

# **CHAPTER - I**

## **INTRODUCTION**

### **1.1 Background of the Study**

Taxation is the most powerful tool reserved in the hands of government of the country. It is taxation, which possesses paramount power to hold over the economy of the country. The major objective of taxation is to make fund available for economic development and economic stability. A major part of government revenue comes from taxation that is far better than external resource mobilization. Maximizing revenue through internal sources is much safer and sustainable for the developing countries. Taxation not only contributes for economic development and stability of the nation but also contributes for the equal distribution of national income to its people.

Taxes are usually classified into direct and indirect taxes. There is predominant role of indirect tax in Nepalese tax structure. VAT system has been considered as an attractive alternative to exist as an indirect tax system spreading all round the world. Although it is the youngest form of taxation which is innovated in the second half of the twenty first century. It has been emerged as a main element of worldwide tax reform, in every attempt of tax reform; VAT is now gaining the primary preference.

For the replacement of sales tax, hotel tax, entertainment tax and contract tax the government of Nepal has introduced VAT in 1997AD. Especially it is supplementary of sales tax or improving sales tax. . It is levied on the value added of goods and services. It is levied at different stages of production and distribution. It is a multistage tax, which is connected at the different stages of production and distribution; sales of both domestically produced and imported goods and services. In this reference the government of Nepal charges 13% (effective from 2003AD) as Value Added Tax, VAT,

Emergence of VAT dates back to 1919 A.D. German industrialist Wilhelm Van Siemens proposed the tax to replace multistage turnover in taxes in Germany. In that time Germany did not apply VAT but it reduced the rate of multistage sales tax. The concept of value added tax (VAT) was developed further in 1949 by a tax mission to Japan lead by Professor Carls S. Shoup. This mission recommended the Euka Kachi-Zei (VAT) for Japan in order to avoid the undesirable and unintended effects of Japanese enterprises and turnover taxes in place at that time. That issue was considered seriously but Japanese government decided not to implement it. No country applied VAT till 1953. The modern VAT first appeared in France in 1954 A.D. It covered industrial sector that extended to the wholesale level. Following France several other countries such as Senegal, Algeria, and Morocco (1960) introduced VAT, that was limited to import and manufacturing stage only. Thereafter, Brazil (1967), Uruguay (1968), Ecuador (1970), Bolivia (1973) and Argentina (1975) introduced VAT in their countries subsequently. Many European countries such as Denmark, Sweden and Norway also adopted VAT during 70s and 80s VAT spread to Asian countries such as Vietnam (1973), Korea (1977), China (1984) and Indonesia (1985).

In South Asia, Pakistan introduced VAT in 1990 A.D., following by Bangladesh (1991) and Sri Lanka (1995).

In the Nepalese context, the tax system review task force constituted by Nepalese government in 1995 under the chairmanship of Professor Madan K. Dahal proposed and recommended to implement VAT in lieu of sales tax, hotel and entertainment tax and Nepalese government implemented it in 16 Nov. 1997. However, VAT came into full operation in Feb. 1998.

"VAT is levied on all goods and services, unless specifically exempted by the law and collected in different stages in the process of production and distribution" (Khadka, 2000:61).

Now VAT became the effective tool for the collection of revenue of the government. In total tax revenue the contribution of VAT is considerable and attractive. VAT is collected throughout the country. All 75 districts take part to gather national revenue through all kinds of taxes where VAT plays significant role among others.

Like other 13 zones, Mechi zone also contributes the VAT revenue from IRO office Bhadrapur Jhapa for domestic taxable transactions. Mechi zone is eastern Nepalese zone that consists of 4 districts namely Taplejung, Panchthar, Ilam and Jhapa. Taplejung and Panchthar and Ilam are hilly districts while Jhapa is plane one. Among three districts Ilam produces cash crops like tea and ginger and all three districts produce cardamom. Ginger and cardamom are exported in to India. Generally the three districts don't have the taxable home products because all are agricultural products. But they pay tax (VAT) in consumption. Jhapa is few more industrial districts than rest 3 districts of Mechi zone. It has three municipalities. But big production companies paying VAT are not there. VAT generation from consumption pattern is major for the district. IRO office for Mechi zone is in Bhadrapur, Jhapa. There is Kakarvitta, custom point in Jhapa that collect VAT for foreign trade.

## **1.2 Statement of the Problem**

With the common characteristics of developing countries such as: rapid population growth, increasing unemployment, resource constraint and high dependency in agriculture, low living standard and poor infrastructure etc., Nepal is also a developing country situated between two rising nations India and China. To fulfill the aspiration of its people it needs more revenue obtained through the effective mobilization of resources. But Nepalese resource mobilization is still poor that does not cover the growing expenditure. Government expenditure is increasing while there is no equivalent increment in government revenue, except economic year 2065/66, such as unbalanced

growth in revenue and expenditure has resulted in massive revenue expenditure gaps or budgetary deficit in the economy.

Thus, fiscal deficit is increasing due to growing expenditure of the government instead of the low revenue performance in Nepal. In addition the country is also facing the increasing burden of foreign loan.

In order to increase revenue, different sources are available but they have their own merits and demerits, that's why, government should try to mobilize resource through such measure which has less trouble and more benefits.

Grants are based on several political considerations. In our past experience, grant volume is decreasing and amount of loan is increasing. On the other hand, grant is not the permanent solution. It can never be a substitute to domestic resource and can never be remedy too. Non tax revenue is raised form private sector but it has low base and can't mobilize adequate fund. Loan has to be repaid from the amounts of regular expenditure. Furthermore, foreign loan may drag the country into debt trap.

Nepalese tax system is still dominated by custom duties but Nepal has entered the member of WTO (World Trade Organization). It should be able to reduce the custom duties drastically in between 0.5% to 20%. So, it is expected that VAT would be a major instrument to avoid deficit financing. Sales tax is found to suffer from very low tax base, cascading effect and distortion effect, but, VAT is considered as the best form of sales tax within the merit of self-pricing, catch up effect, broad base etc. So there is no alternative available except increasing effectiveness of it to mobilize internal resource effectively. Thus VAT may be the optimal solution to resource gap and high dependency of foreign aid.

However, the problems at VAT in Nepal are still a matter of discussion. Mainly, the individual businessmen are reluctant to pay VAT, even the consumers are not aware of taking VAT invoice. Uneducated individuals are scared whether the VAT is raising prices. Low voluntary tax compliance, cumbersome legal and administration procedures, weak tax administration and tax evasion are still prevailing. There is controversy with regard to the multiple or single rate of VAT. There is problem related to the threshold also. Even though, no another best alternative except itself is seen for a long far away.

The study will seek to find out the answer of the following investigation.

- ) Is VAT an effective instrument for resource mobilization?
- ) What is the contribution of VAT from Mechi in total tax revenue?
- ) What are the problems associated with VAT and its prospect?
- ) Is the same provision effective for all districts and regions?
- ) Whether businessman and community are satisfied with VAT or not

### **1.3 Objectives of the Study**

The research work will focus on following specific objectives:

- ) To analyze the trends and composition of VAT in Nepal.
- ) To examine the problems of VAT.
- ) To analyze the contribution of VAT collected from Mechi zone to total VAT collected in Nepal.
- ) To provide suggestions based on research.

### **1.4 Significance of the Study**

Because of ineffectiveness in mobilization of resources, Nepal has been facing a serious resource gap for many years and this trend seems to be continued in future if not manage properly in time there by leading the economy in the state of external dependency. Since VAT is a powerful tool to mobilize the resource effectively and the study has evaluated the contribution of VAT in resource mobilization. The study has given major focus on resource mobilization

through VAT in Nepal. Moreover, the study has examined the laws and regulation of VAT, contribution of VAT collected from Mechi zone to national revenue. The research work has identified research gap and beneficial to that people who are curious to know about VAT. So this study deserves special significance.

### **1.5 Research Methodology**

This research study has focused particularly on the mobilization of resource through VAT especially of the VAT from Mechi zone and its contribution to total VAT etc. The study follows the analytical cum descriptive research design which has been supported by both primary as well as secondary data.

To make research objective, find to accurate result and practicable, different tools are used. The information received in different aspect of VAT from primary and secondary sources was first processed for tabulation and analysis. For the purpose of analysis generally simple statistical tools have been used which are as follows:

- ) Simple percentage
- ) Bar diagram and trend line
- ) Other statistical tools

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

To keep the research work feasible, to keep study in track, to go according to plan, the researcher has to barricade the research from same limitations. The following are the limitations of this study.

1. No attempts have been made to examine the reliability of the secondary data.
2. Mechi zone has been selected purposively for primary data collection.
3. The research study covers the period from FY 2002/03 to FY 2008/09.

## **1.7 Organization of the Study**

This research work contains five chapters. The first chapter includes background of study, statement of problem, objectives of the study, limitation of study and research methodology. Second chapter deals with concept of vat and review of literature. Third chapter belongs to the methodology employed to the study. Presentation and analysis part is in forth chapter and the fifth chapter provides summary recommendation and conclusion of the study to the readers.

## **CHAPTER - II**

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

#### **2.1 Origin and Development of VAT**

As we know VAT is an advance sensation in the field of taxation. It has been regarded as one of the most important fiscal innovation in modern times. Development of VAT is the modern significant event in the history of commodity tax and the speed with which the Value Added Taxes has around the world is supreme by that of any other tax in modern time.

The origin concept of VAT (Value Added Tax) dates back to 1918/19 when a German industrialist Carl F. Von Siemens proposed to replace multistage turnover taxes in Germany. Immediately after that proposal were made in United States such a tax to replace corporate income tax in 1949. A mission led by Professor Carlos S. Shoup proposed a value added tax (VAT) for Japan and developed its broad structure to avoid the defects of existing turnover taxes. However, the tax was considered very seriously, it was decided by Japanese government not to introduce promptly, showing the course of further study but the tax was not introduced by any country till 1953. In real practice France launched the value added tax in 1954 in place of production tax .The father of modern VAT is Mc. Maurice Lavre who covered industrial sector alone and extended to wholesale level only. It was supplemented by a separate tax on service and special exercise.

The development of VAT took two great leaps forward in 1960's and early 1970's.As first leap, following France ,several developing countries of Africa and America replaced their turnover taxes with a VAT along with the lines of 1954 French module, Some of these countries were formerly French colonial countries such as ivory coast (1960) . VAT in these countries was limited to



import and manufacturing stage only. The other developing countries adopting VAT were Brazil (in state level) in 1967, Uruguay in 1968, Ecuador in 1970, Bolivia in 1970 and Argentina in 1975. As a second leap, it was recommended all European common market countries to shift to a VAT to replace their existing taxes in 1962. This direction was first followed by Germany in 1968 than Netherlands in 1969, Luxembourg in 1970, Belgium in 1971, Ireland in 1972 and Austria Italy, United Kingdom in 1973. Scandinavian countries introduced VAT commencing with Denmark in 1967, followed by Sweden in 1969 and Norway in 1970. The Value Added Tax adopted by European countries was broad based and extended adapted by European countries was broad based and extended through the retail level.

During 1970's the VAT also spread to Asia. Vietnam being a leading nation to adopt a broad based VAT in 1973 followed by Korea VAT in 1984 although it was planning to introduce in 1974. Similarly, Indonesia introduced VAT in 1985, Taiwan in 1986, Philippines in 1988 and Japan in 1989. During this period, several other countries around the globe introduced a VAT in their tax system. By the end of 1989, the number of countries adopting VAT system was 49. The list of countries having VAT is shown in the table below which explores the main findings received from data analysis, suitable suggestions as recommended.

The last decade of the twentieth century witnessed a rapid acceleration in the introduction of VAT in the countries around the world. During the first half of the present decade the number of countries having VAT became more than double and VAT established itself as the most popular form of sales tax. In this period, the countries of eastern Europe and the republic of former Soviet Union including Russia, all of them formally having socialist economy, adopted a VAT in their tax system as a measure to overhaul their tax system completely which was readied by the transition from a planned economy to a market oriented economy. Moreover, in the same period, many developing countries

of Asia, Africa, and Latin America adopted VAT. The tax reform and adaptation of VAT in the counted reflected their effort to rationalize their tax system making it more revenue productive efficient and less distortive.

Recently, the tax reform committee, 1992 headed by Raja J Chelliah recommended a full –fledged single related VAT at the central level and government of India is seriously considering it. As a result ,India has just adopted full VAT since the year 2004.Nepal is considering VAT since 1992.The first intention to move towards VAT could be found in eighth plan (1992-97).VAT in experimental basis was announced in 1992/93 budget with a two-tier sales tax system on selected times. The tax system reviewer Task from 1995 headed by Madan Kumar Dahal recommended a VAT in the place of existing sales taxes as a long term tax reform measure. A commitment to implement a VAT in Nepal was made in 1995/96 budget and it was scheduled to come into effect from April 1997 but for some reasons, the implementation is postponed until November 1997.

Following table shows the adopting of VAT by various countries in the world.

**Table 2.1**  
**Adaptation of Value Added Tax in the World**

Year of adaptation	Countries
1954	France
1960	Ivory Cost
1961	Senegal
1967	Brazil, Denmark
1968	Germany, Uruguay
1969	Netherlands, Sweden
1970	Equator ,Luxemburg ,Norway
1971	Belgium
1972	Ireland
1973	Austria, Bolivia, Italy, UK, Vietnam
1975	Argentine, Chile, Costerica, Nicaragua, Colombia
1976	Honduras, Israel, Peru
1977	S.Korea, Panama
1980	Mexico
1982	Haiti
1983	Dominican Republic, Guatemala
1984	China
1985	Indonesia, Turkey
1986	Morocco, New Zeeland, Niger, Portugal, Spain, Taiwan
1987	Grenada, Greece
1988	Hungary, Philippines, Tunisia
1989	Japan, Malawi
1990	Iceland, Kenya, Pakistan, Trinidad & Tobacco
1991	Bangladesh, Benin, Canada, south Africa, Mali, Jamaica
1992	Algeria, Armenia, Azerbaijan, Cyprus ,E.I Salvador, Estonia, Fiji, Kzakesthastan, Latvia, Moldova, Russia, Tajikistan, Thailand, Turkmenistan, Ukraine, Uzbekistan
1993	Burkina, Czech Republic, Mongolia, Paraguay, Poland, Romania, Slovakia
1994	Bulgaria, Finland, Georgia, Singapore, Tanzania, West Gambia.
1995	Goblin, Ghana, Switzerland, Zambia
1997	Nepal
1998	Sri Lanka
1999	Cambodia, Cameroon, Mozambique, Netherlands, Antilles, Papua New Guinea and Slovenia.
2000	Australia, Macedonia, Namibia, Sudan
2001	Rwanda
2003	Lebanon
2004	India

*Source: Ghimire (2008)*

## **2.2 Introduction of Value Added Tax (VAT)**

Value Added Tax (VAT) is a multi point sales tax with set off for tax paid on purchases. It is basically a tax on the value addition on the product. The burden of tax is ultimately born by the consumer of goods and services. In many aspects it is equivalent to last point sales tax. It can also be called as a multi point sales tax levied as a proportion of Valued Added.

Value added tax (VAT) 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 a modified form of sales tax. It is spread all over the world within a short span of time having sound popularity.

Value added tax (VAT) is a component of indirect tax which is imposed on the value at each level of exchange relation from production to consumption of goods and services. It applies in the total sales price minus purchase price of goods and services. That means the system only considers valuing added price in different levels of exchanging. The levels or stages are import, manufacturing, wholesale and retail. The tax system is laid down to cost plus profit. Conversion cost includes wages, interest, rents, depreciation and taxes excluding VAT and income tax. The base of value added tax (VAT) is the value added by each firm during its production and distribution activities. Value added may not be calculated directly but the exact result is obtained by levying tax in different stages.

### **2.2.1 Types of VAT**

There are three types of VAT. They are:

- ) Income type of VAT
- ) Gross national product type of VAT
- ) Consumption type of VAT

### **Income Type**

Under the income type, VAT does not exclude capital goods purchased from other firms from the tax base in the year of purchase whereas depreciation is excluded from the tax base in the subsequent years. In this variant, capital equipments are divided over a period on the basis of their useful life. As in consumption type, in this variant, all the purchases of the capital goods are not allowed to deduct in the same year when it is purchased. Only a relevant portion to the particular period is allowed to deduct and the remaining portion is carried over for the next period. The tax falls both on consumption and net investment and the conceptual tax base of this category is the net natural income. Under this method, tax base equals to private personal income. Many countries do not prefer practice of this method because it faces the same problem as we face in calculating income for a particular period. It is consistent with the origin principle of taxation where exports are taxed and imports are relaxed from the tax.

### **Gross National Product Type**

Under this method, the purchase of capital goods are neither deducted from the tax base in the year of purchase nor the depreciation is allowed to deduct from the tax base in the subsequent years. As no input tax on the purchase of capital goods is allowed in this variant, it discriminates among the techniques of production and finally favours international production. Neutrality of tax is not satisfied in this method, therefore, it has not practical ground it is suggested to impose the tax on the consumption and gross investment in this variant. Finally Gross National Product becomes the base of this variant, it creates a substantial discriminative for savings, investments, and capital incentives production.

The bases of VAT under various categories may be shown as:

$$\begin{aligned}\text{Consumption Type} &= \text{Gross National Product} - \text{Gross Investment} \\ &= \text{Total Consumption Expenditure}\end{aligned}$$

Income Type           = Gross National Product - Depreciation.  
                              = Net Investment + Consumption  
                              = Net National Product

Gross National Product Type = Gross Investment + Consumption = GNP

Both the Income and GNP variants do not exclude the purchase of Capital goods from the tax base in the year of purchase. But the income type excludes the depreciation from the tax base in the subsequent year while GNP type does not treat as so. The GNP type of VAT is less practicable because it is biased to labour incentive techniques. The income type is also rare in practice because it excludes the depreciation from the tax base in the subsequent years. Both types of VAT are theoretically defective and practically difficult to implement. It has just academic value. The consumption type of VAT is most popular and widely recognized by almost all the countries. It does not affect decision regarding investment and growth since it excludes investment from any tax burden. Furthermore, the consumption variant is more lucrative from the point of view of tax administration as well as from the consideration of foreign trade. As several advantages have incorporated in consumption theory, in comparison to other, it has been accepted and successfully implemented.

### **Consumption Type**

This classification is considered as neutral type because under this type, no discrimination is done with respect to capital or consumable goods. It is really superior for the VAT because full credit of inputs, irrespective of what type of purchase is done, is provided. All capital purchased from other firms, in years of purchase, is excluded from the base while depreciation is not deducted from the tax base in the subsequent years. Investment is freed from taxation and consumption is considered as the base of tax.

### **2.2.2 Nature of Value Added Tax (VAT)**

The nature of value added tax can be seen with the points given below.

1. New innovation: VAT is the most modern innovation in the field of tax so new innovation is regarded as its nature. It is the most important tax innovation of the second half of twentieth century.
2. Not taxed twice: Tax under the value added is not is not imposed twice. It moves the duplication of paying tax in the case given above same value added in never taxed twice that is cumulative effect do not occur.
3. Consumption related tax : Value Added Tax is imposed in the added value right from manufacturing level to consumers
4. Self policing: in the traditional method of indirect taxes collection there was under valuation and over valuation of the time of making bills, but in value added tax the charge of making such situation will be less because of the requirement of details record to be maintained in those concerned office such as value added tax department.
5. Transparency: As transaction must be disclosed by the venders regarding the paying tax under the value added tax. Records are maintained scientifically for the purpose of raising value added tax. All required records can be found easily through the help of computer with regards the value added tax. Hence it is more transparent in compassion to the traditional sales tax.

### **2.2.3 Features of Value Added Tax (VAT)**

Although value added tax is most recent innovation in the field of taxation, it is not new form of tax, it is refined form of traditional sales tax. Sales tax has three form i.e. turnover tax, single stage tax and value added tax. Turnover tax is levied at all stage of production and distribution process where as single stage sale tax may be imposed at the manufacturing level or at the whole sale level or at the retail level tax is known as manufacturing tax, wholesale tax and retail tax. The third form of sales tax VAT has been developed as hybrid of turnover tax and retail level sales tax. It is very similar to turnover tax as it is

imposed at each stage of production and distribution activities as turnover tax. Likewise it is similar to retail level sales tax consumption type VAT based on consumer goods and service as retail level sales tax. But they are different in other respect that turnover tax is levied on total value each stage while VAT is levied only on value added at each stage. Similarly, VAT is imposed at each stage of selling and distribution activities but retail level sales tax is levied at only on final stage of selling and distribution activities. Thus the main features of value added tax extracted as below:

- ) Indirect tax in nature
- ) Free from cascading effects
- ) Based on value added principle
- ) Timely tax realization
- ) Provision of tax credit facility
- ) Provision of refund in case of over payment
- ) Based on self-assessment system
- ) Separate treatment of capital goods
- ) Zero rate for social and economic purpose, and
- ) Provision of tax exempt goods and services

#### **2.2.4 Objective of Value Added Tax (VAT)**

The objective of VAT is governed by certain principles. The transaction including the selling, distribution, delivery, import, export of goods or service to collect the revenue effectively by regulating the process of collection to increase revenue mobilization required for the economic development of the country. Thus the objectives of the value added tax would point as below:

- ) To increase revenue mobilization of the country.
- ) To develop a stable source of revenue by broadening the tax base by imposing the tax on sales distribution transfer and import as well and export of goods services.



- J To establish an account based modern transparent and efficient tax system.
- J To make value added tax as main stream of tax system and to promote the interchange of information between the other tax systems particularly with custom, excise duty and income tax.
- J To remove the cascading effect of traditional sales tax and develop alternative tax system to sales tax, hotel tax entertainment tax and contract tax.

### **2.2.5 Methods of Computing VAT**

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

#### **Additional Method**

In this method, the tax base is calculated by adding the payments made by the firm to the factors of production employed in turning out the production such as wages, interest, rent, royalties and profit. This method is very close to income type of VAT that includes the rewards to all the factor of production in its base. Because all the payments made for the factors of production have to be added, it creates complexities in calculating them in practice. Virtually no country has used the additive method; however, Argentina and Israel have used it in selected economic activities, such as banking and finance, where value of inputs and outputs are difficult to measure.

#### **Subtraction Method**

Under this method, cost of production is deducted from the sales. In other words, value added is determined as net turnover that is obtained by subtracting the cost of materials from sales proceeds. It is very close to consumption type of VAT. Theoretically, it looks simple and easy but it is very difficult to

compute especially where multiple rates of VAT exist. Problems like ascertaining tax value in an accounting period may also arise.

Above two methods are called direct method because value added is computed directly either by adding the payments made by the firms to the factors of production or by subtracting the cost of production from sales.

### **Tax Credit Method**

Tax credit method is known as indirect subtraction method or invoice method. Under this method, input tax is credited from output tax and passed into next stage up-to consumption level. Tax credit method is similar, to some extent, to subtraction method but the major difference among two are:

- ) In the earlier Method, the tax base is levied in the 'difference amount' of tax on sales and tax on purchase, where as in the latter method; the tax is levied on the 'difference amount' of sales value and purchase value
- ) Earlier method requires invoices, while the latter does not require

If the tax rate were same throughout the production and distribution method, all three methods should give the same result. Among the three methods of computation of VAT, the tax credit method is widely used in Europe. This is because this method has several advantages over the other two methods, which are:

- ) The tax liability in this method is attached to the transaction that makes it technically and legally far superior to other methods.
- ) The tax calculation of Value Added, which is a difficult task, is not necessary.
- ) The tax credit method creates a good audit trail making the crosschecking possible.
- ) It provides an effective way to completely free any product such as exports from tax and makes border tax adjustment easier and possible.

- J Due to its 'catch up effect', under-valuation and evasion at some stages are not possible.
- J There will be no revenue loss due to exemptions granted to small firms or products.
- J Rate differentiation at different stages for administrative or other reason becomes possible under this system without reducing the total tax paid. If tax rate is reduced at earlier stages, this simply gives rise to unequally increased tax at later stages.

Thus, the tax credit method is desirable for several reasons and has to be adopted by many countries of the world. Nepal has also adopted this method to calculate VAT payable. Calculations of VAT revenue (T) can be expressed as follows for the above-mentioned three different types.

Additional Method (T) =  $t$  (wages + rent + profit).

Subtraction Method (T) =  $t$  (sales value – purchase value).

Tax Credit Method (T) =  $t$  (tax on sale) –  $t$  (tax on purchase)

Where,

$t$  = VAT percentage rate.

For the purpose of Calculation of VAT, the purchase value at the point of import is shown zero. From the above illustration, it is clear that, if the tax rate is same throughout the production and distribution method, the VAT amount to be paid is same in all the methods. Only calculation procedures are different from each other. Finally, all the burden of tax falls on consumers. In this example, the consumer has paid Rs 88 against VAT. The government collects not only by one stage but by multiple stages of production and distribution that means Rs 24 from Importer, Rs 31 from Manufacturer, Rs 23 from Wholesaler and Rs 10 from Retailer.

## **2.2.6 Principles of VAT**

### **Original Principle**

In this principle, tax is levied at the place, where it is produced or rendered irrespective of whether they have been consumed or not. In this principle, preference is given to imported goods or services over domestic production because all exports are treated as taxable whereas all imports are treated as non-taxable. These sort of principle may be beneficial where common trade exists like European Union; otherwise rest of the countries do not prefer this principle.

### **Destination Principle**

Contrary to the earlier, under destination principle, tax is imposed at the place where it is consumed irrespective of where it is produced or rendered. Neither has it preferred imported goods or services nor the domestic goods or services. Equal preference is given to both imported and domestic products. In this ground, it is assumed neutral principle and with the purpose to boost the exporting goods, many countries prefer to apply this principle of taxation.

## **2.2.7 Tax Base**

Theoretically the taxable base of VAT is all types of expenditure on final consumer goods. Hence, the aim of the VAT is to reach much of the consumption expenditure making the tax base as broad as possible. The tax base of a VAT depends on its scope or coverage, that defines what kinds of goods and services or business activities are included into tax base. The scope or coverage of VAT is defined with reference to both taxable transactions and taxable persons. Taxable transactions are defined broadly as supplies made by the persons engaged in industrial and commercial activities. Taxable persons are those who independently engaged in supplying goods and services including imports.

It is desirable to include all kinds of goods and services or business activities into the scope of VAT so that all the consumption expenditure comes under the taxable base of VAT however , in practice the base of VAT is not as broad as to cover all exemption expenditures.

The taxable base is only largely determined by the treatment of different economic activities like agriculture, service and consumption. Although those activities form a substantial part of consumption expenditure, special problems arise in treatment of those activities and exclusion of those activities from coverage of VAT considerably erodes the tax base making it than is desirable.

In many countries, particularly in developing countries agricultural sector (or sales of farmers) is exempted. It is because taxing agriculture is not administratively feasible and economically desirable. Similarly, services are generally exempted or taxed as per selective basis. Exclusion of service is mainly due to applicability problems. Many services, for example, financial services are exempted because they are difficult to take under VAT due to conceptual difficulty in determining VAT liability and inapplicability of tax credit principle.

However, some selective services like telephone, electricity, entertainment, advertising hotels and restaurant etc. are taxed. The inclusion of construction industries which generate a substantial portion of GDP into VAT base also creates a host of problems as mentioned for agriculture and service. In many cases, the construction industries are exempt from VAT whereas the construction materials are subject to VAT. Even though, the scope of VAT is limited by the exemption of agriculture, service, construction, etc. a substantial part of output of exempted sector is taxed indirectly as the output of exempted sector enters into the production process of taxable sector as its input and it brings no credit with it. For example, when agricultural products go into processing stage they are the subject of VAT.

### **2.2.8 Freeing From VAT**

Some goods and services are left free from VAT or they are not taxed the theoretical based of VAT is largely reduced because of such exclusions from the scope of VAT. Freeing from VAT may be justified for three sets of reason (that taxing some goods are administratively very difficult), equity reasons that taxing some goods make the tax system much inequitable and economic reasons (that production and consumption of the some sort of goods and services are induced ) in legal, these are three methods of freeing from VAT. They are presented as per below.

#### **Exemption**

VAT divides all the goods and services into two basic categories taxable and tax exempt. According to Rup B Khadka (1997) “Exemption simply means the goods and services free from a tax jurisdiction. Under this approach, input tax, incurred for goods and services subject to exempt is not refundable. On the other words, a supply of a commodity or service is exempted from VAT. The input tax is not deductible or cannot be deducted or refunded. So for instance, exemption from VAT means the condition where the traders do not pay the VAT”.

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:

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

- J Social welfare services including medicine, medical services, veterinary services and educational services
- J Goods made for the use of disabled persons.
- J Air Transport.
- J Educational and cultural goods and services such as books and other printed materials, radio and television transmissions, artistic goods, cultural programmes, non-professional sporting events and admissions to educational and cultural facilities.
- J Personal services are also tax-exempt. These are services provided, for example, by actors and other entertainers, sportsmen, writers, translators and manpower supplies agents.
- J Exemption from VAT is also extended to the purchase and renting of land and buildings.
- J Financial and insurance services
- J Postage and revenue stamps, bank notes, cheque books.

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

### **Zero-rating**

Zero rating means taxing goods and services with zero rates. If zero rating is granted for a particular goods and services, the goods of technically taxable and the tax payer (supplies of goods) is required to fulfill all the formalities like regular taxpayer with or difference that the supplier of zero rated goods are not required to pay tax and he is not allowed to claim back the tax on any of his purchase. For example, if exports are zero rates the exporter is able to get the refund of the tax on his purchases which he has used for producing the export items.

Zero rating is an actual rate of VAT against which credit for VAT paid on inputs can be claimed and there by a full rebate obtained. So zero rating a VAT rate has a rate of zero percent which is imposed on selected goods and services ([www.ird.gov.np](http://www.ird.gov.np)).

## **Threshold**

This is a point at which a deviation provision becomes operative. Thus it is a VAT of an upper limit beyond which VAT system is in operation. The traders who have lower of transaction will have a lower revenue yield relative to the compliance cost and either they are capable to fulfill all the formalities of VAT. Furthermore, it will create administrative complexity, if all the small vendors register in the VAT. In such a situation, it is also an important provision of VAT, which keeps the small vendors beyond the tax net. Thus it is a kind of exemption based on the amount of the transaction but not on category of goods and services. So it must be said on the basis of nature of the production and distribution system in the country concerned, and the standard of education and record keeping at various level of volume among business firms.

### **2.2.9 Tax Rate**

Rate means positive rate excluding zero rate. Design of tax rate structure is an important aspect to the VAT. The design of tax rate structure is chiefly influenced by revenue requirement, administrative simplicity, efficiency, types of products, tax burden etc. However all the requirements cannot be achieved simultaneously as one may be contrasting to another.

On the basis of statistical picture given by those countries adopting VAT is a fiscal instrument with the differential VAT rate in the world. Theoretically and practically the rate of VAT can be diversified into two rates. They are:

#### **Single VAT Rate**

In single VAT rate system the rate of VAT is fixed in each level of trading activities. In other words the manufacturer, wholesaler and retailer pay the same rate of VAT. In practice most of the countries in the world have been adopted the single VAT rate considering its advantages. Mainly the system's singularity brings simplicity and VAT administrators and the traders both can easily understand and deal for its implementation. Also its simplicity reduces



the cost of VAT administration. Single VAT system is more transparent that gives clear account for government and public auditing.

### **Multiple VAT Rate**

Multiple VAT rate means the implication of more than one type of VAT rate based on the types of commodities and nature of services. In this systems, various level of trading activities are taxed in different rate.

As well as single VAT rate, multiple VAT rate is also adopted widely in the world. Mainly, this system is applied for strong progressive and higher rates revenue collection. Multiple VAT rate is adopted considering the following reasons:

- J Differential VAT rate makes tax burden to the higher income class more than to the lower incomes class, so the vertical progressive tax system may be strong in the society. The gap between the higher income and lower income class may deform the economy. Therefore, it should be mitigate for second economy.
- J Differential VAT rate discourages luxurious life and unproductive expenditure and encourages social welfare for the lower income class by imposing two different VAT rates.
- J Since multiple VAT rate enlarges its tax coverage by including all kinds of goods and services, the estimated revenue level may be collected. The higher ratio of revenue collection supports for the additional development activities.
- J To implement the policy of protection especially for domestic products for industrialization. Differential VAT rate is suitable instrument that is applied to discourage the import of goods and encourage domestic goods. Therefore, the system can be named for protective umbrella for domestic goods.

## **2.2.10 Operation of VAT**

### **Registration**

Registration is required for any business:

- ) With an annual taxable turnover of more than 2 million rupees.
- ) Belonging to a conglomerate which has an aggregate annual taxable turnover exceeding 2 million rupees (Source: [www.ird.gov.np](http://www.ird.gov.np)).

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. Businesses with taxable annual sales of fewer than 2 million rupees may apply to register. If a business chooses to register, it must remain registered for a full fiscal year. Following statement shows office wise VAT registration status over the year 2065 (2008/09).

**Table 2.1**  
**Office wise registration status on VAT**  
**As of 2065 Mangshir End**

<b>Office Code</b>	<b>Inland Revenue</b>	<b>Office Total Registration</b>
11	Bhadrapur	1770
12	Biratnagar	2761
13	Dharan	1543
14	Janakpur	1497
15	Lahan	1450
16	Samara	936
17	Birgunj	2698
18	Hetauda	960
19	Bharatpur	1434
20	Dhangadhi	1493
21	Mahendranagar	937
22	Pokhara	3174
23	Lalitpur	3313
24	Bhairahawa	2703
25	Kathmandu-3	8475
26	Nepalgunj	2257
27	Kathmandu-1	9634
28	Kathmandu-2	5674
29	Bhakatpur	2387
30	Krishnanagar	573
51	Dang	1071
52	LTO	256
<b>Total Taxpayers</b>		<b>56996</b>

*Source: www.ird.gov.np*

### **Deregistration**

A VAT registration may be cancelled by anyone 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, death and so on.

### **2.2.11 Obligations to VAT Registrants**

VAT registrants are required to:

- J Submit VAT return and pay tax within the 25th day of the following month.
- J Provide their customers with a tax invoice
- J Maintain Purchase Book, Sales Book, and VAT Account.
- J Keep their VAT records for a period of 6 years
- J Inform the IRO of changes to the business including new address, telephone number or a reorganization of a partnership within 15 days.
- J Put their Certificate of Registration in the premises where customers may easily see and read it,
- J Allow tax officers to enter the business to examine the business records and the stock on hand (Source: <http://www.ird.gov.np/information>).

### **2.2.12 Invoicing**

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 to be 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.

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.

### **2.2.13 Accounting**

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. All the registered taxpayers are required to maintain following account as referred to schedule 7, 8, and 9 of VAT Regulations.

- ) A purchase book
- ) A sales book
- ) A VAT accounts

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

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

### **Purchase and Sales Books Include**

- ) The invoice number
- ) The invoice date
- ) The supplier's name and PAN number in the purchase book
- ) The customer's name and PAN number in the sales book, and
- ) The taxable value and 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. PAN number refers to the Taxpayer Identification Number,

which will be allocated to each registrant after completion of the registration process.

#### **2.2.14 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.

#### **2.2.15 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.

#### **2.2.16 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 colour 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 to be shown on the tax plate:-

- ) Permanent Account Number (PAN)
- ) Taxpayer`s Name.

C. Colour: The tax status of the taxpayer will be identified on the basis of the following background and the colour of the tax plate:-

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

### **2.2.17 Conscious Consumer Lottery Programme**

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 programme has been introduced since Magh, 2060.

#### **Types of bills to be included in Lottery Programme**

Purchase bill issued by VAT registered taxpayers to consumers who are not registered in VAT.

Tax invoice or abbreviated tax invoice in the name of natural person among individual purchasers who are unregistered.

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 programme.

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

The prize will be declared once a month on the basis of coupons distributed in that month. Procedures of conducting lottery programme:

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

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:

<b>Cash prizes:-</b>	<b>Total Prize Amount</b>
- First winner - 1 Seller	Rs. 25,000
- Second winner- 5 Sellers (Rs.5,000 each)	Rs. 25,000
- Third winner- 10 Sellers (Rs.3,000 each)	Rs. 30,000
- Consolation Prize - 20 Sellers (Rs.2,000 each)	Rs. 40,000
<b>Total</b>	<b>Rs. 1,20,000</b>



### **2.2.18 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:-

- ) 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;
- ) If the annual expenses of the tax payer on the telephone and the rent exceeds Rs. 1 Lakh; or
- ) If the premises of the taxpayer lies within the specified area of the market or the street as specified by the Department (IRD).

### **2.3 Historical Development of VAT in Nepal**

Nepal was practicing all the indirect taxes before the government introduced this new concept of value added tax (VAT). Except of indirect taxes, land revenue, custom duties and excise duties were major source of taxes in that period of time. The concept of Value Added Tax was developed along with the eighth plan (1992-1997) when the government indicated its intention to convert the import/manufacturing level sales tax into value added tax. A task force was created in order to make necessary document for plan preparation of value added tax in place of sales tax by excise department. A VAT steering committee was also formed to evaluate and monitor preparatory activities. After the depth study on various aspects relating to the structure and operating of VAT, The task force prepared the draft of VAT law in 1994. It was discussed in depth at several stages with concerned parties. After review by steering, the draft was sent to various business groups for their comments. Although the business committee did not provide written comments, the private sector opposed to the implementation of value added tax.

Due to the disagreement of private sector and political instability in those days, the government did not indicate its commitment to introduce value added tax and also preparation were insufficient to implement the value added tax effectively. In September 1995, along with the formation of coalition government, the committee introduced value added tax in the same fiscal year 1995/96 .The VAT bill was presented to the parliament on December 1995.As per parliamentary processes, it easy referred to the finance committee (Parliamentary committee) and the committee return the bill to the parliament in the same month while upper house parliament passed it January 1996.The royal seal was provided to ‘Value Added Tax Act 1995 (2052) on 21st March 1996. For effective implementation and administration of VAT, the government established a department in center and 17 VAT offices in different districts by changing the name of sales tax and excise department and its office as value added tax department and value added tax respectively in 19th July 1997 (2053) in 24th March 1997.

As VAT law designed to handle a single rate, the multiple rates of sales tax were unified in 1996 at 15 percent against the rate of 10 and 20 percent. Again, more trainings, interaction programs, information sharing meetings etc. were held to convince people about the introduction of VAT system. VAT task force was set up with numbers from administration FNCCI, NCC and consumer forum. The cabinet approved VAT regulation in 1997. The national VAT steering committee consisting of representative from recent HMG of Nepal FECCI, NCC and Donors was formed. Another VAT task force was formed with number from recent HMG/N. Industry and commerce sectors besides VAT Act and its regulation. The ministry of finance approved nine volumes of manual in 1997 to run up to the budget for the year 1997/98.The recent government decided to convert hotel tax in to the sales tax and the rate of tax was also reduced to 10 percent from 15 percent. Despite suspecting by international monitory fund (IMF) of such rate reductions, as there was a significant revenue risk associated with the rate reduction, recent HMG went

ahead with its agenda. The government declared appropriate rate of VAT. The study had recommended 15 percent as a revenue neutral rate. At the time of announcing its budget for the year 1997/97, the government did not need the recommendations. Similarly, exemptions of the sales tax were not brought in line with what was visited in VAT Act, 1995.

The final date for the introduction of VAT was set for November 16, 1997 and came in to practice. The existing Sales Tax Act 2033, Hotel Tax Act 2018, Contract tax Act 2023, and Entertainment Tax Act 2017 were replaced along with the implementation of VAT. Soon after its going into live, something went wrong. Despite all preparation, the introduction phase ran into many problems. The business community stated protest. Negotiations were held to research for amicable settlement. Such negotiation with businessman resulted into poor implementation. The sentiments of the whole business committees were divided between “No VAT and Yes VAT”. The most significant of all events at that time was vertical separation between FNCCI, the umbrella body, but they were also apprehensive of the full-fledged implementation of VAT. The whole environment was poisoned. The process of implementation of full flagged VAT was thus showed down .Considering the situation, VAT technical groups was formed in order to solve VAT implementation problems. Several new provisions relating to VAT were introduced through the finance bill in July 1998, the situation became so bad that the survival of VAT was put on stake. Recent government compromised in number of areas including solving down in registrant, raising thresholds, and more exemptions etc. which is known as 39 pints agreement. In this process the basic spirit of vat were destroyed. So was the revenue collection form VAT is supposed to be neutral broad-based and transparent tax system. But when recent government entered into negotiation with business communities, the spirit of VAT was diluted to a large extent. In the name of negotiations, everything was destroyed except the mane of VAT. Again several proposals were introduced in VAT though 1999/2000. Budget of the finance bill in order to create a congenial atmosphere for the smooth

implement of VAT through a notification in 1999. The parliament passed VAT bill 2001 on September 2001. To sum up in pursuit of this policy, which has been a worldwide movement, recent government had made several policy announcements, laid down several laws, formed many task forces produced volume of reports. It will remain true for future too.

In fact, the implementation of VAT was not easy in the beginning years. It was a matter of great debate. Although, a large number of traders were against VAT, policy maker and bureaucrats were not bothered, VAT yielded a positive fiscal gain. Now the situation has changed. VAT has just completed its decade of implementation. Despite some shortcomings, the overall functioning of VAT so far is satisfactory (Ghimire, 2008).

## **2.4 The Existing Problems with VAT**

In spite of possessing many beauties and advantages, VAT is running in Nepal having many problems challenges and constraints in its 12/13<sup>th</sup> year of operation. There are substantial problems that have affected its worthiness of implementation. Businessmen, consumers and tax administrators are all suffering with the weak side of VAT's implementations and its administrative processes. The administrative incapability, institutional structure, information and communication system, irrational thoughts towards VAT, untruthful behavior from stakeholders of VAT and so on are the few examples that have engulfed the VAT system in a negative tangled web. Therefore it has been essential to analyze the problems in its implementations and ongoing processes regarding to VAT; and find out the measures to diminish or shorten them. Currently, the following problems are extracted in VAT system.

### **2.4.1 Problems Regarding Issuance and Receiving of Invoices**

Invoices are the base for charging/paying VAT. On the basis of invoice, it is determined how much tax the taxpayer paid in the purchase, how much was taken from the sales, how much has to be paid to the government and how

much has to be refunded. But in practice, the trend of billing system is very low in the market until yet. In the context of Mechi and the whole Nepal, some businessmen have not been issuing the invoices, some have been issuing improperly even if they have issued, while others have been stating that an additional ten percent has to be paid, if invoices are required. And this lack of practice of issuing and receiving invoices in the market has remained one of the obstacles to the effective implementation of VAT. However, to sort out these problems, the government initiated the policy of accepting the transaction price for the purpose of custom duties instead of the custom's separate billing evaluation. It seems to have established the proper billing system in sales, and the opportunity of self-declaration of old stock was given to the sellers with some facilities. Similarly few programs were conducted to the taxpayers and consumers inculcating the habit of issuing and receiving invoices. Despite of the government's effort to have a proper billing system and awareness messages to the consumers, the practice of issuing and receiving proper invoices could not be increased due to the following reasons.

- ) Most of the businessmen do not issue proper invoices; if they do not receive the proper invoices from the importers
- ) Some taxpayers do not want to receive the proper invoices at the purchase due to the fear that they have to pay the income tax
- ) Some consumers do not have much concern in receiving invoice
- ) Custom administration generally does not purchase the imported goods that have been undervalued in custom.
- ) At present, there is a legal provision is to impose customs in terms of transaction price. But it is found that custom is imposed on the basis of price of custom evaluation registered as before and sometimes. It is also hampering in the collection of VAT from custom.
- ) Inland Revenue Administration does not make the domestic market price list necessary or the audit for taxation.

- J Inland revenue administration does not conduct the sufficient monitoring and follow up of the market to check whether or not invoices are being issued and whether they are being issued properly
- J The taxpayers can also issue the computer bill, but they tend to erase large amount of transaction with the objective of tax evasion, it is due to the lack of developed mechanism to control the transaction entered in computer. The act has been revised to cover those types of crimes but looks not more effective in its implementation.
- J The trend of not invoicing or under invoicing found in the sales and distribution of domestic production or services. And under invoicing in initial stage of production or sales of services causes under invoicing in successive stages of sales and distribution too

#### **2.4.2 Consumer's Unwillingness for Paying VAT**

The consumers are confused and agitated as the government has not been able to give confidence to the public that the tax paid amount will be properly utilized. Since the leakage in financial system in Nepal having lots of loopholes with immense corruption, people have been adamant to rely on if the money they have paid as VAT would really go the taxation department or not. The consumers also do not know which shop would give VAT invoices and which shop would not. The consumers know that no actions will be initiated by the administration when VAT invoices are not issued even in a place, where VAT invoices should be made (Joshi, 2001).

#### **2.4.3 Large Number of VAT-Exempted Goods and Services**

The numbers of VAT exempted goods and services are still large. This large number of exemption works against the principle of VAT and this leads to loss of revenue, transparency, neutrality and efficiency of VAT system and revenue leakage controlling mechanism. It further leads to the unnecessary complication of the tax system. The exemption does not seem justifiable except

in the case of administrative complications, since VAT is based on the consumption and used only for revenue collection in the world (Joshi, 2001).

#### **2.4.4 Large Numbers of Non-Registered Potential Taxpayers Promoting Unhealthy Competition**

Many potential taxpayers have not been registered yet. It is believed that non-registered taxpayers are more in Kathmandu. In one hand, there is the large number of potential taxpayers while on the other hand; the illegal import and under invoicing is great. As a result, the honest taxpayers who are within the VAT net have to do unfair competition with other sellers. If such trend extends, the honest and registered taxpayers will have the problem to continue transaction. And they will attempt to exceed the tax net or be compelled to hide the transaction. In such condition, the policy to make tax system transparent, basing on transaction cannot be successful.

#### **2.4.5 Delay in Tax File Procession**

Tax file entry and procession do not seem to happen in time. And the discipline to precede the right file has not been maintained. As a result, the number of suspended file has unnecessarily increased. Likewise, taxpayers, who do not submit their file in due time are not informed in time and computer tax assessment also has not been made in time regularly. Due to the increasing number of taxpayers, the problem is likely to increase.

#### **2.4.6 Problem and Disputes Concerning the Thresholds**

In an original VAT Act, threshold limit was determined to Rs. 1 million. Finance Act 1997 increased it to Rs. 2 million and again, the changed Finance Act 1998 increased it to Rs. 3 million just after eight months of its implementation. First amendment in VAT Rules 1997 was done only to further increase the threshold limit to Rs. 4.5 million. This amendment was again replaced by the Finance Act 1999/00. The threshold limit again lowered to Rs. 2 million. Thus it can be seen, as the threshold limit has been a much debated

issue in Nepalese context. Some consider that the existing threshold is too low and should be increased while others consider that the registration should be reduced or remove. If the threshold is too high, a majority of the businessmen may not come under the VAT net and under such circumstances, it will simply not be possible to implement VAT effectively. Therefore, it is common to keep the threshold as slow as possible. If a VAT threshold is not established, even small vendors will have to be brought under the VAT net. If the threshold is abolished, then the thousands and thousands of small vendors will have to be registered for VAT and it will be hard to control the large number of taxpayers in a country. Bringing very small vendors under the tax net cannot be justified from revenue, administration, or equity points of view. It is for this reason that all countries keep vendors outside the tax net through a medium of a threshold and this factor is equally relevant in the context of Nepal.

#### **2.4.7 Open Boarder and Unauthorized Trade**

There is not any measurement of authorized trade between Nepal and India. It is generally agreed that such trade in the boarder area is considerable. Many businessmen have claimed that only a little amount of goods from India comes through custom. One of the main points of opposition of the businessmen opposing VAT is that, it is not feasible due to open boarder with India and illegal imports from India. They are saying that they cannot compete with illegal imported goods or goods brought without paying tax and imported goods by paying minimum custom duties.

Unauthorized trade is very much organized in systematic in boarder area, there are many organized groups active on the both sides of boarder and these groups are responsible for illegal supplying goods from India to Nepal, Nepal to china and china to Nepal.

#### **2.4.8 Increasing Outstanding Amount and Total Tax Credit Amount**

Both the tax outstanding amount and tax credit amount are increasing every year. The increasing amount of outstanding has left adverse effect in the



revenue collection. In public finance, not depositing collected tax from the customers in government revenue is a serious crime. The international experiences show that the taxpayers are likely to take advantage of the tax credit. The misuse of the tax credit has not been estimated in Nepal yet but in future, the dishonest taxpayers might do that. If the controlling mechanism is not developed by the VAT administration-expanding audit and investigation activities in order to identify and remove such artificial credits. It cannot be totally trusted that some of the numbers are not fabricated because of taxpayer's aim to reduce tax liability by submitting artificial credit files.

## **2.5 Review of Related Literature**

A study on "Value Added Tax in Developing Countries" by IMF staff, Lent, Cascenegra and Guerard (1973; page 318-378) examines the applicability of VAT in seven developing countries (Brazil, Ecuador, Ivory Coast, Malagasy, Morocco, Senegal and Uruguay) considering the fact that uncertainties may arise in introduction of any major new implementation especially with very limited experiences. According to the study, the most important feature of VAT in such countries is its' conceptual basic such as taxable base (value- added) exemption, treatment of small traders etc. Problems of VAT depend on the administrative capacity in the developing countries. Economic and social atmosphere also plays vital role to make comprehensive tax base of VAT.

A VAT applies only through the production or wholesale stage does not generate the advantage of non-interference with market process to the same extent as one that covers other all sector of economy including retailing and services. The study shows that,

- ) Developing countries have limit range of VAT based by excluding the most troublesome because they have their own difficulties.
- ) VAT produces between 10 to 30 percent of government revenue of seven developing countries; the revenue of VAT is expected to increase at faster rate than the rate of growth of the economy.

- J There are fundamental difficulties in VAT operation administration in developing countries. The problem is the treatment of small taxpayers, which includes large numbers of retailers' service enterprise and farmers.
- J It is not possible to construct a mode of VAT in developing countries, on the basis of laws enacted in those countries.
- J Value-adding technique has greater precision in elimination the 'cascading' if there exists the remission of tax-off on exports and is less subject to tax evasion.

**Khadka, Rup Bahadur** (1989), published a book entitled "*VAT in Asia and Pacific Region*", after analyzing the VAT system in this region, he has stated, "VAT is the recent innovation in the field of taxation, which is levied on the value added goods and services, and is shifted forward completely to the consumers". The main objective of the study is "to examine the structure and operation VAT in the Asian Pacific countries". This also explores the possibility of introducing VAT in Nepal. He lastly developed a VAT proposal for Nepal. He concluded mainly as followings:

- J The broad base of VAT makes more revenue productive as well horizontally equitable.
- J Even though it is complicated to administer, it provides self-policing nature and catch-up facilitation to the tax administration.
- J Asian Pacific countries, such as China, Indonesia, Korea, New Zealand, the Philippines, and Taiwan have operated VAT from 1989 where it has been introduced as a part of large-scale tax reform. With some exceptions in China, all Asian Pacific countries adopted the consumption type of VAT with tax credit method for computation of VAT base. The New Zealand VAT has been considered as the best in the world.

**Dahal, M.K.** (1991), in an article, "*Tax Structure and Policy*" stated that an efficient and successful tax administration could improve the tax structure raising the productivity of tax yields. Administrative constraints lead to faulty

tax structure and heavily reliance on easy way to administer taxes is costly for developing countries. Tax administration is not possible to change in the same manner that one can change the exchange rate. Moreover, the state pf corruption in all tax offices is a sensitive issue that is beyond calculation and cannot be improved easily. Perhaps, developing countries have neglected this central issues while reforming the tax system. Nepal is no exception to it. While proposing a tax reform in a developing economy like Nepal, the focus should be on raising the productivity and responsiveness should be made to increase the contribution of progressive direct taxes in order to maintain equity in the tax structure. This needs efficient, dynamic and honest people in the tax administration.

**Singh, S.K.** (1996), in his book “*Public Finance in Theory and Practice*” stated that administration of VAT does not require firms to calculate Value Added Tax. VAT is administrated by invoice method. He found the merits of VAT as neutral and efficient resource allocation, neutral between different goods and services, neutral between business, neutral between different types of production and distribution. Since neutrality is important and neutrality in produced in goods is possible in VAT system because it does not distort any one of the above.

The author has explained that VAT at single rate with exemption of food stuffs, farmers, housing, finance, health, education, charities, newspaper, books, and periodical may be levied in such a way as to make the entire system of taxes, benefit the goods to deal more progressively and the cross audit features of VAT provide this facility to reduce tax evasion and demerits. VAT may raise price at the time of replacement. Author further stated that VAT being complex tax, individual and small firms do not maintain proper records. Accumulation of inventory is likely to higher smooth tax payment. Regarding the VAT in developing countries, the main requirements to introduce VAT are described as: (a) Ability to administer VAT, determines the feasibility. (b) Small business

and compliance are also other problems which should be created very carefully in developing countries while introducing VAT. (c) Successful introduction of VAT depends largely on previous experience of multiple stage sales tax or general sales tax.

**Khadka, Rup Bahadur** (1998), in his book entitled “VAT in Nepal” has described the theoretical background and the development of VAT in Nepal. Preparation and status of VAT are also addressed in this book. Since it is the collection of the published papers, the government has already addressed many recommendations provided earlier. Different aspects of VAT have also been analyzed in his book entitled “The Nepalese tax system”. In his own words “Tax compliance is very poor in Nepal and different taxes are not being fully paid as per the law. There is an advantage of the situation. There is lack of coordinating approach and long-term strategies. Several tax measures were introduced in 1997/ 98 without any consideration and their possible effect”.

**Silwal, Narayan Prasad** (1999), has expressed his practical experience about VAT in his book “*VAT a Nepalese Experience*”. It covers all aspects of VAT. In author’s word “VAT is in all stages non-cascading tax system. It extent to all levels of production and distribution, similarly it covers all aspects of VAT. In author’s word “VAT is in all stages non- cascading tax system. It extent 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”. Silwal suggests that factor affecting VAT design take also into consideration. A poorly designed VAT accompanied by weak administration would just drain the treasury. So almost all cases are necessary while designing a VAT. According to him, Tax base issues, Rate structure issues, Exemption issues and Threshold issues were considered while designing a VAT in Nepal. Finally, Silwal reached a conclusion that introduction of VAT provides and opportunity to sweep away to cub webs and revamp a substantial part of the tax administration. In every country, where it has been implemented

properly, the VAT has proven itself as a revenue productive tax. However, benefit from VAT depends upon its coverage.

Also the author examined performance of VAT in the first 15 months (November 1997 – January 1999) in an article “Effect of VAT on revenue: a pre and post VAT appraisal” visualizes a scenario of Nepalese economy. In general, he analyzes VAT very precisely after its implementation in particular. is mixed. The first three months of the information was considered to be a grace period. There were only 3000 taxpayers on which 2045 were the converted ones from the sales tax. About 400 million worth of stocks of sales tax were carried over from old system. At present the total registrations are just over 7900 of which only 4% contributes to 80% of interval VAT collection. Further segregation of internal collection reveals that 20% collection is coming from Nepal Telecommunication Corporation, 40% from excisable producers, producers like cigarettes, beers and liquor manufacturers and their distributors and only 40% from the other traders and industries. Thus, the accumulated credit in the system by the end of the 15 months was around one billion rupees.

In an article entitled “Status of VAT implementation Necessity Realized” published in the rising Nepal on 14 Nov, 2002 by Rup Bahadur Khadka concludes that the number of VAT registrations was 4959 in the first year of VAT implementation against 2045 sales tax registrations, which has increased almost to 27000 by mid November 2002. This indicates that there has been substantial increase in the tax base in terms of number of taxpayers. VAT refund system has also becoming gradually effective. As there was no belief of taxpayers on the refund mechanism, no taxpayers applied for the refund on the first fiscal year of VAT implementation. But after publicity regarding the tax system, the trust of the taxpayers regarding this process gradually increased. Then, they started applying for the refund. The refund amount increased to RS 1710 million 2001/02 from RS. 70 million in 1998/99 of the total returns, the share of credit, debit and zero returns was 39 percent, 32 percent and 24 percent respectively at the end of the fiscal year 2001/02.

A study made by Nepal Chamber of Commerce (1997) also analyzed the possible effects of VAT in Nepalese economy in 1997. Pushpa Raj Karnikar headed the team. The main findings of the study report were as follows:

- ) VAT affects adversely in price level.
- ) Increase in the price of imported goods and ultimately increase the cost of production, thereby reducing the export business.
- ) Requirement of bookkeeping is complicated.
- ) It would finally affect the small traders.
- ) It is untimely to implement.
- ) It would be unjustifiable on social ground.
- ) Present administration is incapable for handling VAT.
- ) Computerization system is not sufficient and it is new concepts for the tax administrators.

The study report suggested for a partial VAT on some commodities. It was in favor of phase wise implementation of VAT. The study analyzes negative impact of VAT neglecting its positive impact.

An article entitled “Tax System and its reform in Nepal” written by Dr. Govinda Bahadur Thapa, was published in Business age in Dec. 2003 views VAT as an important element of tax return programme. In the same Magazine in Dec. 2003, Yadav Pd. Dhungana Has scrutinized the legal aspect of VAT in “Value Added Tax and its Legal Scrutiny”. Dhungana Has Concluded that, as other areas of economy that are heavily influenced by political instability, corruption, bad governance, frequent change government and Maoist revolution. VAT also witnessed weak implementation owing to this hurdles.

**Sharma, Janaki** (2006) concludes opinion in the dissertation of MA as “it can be concluded that VAT is neutral in its effects, and cross check audit easier with VAT. It promotes exports, and broadens the tax base, hence VAT is revenue productive. However VAT would be more problematic in developing

countries where tax administration is weak, so it must be implemented after full preparation. As a reform of indirect tax, most of the efforts in VAT were held only on the theoretical background” (Sharma, 2006).

**Pandit, Shakti Prasad** (2006), in an article "*VAT Nine Years*" published in Kantipur January 15, Emphasized in revenue collection from VAT and refund of VAT. After analyzing nine years condition of VAT he seemed to be optimistic and expressed his satisfaction. He further concluded that Nepal Government (NG) collected Rs. 7120 million in FY 2054/055 from VAT. Among which Rs. 2100 million was from domestic and Rs.5020 million from import. In FY 2062/63 total VAT collection was Rs. 21930 million among whom Rs. 13870 million was from import and 8060 million from domestic sources.

Pandit also focused on the tax refund. In tax refund case in FY 2055/056 Rs. 80 million was refunded, then in FY 2062/063 Rs. 4057 million refunded. Pandit also talked about the registration. In total registration, 72% taxpayers submitted their returns in FY 2061/062. In which 30 to 35% submitted debt statement, 36 to 42% submitted their credit statement and remaining don't show their transactions.

Finally, he concluded that in total taxpayers, only 31 to 35% taxpayers paid tax regularly to government. Form this article he tried to analyze the contribution of VAT in revenue and effectiveness of VAT in Nepal.

**Ghimire, Madhab** (2008), in his dissertation for MBS has evaluated the performance of VAT as “The share of value added tax in GDP in Nepal is very low with comparison to other developed countries. The contribution of VAT revenue as percentage in GDP remained 2.76, 2.82, 2.66, 2.80, 3.15, 2.78, 2.93, 2.94, 3.52, and 3.67 from fiscal year 1996/97 to 2005/06 respectively, however showing a improving trend likewise the registration into VAT is also increasing

day by day. The number of registrants increased from 5237 to 46831 from the fiscal year 1997/98 to 2005/06 by almost seven fold” (Ghimire, 2008).

**Sharma, Shamvabi** (2009), in her dissertation of MBS concluded as “... in the context of present world VAT is one of the best alternatives of tax reform process. In that process, Nepalese government adopted VAT by replacing four tax systems. After the implementation of VAT, it broadens the tax base which increases revenue mobilization.”

**Bhatta, Prem Prasad** (2009), in the thesis of MBS focuses that VAT been encouraging the registration trend in Nepal. According to him “VAT is more efficient tax to avoid the cascading and pyramiding effects. On reviewing registration trend people are being more conscious toward the advantages of registering in VAT and the implementation scenario of VAT is going on sound wards. Revenue collection from import is very much higher than from internal sources.”

## **2.6 Research Gap**

VAT has become so popular in the field of taxation. Many research studies terms papers, project works and reports have been made from the university and other sectors in the topic of VAT concerning its implementation, its issues and its effectiveness etc. these studies have been adding valuable inputs for the construction of VAT literature, laws and practice. Most of the studies are focused on its effectiveness. And some are centered on comparative performance of fixed period of time. This study puts its effort to analyze the contribution of VAT collected from Mechi zone to total VAT revenue. It is hoped that the work will fulfill the research gap for the zonal contribution of VAT and its related issues for the curious persons and organizations.



## **CHAPTER - III**

### **RESEARCH METHODOLOGY**

This chapter is dedicated to a detailed discussion of the methodology used in this study by covering the procedure of getting research problems answers as per the objectives. There are six parts as research design, population and sampling, sources of data, procedure of data collection, data analysis procedure and presentation and analytical tools.

#### **3.1 Research Design**

The research topic entitled "VAT collection from Mechi Zone and its contribution on total VAT," is abstracted from the socio-economic environment of Nepal. As the VAT system and structure is based on various rules regulations and acts which are always setting on different countries own socio-economic infrastructure, descriptive research design is more suitable to analyze Nepalese VAT structure. For contribution of corporate income VAT, the study needs to analyze its past performance in different time period with respective indicators. So, historical as well as descriptive research design is used. The data and information of the study are concerned with past phenomena of performance. An opinion survey has been conducted for an empirical research. The opinion of the various respondents, associated with VAT i.e. tax administrators official and experts and tax payers (entrepreneurs/businessman and consumers), collected through structured questionnaire with reference to VAT system of Nepal. Thus, the research methodology followed in the study can be termed as analytical as well as descriptive research design.

#### **3.2 Population and Sampling**

The targeted whole area relating to indirect tax specially Total VAT is set for the research population. VAT collected from Mechi zone is taken as sample. To achieve the objectives of the study, 40 sample size from Mechi zone has been taken. Persons included in the sample are carefully selected by

consultation with the tax experts, professors and lectures and judgment of the researcher. The respondents have been divided into two groups. The following table shows the groups of respondents and the size of samples.

### **Groups of Respondents and Sample Size**

<b>S.N.</b>	<b>Groups of Respondents</b>	<b>Sample Size</b>
1	Tax officer and experts	15
2	Tax payers(Entrepreneurs and consumers)	25
	Total	40

### **3.3 Nature and Sources of Data**

To find the good and fact results, primary as well as secondary data and information has been collected. But most of the data and information used in the study are collected from secondary sources. The major sources of data are as follows:

- a. Annual report of IRD/N of different years.
- b. Economic survey of various years, published by MOF.
- c. Nepal Rastra Bank's Economic Bulletin of various times.
- d. Central Bureau of Statistics etc.

### **3.4 Data and Information Collection Procedure**

A structured questionnaire were developed and distributed to the selected respondents. Distribution was done personally through field visits rather than sending by any means to get accurate and actual information in time. The questionnaires were administered in personal meeting with the respondents and additional information was also collected from interview with the respondents. Various numerical data and information are collected as per the objective of the study and research questions. Firstly, laws, rules, regulations and policies related to VAT and other tax are studied to get more information about VAT system including book related to public finance. Secondly, different libraries such as Chamber of Commerce, FNCCI, and NRB are also consulted. Thirdly,

the numerical data are collected from the publication of annual reports of IRD/N, economic bulletin of NRB, Economic survey of MOF, publication of security board, CBS, publication of CEDA, T.U., Budget speech etc. Lastly, various journals, national newspapers are also reviewed. Respective parties are consulted while analyzing the research questions.

### **3.5 Data Processing and Analysis Procedures**

The collected data and information from different sources of VAT was processed for tabulation and analysis. According to the subject matter and requirement, the data were tabulated into separate tables and format. Then simple statistical tools such as percentage, average, graph and diagram, etc were calculated and used where necessary. They have been presented and analyzed in descriptive way.

### **3.6 Presentation and Analytical Tools**

Various tools are applied while conducting this study, which are table, percentage, average, correlation, and regression analysis.

**Table:** Various tables are formulated to tabulate the data.

**Simple Average and Percentage:** These tools are used to make comparative study of the data in the tables.

**Charts and Diagrams:** These tools are used for visual description of the data. Trend line, bar diagrams are used for this purpose.

## **CHAPTER - IV**

### **DATA PRESENTATION AND ANALYSIS**

#### **4.1 Presentation and Analysis of Secondary Data**

Secondary data has been obtained from Economic Survey (2009/10) and report of IRO Bhadrapur (2008/09). Purposively Total Revenue, Tax and Non Tax Revenue, Direct and Indirect Taxes and the contributors for direct and indirect taxes have been selected here to achieve meaningful findings and conclusion.

##### **4.1.1 Revenue Structure of Nepal**

Government Revenue is considered as major component while setting fiscal policy in Nepal. It is backbone in the process of economic development and in reducing the burden of external debt. The surplus revenue can be utilized for the development work of the country. The government has to broaden the domestic and International tax revenue and increase the per capita income of the people. In this respect, the tax structure has vital role in development. Government has introduced several taxes to raise revenue and to perform numbers of functions for the betterment of the people in the country. It collects revenue from different sources like tax, borrowing, fees, donations, etc. is called public revenue. In general government income source are classified mainly into two categories namely tax revenue and not- tax revenue. Those both sources are subject to non-payment and their sum constituted the government revenue. Beside these sources, government has other sources which are subject to repayment such as loans, grants however grants are not compulsorily for replay. Those sources are desirable only to meet the fiscal deficits. The trend and composition of tax revenue in the recent years and contribution of VAT's to other tax associated variable will be discussed and analyzed throughout overall study. For this purpose, the trend of tax and non tax revenue collection is presented below:

**Table 4.1**  
**Trend Showing Revenue Collection in Nepal**

(Rs. In ten millions)

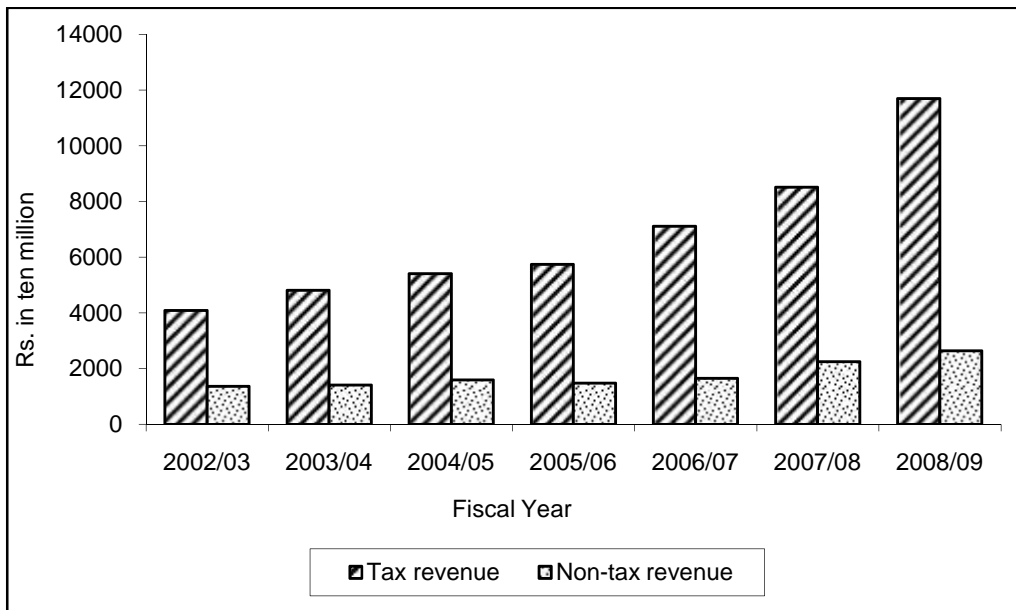
Fiscal Year	Total Revenue	Tax Revenue		Non - Tax Revenue	
		Amount	%	Amount	%
2002/03	5453.9	4089.60	74.99	1364.29	25.01
2003/04	6233.1	4817.30	77.29	1415.80	22.71
2004/05	7012.3	5410.47	77.16	1601.80	22.84
2005/06	7228.20	5743.04	79.45	1485.16	20.55
2006/07	8771.22	7112.67	81.09	1658.55	18.91
2007/08	10762.25	8515.55	79.12	2246.70	20.88
2008/09	14347.45	11705.19	81.58	2642.26	18.42
Total & Average	59808.38	47393.82	78.67	12414.56	21.33

*Source: Government of Nepal, Ministry of Finance, Economic Survey, 2009/10*

Above table shows revenue collection trend in Nepal for seven years. Since the year 2002/03 to the year 2008/09 the total revenue has increased from Rs 54539 million to Rs. 143474.5 million. It means that the both tax revenue and non-tax revenue are in increasing trend. Total tax revenue has been increased from Rs, 40896 million to Rs. 117051.9 million for the respective years 2002/03 to 2008/09. Tax revenue is the main source of revenue collection. It has been contributing huge part in national revenue. Similarly, non-tax revenue has also been increased from Rs. 13642.9 million to Rs. 26422.6 million in the year 2002/03 to 2008/09 respectively except declination in the year 2005/06. Contribution from non tax revenue seems less than tax revenue in comparison but this part is also significant and cannot be tolerated. Tax revenue has contributed to total revenue by about 80% and non-tax about by 20% in average of seven years.

As per the trend of seven years tax revenue contributes the four-fifth part in the total revenue of the government. And also, the table proves that tax revenue is an economic pillar of the country. In overall trend tax revenue seems increasing its part in the composition of total revenue.

**Figure 4.1**  
**Trend Showing Revenue Collection in Nepal**



The figure represents the data of table no 4.1 showing the relationship of tax and non tax revenue in the construction of national revenue. It demonstrates that tax collection is upward sloping from the year 2002/03 to the year 2008/09 and also clearly seen that tax revenue has been contributed major part in total government revenue in the ratio of about 4:1 in each year. Increase in collection of revenue is a reliable means to fulfill the increasing demand of the country. It is positive indicator for the country.

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

A person is obliged to pay tax as per the rules of the country. In other word paying tax is not a voluntary contribution to the tax payer but it is compulsory in nature and taxation is a main source of income of the government among all source. Tax revenue comprises compulsory, unrequited, non-payable receipt collected by government for public purposes. It includes interest collected on tax arrears and penalties collected on on-payment or late payment of taxes. Tax revenue is the principle source of the government revenue; however its contribution differs among different countries. In the context of Nepalese

economy, tax revenue is major source of government revenue to run the nation and go straight forward effectively, as it has been dominating the government revenue.

Tax revenue, one of the principle sources of the government revenue, is a compulsory contribution imposed by public authority, irrespective of the extra amount of service rendered to the tax payer in return. It covers theoretically and practically many heads such as persons, organization business firms and even foreigners who are doing business of consuming goods or using service in Nepal.

In the fiscal trend of Nepal, tax revenue structure is a combination of two elite taxes. They are namely direct tax and indirect tax. The trend and composition of tax revenue for the fiscal year 2002/03 to 2009/10 are given below:

**Table 4.2**  
**Trend Showing Composition of Tax Revenue**

(Rs. In ten million)

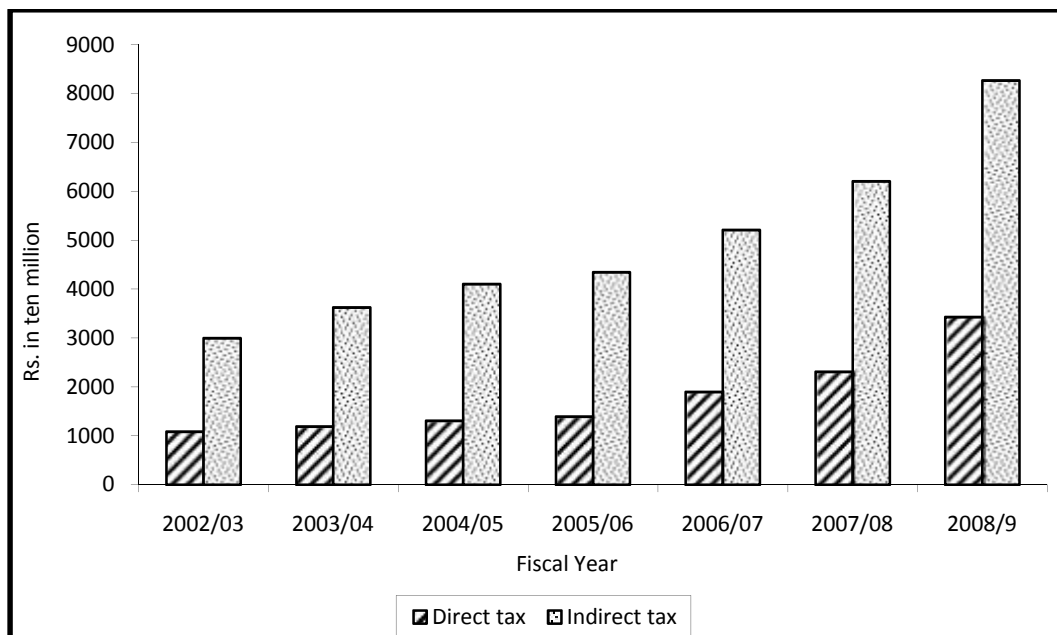
Fiscal Year	Total Tax Revenue	Direct Tax		Indirect Tax	
		Amount(Rs.)	%	Amount(Rs.)	%
2002/03	4089.60	1088.19	26.61	3001.41	73.39
2003/04	4817.30	1190.74	24.72	3626.56	75.28
2004/05	5410.47	1307.18	24.16	4103.29	75.84
2005/06	5743.04	1396.81	24.32	4346.23	75.68
2006/07	7112.67	1898.03	26.69	5214.64	73.31
2007/08	8515.55	2308.77	27.11	6206.78	72.89
2008/09	11705.19	3432.07	29.32	7273.12	70.68
Total & Average	47393.8	12621.8	26.13	34772.51	73.87

*Source: Government of Nepal, Ministry of Finance, Economic Survey, 2009/10*

Above table shows the dominant part of indirect tax in the structure of tax revenue. From the year 2002/03 to the year 2008/09 both tax revenue are in

increasing trend. It indicates positive trend for the country's health. Ratio of both indirect and direct tax is about 3:1 or 75%: 25% in total respectively. The volume of indirect and direct tax is Rs. 30014.1 million and 10881.9 million that is 73.39 percent and 26.61 percent of total revenue respectively in the fiscal year 2002/03 and the amounts reached to Rs. 82731.2 million in indirect tax and Rs.34320 in direct tax for the year 2008/09 respectively. The highest and lowest percentage of indirect tax is 75.84% and 70.68% during seven years while total is 73.75%. Similarly, the highest and lowest percentage of direct tax is 29.32% and 24.16% for seven years. Total average contribution of indirect tax is 73.87% and the direct tax contributes 26.13%.

**Figure 4.2**  
**Trend of Direct Tax and Indirect Tax Revenue**



#### 4.1.3 Composition of Direct Tax Revenue

Direct tax is actually paid by the person on whom it is imposed legally (Dalton, 1957:17). Direct tax is a levy laid down by the government on the income and wealth received by house holds and business enterprise in order to raise revenue and as on instrument of fiscal policy. Direct tax is as per the name because it is normally assumed that the real burden of payment falls directly to



the person or business enterprises as s/he is responsible for paying them and cannot divert the responsibility on to anybody else. Direct tax is progressive so far as the amount paid varies significantly according to the income level and wealth of the tax payers.

In Nepalese tax structure; the major components of direct taxes are income tax, vehicle tax and house and land registration tax. Direct tax in Nepal seems to less effective, to mobilize the domestic resources.

Although, it is an inevitable instrument of the fiscal policy hence it must be designed and practiced properly. In general revenue productivity of the direct tax goes on per capita income per annum of the country. Income tax is one of the major sources of the direct tax. Nepal is levying four different types of income tax. Its categories are individual income tax corporate income tax, house rent tax and interest tax. On the other hand property tax is another major direct tax. It includes land revenue, Bhumikar, house and land registration tax. Major components of Nepalese direct taxes are income tax, land tax, house and land registration tax. Composition of direct tax revenue is given below:

**Table 4.3**  
**Composition of Direct Tax Revenue**

(Rs. In ten millions)

<b>Fiscal Year</b>	<b>Income Tax</b>	<b>%</b>	<b>Land Tax</b>	<b>%</b>	<b>Vehicle Tax</b>	<b>%</b>	<b>Other Tax</b>	<b>%</b>	<b>Total Tax</b>
2002/03	881.18	80.98	60.78	5.59	42.96	3.95	103.27	9.49	1088.19
2003/04	851.25	71.46	169.75	14.25	70.06	5.88	100.2	8.41	1191.26
2004/05	940.24	71.93	179.92	13.76	80.65	6.17	106.37	8.14	1307.18
2005/06	959.78	68.71	218.11	15.61	84.76	6.07	134.16	9.60	1396.81
2006/07	1397.91	73.65	225.35	11.87	99.5	5.24	175.27	9.23	1898.03
2007/08	1622.33	70.27	294.07	12.74	106.92	4.63	285.45	12.36	2308.77
2008/09	2345.73	68.35	522.33	15.22	185	5.39	379.01	11.04	3432.07
Total & Average	8998.42	71.29	1670.3	13.23	669.85	5.31	1283.7	10.17	12622.31

Source: *Government of Nepal, Ministry of Finance, Economic Survey, 2009/10*

In the above figure direct tax has been divided in to four parts namely; Income tax, Land tax, Vehicle tax, and other tax. Where, other tax includes Tax on interest and urban house and land tax for convenience of the study. Table 4.3 shows that in F/Y 2002/03, the percentage share of income tax was 80.98%, followed by other tax 9.49%, land tax 5.59% and vehicle tax 3.95% of total tax revenue. In an average, the percentage share of income tax constitute to the total direct tax is 71.29% followed by land tax 13.23%, other tax 10.17% and vehicle tax 5.31%.

From the year 2002/03 to year 2008/09 the amount in all four slabs of direct tax revenue has been increasing apart from the amount of income tax in the year 2003/04. Percentage share looks decreasing with respect to income tax. Its share on 2002/03 was 80.98% that falls to 68.35% in year 2008/09 while land tax and other tax are raising its volume in amount and percentage. Land and other tax on 2002/03 were 5.59% and 9.49% respectively they reach 15.55% and 11.04% in F/Y 2008/09 respectively.

Land tax is increasing gradually rising in the years. From this we can conclude that investment activities have not flourished with in nation due to the political instability. In this situation investor might have been investing their investment in purchasing land and building. This might the reason to be increased in land tax revenue in recent years.

#### **4.1.4 Composition of Indirect Tax Revenue**

Indirect tax is major tax source in Nepal. Value added tax also falls upon the same group. Tax from contract, hotel and entertainment have been included in value added tax after the adoption of VAT all these taxes were replaced.

**Table 4.4**  
**Composition of Indirect Tax Revenue**

(Rs. In ten million)

Fiscal Years	Indirect Tax								
	Custom	%	VAT	%	Excise Duty	%	Others	%	Total
2002/03	1278.32	42.59	1345.97	44.84	377.12	12.56	0	0	3001.41
2003/04	1555.48	42.90	1447.89	39.93	622.67	17.17	0	0	3626.04
2004/05	1570.16	38.27	1888.54	46.03	644.59	15.71	0	0	4103.29
2005/06	1534.4	35.30	2161.07	49.72	650.76	14.97	0	0	4346.23
2006/07	1670.76	32.04	2609.56	50.04	934.32	17.92	0	0	5214.64
2007/08	2106.25	33.93	2981.57	48.04	1118.96	18.03	0	0	6206.78
2008/09	2679.29	36.84	2970.09	40.84	1622.09	22.30	1.65	0.02	7273.12
Total & Average	12394.66	36.70	15404.69	45.61	5970.51	17.68	1.65	0.00	33771.51

Source: *Government of Nepal, Ministry of Finance, Economic Survey, 2009/10*

The above figure shows the supremacy of VAT and Custom duty in the composition of indirect tax. In an average for the last eight years VAT possesses 45.61% share followed by international trade tax or Custom constitutes 36.70%, Excise duty 17.68% and, nominal figure, others contribute nil. All the figures are in an increasing trend reflecting a positive sign to the country. Contribution of VAT is within the range of 40 to 50 percent. It is 50.04% in the year 2006/07, one half part in the composition of indirect tax of the nation. It is a very large contribution. The country must capitalize this in the best manner.

#### 4.1.5 Contribution of VAT to Total Revenue, Total Tax Revenue and Total Indirect Tax

**Table 4.5**  
**Contribution of VAT to Total Revenue, Total Tax Revenue**  
**and Total Indirect Tax**

(Rs. In ten million)

Fiscal Years	VAT	Contribution of VAT					
		Total Revenue	% of VAT	Total Tax Revenue	% of VAT	Indirect Tax	% of VAT
2002/03	1345.97	5453.9	24.68	4089.60	32.91	3001.41	44.84
2003/04	1447.89	6233.1	23.23	4817.30	30.06	3626.04	39.93
2004/05	1888.54	7012.3	26.93	5410.47	34.91	4103.29	46.03
2005/06	2161.07	7228.20	29.90	5743.04	37.63	4346.23	49.72
2006/07	2609.56	8771.22	29.75	7112.67	36.69	5214.64	50.04
2007/08	2981.57	10762.25	27.70	8515.55	35.01	6206.78	48.04
2008/09	2970.09	14347.45	20.70	11705.19	25.37	7273.12	40.84
Total & Average	15404.69	59808.42	25.76	47393.82	32.50	33771.51	45.61

Source: *Government of Nepal, Ministry of Finance, Economic Survey, 2009/10*

Table no 4.5 shows the Contribution of VAT to total revenue, total tax revenue and total indirect tax revenue. This relationship clearly shows the giant role of vat in the formation of national revenue. In average the contribution of VAT to indirect tax is 45.61%. It is about half part. For the composition of total tax revenue VAT has contributed as one third collaborator, that is 32.50 in average. And VAT stands as one fourth contributor for the composition of total national revenue as a result of the relationship of last 7 years data which is 25.76 or more than a quarter.

#### 4.1.6 Contribution of VAT Collected from Mechi Zone to Total VAT

**Table 4.6**

##### **Contribution of VAT from Mechi Zone to Total VAT**

(Rs. In ten million)

<b>Fiscal Year</b>	<b>VAT from Mechi zone</b>	<b>Total VAT</b>	<b>% of VAT from Mechi to Total VAT</b>
2006/07	115.86	2609.56	4.44
2007/08	131.46	2981.57	4.41
2008/09	168.45	2970.09	5.67
Total and Average	415.77	8561.22	4.86

*Source: IRO, Bhadrapur/ Economic Survey 2009/10*

The figure shows contribution of VAT from Mechi zone to total VAT collected in the country. Comparison has been made for three years data beginning from fiscal year 2006/07 to 2008/09. Yearly contribution VAT collected from Mechi to total VAT is 4.44%, 4.41% and 5.6% for the respective financial year 2006/7, 2007/08 and 2008/09. Where average for three years stands 4.86%.

Mechi zone is eastern Nepalese zone that consists of 4 districts namely Taplejung, Panchthar, Ilam and Jhapa. Jhapa and Ilam districts consist of 3 and 1 municipalities respectively. Rest of the districts Taplejung and Panchthar lack the standard of declaring Municipality. It shows that Jhapa district has strong influence over the economy of the zone followed by Ilam district. Jhapa district is the eastern point of Mechi highway which ends in Kakarvitta boarder, Nepal-India, with custom office. A part from this, the district has some small industries and commercial sector. In other words most of the taxpayers are in Jhapa district followed by Ilam and very less in Ttaplejung and Panchthar. So it seems very hard to maintain zonal weighing scale among 14 zones in the collection of VAT despite having different constraints.

If given equal weight to all zone it is 7.14 (75/14). Finding the weight considering the distribution of districts that is 5.33% (4/75\*100) as actual

contribution is 4.86%. While considering with total no of Municipality that is  $(4/58*100)$  6.89% and if comparing with the data of VAT registrants based on the report of IRD website 2065, the number of registrants in Vhadrapur and all total is 1770 and 56996 the percentage is 3.10%. It must be considered that VAT collected from Mechi, presented in table no 4.6 is the VAT collected by IRD Bhadrapur except from the VAT collected from custom. Total VAT in the same table is including the VAT of custom. So, inland VAT revenue has been compared with total VAT here. That is 4.86% of total is significant amount.

From above discourse we can conclude that VAT collected from Mechi zone is significant to total VAT. From the point of view of zonal average and weighted average it seems slightly low. It is by reason of more participation of taxpayers inside metropolitan, sub metropolitan, capital city and industrial area. Mechi zone doesn't have at least one standard out of the above condition. From taxpayers prospective the average collection of VAT from Mechi is more than its share. It is the positive outcome for the financial health of the zone.

## 4.2 Presentation and Analysis of Primary Data

For primary data, a field survey through direct personal questionnaire has been made to entrepreneurs, Tax payers, Tax officials and Tax experts form Mechi Zone for achieving their free reposes regarding VAT and its various issues. The opinion presented in the following analysis.

### 4.2.1 Opinion Towards “Existing Rate of VAT”

**Table 4.7**

#### **Opinion Towards “Existing Rate of VAT”**

<b>High</b>		<b>Low</b>		<b>Medium</b>		<b>Don't know</b>		<b>Total</b>	
No.	%	No.	%	No.	%	No.	%	No.	%
15	60	-	-	7	28	3	12	25	100

*Source: Field Survey*

The above table is presented from the survey made to the entrepreneurs and consumers regarding the existing rate of VAT. Opinion for “the rate is high” is

60% with the survey made to taxpayer community. While 28% respondent are satisfied for the rate and 12% are unknown to compare for the matter. According to this current rate of VAT laid down by the government is high in the national context. Therefore the authority must review the rate of VAT.

#### 4.2.2 Opinion Towards “VAT as the Best Instrument for Mobilizing Revenue”

**Table 4.8**

**Opinion Towards “VAT as the Best Instrument for Mobilizing Revenue”**

Yes		No		To Some extent		Total	
No	%	No	%	No	%	No	%
15	100	-	-	-	-	15	100

*Source: Field Survey*

This table is presented with reference to the survey made to tax officers and tax experts of Mechi zone. Issue of the table is whether VAT is the best instrument for mobilizing revenue or not. The response is 100 in favor of issue. From this we can conclude that VAT is mobilizing the revenue in optimum way so tax administrators as well as tax experts are satisfied from its performance.

#### 4.2.3 Opinion Towards “View about Billing System”

**Table 4.9**

**Opinion Towards “View about Billing System”**

Possible		Impossible		Costly		Ridiculous		Total	
No	%	No	%	No	%	No	%	No	%
12	48	3	12	-	-	10	40	25	100

*Source: Field Survey*

The survey in the issue regarding the view of entrepreneurs for the billing system is presented in the above table. The opinion towards possibility to maintain current billing system is 48%. While 48% taxpayers expressed it as

ridiculous process and 12% expressed as impossible system laid down by the government to business community.

#### 4.2.4 Opinion Towards “VAT is Well Functioning in Nepal”

**Table 4.10**

**Opinion Towards “VAT is Well Functioning in Nepal”**

<b>Well Functioning</b>		<b>To Some extent well Functioning</b>		<b>Not well Functioning</b>		<b>Total</b>	
No	%	No	%	No	%	No	%
15	100	-	-	-	-	15	100

*Source: Field Survey*

The survey, in the issue regarding functioning of VAT in Nepal made to tax official and experts, is presented in the above table. All 15 respondents put their view that the VAT system is well functioning in Nepal. None of the respondents put their consent against the well functioning triumph of VAT.

#### 4.2.5 View Towards “Problems Facing by the Government to Collect VAT”

**Table 4.11**

**View Towards “Problems Facing by the Government to Collect VAT”**

<b>Registration</b>		<b>Account Keeping</b>		<b>Billing</b>		<b>All</b>		<b>Total</b>	
No	%	No	%	No	%	No	%	No	%
-	-	-	-	-	-	15	100	15	100

*Source: Field Survey*

View of 15 tax experts and officials for the questionnaire “problem facing by the government to collect the VAT” is presented in the above table. All the respondents put the opinion for the three problems namely; registration, account keeping and billing related problems. They choose “all” despite choosing one of other three options.



#### 4.2.6 View Towards “The Most Haunting Problem on Effectiveness of VAT in Nepal”

**Table 4.12**

**View Towards “The Most Haunting Problem on Effectiveness of VAT in Nepal”**

<b>Political instability</b>		<b>Non/over/under invoicing</b>		<b>Administrative incapability</b>		<b>Unawareness of people</b>		<b>Total</b>	
<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>
<b>3</b>	<b>20</b>	<b>9</b>	<b>60</b>	<b>-</b>	<b>-</b>	<b>3</b>	<b>20</b>	<b>15</b>	<b>100</b>

*Source: Field Survey*

View of 15 tax experts and officials are presented in the above table for the issue of “the most haunting problem on effectiveness of VAT in Nepal”. 60% respondents put their opinion for “non/over/under invoicing” followed by the options “political instability” and “unawareness” of people” 30% each. It shows that the billing related problem is the major one for ineffectiveness of the VAT system in Nepal.

#### 4.2.7 Opinion Towards “Existing Laws and Regulation of VAT are Sufficient”

**Table 4.13**

**Opinion Towards “Existing Laws and Regulation of VAT are Sufficient”**

<b>Yes</b>		<b>No</b>		<b>To Some Extent</b>		<b>Must be Revised</b>		<b>Total</b>	
<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>
<b>12</b>	<b>80</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>3</b>	<b>20</b>	<b>15</b>	<b>100</b>

*Source: Field Survey*

The view of the tax experts and officials are presented in the above table for the issue of sufficiency of existing law and regulation of VAT. While responding for the above questionnaire, 80% of the respondent put their opinion for

sufficiency of existing laws and 20% of the respondent expressed to the rule must be revised. From this we can analyze that the laws for the VAT is satisfactory but it must be revised to get compatibility with the pace of the innovations in the field of business.

#### 4.2.8 Opinion Towards “Single Rated VAT Good Enough than Multi Rated VAT”

**Table 4.14**

**Opinion Towards “Single Rated VAT Good Enough than Multi Rated VAT”**

Yes		No		Total	
No	%	No	%	No	%
15	100	-	-	15	100

*Source: Field Survey*

The view of the tax experts and officials are presented in the above table for the issue of “single VAT is good enough than multi rated VAT”. For the issue, 100% respondents put their response for the matter. They all agreed for single rated VAT system to adopt in Nepal rather than to adopt multi rated VAT.

#### 4.2.9 Opinion Towards “The Most Specific Objectives of VAT”

**Table 4.15**

**Opinion Towards “The Most Specific Objectives of VAT”**

To Cover Transaction in Tax Net		To Enhance Government Revenue		To Check and Balance Inflation		Others		Total	
No	%	No	%	No	%	No	%	No	%
3	20	12	80	-	-	-	-	15	100

*Source: Field Survey*

The view of the tax experts and officials are presented in the above table for the issue of “the most specific objectives of VAT”. For the issue, 80% of the

respondents accepted for the option that the most specific objective of VAT is to enhance government revenue while 20% of them accepted that the objective is for covering the transaction in tax net. From this, we can analyze that the most specific objective of the government to lay down the VAT system is to enhance the revenue of the government and to cover transactions in tax net.

#### 4.2.10 Opinion Towards “Types of Effort Needed to Make VAT System Successful”

**Table 4.16**

**Opinion Towards “Types of Effort Needed to Make VAT System Successful”**

<b>Strengthen VAT Administration</b>		<b>Update VAT laws Regularly</b>		<b>Organize Public Awareness Programmes</b>		<b>All</b>		<b>Total</b>	
<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>
<b>4</b>	<b>26.67</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>11</b>	<b>73.33</b>	<b>15</b>	<b>100</b>

*Source: Field Survey*

The view of the tax experts and officials are presented in the above table for the issue of “types of effort needed to make VAT system successful”. 15 respondents have been given 4 options namely; strengthen VAT administration, Update VAT laws regularly, Organize public awareness programmes and all. While responding to the options 73.33% of the respondents opted the option “all”, and 26.67% opted for the option “strengthen VAT administration”. From this reaction we can conclude that for the success of the VAT system in Nepal the first three options must be improved with focusing more to strengthen VAT administration.

#### 4.2.11 Opinion Towards “The Most Effective Effort to Collect VAT”

**Table 4.17**

##### **Opinion Towards “The Most Effective Effort to Collect VAT”**

<b>Reward system</b>		<b>Punitive system</b>		<b>Self-assessment system</b>		<b>All</b>		<b>Total</b>	
<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>
-	-	-	-	-	-	15	100	15	100

*Source: Field Survey*

The view of the tax experts and officials are presented in the above table for the issue of “the most effective efforts to collect VAT”. The questionnaire had been given to 15 tax officials and tax experts to grasp their response. While responding 100% of the responded recommended for “all” option. In other words they put emphasis on to make effort on all the three options namely Reward system, punitive system, Self-assessment system. From this vision of the experts it can be said that tax administration must make well effort for reward, punitive, Self-assessment system to collect the VAT effectively.

#### 4.2.12 Opinion Towards “Impact Created by VAT System in Business Organizations”

**Table 4.18**

##### **Opinion Towards “Impact Created by VAT System in Business Organizations”**

<b>Positive</b>		<b>Negative</b>		<b>Neutral</b>		<b>Others</b>		<b>Total</b>	
<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>
4	16	13	52	8	32	-	-	25	100

*Source: Field Survey*

The view of the tax payers, namely entrepreneur and consumers, is presented in the above table for the issue of “impact created by VAT systems in business organizations”. The questionnaire had been given to 25 entrepreneurs and businessmen from Mechi zone to grasp their response. While responding for

the matter, 52% of the respondents put their view for negative impact created by VAT system. 32% of the respondents responded that the new taxation system has been creating neutral effect because there was and will be another taxation system unless there would be VAT currently. And 16% out of total respondent replied that VAT is creating positive impact as it is discouraging illegal business. From this response we can say that perspective of business community towards VAT is still negative as they look VAT as negative impact creator.

#### 4.2.13 Opinion Towards “The Most Responsible Group for Tax Evasion”

**Table 4.19**

##### **Opinion Towards “The Most Responsible Group for Tax Evasion”**

<b>Business Enterprises</b>		<b>Tax Administration</b>		<b>Consumers</b>		<b>All</b>		<b>Total</b>	
<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>
<b>5</b>	<b>20</b>	<b>4</b>	<b>16</b>	<b>-</b>	<b>-</b>	<b>16</b>	<b>64</b>	<b>25</b>	<b>100</b>

*Source: Field Survey*

The view of the tax payers including entrepreneurs/businessmen and consumers, is presented in the above table for the issue of “the most responsible group for tax evasion”. The questionnaire had been given to 25 entrepreneurs/businessmen and consumer from Mechi zone to grasp their response. While responding, 64% put their view for the option “all” followed by 20% for the option “business enterprises” and 16% for the option “tax administration”. From this feedback we can wrap up the issue that all of the groups, except consumer, are responsible for the tax evasion despite a little difference in weight. It must be rectified through the strong participation and commitment of all above groups.

#### 4.2.14 Opinion Towards “Whether Tax Personnel Check all the Books of Account or Not”

**Table 4.20**

##### Opinion Towards “Whether Tax Personnel Check all the Books of Account or Not”

Yes		Most of them		Some of them		No		Total	
No	%	No	%	No	%	No	%	No	%
4	16	13	52	7	28	1	4	25	100

*Source: Field Survey*

The view of the tax payers including entrepreneurs and businessmen is presented in the above table for the issue of “whether the tax personnel check all the book of account or not”. The questionnaire had been given to 25 entrepreneurs and businessmen from Mechi zone to grasp their response. In the response, 52% of the respondent opted for the option that says most of the tax personnel check all the books and account of tax payers especially of VAT registrants. 26% response received for “some of them” while 16% response is in favor of the tax personnel’s dutifulness that says “yes! tax personnel check all the books of account” and 4% response is against the dutifulness of tax personnel’s that says “no! tax personnel check all the books of account”. From this reaction it can be understood that account checking function performed by tax personnel is acceptable in Mechi zone despite few disappointment.

#### 4.2.15 Opinion Towards “Superiority of VAT Over Sales Tax”

**Table 4.21**

##### Opinion Towards “Superiority of VAT Over Sales Tax”

Yes		No		Don’t Know		Total	
No	%	No	%	No	%	No	%
16	64	-	-	9	36	25	100

*Source: Field Survey*

The view of the tax payers including entrepreneurs/businessmen and consumer is presented in the above table for the issue of “superiority of VAT over sales tax”. The questionnaire had been given to 25 entrepreneurs/businessmen and consumers from Mechi zone to grasp their response. In the response 64% of the total respondents accepted the superiority and 36% of the respondents are unknown for the matter. From this reaction it can be concluded that VAT is superior to sales tax from its nature and beauty. And it is understood that the fact has been perceived by Nepalese business and its stakeholders too.

#### 4.2.16 Opinion Towards “Price Rise Due to VAT System”

**Table 4.22**

##### **Opinion Towards “Price Rise Due to VAT System”**

<b>Yes</b>		<b>No</b>		<b>Don’t know</b>		<b>Total</b>	
<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>
<b>11</b>	<b>44</b>	<b>8</b>	<b>32</b>	<b>6</b>	<b>24</b>	<b>25</b>	<b>100</b>

*Source: Field Survey*

The table reveals the fact of the survey made to 25 business persons and consumers on the questionnaire for “whether price rise due to VAT System”. 44%, 32% and 24% reaction is received for the option “yes” “no” and “don’t know” respectively. The respondents are from business community and consumer group. Therefore most of them might have negative perception towards VAT. And some are unknown for this taxation system in spite of involving in the trading activity. In the group of respondent some are rationale people. Those people can express the inner sensation by knowing the essence of questionnaire if they want. However the table concludes that VAT is the cause to raise the price of the goods and services.

#### 4.2.17 Opinion Towards “The VAT been Discouraging Illegal Business”

**Table 4.23**

##### **Opinion Toward “The VAT been Discouraging Illegal Business”**

<b>Yes</b>		<b>No</b>		<b>Don’t know</b>		<b>Total</b>	
<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>
<b>11</b>	<b>44</b>	<b>7</b>	<b>28</b>	<b>7</b>	<b>28</b>	<b>25</b>	<b>100</b>

*Source: Field Survey*

The table reveals the fact of the survey made to 25 business persons and consumers through direct personal questionnaire on “whether the VAT been discouraging illegal business or not”. The response is received 44% for “yes” option and 28% each for the options “No”, and “don’t know” options. From this reaction we can conclude that the modern taxation system VAT is discourage illegal business through its multiple dimensions.

#### 4.2.18 Opinion Towards “VAT Collected from Mechi Zone is Significant for the Structure of Total VAT”

**Table 4.24**

##### **Opinion Towards “VAT Collected from Mechi Zone is Significant for the Structure of Total VAT”**

<b>Yes</b>		<b>No</b>		<b>Total</b>	
<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>
<b>15</b>	<b>100</b>	<b>-</b>	<b>-</b>	<b>15</b>	<b>100</b>

*Source: Field Survey*

The table reveals the fact of the survey made to 15 tax official and tax experts through direct personal questionnaire on “whether VAT collected from Mechi zone is significant for the structure of total VAT of not”. Respondents are 100% agree to the option “Yes”, while giving their free consents. It enlightens that the collection of VAT from Mechi zone is significant for the combination



of total VAT. And also it is realized, from the opinion of experts, that VAT system is mobilizing good enough resource from Mechi zone.

### **4.3 Major Findings of the Study**

From the study and analysis of primary as well as secondary data relating to VAT, major findings has been grasped and is presented as per below:

#### **4.3.1 Findings from Secondary Data**

VAT has been found the most effective tool to mobilize revenue from domestic sources. By analyzing primary data we the following finding is revealed:

- J As per the trend of seven years tax revenue contributes the four-fifth part in the total revenue of the government. And also, the table proves that tax revenue is an economic pillar of the country. In overall trend tax revenue seems increasing its part in the composition of total revenue.
- J From the year 2002/03 to year 2008/09 the amount in all four slabs of direct tax revenue has been increasing, apart from the amount of income tax in the year 2003/04. Percentage share looks decreasing with respect to income tax. Its share on 2002/03 was 80.98% that falls to 68.35% in year 2008/09 while land tax and other tax are raising its volume in amount and percentage. Land and other tax on 2002/03 were 5.59% and 9.49% respectively they reach 15.55% and 11.04% in F/Y 2008/09.
- J By analyzing the data of seven years from FY 2002/03 to 2008/09 the supremacy of VAT and Custom duty in the composition of indirect tax is found. In an average for the last eight years VAT posses 45.61% share followed by international trade tax or Custom constitutes 36.70%, Excise duty 17.68% and, nominal figure, others contributes nil. All the figures are in increasing trend reflecting positive sign to the country. Contribution of VAT is within the range of 40 to 50 percent. It is 50.04% in the year 2006/07, one half parts in the composition of indirect tax of the nation. It is very large contribution. The country must capitalize this with the best manner.

- J From the table and the trends above Contribution of VAT to total revenue, total tax revenue and total indirect tax revenue is prominent. This relationship clearly shows the giant role of VAT in the formation of national revenue. In average the contribution of VAT to indirect tax is 45.61%. It is about half part. For the composition of total tax revenue VAT has contributed as one third collaborator, that is 32.50 in average. And VAT stands as one fourth contributor for the composition of total national revenue as a result of the relationship of last 7 years data which is 25.76 or more than a quarter.
- J From above discourse we can conclude that VAT collected from Mechi zone is significant to total VAT. From the point of view of zonal average and weighted average it seems slightly low. It is by reason of more participation of taxpayers inside metropolitan, sub metropolitan, capital city and industrial area. Mechi zone doesn't have at least one standard out of the above condition. From taxpayers prospective the average collection of VAT from Mechi is more than its share. It is the positive outcome for the financial health of the zone.
- J In spite of possessing many beauties and advantages, VAT is running in Nepal having many problems challenges and constraints in its 11/12<sup>th</sup> year of operation. There are substantial problems that have affected its worthiness of implementation. Problem regarding invoicing, threshold, registration main among all.

#### **4.3.2 Findings from Primary Data**

From the survey with the tax experts and officials, entrepreneurs and taxpayers the following findings has been obtained:

- J The rate of VAT is found high as per the response of 60% respondents.
- J VAT is mobilizing the revenue in optimum way and functioning well so tax administrators as well as tax experts are satisfied from its performance.

- J Problems namely, non/over/under invoicing, registration, account keeping etc. are facing by the VAT.
- J From the study it has been found that the laws for the VAT are satisfactory but it must be revised to get compatibility with the pace of the innovations in the field of business.
- J It is found that single rated VAT system is good enough to adopt in Nepal rather than to adopt multi rated VAT.
- J The most specific objective of the government to lay down the VAT system is to enhance the revenue of the government and to cover transactions in tax net.
- J To make VAT system successful the steps as strengthen VAT administration, Update VAT laws regularly, Organize public awareness programmes must be proceed as per the response of the experts.
- J From this vision of the experts it can be said that tax administration must make well effort for reward, punitive, Self-assessment system to collect the VAT effectively.
- J From this survey we can conclude that perspective of business community towards VAT is still negative as they look VAT as negative impact creator.
- J From this feedback we can wrap up the issue that all of the groups, except consumer, are responsible for the tax evasion despite a little difference in weight. It must be rectified through the strong participation and commitment of all above groups.
- J From the opinions it can be understood that account checking function performed by tax personnel is high and acceptable for the consumers in Mechi zone despite few disappointment.
- J From the survey it can be concluded that VAT is superior to sales tax from its nature and beauty. And it is understood that the fact has been perceived by Nepalese business and its stakeholders too.

- J From the view of most of the entrepreneurs VAT is the one of the cause to raise the price of the goods and services.
- J Respondents are 100% agree for the significance of the collection of VAT from Mechi zone and its contribution to total VAT revenue while giving their free consents. It enlightens that the collection of VAT from Mechi zone is significant for the composition of total VAT. And also it is realized, from the opinion of experts, that VAT system is mobilizing good enough resource from Mechi zone.

## **CHAPTER - V**

### **SUMMARY CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Summary**

This study outlines the collection of Value Added Tax (VAT) from Mechi zone and its contribution to total VAT and other variables, identifies the existing problems with VAT, and makes the recommendations for the effective implementation and operation of VAT in Nepal. Secondary data have been used to analyze the VAT collected from Mechi zone with total VAT, Total indirect tax and so on.

More than hundred countries have adopted this tax system, which is considered as the most scientific taxation tool invented until the date. Most of the European countries, North and South American countries, and Asian countries have already adopted the VAT system and the African and Asian countries have shown their interest in adopting this system gradually.

VAT is levied to the amount of value added in each level of distribution and import of taxable goods and services. It is the indirect tax which is charged for the consumption of goods and services. While Self policing / catch up effect, none tax cascading, wide tax base are the beauty of VAT.

The modern taxation concept, Value Added Tax (VAT) is propounded by German industrialist Wilhelm Von Siemens in 1918. VAT system has been introduced first time in France in April, 10, 1954.

In Nepal VAT act in 1995 (2052/12/17) and VAT regulation in 1997 (2053) came in to force. In the process of adopting modern taxation system, Nepal introduced Value Added Tax (VAT) system in 16 November 1997 (2054 Marga 1), replacing Sales tax, Hotel tax, Contract tax and Entertainment tax.

Nepal has adopted Destination principal for charging the VAT. Although, there are two rates of VAT 0% and 13% but positive rate is single 13% in Nepal

Contribution of VAT in national revenue is about 28%.Contribution of VAT collected from Mechi zone to total VAT is about 5%.Contribution of VAT from Mechi zone is considered as significant by experts, and the instrument is very effective to mobilize revenue resource, while consulting with them.

From empirical survey, Service delivery by administration and Level of satisfaction of VAT registrants seems increasing despite some disappointment.

Still there are many challenges to cover all level of distribution and imports by VAT like; administrative incapability's, tendency of businessmen regarding evasion of tax, low public awareness as well as tax payers ignorance, threshold related problems, non/under invoicing etc.

## **5.2 Conclusion**

Value Added Tax (VAT) has developed as an advance form of sales tax. It has spread all over the world within a short time. The system is gaining huge popularity in the field of taxation that any taxation tool had not gained earlier in such a short period in the world.

Nepal has adopted a consumption type – invoicing method VAT based on the destination principle with a single positive rate of thirteen percent as a major part of tax reform. Despite the intensive study and various steps taken for the preparation of the implementation of VAT in Nepal, the results the result is not meeting the expectation of department. Though many achievements have been realized in the field of registration, collection, coverage, refund system, updating the laws and reducing the number of non-filer, there are still lots of challenges to be managed for the effectiveness of VAT. Conclusion of the study is presented in the following bullets;

VAT proved its superiority over previous taxes (sales tax, hotel tax, entertainment tax and contract tax) for being the best instrument to mobilize the revenue resources as it is appreciated from the study of past 6 year's performance.

The taxation system has gained more popularity in the short period of time as it is well functioning in the country and mostly fulfilling its objective by enlarging the area of VAT so as to increase revenue collection, making taxation system transparent, demoralizing the tendency of tax evasion and so on. All this is because of the advance and scientific characteristics of VAT like catch up/ self policing, no cascading etc.

Performance of tax administration is also being appreciated as high-quality than previous years as the officials use to check the books of accounts, deliver fast and fare services and in general there are no institutional corruption except the corruption made in the individual risk. One of the cause behind this positive change may be the government has made performance based incentive system for the employees of IRD.

Nepal has adopted the destination principal of VAT with single positive rate of 13%. In the destination principle goods and services are taxed where supplied for consumption. It focuses on export promotion because export is freed from tax as per the principle. The authority of Nepal has adopted this principle to enhance export so as to earn foreign exchange, reduce trade deficit and, as a whole, to make correction on the balance of payment (BOP).

Still there are many challenges in the effective implementation of VAT problem of registration, account keeping and billing, threshold related problems, unwillingness of consumers, refund related problems. These all cause are the product of administrative incapability. Administration doesn't possess the capacity to administer all exchange relationship, there is constraint

of expert manpower in adequate amount and political social constraints are also there.

VAT collected from Mechi Zone (IRO Bhadrapur) is appreciated as significant to total VAT .From the point of view of zonal average and weighted average it seems medium only. It is by reason of more participation of taxpayers inside metropolitan, sub metropolitan, capital city and industrial area. Mechi zone doesn't have at least one standard out of the above condition. From taxpayers prospective the average collection of VAT from Mechi is more than its share. It is the positive outcome for the financial health of the zone and nation as well.

According to the experts and tax official, single rated VAT is good enough than multi rated VAT. It reduces; the administrative difficulties for the government, VAT charging and computation difficulties to the businessmen and VAT paying and knowing difficulties to the consumers. Single rate also eliminates the chance of possible fraud by the businesspersons to ignorant consumers in respect of the rate of VAT.

The fixation of threshold has been a debatable issue between the taxpayer and the administrator. If the threshold is made high, many small vendors and large groups of businessmen will be out of the VAT net and it adversely affect the revenue collection but if the threshold is made low or zero, the administration feels it too hard to control the excessive loads of administrative work and believe as it also adversely affect the revenue collection. Besides that, the control of the exemptions of tax on goods and services have also been very challenging for tax administrators because of the contradictory interests of the taxpayers and the administrators in regard to exempted goods and services.

### **5.3 Recommendations**

This study discusses various features of VAT. Among them, despite of its implement nature, administrative policy, and its computation; the worrying



subject is problems in VAT. Unless the problems in VAT are addressed rationally, the potential revenue growing in the country would not match with the practical revenue collection. So these problems are needed to minimize continuously up-to its diminishing level. After that having technological assistance and logical addition in multiple components of VAT, it can really help to resource mobilization of the country by heavily generating the increased-revenue collection in the country. The major recommendations after the analysis of theoretical aspects, and practical aspects with the evaluation of several data in various economies' parameters, are as follows: These recommendations are for business communities, Tax-administrators, the common consumers, and several others who have interest in the VAT policy.

### **For Consumers**

- J Vat collected from Mechi zone is considered as significant contribution. So it is recommend that consumer must make additional enthusiastic participation in VAT paying, asking for the invoice and demoralize the illegal transactions. They must know that the benefit forgone by them by paying VAT is a share of national revenue. It reflects that they are participating for the nation building by paying tax.
- J Most of the tax payers lack the adequate knowhow of VAT and consumers are uninformed about it. For minimizing this challenge consumers can take part in awareness programs about VAT run by the IRD and it helps them to understand their rights and responsibility so that they may not be cheated.
- J Consumers are not well practiced for asking the invoices. This bad practice is hindering the revenue of the government. For minimizing this challenge it is recommended that IRD must lunch the consumer oriented programme through students of schools and college so that they can cover the actual transaction's place and time. Its impact goes to change consumer's habit of asking for the invoices. If the trades-person does not issue an invoice or asks for extra money to be paid on the purchased

items, the consumers should make written or oral complaints about it to the taxation authorities.

- J The consumers should protest and come forward to the legal authority if they find out the corruption and leakage in the taxation system.

### **For Business Community**

- J The trade-persons should issue original invoices to the consumers. Asking extra money to pay on purchased items for VAT is illegal. There is also a practice of conveying false information to the common consumer as the goods would be cheaper without paying the VAT amount and it is not necessary to pay. This is a crime. So it is recommended that the business community should stop this immediately. They must be liable with the government because the government has provided the circumstances to run the business.
- J Under Invoicing, under billing, un-invoicing, under valuation in different points of taxation, false transaction are taking place. So it is recommended to stop such activities. It is not other than the destructive path. Crime cannot be hidden. Government has formulated many teams and units including revenue investigation department under IRD, flying squad in ministry of finance (MOF) and so on to find out and penalize fraud and fault trade activities.
- J The trade-persons are recommended to register to the VAT if the transaction of the business reaches the threshold limit. They must know that they can get back the VAT paid in while purchasing goods and services if the amount exceeds VAT collection in sales. Also business person must not bear the burden of VAT. False papers to help to remain outside of the VAT net are not acceptable. The transparency in the business transaction is compulsory.
- J The business people would definitely know more than the common consumers about the corrupt tax-officials. The whole business community can commit themselves, as they would help to eradicate the corruption

related to the VAT administrations. It should be realized that though the businessmen may get few gains by the illegal ways in VAT step-door but they become an accessory to the crime. Their whole business may go into haywire if they are brought in the court of law and get punished. Thus the sincere commitment, morality and truthfulness behavior from the business community will definitely broaden the significance of VAT.

### **For Tax Administrators**

- J The tax administration must keep its superiority, improved performance and fast service delivery in the future as appreciated by stakeholders for present performance.
- J To make the market monitoring system effective, immediate legal steps must be taken against those who do not give invoices, gives fraud invoice or under-valued invoices. Using all the rights vested by the Finance Act, and the VAT act, the culprits must be penalized, their goods must be bought and auctioned or the tax liability must be established as per the law after completing the investigation process.
- J Publicity and taxpayer's education must be made more effective. A publicity campaign must be initiated to make the buyers and sellers aware of the long term benefits of billing system through public awareness, hording boards, pamphlets, student mobilization, interaction programs, by using all the materials and methods.
- J It must be made mandatory for the government and its organization to buy from sellers who have registered with VAT. Also, the concerned department must be approached to establish a code of conduct for government's employees and corporation's employees, and their close family members to demand invoice while buying personal goods in the market.
- J Conducting link audit at levels of business chain with emphasis on tax audit must get on.

- J The department should investigate the false billings through the result of income tax audits and post-auditing for customs.
- J The administration must assess complaints/dissatisfactions/undue influence/irregularities made by the officials and punishes accordingly if found guilty. Also mentality of the corruption should be eliminated by establishing good incentive system, making best and strict implementation of law and order and establishing advance information and communication technology (ICT) specially networking system for transparency and fast service delivery.
- J As the world is emerging to the technological phases, the administrators should equip themselves with the latest knowledge, skills and technology, so that the administration could be matched with the continuously growing demand.

All the suggestions for the consumers, business community and tax administration are for Mechi zone and for the whole nation as well. Diversities, living style, education level, consumption pattern and other social as well as economic variables of consumers in Mechi zones matches with the consumers of other zones. The issues related with VAT are also not different with Mechi zones to other zones and the country. Also, central agency (IRD/ ministry/ cabinet) is law maker while operational agency (IRO/LTO/custom offices etc) is actor for implementation. So the recommendations are for law making body, implementation body, tax officials, entrepreneurs, consumers and others VAT stakeholders of whole country including Mechi zone.

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

# QUESTIONNAIRE

## Questionnaire for Businessmen / Entrepreneur

Date:

**Dear Sir/Madam,**

Kindly allow me to introduce myself as a student engaged in a research work on "Collection of VAT from Mechi zone and its contribution to total VAT revenue" for the fulfillment of my dissertation paper on management for the Master's Degree in Shankar Dev Campus, Kathmandu.

I humbly request for yours valuable comments, views, suggestions and information on this issue which would prove very useful for my study. That's why I request you to fulfill the following questionnaire.

I hope for your kind cooperation and assure you that whatever information you provide me will solely be utilized in research work.

Yours faithfully

Pushpa Narayan Dahal

MBS Thesis Year

### Questionnaire

Name of Respondent: .....

Address: .....

Name of Organization: .....

1. What do you think about the rate of Vat at 13%?  
a. High                      b. Low                      c. Moderate                      d. I don't know
  
2. What is your view about billing system?  
a. Possible                      b. Impossible                      c. Costly                      d. Ridiculous
  
3. What types of impact does VAT system create on business enterprises?  
a. Positive                      b. Negative                      c. Neutral                      d. Others
  
4. In your opinion, who is the most responsible group for tax evasion?  
a. Business enterprises                      b. Tax administration  
c. Consumers                      d. All
  
5. Do tax personnel check all of the accounting statements and ledgers?  
a. Yes                      b. Yes, most of them                      c. Yes, some of them                      d. No
  
6. Is VAT superior than sales tax?  
a. Yes                      b. No                      c. I don't know.
  
7. Will price rise due to VAT system?  
a. Yes                      b. No                      c. I don't know
  
8. Has the VAT been discouraging the illegal business?  
a. Yes                      b. No                      c. I don't know

**Thank You!**



## Questionnaire for Tax Experts/Tax Officers

**Dear Sir/Madam,**

Kindly allow me to introduce myself as a student engaged in a research work on "Collection of VAT from Mechi zone and its contribution to total VAT Revenue" for the fulfillment of my dissertation paper on management for the Master's Degree in Shankar Dev Campus, Kathmandu.

I humbly request for yours valuable comments, views, suggestions and information on this issue which would prove very useful for my study. That's why I request you to fulfill the following questionnaire.

I hope for your kind cooperation and assure you that whatever information you provide me will solely be utilized in research work.

Yours Faithfully

Pushpa Narayan Dahal

MBS Thesis Year

Questionnaire

Kindly provide your,

Name: .....

Profession: .....

Organization/Employer: .....

1. Do you think VAT is the best instruments of government for mobilization of resources?
  - a. Yes
  - b. No
  - c. To some extent
  
2. Do you think VAT is well functioning in Nepal?
  - a. Yes
  - b. No
  - c. To some extent
  
3. What kinds of problems the government is facing to collect VAT?
  - a. Registration
  - b. Account keeping
  - c. Billing
  - d. All
  
4. Which one is most haunting problem on effectiveness of VAT in Nepal?
  - a. Political instability
  - b. Non/over/under billing
  - c. Administrative incapability
  - d. Unawareness of Public
  
5. Do you think that existing laws and regulation of VAT are sufficient?
  - a. Yes
  - b. No
  - c. To some extent
  - d. Must be revised
  
6. Do you think that single rated VAT is good enough than multi-rated VAT?
  - a. Yes
  - b. No
  
7. What should be the most specific objectives of VAT in Nepal?
  - a. To cover transaction in tax net
  - b. To enhance the revenue of the government
  - c. To check and balance inflation
  - d. Others
  
8. What kind of effort is most needed to make VAT effectively successful?
  - a. Strengthen and improve VAT administration
  - b. update VAT laws regularly
  - c. organize public awareness programme
  - d. All
  
9. What effort the government should make to collect VAT?

- a. Reward system
- b. Punitive system
- c. Self-assessment system
- d. All

10. Do you think VAT collect from Mechi zone is significant for the structure of total VAT ?

- a. Yes
- b. No

**Thank You!**