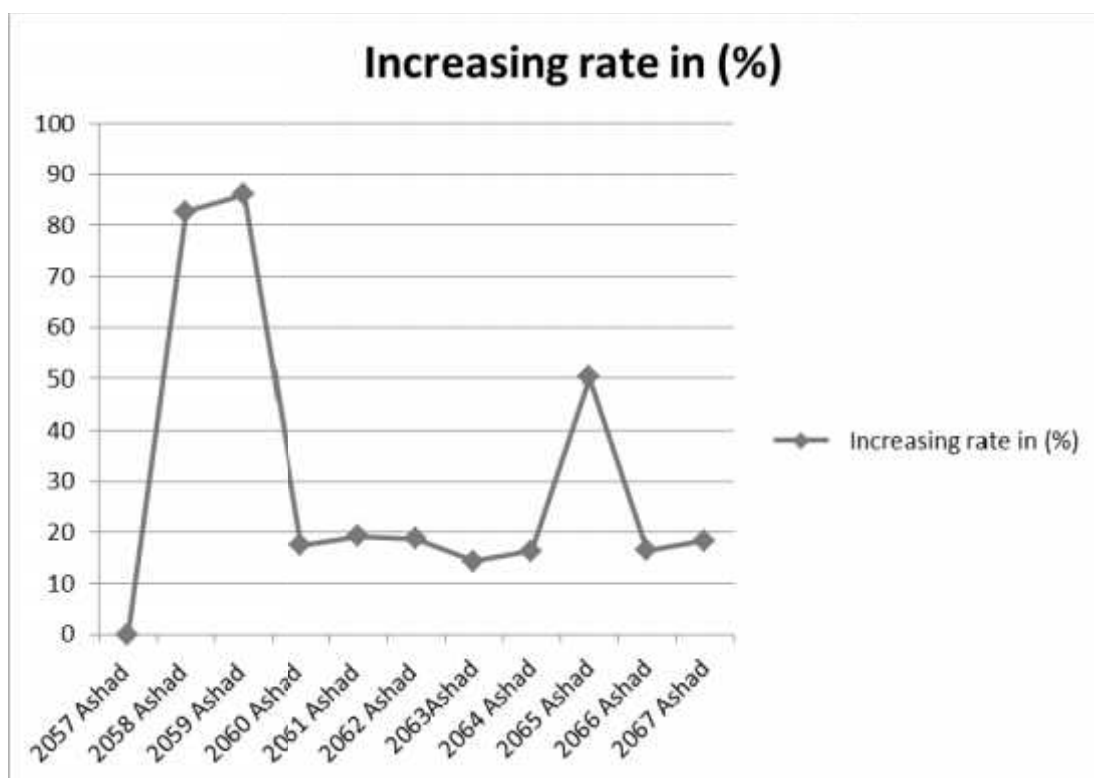
Source: Inland Revenue Department (annual Report 2066/067)

Above table depicts that in initial stage of VAT introducing, the growth rate of Tax payers registration is high but for the time being the rate is reduced except the year 2065.

In the past ten years average growth rate is 34.02 percent. In late years the growth rate can't move up 20 percent above except the year 2065. Until Potential taxpayers could not tie up with tax net.

Effective monitoring and supervision is still required to expand the tax base. Trend of annual growth in VAT registration can be clearly shown in graph below:

Figure: - 2.1 Trend of VAT Registration



II. Tax invoice

The tax invoice is a crucial document for VAT as it established the seller liability for tax and purchaser's entitlement to credit. A VAT registrant is required to issue a tax invoice whenever a transaction takes place. Invoices are the important documents for VAT control. There are two types of invoices; (i) tax invoices and (ii) abbreviated invoice.

Tax invoices established both the liability of the supplier and the amount of the deduction allowed to the registered purchaser. A VAT registrant is required to issue a tax invoice in the prescribed form whenever a transaction takes place. Only VAT registrants' taxpayers should issue a tax invoice. A minimum of three copies of each invoice must be prepared. The first copy must be given to the buyer and the venter must retain the remaining two copies. A tax officer must make these available at all reasonable times for inspection. The invoice must be used in sequential numerical order. However, they can prepare invoices with different serial numbers for branches or different sections with prior approval of the VAT office.

The abbreviated invoice is simple type of invoice for registered sales to unregistered persons, who should be considered final consumer under the VAT. VAT registrants may make an application to use abbreviated invoice and the tax officers may allow it use. In the case of sales under abbreviated invoice, VAT is calculated by multiplying the sales by the VAT quotient. The VAT quotient is found by dividing the rate of VAT. The abbreviated invoice can issue up to 5 thousand transactions. There is restriction to cross the limit.

III. Accounting

Every VAT registered vendor should be kept clear account of his activities (purchases and sales), which come into VAT base. The record of all invoices including other information such as the serial number and date of issue, of invoices the amount charges, and the VAT charged. The account should be kept in such a way that the VAT authorities are able to check the accuracy of VAT returns. Such records are kept for 4 to 6 years. So that it can be provided the tax administration if asked to check its accuracy and fairness. The period relating to the preservation of the account depends on internal audit. VAT liability should be calculated accordingly VAT account. This is, because if it is levied only on the cash basis, Taxpayers might delay payment. Small vendors, public or local bodies and not profit making organization, however, may be allowed to account for their output tax input tax only upon receipt or payment.

Account system can be made simple and clear by using a separate purchase book to record all the details of purchases and a separate sales book, which records all the details of sales. However in case of the details of sales. However in case of the small vendors the cash flow problems can be made simple by allowing accounting for their output tax and input tax only upon receipt or payment. Government can also provide a form for the accounting purpose to the vendors. It is undesirable to prescribe exact form because record systems differ significantly among the various types of businesses.

IV. Submission of Return

Nepalese VAT system, taxpayers must complete a VAT return and submit their returns to the concerned Inland revenue office within 25 days of the month following the end of the accounting period, this is for the use of compulsory registrants, and four months

for voluntary registrant. The head office is required to submit tax returns for the transaction carried out by it and its branches and sub- branches if any. There are no special rules, for example for seasonal business. Even if there is no transaction, it is necessary to submit a zero return. On receipt a VAT return, the tax officer is required to examine the return and check for arithmetical accuracy of this confirms that the amount. Shown, as payable and other particulars on the return are correct, the return is to be accepted. There is no need to attach purchase and sales invoices or any other document relating to the tax with the return Returns can be classified in 3 categories.

They are;

(i) Debit Return:

Debits return are those return where taxpayer have to pay tax to the government.

(ii) Credit Return:

In credit return, collected VAT on sales is greater than payment of VAT on purchase. In this case, VAT is refunded to taxpayer.

(iii) Zero Return:

Similarly, collected VAT on sales is equal with payment of VAT on purchase or there is no any transaction.

If a taxpayer doesn't submit a return with in the stipulated time, he will be subject to penalty of 0.05% of payable tax per day or Rs.500 whichever is higher. In below table, trend of tax submission is clearly shown.

Table:-2.5
Submission of tax Return

Year	No. of taxpayer	Submission of Return					Not Submission	
		Total (No.)	Dr. (%)	Cr. (%)	Zero (%)	Total (%)	Number (No)	p.c. (%)
2057 Ashad	17947	17271	34.90	44.97	20.12	96.21	676	3.79
2058 Ashad	21093	19710	35.95	41.86	22.68	93.28	1383	6.72
2059 Ashad	25147	21473	32.30	41.19	24.25	84.82	3676	15.18
2060 Ashad	29872	23099	31.06	41.36	25.85	82.41	5255	17.59
2061 Ashad	34174	25049	33.87	38.42	27.08	78.57	7322	21.43
2062 Ashad	39776	28525	33.20	36.00	29.00	77.04	8492	22.96
2063 Ashad	46831	33633	31.06	38.17	30.14	78.73	13198	21.63
2064 Ashad	52965	36457	31.43	37.29	30.29	85.42	7098	14.58
2065 Ashad	59775	45560	33.25	41.45	25.30	76.20	14215	23.78
2066 Ashad	69653	57290	35.25	29.40	35.35	82.25	12363	17.75
2067 Ashad	82433	63523	37.24	31.55	31.21	77.06	18910	22.94

Source: Annual Reports (2066/067), Inland Revenue Department

In above table implies that initial stage of introducing VAT, percentage of submission is high but in recent year the trend is gradually reduced. It is a signal of indiscipline and ignorance of law. There is a need of regular monitoring and supervision. Reward and Punishment is also required.

V. Payment of tax

In the Nepalese VAT system, if a registrant output tax liability is greater than his input tax credit, he is required to remit the difference to the government within 25 days from the close of the month in which the tax liability occurs. Compulsory registrants have to pay tax monthly while the voluntary registrant will have to pay trimester basic. On the other hand, if input credit is greater than the output tax liability, the balance of credit is to be forward up to a six-month period. The excess credit for a continuous period of six month should be refunded to the vender concerned within a month for date of submission of the return. If the VAT registrant has more than 60% of his sales as exports, he can apply for a refund instead of carrying forward of excess credit. In the above both cases the VAT office should pay 15% interests, if the Tax officer doesn't refund within two month from the date of submission of appeal of the return.

The VAT act makes provision for the additional charge as the late payment penalties. The rate of penalties is 10% of the VAT payable first month, and additional 10% in the second month and then no further action are taken. There is also a provision for interest on non-payment. The current rate of interest is 15% interest on overdue VAT is charge on calendar month basic.

VI. Tax Assessment

VAT is self-assessment tax. The taxpayers determined their liability and pay tax. This system a taxpayer determines his tax liability and files his return to the Inland Revenue office. However, not all taxpayers may file their return and pay tax within the specified time. Similarly not all taxpayers may file the correct return and pay the correct return and pay the correct amount of tax. In such cases, Tax officials may have to make a tax assessment. Such assessment could be computer or management assessment.

VII. VAT Enforcement

Enforcement of VAT is one of the major requirements for successful operation of VAT. VAT system can be found more equitable along with the restriction for tax evasion when the enforcement of VAT is effective. For the purpose of VAT

enforcement various techniques have been developed and used. The most important is the requirement of adequate account keeping and preserving it for a long time and administrative power to review to inquiry, size and check the records in the cases of suspected fraud. Tax officials can enter and search the business premises. In addition those, the tax liability of a VAT payer when they tax liability or when return are not presented at all. Further, a system is developing for ascertaining failure to file and pay. The system is easier through master file management and use of computer programmers. The delinquents are persuaded to pay through notices and visit, If they sill delay with them. Such measures include automatic penalties, different changes and action including legal action.

VIII. Penalties

Penalties play the important role for effective operation of VAT. Actually penalties are designed to punish the taxpayers who are not following the legal rule. Penalties are considered essential as they create an incentive to tax payers to deter evasion and non-compliance for smooth functioning and producing a full revenue potential of a VAT system. However penalty taxes became inequitable if they are imposed heavily on some defaulters but not on others, so all defaulters should treat equally.

The penalties have divided into four forms: automatic financial, automatic non-financial, criminal financial and non-financial. Some other typical devices for penalties are attachment of bank account, revocation of business certificate, seizure of property shut down of premises, temporary suspension of trading license, threat of imprisonment, criminal prosecution etc." (Alan a Tait 1998:3 19)

IX. Auditing

The purpose of the audit is to find out, according to the law and regulation, the actual VAT liability of the taxpayers. Auditing in VAT system is a selective review of the taxpayer's books of accounts and other records including balance sheet profit and loss accounts. Main cause of auditing is to be ensured that the major areas of purchases, sales, stock and profit or loss accounts are substantially correct or not. The purpose of VAT audit is to find out actual VAT liability of the taxpayer's. A VAT audit, which is based on the principle of self-assessment by taxpayers, may be integrated with that of income tax. However the intergraded audit is more desirable and popular. The types of

a VAT audit can divide into field audit and office audit, where the former include advisory visit, verification of records and fraud investigation and the latter includes desk audit checking the return for arithmetical accuracy and completeness. The office audit is desirable to check each return for probable accuracy, as a basic for selecting account for audit.

Several activities and steps; which appear in performing the audit, are included in the audit management. Generally the audit management activity includes (Sharma, 1997:40):

- a) Searching of the taxpayers who fail to register and file the return.
- b) Reviewing the tax returns, checking the conformity of calculation and verifying the data inputs, outputs, zero-rated goods and exemptions.
- c) Selecting the business unit for audit through the establishment of appropriate selection criteria and accounting to the audit capacity of the administration.
- d) Preparation for audit and audit result for further decision-making and auditors, allocation of tasks among inspectors and auditors, audit manuals etc.

X. Computerization

This is an age information technology. Computer is a integral part of information technology. Computerization is an essential element of VAT operation for efficient monitoring administering and controlling departmental policies. Modern tax system is highly demanded efficient administration efforts. The need is fulfilled by computer technology. So, computerization may be considered as an essential and accompanying component in VAT operation. Thus, regardless for their exact form computer perform several functions. Computerization makes its possible to select suspect cases for audit, which would be vary different to so manually. Similarly, defect, non-filers and non-payers considering this a comprehensive computerization system have been developed in Nepal.

2.2 Overview of Nepalese VAT

2.2.1 Introduction

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. Since the collection of both customs duties and income tax depends, to a great extent, upon the effectiveness of VAT, it is expected to help enhance revenue collection (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 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. The current threshold for VAT registration is Rs.2 million. Those vendors whose annual turnover is below the threshold can however register voluntarily.

There is a persistent increase in the number of VAT registrants. IT has crossed the 40,000 mark. At the time of conversion from the then existing sales tax to VAT, a total of 2045 taxpayers were converted as VAT registrants. As the taxpayers are increasing, the amount of revenue collection and the level of tax compliance are improving today. (Laudari Rajan, 2001)

2.2.2 Methods of Tax imposed

VAT is a tax imposed on the value added to goods and services consumed in Nepal or exported outside. 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 chain. There is the presumption that VAT is shifted forward completely to the Consumer.

In the VAT system, producers, distributors and people providing services raise VAT on the products value, in some way, to the materials they have purchased and it is this added value that is taxed at each stage of the production and distribution chain. There is the presumption that VAT is shifted forward completely to the Consumer.

In the VAT system, producers, distributors and people providing services raise VAT on the products or services sold or provided. The difference between the VAT collected on sales and the VAT charged on purchases determines the amount a registrant must remit or the amount that may be claimed as a refunding other words, if the tax on sales is more than the tax on purchases, the dealer / businessman remits the difference. If the tax on sales is less than the tax on purchases, the dealer may carry forward this credit to the next month.

2.2.3 An input tax credit

Registered businessmen are obliged to collect and remit VAT on their taxable transactions. These registrants are entitled to recover the tax paid on their purchases. This recovery or refund is known as input tax credit. The Input Tax Credit (ITC) is the total of the tax paid or payable on taxable goods and services purchased in Nepal, and the tax paid on taxable goods imported into Nepal. Where VAT is paid or payable by a registrant on a purchase or on imports, the registrant is allowed to claim input tax credit for those purchases made by the registrant in his commercial activities.

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

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

2.2.4 Categories of goods and services for VAT purpose

VAT divides all goods and services into two basic categories, taxable and tax-exempt. Goods and services are either taxed at the standard rate of 13 percent or they are taxed

at 0%. Those taxed at the standard rate include all goods and services except those, which are specified as taxed at 0% or tax-exempt.

2.2. 5 Tax-Exempt

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

- a) Goods and services of basic needs which include rice, pulses, flour, fresh fish, meat, eggs, fruits, flowers, edible oil, piped water, wood fuel.
- b) Basic agricultural products are also tax-exempt, for example, paddy, wheat, maize, millet, cereals and vegetables.
- c) The expense of buying goods and services required to grow basic agricultural products are tax-exempt. This includes live animals, agricultural inputs including machinery, manure, fertilizer, seeds, and pesticides.
- d) Social welfare services including medicine, medical services, veterinary services and educational services.
- e) Goods made for the use of disabled persons.
- f) Air Transport.
- g) Educational and cultural goods and services such as books and other printed materials, radio and television transmissions, artistic goods, cultural programs, non-professional sporting events and admissions to educational and cultural facilities.
- h) Personal services are also tax-exempt. These are services provided, for example, by actors and other entertainers, sportsmen, writers, translators and manpower supplies agents.
- i) Exemption from VAT is also extended to the purchase and renting of land and buildings
- j) Financial and insurance services.
- k) Postage and revenue stamps, bank notes, cheque books.

2.2.6 VAT on Imported Goods

The VAT Act, Schedule I lists imports which are tax-exempt. Some of these include prescription drugs, basic groceries, medical devices and agricultural products.

Most imports, however, are fully taxable at customs point. There after these are treated on the same basis as domestically produced goods. The VAT on imported goods is collected by Customs. It is calculated on the dutiable value of the goods, in other words, on the value of the goods including transportation, insurance, freight and commissions plus any duty or other taxes (other than VAT) payable on the goods.

The value for the duty of the goods is determined in accordance with the valuation provisions contained in the Customs Act. Registrants may claim input tax credit for the VAT paid on imported goods used in their commercial activities.

2.2.7 VAT on Exports goods

VAT is applicable only to the consumption of goods and services in Nepal. However, supplies made in Nepal that are exported are taxable at 0%. Exporters are allowed to claim input tax credits for VAT paid or payable on purchase of goods and services relating to their commercial activities. Exports taxed at 0% include exports of both goods and services.

2.2.8 Registration on VAT

Registration is required for any business:

- (a) With an annual taxable turnover of more than 2 million rupees.
- (b) Belonging to a conglomerate that has an aggregate annual taxable turnover exceeding 2 million rupees.
- (c) The importer who imported goods more than 10 thousand at ones time.

2.2.9 Affected by VAT

In addition to consumers, VAT affects persons involved in commercial activities. A person means an individual, firm, company, association, cooperative, institution, joint business, partnership, trust, government body or religious organization.

There are categories of persons and organizations which are not required to collect VAT nor allowed to claim a refund of the VAT they have paid in producing their goods and services for sale. These would include unregistered small suppliers, that is, persons with annual sales of taxable goods and services of Rs. 2 million or less. But even such people can voluntarily register for VAT purposes.

2.2.10 Determining annual sales of taxable goods and services

In assessing the value of taxable supplies a vendor must include the value of the supplies taxed at the standard VAT rate and his sales of supplies sold at 0% (the zero-rated supplies). Sales of exempt supplies will not be included. If he has had or expects an abnormally large sale he should contact his IRO to determine if this sale should be taken into account when calculating his need to register.

2.2.11 Registration of small business

Businesses with taxable annual sales fewer than 2 million rupees may apply to register.

If a business chooses to register, it must remain registered for a full fiscal year.

2.2.12 Cancellation of Registration

A VAT registration may be cancelled by any one whose total taxable sales for four consecutive calendar quarters is not more than 2 million rupees and who has been registered for a full fiscal year or by persons who no longer has a commercial activity because of bankruptcy, receivership, or cessation of the business.

2.2.13 Obligations of VAT registrants

VAT registrants are required to:

- a) Submit VAT returns and pay tax within the 25th day of the following month.
- b) Provide their customers with a tax invoice
- c) Maintain Purchase Book, Sales Book, and VAT Account.
- d) Keep their VAT records for a period of 6 years.
- e) Inform the IRO of changes to the business including new address, telephone number or a reorganization of a partnership within 15 days.
- f) Put their Certificate of Registration in the premises where customers may easily see and read it.
- g) Allow tax officers to enter the business to examine the business records and the stock on hand.

2.2.14 Requirement of tax invoice

The tax invoice will require the name and address of the seller and the purchaser, the seller's PAN number and invoice number, the date of the transaction and a description of the sale including the number of items purchased, the unit cost of each item and a mention of any discounts given. The tax invoice must be prepared in three copies and the first copy should be clearly identified as a tax invoice. The original copy is given to the purchaser; the second copy is to be retained for audit purposes while the bottom copy is for use by the seller in preparing a record of the transaction.

2.2.15 An abbreviated invoice

Tax Officers may grant permission for a VAT registrant to issue an abbreviated invoice for retail sales below the value of Rs.5000. The chief difference between the two tax invoices is that an abbreviated invoice does not require the name and address of the purchaser.

The registrants have the right to request a detailed tax invoice, as they will not be able to claim input tax credits with abbreviated invoices. IRD may order taxpayer to issue invoices by using cash machine or computer. The procedure in such case shall be as prescribed by the DG of IRD. IRD will have anytime access to the database of the taxpayer.

2.2.16 Maintaining special accounting system

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

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

(Value added tax act, 1998)

2.2.17 Necessity of books and records must be kept

A taxpayer must keep the following books and records:

(a) A purchase book, (b) A sales book and (c) A VAT accounts.

2.2.18. Matter included in the purchase and sales book

Purchase and sales books include: (a) The invoice number, (b) The invoice date, (c) The supplier's name and PAN number in the purchase book, (d) The customer's name and PAN number in the sales book, (e) The taxable value and (f) The amount of VAT.

Businesses, which sell both taxable and exempt goods, will need to complete additional columns of information to separate exempt sales and the purchases related to them. IROs will be pleased to provide taxpayers with a sample Purchase Book (Schedule 8) and a sample Sales Book (Schedule 9) format. PAN number refers to the Taxpayer Identification Number, which will be allocated to each registrant after completion of the registration process.

2.2.19 VAT account

The VAT account is a monthly summary showing the source of the figures used in the VAT return. This account contains purchases and sales and the VAT spent and collected. A sample VAT Account (Schedule 7) may be obtained from the concerned IRO.

2.2.20 Offences

Fines will be imposed if the taxpayer fails to file his return within the specified time. A registrant will make his VAT payment at a bank where he will receive a bank voucher as proof of payment. This number is to be entered on his VAT return to be submitted within 25 days after the end of the month of business transaction. The VAT Act imposes fines for failing to register. Similarly, if a registrant fails to use his registration number or clearly display his registration certificate in the business premises, he is liable to fine.

Other penalties may be imposed if, for example, a registrant fails to file a return, issue invoices, keep an up-to-date account of transactions, obstructs visits by a tax officer in

investigation, prepares false accounts and invoices or attempts to evade tax. Similarly, IRO/IRD may purchase or cause to purchase under invoiced goods.

2.2.21 Administrative Review

A taxpayer who is not satisfied with the Tax Assessment of a Tax Officer may submit an application to the DG of IRD for administrative review within 30 days from the time of receiving such decision.

2.2.22 Tax Plate

In order to make public the status of the registered taxpayer, automatically, each registered taxpayer is required to display the tax plate, which is visible from outside in the premises of the taxpayer. The size and the color of the tax plate should be as follows:

A. Size: The size of the tax plate should be 30 cm long and 10 cm width.

B. Information: Information to be shown on the tax plate:

- (i) Permanent Account Number (PAN)
- (ii) Taxpayer's Name.

C. Color: The tax status of the taxpayer will be identified on the basis of the following background and the color of the tax plate:

- a) Bush green background and letters in white color: VAT registered tax payers.
- b) Lemon yellow background and letters in black color: Tax payers dealing in VAT able goods and services but whose transaction is the below threshold i.e. Rs.2 million per year.
- c) Signal red background and letters in red color: Tax payers dealing in non - VAT able goods and services.

2.2.23 Conscious Consumer Lottery Program.

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

Types of bills to be included in lottery programs are:

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

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

<u>Provision of Cash Prizes to Consumers</u>	<u>Total Prize amount</u>
(i) First winner - 1 Person.	Rs.1, 00,000
(ii) Second winner- 5 Persons (Rs.20, 000 each)	Rs. 1, 00,000
(iii) Third winner- 10 Persons (Rs.10, 000 each)	Rs. 1, 00,000
(iv) Consolation Prize - 20 Persons (Rs.5, 000 each)	Rs. 1, 00,000
Total	Rs. 4, 00,000

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

Procedures of conducting lottery program:

- a) IRD will print lottery coupons with serial numbers of two copies.
- b) A separate number will be marked in each coupon.
- c) One coupon will be issued to the purchaser after receiving the purchase bill of Rs. 1,000 and the contractor conducting the program will retain a copy. For instance, if a consumer submits 3 bills containing the purchase of Rs. 400 each, he will receive one coupon and will be eligible to get another coupon in each additional amount of Rs. 1,000. However, surplus amount will not be entertained for the purpose of competition once coupons are issued after submission of the bills. The bills worth less than Rs. 250 will not be entertained in the program.

Provision of Cash Prizes to sellers:

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

<u>Provision of Cash Prizes to Sellers</u>	<u>Total prize amount</u>
(i) First winner - 1 Seller	Rs. 25,000
(ii) Second winner- 5 Sellers (Rs.5, 000 each)	Rs. 25,000
(iii) Third winner- 10 Sellers (Rs.3, 000 each)	Rs. 30,000
(iv) Consolation Prize - 20 Sellers (Rs.2, 000 each)	<u>Rs. 40,000</u>
Total	Rs. 1, 20,000

2.2.24 Proxy Criteria

Taxpayers whose annual turnover is more than Rs.2 million are required to register in VAT compulsorily. Taxpayers who fall below this limit will be required to register in VAT within 30 days of their annual transaction reaching or crossing Rs.2 million. However, if the tax payer falls under any one of the following proxy criteria, he is required to register in VAT compulsorily:

- a) If the stock of the tax payer exceeds the specified amount when the tax officer inspects the stock or if the monthly sale exceeds Rs. 2 lakh or More during a month;
- b) If the annual expenses of the tax payer on the telephone and the rent Exceeds Rs. 1 lakh; or
- c) If the premises of the taxpayer lies within the specified area of the market or the street as specified by the Department (IRD).

After the transition of democracy in 1990, the government launched a reform program to promote modern market oriented economy, while maintaining sound macroeconomic policies. A major structural reform initiated then was to introduce VAT system in the country. This kind of political acceptance to introduce VAT was a milestone in tax reform process. The government adopted a policy of adopting VAT in eight fifty years plan (1992-1997). Similarly, the 1993/94 budget stated that VAT would be introduced with in a year or two.

VAT steering committee and VAT tax fore were formed in 1993. As a part of its liberal economic policy, HMG asked donors to study VAT system. The technical assistance of the Harvard Institute for international Development (HIID) under the united state agency for international Development (USAID) financial assistance took up the study. This assistance was suspended in 1995, resumed in 1996 and continued until 1997. HMG started exploring donors for the continuation of VAT programs. The Danish International Development Agency (DANIDA) accepted the government's request and pledged to support VAT project. The DANIDA has been extending technical assistance since 1997. Afterward, VAT steering committee, was reconstituted in 1995 VAT act was passed in 1995 by the parliament. Meanwhile, the departments of sales tax and excise duties were renamed as the department of VAT in 1996. It had the full responsibility to administer VAT system. VAT interaction and training programs were organized by the representative of the federation of Nepal Chamber of Commerce and Industry (FNCCI), Nepal Chamber of Commerce (NCC) journalists, parliamentarians chartered accounts association, businessmen and several other professional groups.

As VAT law was designed to handle a single standard rate, the multiple rates of sales tax were unified in 1996 at 15% from the rate of 10 and 20%. Again some more training, interaction programs, information campaigns, meetings, etc. were held to convince people about the interdiction of VAT system. VAT task force was set up to convince people about the introduction of VAT system. VAT task force was set up with members from VAT

2.3 Review of Literature

Although the history of VAT is not so long even in global context several studies and experiment have been undertaken on vat which has been major instrument of tax reform since last four decades. But very few studies have been done on the topic concerning Nepal. An attempt has been made in this chapter to review the theory of tax reform as well as the recent literature on VAT.

2.3.1 Review from books

The reform is one of the seriously raised concerns of any countries fiscal system although there is several experiments on value added tax a major instrument on tax reform for last three – four decades, there are very few efforts have been undertaken on the topic concerning Nepal. Such available studies are found to the descriptive rather than analytical. The present chapter would review the tax reform containing VAT by analyzing recently developed sophisticated tools and techniques, as well as briefly reviewed the recently developed literature on VAT in Nepal.

Narayan P. Silwal, in his book "Value added tax: A Nepalese experience (1998) has expressed his practical experience about VAT. The book covers all aspects of VAT. In writer's word "VAT is an all stages non cascading tax system. It extends to all levels of production and distribution. Similarly it covers all stages and services. Any discrimination in taxing goods or services or exempting any of them renders VAT ineffective. The book mostly concentrates on Nepalese tax system. The book clearly analyze why the government of Nepal introduced vat. HMG announced retail level sales tax at the rate of ten percent covering a whole range of goods and services. There was no procedural law to administer it. When RST introduced in Nepal, literacy level was just meager and billing and record keeping was fanciful. In this situation, required revenue cannot take place, which in turn in to the development expenditures. So that, a modern, efficient and neutral tax like VAT was, therefore, preferred to get rid of past anomalies.

The writer expressed a version by borrowing HMG declaration that- "The government of Nepal doesn't have the option of doing nothing. Major changes must be made in order to make tax administration fair, efficient and effective. The hostility, harassment and corruption that currently exist between the tax office and the business community must end if Nepal is to have a modern tax system. The business wants the system changed and willing to pay a reasonable tax but they want the system transparent and fair."

Dr. Rup Bahadur Khadka, (1992) an expert of Nepalese tax system, in his book entitle "VAT in Asia and the Pacific region" writes – VAT is the most recent innovation in the field of taxation. It is levied on the value added of goods and

services. The tax is broad based as it covers the value added to each commodity by a firm during all stages of production and distribution.

This book covers all aspects of VAT including the nature of VAT, reasons for the growing popularity of VAT, development of VAT etc. This apart, the report examines the structure and operation of VAT in the Asian Pacific countries, which also explores the possibility of introducing VAT in Nepal. Probably he is the person of observer of VAT abroad and the firstly proposed VAT for Nepal with micro studied of Nepalese economy and system.

Carl S. Shoup (1998) in his famous book "Public Finance" considers value added tax as the latest and probably the final stage in a historical development of general sales tax, which is imposed on the "Value added" by the business firms. VAT is the difference between sales proceeds and the cost of materials etc, purchased from other firms, which is the tax based of a VAT. A firm adds value added by processing or handling these purchased items which its labor forces and its own machinery, building or other capital goods.

David N Hyman in the book "the economics of government actively" opines that the vat is simply multi – stage sales tax which exempts the purchase of capital goods and service from the tax base. By exempting capital outlays as the time of purchase consumption type of vat provides a kind of investment tax credit incentive.

A value added tax is a tax assessed at each steps of the production and distribution process, levied on the difference between purchase cost of an assets and the price at which it can sold (the amount of value added on it). Tax is added tax product's price each time it changes hands until delivery to the consumer takes place, when the final tax is paid.

In the book "Government Finance in Developing Countries" Richard Goode describes VAT as the most important tax innovation of the second half of the 20th century and it is classified as a form of sales tax on consumption. The tax applies to the value added at production and distribution that is to sales precedes less purchase of material input and certain services.

2.3.2 Review of Related Studies

Review from Articles, Journals and Research Papers

Dr. Rup B. Khadka (1996), published an articles on "Probability of vat in Nepal." reached a conclusion that VAT, theoretically, is the best alternatives to remove limitations of present sales tax system of Nepal. He further adds, "The merits of VAT don't appear voluntarily. For this, implementation aspect of VAT must be efficient. The implementation aspect of the tax depends on the capability of the tax administration. Co-partnership of taxpayers, according system of the business sector and political confidence etc. So it needs full presentation before introducing VAT in Nepal.

In a study held in 1973 on "value Added Tax in Developing countries" George E. lent Milka Casanegra and Michael Guerard state that, "following the adoption of value added taxes by western Europe countries, many developing countries have been giving increased attention to this form of tax as a means of rationalizing their sales taxes and improving their revenue.

On "key questions considering value added tax for central and Eastern European countries, on the base of the observation on the value added tax in EC and ECD countries. In this article, he states that it requires nearly complete overhaul of the tax system and in most countries the introduction of VAT considered a corner stone of the necessary tax reform. "In addition, he describes that this form of taxation is worldwide, apart from that of transaction based. Accounts controlled VAT in the market economy based on the free enterprise and pricing system."

The government of India in 1978 appointed L.K Sha as the chairperson of the committee to examine "the adoption of VAT at retail level, such as committee was called Jha committee. After study Jha committee presented the report in which the vat was rejected by saying no need to adopt comprehensive VAT because of administrative constrains, constitutional problems and revenue consideration. But Jha

committee concludes VAT can deliver better satisfactory solution of excise duty. It means VAT should be applicable at manufacturing level.

Nepal Chamber of Commerce (1997a) organized a national wise discussion program on VAT. According to a report of the discussion programmed (Nepal Chamber of Commerce, 1997) the various views expressed about VAT in Nepal may be summarized as follows.

- a) Government machinery is not capable for implementing a VAT.
- b) The business community has no confidence in the administration because it has failed to implement many other taxes efficiently and fulfill its own commitment even previously.
- c) VAT will hamper genuine trade and as a consequence, illegal trade will prosper. Rise in the prices of domestic products will make them less competitive. Import and re-export of imported goods will get a negative impact leading to decline in government revenue.
- d) VAT will inhabit the growth of newly developing trade and industrial activities in the country.
- e) The mordent account keeping system required by the VAT is difficult to keep. This will raise the cost of doing business.
- f) There will be a sharp price raise if a VAT is introduced consumers will be badly affected due to price raise. Nepalese markets in boarder area will dry up due to VAT.

It is concluded that, it is not possible to implement a VAT in Nepal and if implemented it will have adverse effect on the economy.

Glenn Jenkins and Dr. Rup B. Khadka (1998) in this research under the title of "Tax reform in Singapore." This working paper carries the successful story of VAT's introduction and implementation in Singapore to be a good lesson for the non-VAT countries and VAT countries. According to authors Singapore put forwards the VAT in order to make Singapore's economy internationally competitive. In this discretion the government of Singapore formed a task force committee for the tax reformation. The committee recommended that the government must shift direct to indirect taxes as its main sources of revenue.

The research paper concluded that Singapore would be facing the problem of an aging population. In such a situation Income taxes will put a greater burden on smaller group of younger, working Singaporeans, might inhibit growth and enterprise. It is therefore, necessary to introduce a broad-based tax like GST/VAT to distribute the burden of taxation among a larger section of the population, GST in tax on consumption and has several futures. It relieves investment and saving from the tax burden and 'rewards enterprises and strengthens economic resilience. GST relives exports commodity taxes through the zero- rating mechanism. Since VAT is a fairer tax and is levied on a large section of the population including the self-employed, it is less affected by Economic Cycles GST provides a more stable source of revenue than many other taxes.

The main objective of Singapore to introduce VAT is to makes its economy internally competitive, to promote exports and to develop a board based and stable source of tax revenue.

2.3.3 Reviews of Master's Degrees Thesis

Ghimire Lalmani (1998) in his dissertation, entitled "Value added tax: key issues in Nepal " According to this study, administrative capacity, organization structure, audit and inspection style, reward and punishment, political intervention, selection of skilled and experienced manpower are needed to improve for effective implementation of VAT among which the first time is not challenging. As Nepal is an agrarian economy, there are a large number of traders. So more, revenue can be generated only if VAT is extended through retail level, which needs proper and adequate preparation to make the retail stage. VAT more effective and efficient, the major suggestion of this research is to improve the following aspects: (i) Administrative power and creditability. (ii) Taxpayer identification system (iii) registration and educational programs. (iv) Some incentive for small traders. Single rated VAT is appropriate in Nepalese context because of administrative simplicity although it is more regressive than the multiple rated. The exiting major problem of VAT implementation in Nepal is existence of small trades in large proportion, lack of large amount of unauthorized trade from accounting records, illiteracy and high compliance cost, the existence of broader and India to Nepal poses a great threat to the success of VAT in Nepal. Strong administration, educational program, existence training program, technical data base system, Combination of various revenue offices high level VAT implementation

terms, co-ordination of VAT department close co-operation between government and private sector etc. are essential pre-requisites for the successful implementation of VAT in Nepal. Focusing on the ever increasing resource gap, inefficiency in sales tax and need of revenue for handling developmental works, VAT should be implemented in Nepal "VAT is applicable in Nepal " and is more useful than sales tax system. This is necessary for making the system broad based, neutral stable, and more revenue creating, transparent and eliminate growing fiscal deficits as well as to lower dependency on foreign loan Nepal.

Sharma, Chintamani (1998), examined several aspects of VAT administration such as its problem constructions, possibility, operation and other aspects. In his dissertation he has found the following findings. (i) Most of the traders and businessmen are lacked with the minimum concept of VAT. They are facing pricing billing and accounting problem etc. (ii) An adequate VAT education programs are not conducted (iii) VAT administration has been facing the lack of administration has been facing the lack of administrative personnel (iv) the relation between government and business community is broken, which has been barrier to implement VAT successfully. His suggestion to the government for successfully implementation of VAT in Nepal are as follows: (i) the government should try to produce gazette manpower and to train them well (iii) comprehensive education programs should be launched by government (iv) other matters relating to operational issues and taxpayer education should also be discussed with them and with other such as employee's association. At last, he concluded that VAT requires the strengthened administration for its effective and efficient implantation.

Bista, Raghu Bir (1999), in his research entitle, "Applicability and feasibility of VAT in Nepal'. He has found the followings;

-) The sales tax system is failure to several cases: narrow tax base, in- elasticity of tax rate, incapable and weak administration, tax leakage, corruption and political intervention. So, the entire tax reform is needed.
-) A VAT is account based, invoice based and record based; it checks the tax loopholes such as under evaluation, non-recording and unauthorized trade. It discourages such issues and problems existed in the sales tax system.

-) VAT mobilized the additional resources and the rest of internal resources by broadening tax base and by discouraging the existing tax loopholes.
-) In VAT system, tax refund and threshold, two provisions are necessary for the effective implementation of VAT. But, they are two gates of possible mal-practice and tax evasion for the effective implementation of VAT in Nepal; these gates should be closed by conducting strict monitoring system and by operating the punishment section of VAT enactment.
-) For implementation VAT, the public awareness level relating VAT and VAT administration should be good and it's a prerequisite in the preparation of VAT.
-) VAT administration should be strong and efficient in order to implement properly. But, in Nepal, VAT administration has been facing the problem like corruption, incapability, inefficiency, delaying ineffectiveness inadequate physical environment, inexperienced and untrained employee and weak organizational setup - The purpose of each fiscal policy is to reduce the economic inequality between the rich and poor by giving the tax incentives to the poor for the social welfare and by redistributing the national income. VAT has the Therefore; its effects are found positive on social welfare and negative on the economic inequality.

Dhakal Arjun (2000), in his dissertation analyzed the Nepalese tax structure along with the basic emphasis and historical background and potential revenue of VAT in Nepal. The increasing trend of resource gap of Nepal is forcing the country to debt trap situation Domestic resource mobilization through the properly designed tax system is the best way to up lift the situation. In this best way to up lift the situation. In this process, Nepal is adopted the destination based, consumption type VAT operated by the credit method. VAT encourages investment, supports economic growth and keeps price stable Exemption and Zero-rating reduced the regressively of VAT, however it makes the administration complex. The study found that vat is unable to complete the existing sales tax mainly due to the minimum use of invoice by sellers and as well as having no interest to obtain invoice by purchases. Elasticity and buoyancy of Nepalese tax system are very low. Further they are decreasing in recent years. VAT, more attractive from the theoretical as well as empirical aspects, is being

hot milk in mouth from practical viewpoint mainly due to the inefficient tax administration. Here the introduction of the VAT is not the fulfillment of the requirement and VAT system itself has a great need of reforming in the Nepalese context.

Laudari, Raju (2001) in his dissertation analysis the problem and prospects of VAT in Nepal, basically on the theoretical aspect. He stated that in the current status of decreasing revenue from custom duties due to the liberal economic policies, importance of VAT is growing for resource Product (GDP) is mobilization. The contribution of VAT in tax revenue and gross domestic product is growing. While the contribution of other tax; replaced by VAT is gradually declining. From the field survey, the study concludes that the VAT having positive effect the national economic growth. Majors' problems associated with the VAT system to business houses are account keeping and billing.

From the field survey, the study concludes that VAT will have effect on economic growth major problems associate with the VAT system to business houses are account keeping and belling. Weaknesses of VAT administration are lack of motivation service minded attitude and dishonesty in VAT officers. VAT system, the best and advanced fiscal tool in theoretical sense, could not yielding the expected returns in Nepal because of the lack of strong and honest tax administration, lack of motivation and service minded attitude among tax officials, lack of the cooperation of business community lack of co-ordination between tax collectors and taxpayers, lack of strong political commitment and weak public consciousness.

Lama (2010) in his thesis entitled "*A study on effectiveness of implementation aspect of Tax Planning in Nepal*" has made a deep study on Tax planning regarding its effective implementation. People in developing country like Nepal tend to greater propensity to evade taxes. Lack of proper measurement of tax assessment, Nepal is facing the problem of tax evasion. Because of this resources have not bee mobilized efficiently and resource gap is increasing year by year in Nepal public finance. He has mentioned the following objectives and methodology for specific findings and recommendations.

Objective:

-) To study the concept of tax planning.
-) To examine the use of tax planning in Nepalese organization.
-) To examine the implementation of Tax planning
-) To provide suggestion of Nepalese organization to use tax planning.

Findings:

-) The provision of best judgment assessment should be put to use in its true spirit.
-) In addition to other financial and non-financial assistance, including incentives, to be provided by government and financial institution for the revival of sick industrial units.

Pradhan (2011) "In Nepal Tax Administration and Income Tax System" The main objective of this study is to analyze the effectiveness of income tax administration and system of Nepal. However, the following specific objectives have been set out for the study.

Objectives:

-) To examine the administrative aspects and system of income tax in Nepal.
-) To examine the tax system in Nepal.
-) To identify major problem related to tax administration in Nepal.
-) To provide appropriate suggestions and recommendations

Findings:

Nepalese total revenue is composed of both Tax revenue and Non-tax revenue. The average contribution of Tax revenue and Non-tax revenue was 79.64% and 20.36% respectively.

-) Nepalese tax revenue is composed of both direct and indirect tax revenue. There is a dominant role of indirect tax revenue in Nepalese tax structure. The average contribution of direct tax and indirect tax to total tax revenue was 26% and 74% respectively. Although the total amount of both taxes is increasing, there is not satisfactory growth in collection of both taxes.
-) The average contribution of custom duties, value added tax and excise duty on indirect tax revenue were 38% 46% and 16% respectively.

2.4 Research Gap

About eleven years have already been passed since VAT came in to operation but very few studies had undertaken on the topic of VAT in Nepalese context and most of the studies were related with theoretical aspect. In this study, the researchers try to evaluate Nepalese VAT by identifying existing problems in major market area of Kathmandu city by conducting field survey, in order to know some how about the practice experience of VAT. Further, an attempt has been made to analysis revenue pattern of vat in government revenue and overview of the future prospect as well.

CHAPTER: III

RESEARCH METHODOLOGY

This chapter is developed to the research methodology applied in the study for the achievement for desired objectives. Both primary as well as secondary sources of data are used to conduct this study. Opinion survey technique was adopted while collecting primary data find out the views of respondents representing different groups related to value added tax. This opinion survey was opted to find out the practical aspect of VAT. While conducting the opinion survey, questionnaires were distributed to the tax officers, consumers, tax experts, economists, politicians, industrialists, journalists, and traders.

The main objective of this research is to analyze and interpret the issues present status of VAT and revenue collection from VAT in Nepal. VAT is being applied instead of import/manufacturing level of sales tax, entertainment tax, hotel tax and contract tax. So, it should be sound and effective value added tax system results the increasing rate of indirect tax on tax structure as well as national revenue at satisfactory and reasonable level. Therefore the main concentration of this study is on the role of value added tax, VAT structure, VAT coverage and planning, organizing and administrative requirement. However, the major focus on different issues, present practice and future prospects of VAT to implement effectively in Nepal.

The problem of delaying tax assessment, tax evasion and avoidance etc may be solved through efficient management system. After performing analytical system on this subject matter, it tries to recommend for tax administration to execute policy of VAT effectively. To achieve these objectives a research methodology has been designed in this chapter.

3.1 Research Design

To achieve the stated objective of the study, the study of VAT act 1996 made for descriptive research where as analytical research has been carried out in terms of role of vat in generating government revenue in Nepal. For an empirical research, an opinion survey has been conducted. The opinions of various fifty respondents associated with district denominations (group) i.e. tax exports and tax payers were collected through

structured questionnaire with reference to VAT system, remedy to minimize corrupt practice administration, the most important factors for effectiveness of vat including necessary suggestion for achieving effectiveness of VAT in Nepal. Hence, the research methodology followed in the study can be termed as survey cum analytical and descriptive research design.

3.2 Population and Sampling

In order to benefit this study, 50- sample size from Kathmandu is selected; persons included in the sample are carefully selected by consultation with tax experts, professor and judgment of the researcher. The respondents have been divided in to eight groups. The following table shows the group of respondents and the size of samples.

Table 3.1
Group of respondents & size of samples

S.N.	Group of respondents	Sample size
1.	Consumers	15
2.	Tax Officers	5
3.	Tax experts	5
4.	Economists	5
5.	Politicians	5
6.	Industrialists	5
7.	Journalists	5
8.	Traders	5
	Total	50

3.3 Natures and Sources of Data

The required information and data as stated earlier have been collected from both primary and secondary sources in order to achieve the real and fact form this research. All the possible and useful data as far available have been collected. The major sources of data are as follows.

3.3.1 Primary Data

The major tools used for the collection of primary data are distributed of a questionnaire to a respective of persons. A set of questionnaire was developed and distributed to the selected respondents in order to get accurate and actual information. The questionnaire was distributed to different tax groups i.e. tax experts, tax officers, consumers, economists, politicians, industrialists, journalists and traders. Tax experts and tax officers are selected from tax department, various sectors of tax officers in Kathmandu and Ministry of law and Justice, reputed lawyers, politicians, economists, auditors and intellectuals who have knowledge and ideas about VAT. Tax payers i.e. businessmen and consumers are selected from different manufacturing company, trading company, departmental stores, shopping center, finance company etc.

3.3.2 Secondary Data

The secondary data were collected through books, articles, magazines, newspaper and reports. The main sources of secondary data are:

- a) Published documents of National Planning commission and Nepal Rasta Bank.
- b) Published report, articles and research. .
- c) Published report and seminar paper of industry and trade association.
- d) Publication of Inland Revenue department
- e) Publication of VAT project
- f) Budget speech as and economic survey of various fiscal years.
- g) Different Publications of central bureau of Statistics.
- h) World Bank reports
- i) Newspaper, magazines and journals.
- j) Various Websites
- k) Related other different books. etc.

3.4 Data collection Procedures

A total 50 sets of questionnaire were distributed to the selected respondents in order to get actual and accurate information. Distribution work is done personally rather than sending by any means to get accurate and actual information in time.

3.5 Methods of Analysis

The information revived from primary and secondary sources is firstly tabulated in to separate formats systematically in order to achieve desire objectives. After that these data are tabulated and analyzed. This study was based in descriptive and analytical methods for the presentation and analysis of data. At the time of presentation and analysis of primary and secondary sources data, were edited and processed. Table, Graph, Diagram, simple percentages and time series analysis are used for the purpose of presentation and analysis of data.

CHAPTER -IV

PRESENTATION AND ANALYSIS OF DATA

4.1 INTRODUCTION

Every government is responsible to perform numerous functions for the betterment of the people in the country. A government needs huge volume of incomes to fulfill various types of expenditure. For this purpose, government collects revenue from different sources. Thus, the income of the government through all sources like taxes, borrowings, fees, donation etc is called public revenue. In general government incomes sources are classified mainly in two categories namely tax revenue and non tax revenue. This contributes 79.1% and 20.9% average revenue to total revenue. These both sources are subject to non-repayment and their sum constituted the government revenue. Beside these sources, government has other sources that are subject to repayment such as loans, grants, however grants are not compulsory repaid. These sources are desired only to meet the fiscal deficits.

Tax revenue can be classified into two groups one is direct tax and another is indirect tax. Average trends of these two taxes are that indirect tax covers 75 percent and direct tax covers only 25 percent of total tax revenue. VAT, custom duty excise duties are the main sources of indirect tax.

In this chapter, deals with presentation and analysis of data and information in connection with taxation in Nepal. Full attention is given about "Revenue collection from VAT with its problems and prospects." To achieve the stated objectives of the study and to make easier to understand the findings qualitative as well as quantitative data and information has been analyzed. Hence, this chapter is concerned with the presentation and analysis of data, through primary as well as secondary sources, Primary data has been collected by the means of scheduled questionnaire and the economic survey has been the main sources of secondary data. At the end empirical investigation based on opinion survey has been presented with relevant sub-topic.

4.2 Analysis of Revenue Structure of Nepal

Taxes are not a voluntary contribution by the tax payers but it is compulsory in nature. Generally a tax is a compulsory contribution imposed by a public authority. Taxation is the main sources of income of the government excluding foreign aid, but also Nepal has been facing growing resource gap rapidly. Despite over five decades of planned developments efforts. Nepal has been suffering from resources constraint, massive poverty, and rapid population growth-increasing frictional seasonal and educational unemployment, aggressive dependence on agriculture, subsistence living standard poor infrastructure most of the national economic activities are dependent upon agriculture and large portion of GDP originating from agricultural sector remains out of the tax net.

To solve the above mentioned problems Nepalese government has practical deficit budget. Government deficit budget is defined as the excess of spending over its revenues. Fiscal deficit has been increasing continuously due to growing expenditure and low revenue performance in Nepal. In addition, the country has also been facing the increasing burdens of foreign loan.

Table 4.1
Trends of Resource Gap in Nepal

(Rs. in million)

Fiscal Year	Total Expenditure	Total Revenue	Resource Gap (I)	Foreign Grants	Resource Gap (II)	Foreign Loan	Resource Gap (III)
2001/02	59579	37251	23328	4336.6	18991.4	11852.4	7139
2002/03	66272.5	42893.2	23378.3	5711.7	17666.6	11812.6	5845
2002/03	79835.1	48893.9	30941.2	6753.4	24187.8	12044	12143.8
2004/05	80072.2	50445.5	29626.7	6686.1	22940.6	7698.7	15241.9
2005/06	84006.1	56229.8	27776.3	11339.1	16437.2	4546.4	11890.8
2006/07	89442.6	62331	27111.6	11283.4	15828.2	7629	8199.2
2007/08	102560.4	70122.7	32437.7	14391.2	18046.5	9266.1	8780.4
2008/09	110889.2	72282	38607.2	13827.5	24779.7	8214.3	16565.4
2009/10	133604.6	87711.7	45892.9	15800.8	30092.1	10053.5	20038.6
2010/11	161349.9	107622.6	53727.3	20320.7	33406.6	8979.9	24426.7

Sources: Economic Survey Fiscal Year 2010/11

In the above table- 4.1, Resource gap I denotes the difference between total expenditure and total revenue in difference years. The resource gap in 2001/02 was Rs. 23,328 million increased to Rs 53727.3 million in fiscal year 2010/11. It shows that the amount of resource gap was in increasing trend.

In Resource Gap II, the relationship between total expenditure, total revenue and foreign grants, has been shown. It is calculated by subtracting total revenue and foreign grants from the total expenditure. The resource gap II was Rs. 18991.4 million in fiscal year 2001/02 increased to Rs. 33406.6 million in fiscal year 2010/11

Resource gap III is the difference between government expenditure and receipts (Total revenue, foreign grants and foreign loan) the resource gap III was Rs.7139 million in fiscal year 2001/02 increased to Rs. 24426.7 million in fiscal year 2009/08. This denotes increasing deficit financing of the government.

4.3 Composition of Major Revenue Heads

Income tax, VAT, Custom duty and Excise duty are the major revenue sources in Nepal. This four revenues heads contribute approx 77 percentage of total revenue. Among them VAT, Income taxes, Excise Duty are administered by Inland Revenue Department likewise custom duty is administered by custom department. Although, VAT and Excise duty on imported goods are charged on custom points by custom administration. Comparative status of major revenue heads is shown in table bellows.

Table - 4.2
Comparative status of major revenue heads

Rs. in Million

Fiscal Year	Excise Duty	Income Tax	Custom Duty	VAT	Total Revenue
2002/03	3807.0	8436	12658.7	12267.3	50445.4
2004/05	4785.1	7102.1	14236.4	13459.7	56229.7
2005/06	6226.7	8512.5	15554.8	14478.9	62311
2006/07	6445.9	9402.4	15701.6	18885.4	70021
2007/08	6506.9	10933.5	15343.7	21610.7	72282
2008/09	8686.2	14607.4	16911.2	26055	86135.2
2009/10	10473.20	17327.9	21325	31154.6	107622.6
2010/11	13843.04	21408.6	23100	35605.33	118250.35
Average growth rate in 10th plan	11.61%	11.61%	5.96%	16.26%	11.29

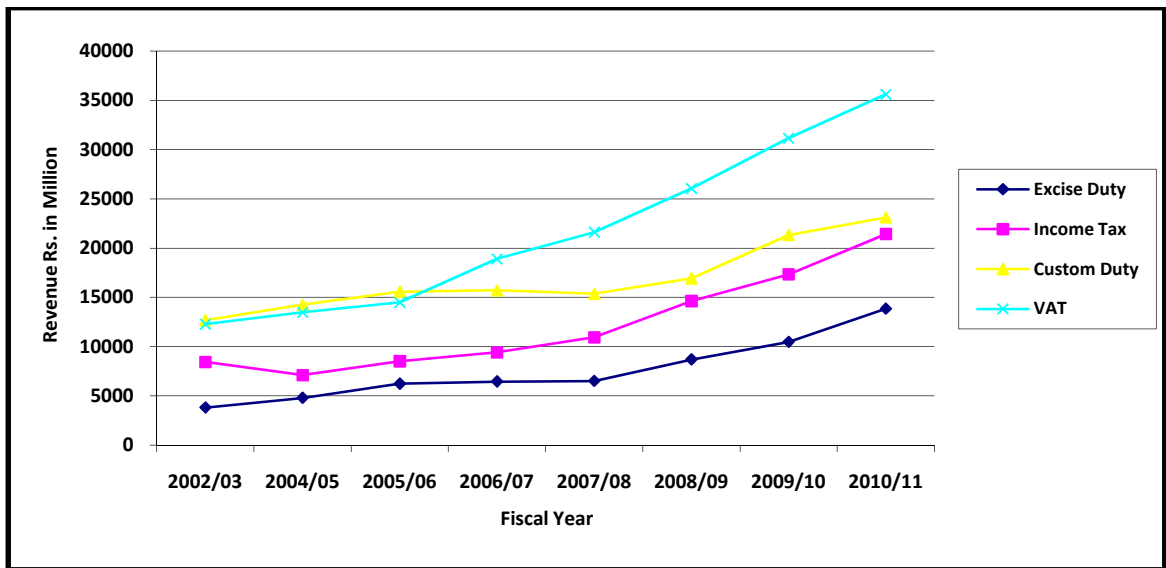
Source: Economic Survey (2010/11), Ministry of Finance

In above table-4.2, composition of excise duty, Income tax, custom duty VAT and total revenue is shown from fiscal year 2002/03 to 2010/11. This table also shows average growth of above taxes in 10th plan. Among these four taxes VAT has great contribution to the total revenue as compared to other taxes.

Average growth rate of VAT is more than other taxes, excise duty. It has higher rate than total revenue growth rate. It clears that, there is no doubt that, VAT has greater potential at present and future for revenue mobilization.

Beside above table, composition of revenue mobilization can be shown by using figures. It shows the trends line of major revenue heads. It helps to analyze the prospects of VAT. Given figure-4.3, shows the comparative trends line of VAT, Income tax, custom duty, and Excise duty. It gives the minor of tax revenue collection in Nepal. The graph is presented as below.

Figure-4.1
Composition trends of revenue mobilization.



In above figure-4.1 composition trends of Excise duty, Custom duty, Income tax and Value Added Tax are shown. An initial year custom duty is the main sources of revenue. But later, this position changed after fiscal year 2005/06. Since 2005/06, VAT becomes a major sources and it is leading total revenue. Slope of trend line of VAT collection is increasing. In fiscal year 2004/05 revenue collection from Excise Duty, Income tax, Custom duty and Value Added Taxes are Rs. 4785.1, 7102.1, 14236.4, and 13459.7 million respectively, But the composition is dramatically changed up to fiscal year 2010/11. In this year revenue collection from Excise Duty, Income tax, Custom duty and Value Added Taxes are Rs. 13843.04, 21408.6, 23100 and 35605.33 million respectively.

4.4 Share of Tax and Non-tax revenue in total revenue

The composition of total revenue of Nepal is the addition of tax and non-tax revenue. The structure of total revenue from 1999/00 to 2010/11 has been shown in the table-4.4. The share of tax revenue has always been greater than the share of non-tax revenue. The share of tax revenue and non-tax revenue in fiscal year 1999/00 was 77.19% and 22.81% respectively and the average share of tax and non-tax revenue is very much important in revenue mobilization of Nepal and to meet the increasing government expenditure.

The trend of tax and non-tax revenue has been presented in the following table.

Table-4.3
Share of Tax Revenue and Non-tax Revenue in Total Revenue.

In million

Fiscal Year	Total Amount	Revenue %	Non-tax Amount	Revenue %	Total Amount	Revenue %
1999/00	2852.9	77.19	8498.10	22.81	37251	100
2001/02	33152.1	77.29	9741.60	22.71	42893.2	100
2002/03	38865.1	79.49	10028.80	20.51	48893.9	100
2002/03	39330.64	77.97	11114.90	22.03	50445.5	100
2004/05	42586.92	75.74	13642.86	24.26	56229.8	100
2005/06	48173.00	77.29	14158.00	22.71	62331	100
2006/07	54104.70	77.16	16018.00	22.84	70122.7	100
2007/08	57430.40	79.45	14851.60	20.55	72282	100
2008/09	71126.70	81.09	16585.50	18.91	87711.7	100
2009/10	85155.54	79.12	22467.04	20.88	107622.6	100
2010/11	102120.3	80.85	24184.5	19.15	126304.8	100

Sources: Economic survey Fiscal Year 2010/11 GON/MOF

This table-4.3, it is clear that, the share of tax revenue is more than the share of not-tax revenue is more than the share of non tax revenue in every year. In average the tax revenue contribute about 79 percent and 21 percent contributed by non-tax revenue.

4.5 Target and Achievement of VAT revenue

For effective mobilization of national revenue, fixation of target revenue collection is needed. All efforts should be made to achieve targeted goal. It helps to measure the capabilities of tax administration and to disclose its problems and prospects. In given table No.4.5. Targeted VAT, collected VAT and percentage of target achieved, is shown from fiscal year 2001/02 to 2010/11.

Table No. 4.4
Target and Achievement of VAT revenue

Rs. In Millions

Fiscal year	Targeted VAT	collected VAT	Target achieved (in %)
2001/02	9420.000	7880.000	83.65
2002/03	1046.0000	9850.000	94.17
2002/03	1350.0000	1204.7760	89.24
2004/05	1475.0000	1194.7955	81.00
2005/06	1373.0050	1344.9123	97.95
2006/07	1550.3500	1447.8896	93.39
2007/08	1695.0000	1889.4627	111.47
2008/09	2365.0000	2194.6014	92.79
2009/10	2646.3000	2670.4180	100.91
2010/11	2953.2900	3115.4633	105

Source: Annual Reports (2010/11), Inland Revenue Department.

In above table, targeted VAT could not be collected except fiscal year 2007/08, 2009/10 and 2010/11. These three fiscal years, collected VAT is more than targeted VAT. In fiscal year 2001/02 2002/03 and 2004/05 target is achieved 80 percent to 90 percent. Like wise, In fiscal year 2002/03, 2005/06, 2006/07, and 2008/09 target is achieved 90 percent to 99 percent. It shows that, In 10 years periods only 2 year target is achieved and remaining 8 years fail to meet target. For this failed situation tax administration is more responsible. This situation is occurred because of administrative inefficiencies, huge amount of tax evasion, economic stagnation, and low projection capacity or more ambitious than they could do.

In Nepal, the full implementation of VAT has reached ten years but still the revenue collection has not been able to increase as expected. The above data shows that the difference between targeted VAT and Actual collected VAT. Even though, growth of total VAT collection increasing slowly but not as estimated. The gapes between targeted VAT collection and Actual VAT collection are fluctuation in percentage.

There are so many problems, by which the gap between target and achievement of VAT is remaining for long time. Low public awareness, lack of billing system, Lack of coordination between government and private sector, lack of skilled manpower, corruption and bribe are main obstacles among them.

4.6 Composition of VAT Revenue

VAT is the main sources of government revenue collection. Total VAT collection is divided in to two parts. They are Domestic VAT and Imports VAT. Domestic VAT is collected from national goods and services which are produced or operated in Nepal. It is collected by Inland Revenue offices. Like wise Imported VAT is collected from imported goods at custom points by custom offices. Volume of its revenue depends up on foreign trade. In Nepal, most of the VAT is collected from imported goods. Ratio between Domestic VAT and Import VAT has large different. It is cleared by table below.

Table 4.5
Composition of VAT Revenue

Rs in millions

Fiscal year	Total VAT Collection	Domestic VAT	Import VAT	Domestic/Imports ration
2001/02	7880.000	2810.000	5070.000	35:65
2002/03	9850.000	3720.000	6130.000	37:63
2002/03	12047.760	4744.720	7303.040	39:61
2004/05	11947.955	4608.373	7339.582	38:62
2005/06	13449.123	4819.610	8629.513	35:65
2006/07	14478.896	5604.123	8874.773	38:42
2007/08	18894.627	6624.333	12270.294	35:65
2008/09	21946.014	8057.438	13888.576	36:64
2009/10	26704.180	9689.979	17014.201	37:63
2010/11	31154.623	10808.241	19007.461	36:64

Source: Inland revenue Department, Annual Report 2010/11.

In above table, total VAT collection, Domestic VAT collection and Import VAT collection and its ratio are presented. Trend of domestic and import VAT collection is given in table 4.5. Domestic / Import ratio in fiscal year 2001/02 was 35: 65. It means that Domestic VAT collection was 35% and import VAT collection is 65% in total VAT revenue. Similarly, domestic / imports ratio are 37:63, 39:61, 38:62, 35:65, 38:62, 35:65, 36:64, 37:63 and 36:64 in fiscal year 2002/03, 2002/03, 2004/05, 2005/06, 2006/07, 2007/08, 2008/09, 2009/10 and 2010/11 respectively. It denotes that Nepalese VAT Revenue is mostly depends on imported goods. Proportion of domestic VAT could not increased above 38 percent. Approximately, 2/3 portion of total VAT is collected from imported goods. This tendency is not favorable for self-dependent economy. Proportion of domestic VAT should be increased for developing VAT as a back bone of total revenue.

4.7 Trend of Revenue collection from VAT

Value Added Tax is a broad-based tax as it is also covers the value added to each commodity by a firm during all stages of production and distribution. VAT is the best form of sales tax, which is neutral regarding method of production and helpful in generation of more revenue collection. Because of its broad coverage, neutrality, transparency and fairness VAT will generate more revenue with less distribution. The revenue collection from VAT in different fiscal year is presented in table below. Trend of VAT collection is analyzed as follows:

Table 4.6
Contribution of VAT on Total revenue

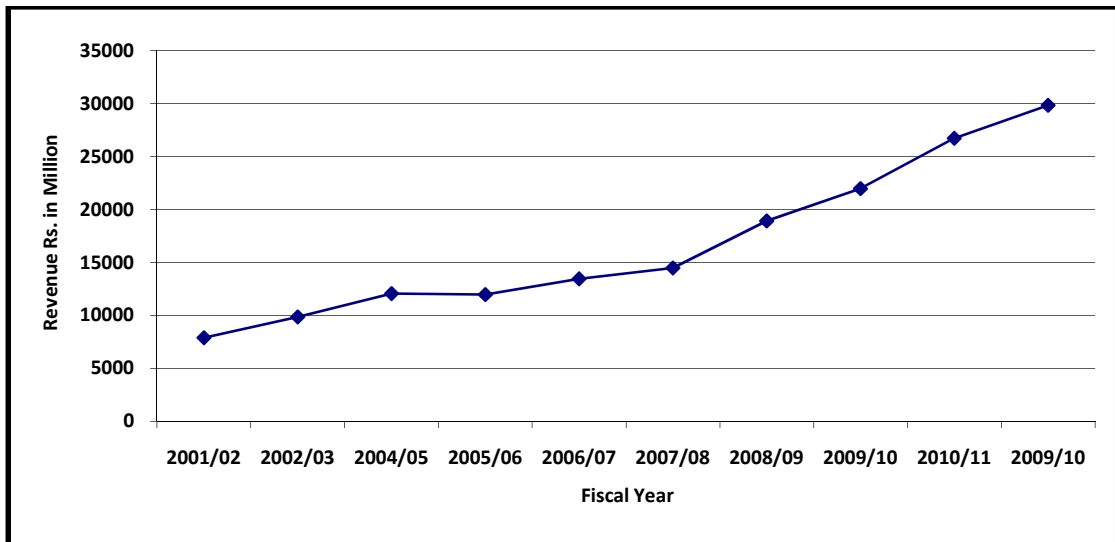
		Rs. in Millions
Fiscal year	VAT collection	Growth rate (in %)
2001/02	7882.20	10.67
2002/03	9854.9	25.03
2002/03	12047.80	22.25
2004/05	11964.0	-0.695
2005/06	13459.7	13.50
2006/07	14478.90	7.58
2007/08	18094.60	24.97
2008/09	21946.00	16.15
2009/10	26704.0	21.69
2010/11	31154.60	16.67

Source: (a) Economic Survey (2010/011), Ministry of Finance.

(b) Annual Report (2067/68), Inland Revenue department.

The Table 4.6 shows that the trend of VAT revenue collection. The VAT revenue collection growth rate was 10.67 in fiscal year 2001/02. After that the growth rate was increases up to 25.03percentage in fiscal year 2002/03. Similarly in fiscal year 2004/05 the VAT collection growth rate was very low i.e. negative -0.695 percent only. In short, the trend of VAT collection is not so bad except fiscal year 2004/05. In fiscal Year 2005/06 rate was increased by 13.50 % but year 2006/07 growth rate was decreased as compared. After that this rate also up – down frequently. Trend of VAT collection from fiscal year 2001/02 to 2010/11 (10 years) is shown in following figure No. 4.2

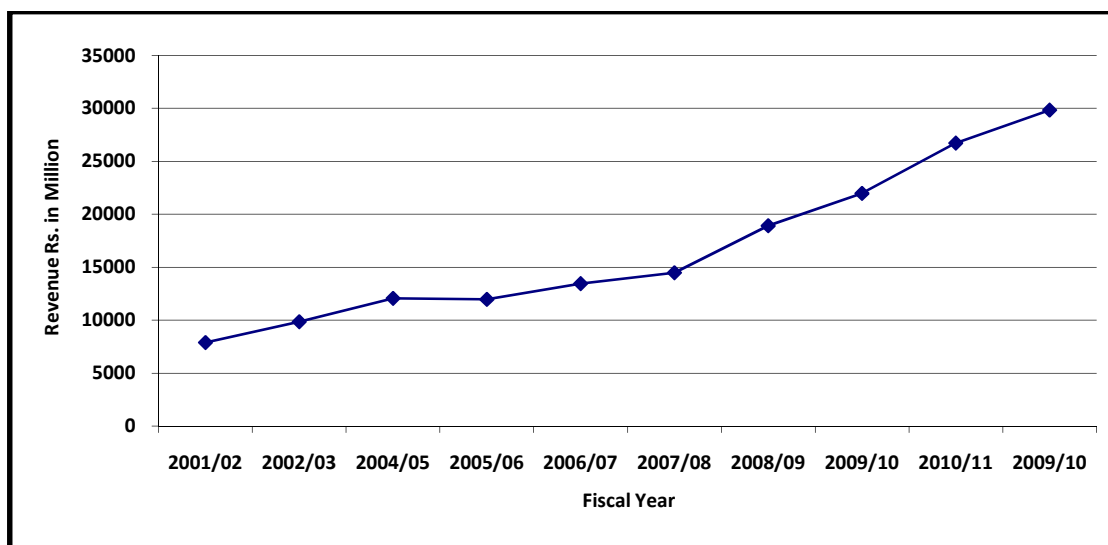
Figure 4.2
Trend of VAT collection



In above figure-4.2, VAT collection is increasing in every fiscal year. Thus, it has prospect.

Another important issue of VAT is its growth rate. Trend of growth rate forecast its potentialities. The figure given below clears its growth status during past ten years.

Figure 4.3
Trend of Growth Rate



In above figure-4.3, trend of VAT growth rate is shown. In fiscal year 2001/02 the growth rate was only 10.67 percent. The growth rate was increased up to 25.03 percent in fiscal year 2002/03. In fiscal year 2004/05, it was very bad for VAT collection because of negative growth rate i.e. -0.695 percent. After that, the growth rate was tries to move up in to 13.50 percent in fiscal year 2005/06. In fiscal year 2006/07 the rate was also decreased to 7.58 percent only. Again in fiscal year 2007/08 the growth rate was also increases up to 24.97 percent. Likewise the growth rate of VAT was also decreased up to 16.15 percent in fiscal year 2008/09. In fiscal year 2009/10 the growth rate was also increased up to 21.69 percent and again in decreased 16.67 percent in fiscal year 2010/11. Rate of VAT collection is above double digit except fiscal Year 2004/05 and 2006/07. We can easily predict that growth rate is not stable because of political stagnation economic distortion, administrative inefficiency and tax evasion. In spite of fluctuation, there is double digit growth rate in given seven years. Thus we can conclude that VAT has large prospect in Nepalese tax system.

4.8 Share of VAT revenue in GDP

The percentage contribution of Value Added Tax (VAT) in GDP is presented in table below.

Table-4.7
VAT Revenue as percentage of GDP.

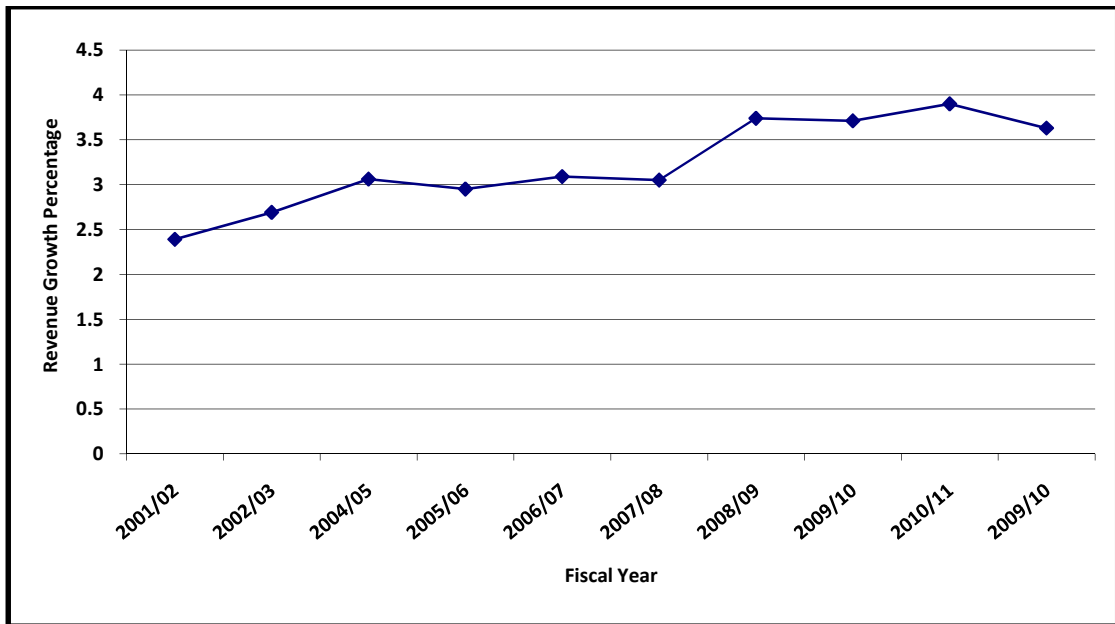
In Million

Fiscal Year	Gross Domestic Product (GDP)	VAT Revenue	Percentage of VAT Revenue
2001/02	330018	7882.2	2.39
2002/03	366251	9854.9	2.69
2002/03	393566	12047.8	3.06
2004/05	405632	11964	2.95
2005/06	435531	13459.7	3.09
2006/07	474129	14478.9	3.05
2007/08	504101	18885.4	3.74
2008/09	582950	21610.7	3.71
2009/10	670588.7	26095.6	3.90
2010/11	820814	29815.7	3.63

Sources: - Economic survey 2010/11, MOF, GON.

This table shows that, the share of Value Added Tax in the GDP in Nepal is very low and it is below 4% throughout the ten years period. From the fiscal year 2001/02 to 2002/03, it has increased to 2.39% to 3.06%. After than in the fiscal year 2004/05, it is decreased to 2.95% and in the fiscal year 2005/06 it is increased to 3.09%. Again it is decreased to 3.05% in fiscal year 2006/07. In fiscal year 2007/08, it is reached to 3.74% and then it is decreased to 3.63% in fiscal year 2010/11.

Figure-4.4
Share of VAT revenue in GDP
VAT as % of GDP.



4.9 VAT Registration

The operation of VAT in Nepal is started by advertising the sales tax registrants to register in the VAT department. The registration is compulsory for these business enterprises that have taxable transaction and taxable capacity. However the traders falling below the threshold limit can register voluntarily. Registration is required for any business.

- a) With an annual taxable turnover of more than two million rupees.
- b) Belonging to a conglomerate which has an aggregate annual taxable turnover exceeding two million rupees.

The trend of VAT registration is shown in the following table.

Table-4.8

Trend of VAT Registrations

Fiscal Year	No. of New VAT registrants	Total number of VAT registrants	Trend Percentage
2001/02	9642	9642	-
2002/03	8305	17947	86.13
2002/03	3146	21093	17.53
2004/05	4056	25149	19.23
2005/06	4723	29872	18.78
2006/07	4303	34174	14.40
2007/08	5602	39776	16.39
2008/09	7055	46831	17.74
2009/10	6134	52965	13.10
2010/11	6742	59707	12.73

Sources: - Annual report 2010/11, Inland Revenue Department

As shown in above table-4.8, the total number of VAT registrants in the fiscal year 2001/02 was 9642 and it was reached 8305 in fiscal year 2002/03. After this year registration trend was quite slowly. But during the ten year period, the number registrants increased from 9642 in the fiscal year 2001/02 to 59707 in fiscal year 2010/11 by almost six fold. This shows that the trend of VAT registration is impressive.

Figure-4.5

Trend of VAT registrations

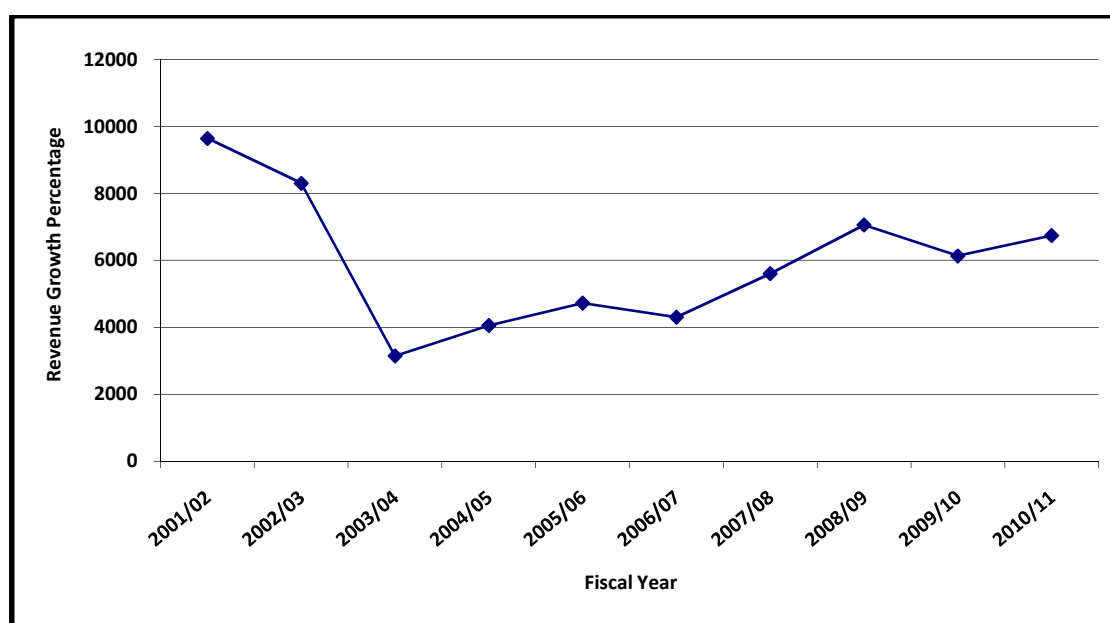
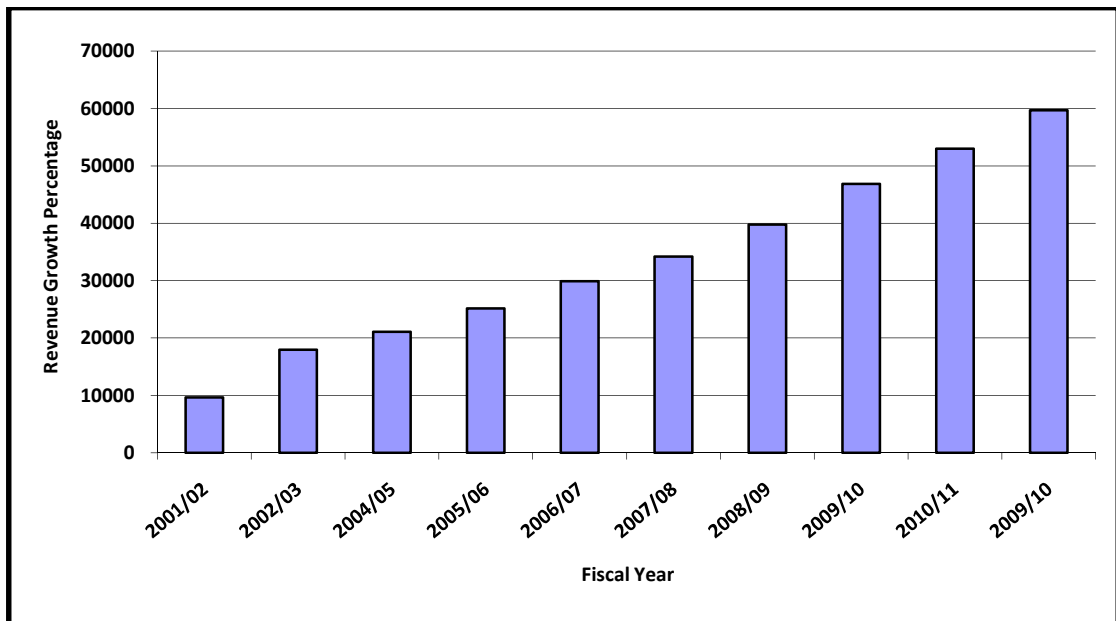


Figure-4.6
Total number of VAT registrations



4.10 Empirical Study

4.10.1 Views on knowing properly about VAT

The views on knowing properly about VAT system are as follows.

Table-4.9

Views about VAT

Alternatives	No. of Respondents	Percentage (%)
Yes	40	80
Partially	5	10
No	5	10
Total	50	100

Sources: Opinion Survey

From the above table, we can concluded that, most of the respondents properly knows about VAT (80% respondents knows about VAT). Only 10% respondents properly know about VAT system. Rest 10% respondents do not know about the VAT system.

4.10.2 Will Price rise due to VAT System?

I take the opinion about, the price rise due to VAT system. The opinions of respondents are as follows.

Table-4.10
Price rise due to VAT system

Option	No of Respondents	Percentage (%)
Yes	45	90
No	5	10
Total	50	100

Sources: Opinion Survey

From above table, it is clear that, 90% of respondents, support the price rise due to VAT system, and rest 10% respondents support price does not rise due to VAT system,

4.10.3 What is the most challenging problem in the process of VAT implementation in Nepal?

The view of respondents in the process of VAT implementation in Nepal is as follows.

Table-4.11
Problems in VAT implementation process

Options	No. of Respondents	Percentage (%)
Smuggling and under valuation	20	40
Lack of proper billing	5	10
Lack of proper Account	10	20
Weak tax Administration	10	20
I don't know	5	10
Total	50	100

Sources: Opinion Survey

From the above table, we can conclude that, most challenging problem in the process of VAT implementation in Nepal is smuggling and under valuation. Among the 50 respondents 40% of respondents support this answer. Only 10% respondents believe that, lack of proper billing is the most challenging problem. The causes of lack of proper account support 10% and another 10% support, weak tax administration is the main cause. Remaining 10% give the answer of they don't know.

4.10.4 Views on rising price due to VAT System

In the beginning period of VAT implementation, there was a strong opposition from the business community. The basic agreement behind it was due to rise in price from VAT. After the implementation of VAT, there was a voice from different people on price rising on commodities. Consumers also complain that businessmen charge more prices without following act of VAT. Here an, endeavor has been made to get the information from the respondents to find out whether there will be raised in price due to VAT system. The following table presents the view of respondents on this aspect.

Table-4.12

Price increment by VAT system

Option	No. of Respondents	Percentage (%)
Yes	45	90
No	5	10
Total	50	100

Source: - Opinion Survey

In above table 80% respondents believes that price increase due to VAT system. Another 10% support that, price not increase due to the VAT system. Remaining 10% are unable to give the answer.

4.10.5 View on suggestion about the rate of VAT in Nepal

To know the respondents view about the present rate of VAT in Nepal, the result are as follows:

Table-4.13

Suggestion on VAT rate

Option	No. of Respondents	Percentage (%)
Existing rate (13%) is ok	20	40
It should be reduced	10	20
It should be increased	5	10
Established two or three rates	15	30
Total	50	100

Source: - Opinion survey

From the above table, we can conclude that majority of respondents (i.e. 40%) support the existing rate (13%) is ok. but 20% of respondents believes that it should be reduced. Another 10% believes that it should be increased for the effective revenue collection. Rest of respondents (i.e. 30%) believes that it should be established two or three rates.

4.10.6 View on the effect has been shown in investment sector

In real, the prevalent tax system has direct impact on the investment sector of the economy. However, the extent of the impact depends on the tax rate, structure, coverage etc. Mainly Nepal has two kind of investment i.e. foreign and domestic investment. Since a long back, both have flown on the productive sector. The major goals are to achieve economic growth through developing productive sector and alleviate the poverty. In general, investment factor affected by the policy of the country or the taxation policy of the government. So we have to know that, what kind of effect a VAT will fall on the investment sector. The effect of investment sector is evaluated by comparing it with the replaced taxes. In the case of developing countries fifth current tax policy also need to be direct towards encouraging the investment in the economy. So the field survey was conducted to know the views of respondents about the effect of VAT on this sector. The survey result is presented in the table below:

Table-4.14
Effect in investment sector

Options	No of respondents	Percentage[%]
Negative	25	50
Positive	5	10
Normal	10	20
I don't know	10	20
Total	50	100

Source: - Opinion survey

From the above table the majority of the respondents (i.e. 50%) believe that, VAT gives the negative impact in investment sector. Likewise, very few (i.e. 10%) respondents believes that, VAT gives the positive result in investment sector. Only

20% respondent's supports that, there is no effect (normal) in investment sector due to VAT. Rest 20% respondents do not know about it.

4.10.7 Views on the most responsible for the tax evasion

Tax evasion is the great problem of our country. Tax Evasion not only tosses the revenue but also creates distortions, market imperfection, encourage illegal business, decline business ethics etc. There are many groups such as consumers and administration who always support business enterprise for tax evasion for their benefits. The field survey is conducted to provide the views on most responsible group for tax evasion among respondents.

Table-4.15
Responsible for the tax evasion

Options	No of respondents	Percentage[%]
Business Enterprises	30	60
Tax administration	10	20
Consumer	8	16
I don't know	2	4
Total	50	100

Source: Option Survey

In the above table, it is known that each sector people blame to another sector people for tax evasion. However majority of respondents (i.e. 60%) agreed that business enterprises are the main causes for tax evasion. Another 20% respondents supports that tax administrator are the main causes of VAT evasion. Similarly 16% respondents blames to consumer for the tax evasion. Rest 4% respondents do not have any idea.

4.10.8 Views on major weakness of Nepalese VAT administrations

VAT administrative reform is weak, inadequate and incomplete, which cause problems and challenges in the path of operation of VAT administration. It is found that, major weakness of VAT administration in Nepal are lack of expertise, trained manpower, weak financial resources, physical infrastructure and miscellaneous. The

field survey was conducted in this aspect to know the major weakness in VAT administration. The outcome of this view is shown in the following table.

Table-4.16
Weakness of Nepalese VAT administrations

Alternative Respondents	Lack of exports		Lack of Physical In fracture		Process Oriented		Miscellaneous		All of them		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	
Consumers	3	20	4	26.67	2	13.33	3	20	3	20	15
Tax officers	1	20	2	40	1	20	1	20	0	0	5
Tax export	2	40	1	20	1	20	0	0	1	20	5
Economists	1	20	2	40	0	0	1	20	1	20	5
Politicians	3	60	1	20	1	20	0	0	0	0	5
Industrialists	2	40	1	20	0	0	1	20	1	20	5
Journalists	1	20	0	0	1	20	2	40	1	20	5
Traders	1	20	1	20	2	40	1	20	0	0	5
Total	14	28	12	24	8	16	9	18	7	14	50

Sources: - Opinion Survey

From the above survey result, it is clear that, 20% consumers, 20% officers, 40% tax experts, 20% economist, 60% politicians, 40% industrialist, 20% journalist and 20% traders viewed that, major weakness of VAT administration is due to the lack of experts. While 26.67% of consumers, 40% of tax officers, 20% of tax experts, 40% of economist, 20% of politician, 20% of industrialist and 20% of traders reported due to the lack of physical infrastructure, but whole journalist does not blame this reason. Likewise, 13.33% consumers, 20% each tax officers, tax experts, politicians and journalist respectively viewed that process oriented is the main problem of VAT administration. Similarly 20% each consumers, tax officers, economist, industrialist, respectively blame the miscellaneous problems for weakness of VAT administration. Where as, 20% each consumers, tax experts, economist, industrialist, journalist respectively viewed weaknesses of VAT administration due to all reasons mentioned above.

4.10.9 Viewed on the present legal provision sufficient for proper implementation of VAT?

The government of Nepal has prepared VAT Act 2052 B.S. and VAT regulation 2053 B.S. Generally, they are amending by every year's finance act when government realized to change or to add any provision in VAT law. The field survey has been conducted to find out whether the act and regulation are sufficient or not with reference to present VAT system.

The survey result presented bellows shows the respondents view are as follows.

Table-4.17
Legal provision for VAT implementation

Options	No; of Respondents	Percentage[%]
Yes	10	20
No	20	40
Moderate	15	30
I don't know	5	10
Total	50	100

Source: Field survey

In above table, 20% of respondents viewed that, the present legal provision is sufficient for proper implementation of VAT. Another 40%, respondents, support that, present legal provision isn't sufficient for proper implementation of VAT. Similarly, 30% respondents believe that, present legal provision must be moderate, for proper implementation of VAT. Rest 10% respondents don't know about it.

4.10.10 Views on the legal provision of VAT in Nepal.

Legal provision is the most important part of VAT system. It regulates all of taxation procedure, tax coverage, zero rates, tax exempt, right and duty of tax administration and taxpayer and so many other provisions related to VAT system. Without legitimate law, no any state could impose tax to their citizens in modern rule of law system. Policy of government, providing facilities to taxpayer, nature of tax administration and so on aspects are depicted in tax law. So, legal provision of VAT plays crucial role for effective implementation of VAT. The attitude of the respondents on this aspect is presented in the table below

Table-4.18
Legal provision of VAT

Respondents Alternative	Sufficient & Appropriate		Insufficient & need to improve		Complex & require simply		I don't know		Total
	No	%	NO	%	NO	%	NO	%	
Consumers	3	20	5	33.33	6	40	4	26.67	15
Tax Officers	2	40	2	40	1	20	–	–	5
Tax Experts	2	40	2	40	1	20	–	–	5
Economists	1	20	2	40	2	40	–	–	5
Politicians	2	40	1	20	1	20	1	20	5
Industrialists	1	20	2	40	2	40	–	–	5
Journalists	1	20	3	60	1	20	–	–	5
Traders	1	20	2	40	1	20	1	20	5
Total	13		19						50

Source: Field Survey

From the above table, it is clear that, 20% consumers, 40% each tax officers, tax experts, 20% economists, 40% politicians and 20% each, industrialists, journalists traders, viewed that, present legal provision of VAT in Nepal is sufficient and appropriate. While, 33.33% consumers, 40% each, tax officers, tax experts, economists respectively, 20% politicians, 40% industrialists, 60% journalists and 40% traders believes that, present legal provision of VAT in Nepal is insufficient and need to improved. Similarly, 40% consumers, 20% each tax officers, tax experts, 40% Economists, 20% politicians, 40% industrialists and 20% each journalists and traders, support that present legal provision of VAT in Nepal is complex, So that, it should be made more simple. Finally 26.67% consumers and 20% each politicians and traders are unable to give the answer. (I.e. I don't know)

4.10.11 Views on the tax burden of VAT to the tax payer

Value Added Tax covers the value added to each commodity by a firm during all stages of production and distribution and it is shifted forward completely to the ultimate users. In short, the tax burden ultimately shifts on the taxpayer. The problem

on this view generally includes dislike of general people to pay more tax on commodities. Mainly, in Nepalese environment, general people have a lower income level. So they don't have much more purchasing power. Like wise, the government is still ineffective to give the guarantee of minimum social security to the general people, in return of tax paid by them. Again, the growing corruptions in the government fade up the tax payers. Finally the tax allotted by the government is expanded on the unproductive sectors. Therefore, Nepalese tax payers are worried about the possible tax burden level and shifting. The field survey has been conducted to find out views of different respondents on burden of VAT to the tax payers. The outcomes are presented in the table given below.

Table-4.19
Tax burden of VAT

Options	No. of respondents	Percentage [%]
Higher	20	40
Lower	5	10
Normal	10	20
Zero	5	10
I don't know	10	20
Total	50	

Source: - Opinion survey

From the above table 40% of respondents believe that, the burden of VAT to the tax payers is higher. Similarly 10% of respondents agreed that the burden of VAT to the tax payer is lower. Like wise 20% of respondents, support that there is no tax burden (normal) of VAT to the tax payers. Another 10% respondents believes that the tax burden of VAT to the taxpayer is zero. Rests 20% of respondents are unknown about it (I don't know).

4.10.12 Views on VAT system in Nepal to improve revenue mobilization

Tax is the main sources of revenue collection of government for developing countries. The major part of the total tax income is contributed by direct tax. In the context of Nepal, the major part of indirect tax is contributed by VAT/ sales tax. To find out

whether the previous sales tax, or vat system will help to improve the government revenue, the respondent's views are presented in the table below

Table-4.20
VAT system to improve revenue mobilization

Options	No. of respondents	Percentage [%]
Yes	25	50
No	20	40
I don't know	5	10
Total	50	100

Sources: Field Survey

From above table, it is clear that 50% of respondents believes VAT system in Nepal improve revenue mobilization. Similarly, 40% of respondents' views that vat system in Nepal do not improve revenue mobilization. Finally only 10% respondents are unknown about it.

4.10.13 Views on their suggestion for effective implementation of VAT

The views on the effective implementation of vat in different level of people are as follows:

Table-4.21
Views on implementation of VAT

Respondents Alternative	Skilled &Trained Manpower		Proper billing & Account System		Taxpayer friendly tax administration		Strictly marked monitoring		All of them		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	
Consumers	3	20	3	20	3	20	3	20	3	20	15
Tax officers	2	40	1	20	1	20	1	20	0	—	5
Tax experts	1	20	2	40	1	20	0	—	1	20	5
Economists	1	20	1	20	2	40	1	20	0	—	5
Politicians	0	—	1	20	1	20	2	40	1	20	5
Industralist	1	20	0	—	1	20	1	20	2	40	5
Journalists	1	20	1	20	0	—	2	40	1	20	5

Traders	1	20	1	20	1	20	0	–	2	40	5
Totals	10	20	10	20	10	20	10	20	10	20	50

Sources: field survey 2010

From the above table, it is clear that 40% of tax officers, 20% each consumers, tax experts, economist, politicians, industrialist, journalist and traders respectively views that skilled and trained manpower is required for effective implementation of VAT. While 40% tax experts and 20% each consumers, tax officers, economist, politician, industrialist, journalist and traders respectively believes that proper billing and account system is required for effective implementation of VAT. Similarly 40% economist and 20% each consumers, tax officers, tax experts, politicians, industrialist, journalist and traders respectively views that tax payers friendly and tax administration is required for effective implementation of VAT. Another 40% politicians and 20% each consumers, tax officers, tax experts, economist, industrialist, journalist and traders respectively believes that strictly marked monitoring is useful for effective implementation of VAT. Lastly, 40% economist, and 20% each consumers, tax officers, tax experts, politicians, industrialist, journalist and traders views all of the above points are equally important for effective implementation of VAT.

4.10.14 Views on main reason for need of VAT in Nepal

Nepal, Bhutan and Bangladesh are the developing countries, so there is a having greater pressure for development need higher revenue collection from internal sources. For the, at, the effective implementation of VAT has great significance for these developing countries. Almost developing countries depends upon the external resource such as foreign aid foreign loan and financial assistance. So these countries tried to seek to stand on the internal revenue through VAT system. The table below vowelized about the option of respondents why VAT is needed in Nepal

Table-4.22**Views on main reason for need of VAT in Nepal**

Respondents Alternative	Effective revenue		Transparency		Avoid tax leakage		Borden tax base		All		I don't know		Total 15
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	
Consumers	3	20	2	13.33	3	20	1	6.66	3	20	3	20	5
Tax officers	1	20	1	20	1	20	1	20	1	20	0	–	5
Tax exports	1	20	1	20	1	20	1	20	0	–	1	20	5
Economists	1	20	1	20	1	20	0	–	1	20	1	20	5
Politicians	1	20	1	20	0	–	1	20	1	20	1	20	5
Industrialist	1	20	0	–	1	20	1	20	1	20	1	20	5
Journalists	0	–	1	20	1	20	1		1	20	1	20	5
Traders	1	20	1	20	0	–	1	20	1	20	1	20	5
Totals	9	18	8	16	8	16	7	14	9	18	9	18	50

Sources: Field Survey

According to the survey, 20% each consumers, tax officers, tax experts, economists, politicians, industrialists, journalists and traders agreed that, VAT is needed in Nepal due to the reason of effective revenue generation. Similarly 13.33% consumers, 20% each, tax officers, tax experts, economists, politicians, Industrialists, journalists and traders supports that transparency is the main reason for need of VAT in Nepal. Likewise 20% each consumer's tax officers, tax experts Economists, industrialists, journalists and traders views on the avoid tax leakage is the main reason for need of VAT in Nepal. Another, 6.67% consumers, 20% each tax officers, tax experts, Economists, politicians, industrialists, journalists and traders respectively, reported VAT is needed due to borden tax base, likewise 20% each, respondents of different fields views there is need of VAT due to all mentioned reasons. Lastly, 20% each respondents views has no idea on this option, out of total respondents 18% supported for effective revenue, followed by 16% transparency, 16% avoiding tax leakage, 14% burden tax base, 18% due to all reasons need of VAT in Nepal.

4.10.15 Views on effect of VAT on revenue mobilization

Due to lack of sufficient revenue sources government is not capable to operate the development activities in the country. Beside this, the large amount of foreign debt is forcing the economy towards the debt trap situation. In such circumstances, VAT was expected to have the greater revenue yield due to its broader base and other features such as catch up effect, self enforcing nature, transparency etc. but it has a low revenue yield due to weak implementation unit the beginning year of implementation until the beginning year of implementation however improving in successive years. The option survey on this aspect is presented in the table below.

Table-4.23
Effect of VAT on revenue mobilization

Respondents Alternative	Positive		Negative		No. effect		I don't know		Total
	No.	%	No.	%	No.	%	No.	%	
Consumers	5	33.33	3	20	2	13.33	5	33.33	5
Tax officers	5	100	1	–	–	–	–	–	5
Tax experts	5	100	1	–	–	–	–	–	5
Economists	3	60	1	20	1	20	–	–	5
Politicians	3	60	1	20	1	20	–	–	5
Industrialists	3	60	1	20	1	20	–	–	5
Journalists	3	60	1	20	1	20	–	–	5
Traders	2	40	2	40	1	20	–	–	5
Totals									50

Sources: Field's Survey

From above survey results, 33.33% of consumers, 100% each tax officers, tax experts, 60% each economists, politicians, industrialists and journalists respectively. 40% traders said that VAT would have positive effect on revenue mobilization as compared to the other replaced taxes. Likewise 20% each consumer, economists, politicians, industrialists and journalists has negative impact on effect of VAT on revenue mobilization. Another 13.33% of consumers, 20% each economists, politicians, industrialists, journalists and traders have viewed that, there is no effect of VAT on

revenue mobilization. At last 33.33% of consumers have no idea about effect of VAT on revenue mobilization.

4.10.16 Views on effect of VAT in the nation's economic growth.

The main tax policy of a government is to intensify the rate of saving and investment to achieve a higher rate of economic growth. Thus, VAT is an ideal tax to achieve higher increment saving ratio and there by attain higher rate of growth in the economy. Economic growth of country depends on the various aspects. The role of tax system significantly affects the country economic development. So from this view higher the revenue collection from VAT means higher will be the growth of national development. So the VAT is a major tool for accelerate the economic growth of a country. Whether the effect of VAT on economic growth the views if respondents is positive, negative, no effect and no idea. The outcome of the survey is summarized in the table below.

Table-4.24
Effect of VAT in the nation's economic growth

Respondents Alternative	Positive		Negative		No effect		I don't know		Total
	No.	%	No.	%	No.	%	No.	%	
Consumers	10	66.66	2	13.33	2	13.33	1	6.67	15
Tax officers	5	100	–	–	–	–	–	–	5
Tax exports	4	80	–	–	1	20	–	–	5
Economists	3	60	1	20	1	20	–	–	5
Industrialists	3	60	2	40	–	–	–	–	5
Politicians	2	40	1	20	2	40	–	–	5
Journalists	3	60	1	20	1	20	–	–	5
Traders	3	60	1	20	1	20	–	–	5
	33	66	8	16	8	16	1	2	50

Sources: Economic Survey

From the table, 66.66%, consumers, 100% tax officers, 80% tax experts, 60% economists, 60% politicians, 40% industrialist, 60% journalists, and 60% traders, expected to have positive effect of VAT on economic growth. Similarly 13.33%

consumers, 20% economists, 40% politicians, 20% each industrialists, journalists and traders views that, they had no adequate idea on this option. Thus, out of total respondents, 66%, 16% 16% & 2% of the total respondents, provided their view respectively on option of positive effect, negative effect, normal effect and unknown matter i.e. I don't know.

4.10.17 Do you have any comment on VAT system?

The respondents, view of their any comment on VAT system is given below

Table-4.25
Comment on VAT system

Options	No. respondents	Percentage[%]
Yes	30	60
No	10	20
If yes	10	20
Total	50	100

Sources: Economic Survey

From above table, 60% of respondents believe that they have comment on VAT system. Another 20% have no comment on VAT system

4.11 Major finding of the study

On the basis of previous chapter and data presentation and analysis, some, important findings can be drawn. The major findings are given below.

- i) Tax revenue increased by 19.7 percent in F/Y 2010/11, compared to that of the previous fiscal year. Such revenue had increased by 23.8 percent in F/Y 2008/08 compared to its preceding fiscal year. Of the total tax revenue in F/Y 2010/11, the share of customs duty was 24.7%, while the share of tax on production and consumption of goods and services was 48.2 percent.
- ii) Of the total revenue share of tax, revenue and non-tax revenue in 2010/11 stood at 80.85% and 19.15% percent respectively. Such share in F/Y 2008/09 year was 81% and 18.9% respectively.

iii) The contribution of VAT revenue to total revenue is in increasing trend, which is beneficial for sound economic development. Despite the various difficulties in the implementation of VAT, the collection trend of revenue through VAT will generate about 7882.20 million revenue in FY 1998/99. It reached up to Rs. 31154.60 million in F/Y 2008/09 which is about 295.251 increased in comparison to F/Y 1998/99.

iv) The share of Value Added Tax in the GDP in Nepal is very low with comparison to other developed countries. The contribution of VAT revenue as a percentage of GDP revenue 2.39, 2.69, 3.06, 2.95, 3.09, 3.05, 3.74, 3.71, 3.90 and 3.63 from fiscal year 2000/02 to 2009/010 respectively however showing an improving trend. Likewise the registration trend in to VAT is also increasing day by day. The number of registrants increased from 4959 in the year 2057 Ashad to 59907 in the year 2055 Ashad to 59907 in the year 2065 Ashad by almost 10 fold

V) 60% of total respondents reached to the conclusion that VAT will raise price of the commodities by 30% claimed for not rise in price due to VAT system.

VI) 40% of total respondents argued that current rate structure of VAT is sufficient to have greater revenue yield where as 20% claimed it should be reduced 10% claimed, it should be increased, and rest 30% claimed that it has to be improved.

CHAPTER: V

SUMMARY CONCLUSION AND RECOMMENDATION

5.1 Summary

Nepal has been under going through several fiscal crises due to limited sources of revenue and increasing government expenditure. The trend of gap between revenue expenditure shows that, it is even conducive to increase in future leading the country to a debt trap situation. In the wake of such a crisis Nepal has adopted a VAT.

Value Added Tax is latest innovation in the field of taxation. Actually, VAT is considered as the most important tax reform in the 21st century, which has already been implemented popularly in more than over 130 countries in the world. VAT is multi staged; commodity and services based tax that is levied on the value added of business enterprises at different stages of production and distribution. It affects only the added portion of price i.e. the value of goods and services added in various stage of transition. It has nothing to do with the rest of the prices purchases pay VAT to the sellers and sellers transfer it to government, deducting VAT paid on their business purchase from VAT amount collected from the consumers on their sales. The ultimate burden of VAT is shifted to the consumers. In this system, every person or business firm, which is above threshold limit should compulsorily be registered in VAT office. Registered person/ business firms get credit facility on tax paid, on their purchase of raw materials, semi produced goods and overheads small venders whose annual taxable turnover is below threshold and business firms that deal with exempt goods only need not registration. The firms, below threshold, could be registered voluntarily.

VAT was first implemented in 1954 by the French government. Then, after almost all countries (more than 130 countries) of the world are being attracted toward this system. Due to some special features such as input tax credit system, based on accounting system, less chance of cascading and pyramiding effect, this system is very popular throughout the world. VAT is self-policing in nature, so there is less probability of tax evasion. VAT plays a neutral role on the methods of production and distribution, which is a basic need for a good tax system. Similarly, the stepwise collection of VAT does not encourage tax evasion.

The structure of Nepalese VAT is designed in the VAT act 1996A.D. Its coverage is defined with reference to both taxable transactions and taxable persons. The base of VAT is the value added by each firm through its production and distribution activities. According to the VAT act 1996, the tax is 10% and exports are subject to a rate of zero percent. There are certain case, such as exemptions and zero rating, under which commodities are tax-free. A tax payer is all owed to deduct the tax paid on purchased for his business from the collected on sale. This deducted is known as an input tax credit. Under the Nepalese VAT system, there is a provision for the refund of VAT. Such a situation will arise in the case of zero rated supplies such an export. Small venders having an annual turnover up to certain amount are not required to register under the VAT system. The amount fixed for this purchase is known as threshold. In Nepalese case, its level is Rs2 million. The taxpayer may not always agree with the assessment made by the tax officer. In that case, taxpayer may file an appeal to the revenue tribunal within 35 days against a tax assessment or penalty.

VAT systems completely new system of taxation for Nepal. His majesty's government of Nepal adopted this system since November 16, 1997. The international of introducing VAT was initially expressed in 1992; VAT task force was created in 1993. After several years and preparation, VAT act was finally passed through parliament in December 1995. VAT becomes effective through the finance bill of 1997. After that, formulation and passage of VAT act; designed of VAT regulations and its final approval preparation of VAT all has been done by Nepali standard. Due to effective VAT act and regulation make well preparation for VAT in Nepal which has made VAT successful today.

VAT is the one of the forms of sales taxes. Actually, it is the replacement of sales tax, entertainment tax, hotel tax, and contract tax. Nepal introduced a consumption type, tax credit method VAT based on the destination principle with single positive rate of 13%

The present VAT administration may be simplified in two functional needs; Department and VAT officers. The VAT department and field offices under this department are responsible for administrating VAT. The organizational structure of the

VAT administration is based on functional line. Large taxpayer, tax refund, taxpayers' services, tax audit and investigations, internal monitoring, collection and registration are important section of VAT administration. There are 17 VAT officers under the VAT department and divided in to four categories, depending upon their workload.

VAT has been in operation for first five years, but is still facing number of challenges/problems. The lack of proper billing is being most of the challenging problem to implement VATs effectively and successfully. However, the problem is equally associated with others such as smuggling and under valuation, weak performance of tax administration, low level of public consciousness, rampant corruption, political instability, geographical barriers, open border and un authorized trade, narrow tax base, lack of coordination between custom office and VAT related officers etc. So improvements in such various areas are needed.

5.2 Conclusion

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

The Value Added Tax (VAT) is a general, broad based consumption tax assessed on the value added on the goods and services. It applies more or less to all goods and services that are bought and sold for use or consumption in the community. Thus, goods which are sold for export or services which are sold to customers abroad are normally not subject to VAT. The success of the VAT system depends upon the proper account keeping, registration of business, effective billing system and so on. Among the factors, non awareness of consumers is one of the main reasons of failure of billing system.

For VAT purposes, a taxable person is any individual, partnership, company or whatever which supplies taxable goods and services in the course of business. However, if the annual turnover of this person is less than a certain limit (the threshold), which differs according to the member state, the person does not have to charge VAT on their sales.

At present, the issues have become the effective implementation of VAT system in Nepal. It is not matter that VAT should be removing but the implementation aspect should be managed. VAT regime is extremely challenging in a burgeoning economy like Nepal. Resistance from the business community, ignorance of general people, lack of full support and commitments from the politicians and government officials forced the authority responsible for implementing VAT to make compromises on various aspects of VAT which has weakened the process of its implementation right from the beginning. The attitude of businessmen and tax administration also appear hostile to the effective implementation of VAT in Nepal. The culture of doing business without maintaining proper books of accounts or maintaining multiple sets of books of accounts have made implementation of VAT difficult.

Hence, VAT has some difficulties in the administrative aspect. It is the most advance and scientific system of tax. Transparency is the most feature of VAT that will help to control the tax evasion. For the successful implementation of VAT system, it needs well trained personnel, proper account keeping, proper billing system etc. and of course, the registration is also an important factor.

Adopting of VAT in Nepal is both a compulsion and necessity. It cannot curtail its development projects for which more revenue is required. The narrow tax base of the previous sales tax failed to generate the minimum required amount of revenue because it included only import and manufacturing units. Similarly, most of the goods and service were exempted from tax. Income tax, however, has some potential for revenue generation in Nepal. The rate of income tax are slowly decreasing because government cannot put more burdens on people to pay income tax. The globalization and recent trend of trade and tax system has affected the Nepalese economy also. As we have just getting the membership of WTO, we shall need to decrease out customs duties drastically. Customs duties are being curtailed in worldwide span in order to accept

liberalization policy. Excise duty in Nepal is severely limited due to the contraction of industrial activities throughout the nation in recent years. Under such condition, we cannot collect more revenue from income tax, custom duty and excise duty. Consumption base tax is only an alternative to collect more revenue, which directly helps to increase domestic resources for development works. One of the bases of the Nepalese tax system is VAT. It is based on consumption. However, the consumption related indirect taxes do not maintain equity norms but they can be considered as one of the reliable sources of revenue generations. Furthermore, this will help reduce the burden of our foreign debt and will provide a great relief to our future generation. There is no doubt on the fact that VAT, in long run, will help to make Nepalese economy stronger. In this sense, the successful implementation of VAT system has a greater significance as well as importance in Nepal.

The issue, however today is not whether VAT or no VAT but now to make the implementation of VAT more effective and efficient. It is not matter that VAT should be removed but the implementation aspect of VAT must be managed and enhanced. VAT regime is extremely challenging in a burgeoning economy like Nepal where with long open border, a large segment of economy is yet to be magnetized. Resistance from the business community, ignorance of general people and the lack of support and commitments from the politicians and government officials forced the authority responsible for implanting VAT to make compromises on various aspects of VAT which has weakened the process of its implantation right from the beginning. The attitude of businessmen and the tax administration also appear hostile to the effective implementation of VAT in Nepal. The culture of doing business without maintaining proper books of accounts for maintaining multiple sets of books of accounts has made implementation of VAT difficult. The problem is further intensified due to lack of culture of issuing and receiving bills at the point of sales and purchase, negative behavior of tax officials, and lack of sense of accountability in the government and political parties. It is a big challenge to resolve these problems. Apparently VAT cannot deliver the intended results unless these problems are addressed seriously.

5.3 Recommendations

Nepal has introduced VAT system, since 1997, after a long preparation and planning, despite the existing constraints and opposition. VAT act, rules and regulation has been set up in the line of international standard and its preparations had been made comprehensible and much more extensive as compared to the other taxes. This preparation has assisted towards creating a favorable environment for the implantation of VAT and VAT is non-going gradual acceptance of the business community and general public at large level. It is a great challenge to Nepal in order to achieve the success. In order to great effective implantation, the empirical study should be conducted from time to time. So to escape from inefficiencies, problems and constraints, VAT administration can be tackled these issues efficiently and effectively. Since the implantation of VAT is a great jump the traditional tax system to a modern system, several things are lacking to be done for the successful implementation of VAT in Nepal. In such circumstances, on the basis of major findings and conclusions, following recommendations have been made to make VAT effective and more efficient, which could be fruitful to concerned authorities while reforming Nepal's VAT system.

- i.) Most of the taxpayers as well as public are still unknown about VAT and its effects on various aspects. They have developed a kind of miss-concept regarding to VAT. They do not think that sellers already include VAT in price of goods rather they do think VAT is an extra charge. So proper publicity for all relate a person is the fundamental tool for success of VAT. Tax related information should be published regularly through journals, magazines, newspaper, pamphlets, radio, television etc. interview program with professors, researches, tax experts and economists should be conducted and published through advertising medias. Similarly, the student at school levels as well as campus level's curriculum should be included tax education and social obligation of playing tax.
- ii.) Many rules and regulations of VAT are only limited in papers and they are not seen in practice. All the rules and regulations should be in practice. Government should make effort to discourage under valuation, including purchase of some consignments, which are imported at realistically low

value. Audit and investigation system need to be improved and make effective, and strictly penalize those who do not follow the rules. Strict rules should be prepared also for tax officers and it is necessary to take action against these officers who are directly or indirectly involved in collusion and corruption, without any hesitation. Also the reward system should be made effective.

- iii.) Lack of proper billing system, is being the most challenging problem in Nepalese context. So consumers should be well informed to take the real bills which they have to pay and strict warning should be given to business that use to issue false bills/invoice. So issuing invoices for every taxable sells must be made compulsory.
- iv.) VAT laws should be effectively implemented. Timely revision should be made on unpractical acts, rules and regulation on the basis of experience gained
- v.) There should be a close co-operation between the private sector and government sector for the successful implemented of VAT. But in practice, there is a crisis of confidence between the private and government sector. There were made many agreements between VAT payer and VAT collector. Persons of each sector blaming to another. Due to lack of understanding between them, there is loss of revenue, the tax authorities in many cases arbitrarily fix taxable amount, which is beyond the current feature of VAT system. Hence, it is necessary to co-operate the private sector with government. A proper co-operation between both sectors should be established confidently.
- vi.) There should be effective awareness programs through advertising media for taking invoice for every taxable purchase by consumers. Beside this, every business firm should come to patch a notice for consumers in form of counter informing about not forget to take bill.
- vii.) Existing threshold and tax refund are two possible gates for tax evasion. It seems that existing exemption has a broad coverage however some exemptions are unavoidable due to administrative complexity and equity aspect. So exemption should be minimized gradually/ successively.
- viii.) Taxpayers should have provided better honor for their regular contribution of paying tax to the government, and be provided better services.

- ix.) Computers system and networking program must be developed and linked so as to make the VAT work simple which also helps to make data base system effective.
- x.) In the present Nepalese environment, there exists instability of political situation, so government should create an environment of strong political comment for effective and successful implementation of VAT system.

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Appendix

Respected Sir/Madam,

I would like to introduce myself as the student of Shanker Dev Campus, MBS final year, engage in a research work. In order to fulfill the partial requirement of Master's Degree in business studies (MBS) of Tribhuban University of Nepal, I am going to prepare a dissertation on "Revenue Collection form VAT in Nepal, An analysis of its problem and prospect."

QUESTIONNAIRES

Dear Sir/Madam,

Would you provide me necessary information of the following questionnaire in the partial fulfillment of MBS to conduct research work and submit to the university as a thesis? I also assure you that the information supplied by you will be exclusively used for academic research purpose only.

Please you are requested to provide your opinion (tick any one) about VAT for the following questions.

Name of respondents:

Office/Organization:

Designation:

1. Do you know properly about VAT?
a) Yes [] b) Partially [] c) No []
2. Will price rise due to VAT system?
a) Yes [] b) No []

3. Which is the most challenging problem in the process of VAT implementation in Nepal?

- a) Smuggling and under valuation []
- b) Lack of proper billing []
- c) Lack of proper account []
- d) Weak tax administration []
- e) I don't know []

4. Do you believe that, VAT increases the price of commodities?

- a) Increase []
- b) Not Increase []
- c) I don't know []

5. What is your suggestion about rate of VAT in Nepal?

- a) Existing rate (13%) is ok. []
- b) It should be reduced []
- c) It should be increased []
- d) Established two or three rates []

6. What effect has been shown in investment sector?

- a) Negative []
- b) Positive []
- c) Normal []
- d) I don't know []

7. Who are the most responsible for tax evasion?

- a) Business enterprises []
- b) Tax administration []
- c) Consumer []
- d) I don't know []

8. What is the major weakness of Nepalese VAT administration?

- a) Lack of expertise []
- b) Lack of physical infrastructure []
- c) Process oriented []
- d) Miscellaneous []
- e) All of them []

9. Does Nepalese present legal provision sufficient for proper implementation of VAT?

- a) Yes []
- b) No []
- c) Moderate []
- d) I don't know []

10. What do you think about legal provision of VAT in Nepal?

- a) Sufficient and appropriate []
- b) Insufficient and need to improve []
- c) Complex and require simplifying []
- d) I don't know []

11. What do you think about the tax burden of VAT to the tax payer?

- a) Higher []
- b) Lower []
- c) Normal []
- d) Zero []
- e) I don't know []

12. Will VAT system in Nepal improve revenue mobilization?

- a) Yes []
- b) No []
- c) I don't Know []

13. Do you have any suggestion for effective implementation of VAT?

- a) Skilled and trained manpower []
- b) Proper billing and Account system []
- c) Taxpayer friendly tax administration []
- d) Strictly marked monitoring []
- e) All of them []

14. What are the main reasons for need of VAT in Nepal?

- a) Effective revenue []
- b) Transparency []
- c) Avoid tax leakage []
- d) Borden tax base []
- e) All []
- f) I don't know []

15. What effect will VAT have on revenue mobilization?

- a) Positive []
- b) Negative []
- c) No effect []
- d) I don't know []

16. What effect will VAT have in the nation's economic growth?

- a) Positive []
- b) Negative []
- c) Normal / No effect []
- d) I don't know []

17. Do you have any comment on VAT system?

a) Yes [] b) NO []

c) If, yes.....

Thank You