

CHAPTER ONE

INTRODUCTION

1.1 Background

Value Added Tax (VAT) is the most recent innovation in the field of Taxation. It is considered as one of the most powerful tool of the fiscal policy. From the long experience of VAT in several countries, many economists as well as policy makers have reached in the conclusion that VAT is probably the best in indirect tax. It has gain huge popularity within the short span of time.

VAT is as the name itself suggests, imposed on the value-added portion in different stage of sales. It is modern and scientific form of sales tax. Ultimately, the real and final burden of tax is shifted towards to the consumers who consumes goods and enjoys the services. As goods and services are shifted in the process of production and distribution, one after another stage the tax is also jointly shifted simultaneously.

Sales tax is commonly divided into three types: turnover tax, single stage tax and multiple stage tax. Turnover tax is imposed at all stages of production and distribution process. On the other hand, the stage tax is levied at only one stage of the production and distribution process. It may be imposed at either manufacturing level or at the wholesale level or at the retail level. According to the stage of its imposition it is called as manufacturing tax, wholesale tax or retail tax. Multiple taxes as a turnover is also levied at different stage of production and distribution process. VAT falls in the category of multiple stage tax. It is the good combination of turn over tax and retail level tax .It is turnover tax in the sense that it as other turnover tax is imposed at each stage in the production and distribution process. VAT ultimately differs from the turnover tax as the letter is imposed on total value while former is imposed only on

value added portion particularly at the stage. Similarly, VAT is similar to manufacturing tax, wholesale tax or retail tax in the sense that as mentioned earlier. VAT follows all the stage in the process of sales. VAT is also called as goods and service tax (GST) in some countries.

Value added Tax (VAT) is levied on the value added more than 120 developed and developing countries have introduced VAT and others are in the process of introducing it. First of all it was introduced in France in 1954 A.D. By Dr. WILHEIM VON SIEMON therefore he is called the father of VAT.

However, the concept of this tax in Nepal was introduced in early of 1990's. Nepalese government included the concept of introducing VAT in Nepal in its eight plan. Finance act 1992 and 1994 B.S. introduced two tier sales tax to make the base of implementing the VAT. VAT task force was formulated in 1993 in technical assistance of USAID which suggested the steps to be followed while implementing the VAT in Nepal.

It drafted the VAT law as well. High level tax system review task force suggested implementing VAT in Nepal in 1995 VAT related act and rules were enacted in 1996 respectively and implemented in the FY 1997 Mangsir 1, 2054 .Nepal has adopted a consumption type, destination based VAT extended right through to the retail level with tax credit method, a single positive VAT rate of 13% together with the zero rate on exports, exemption some goods and services including agricultural product and maintain threshold level of Rs. 2 million for including tax payer in the tax system. In Nepal, VAT was brought to replace sales, hotel and contract and entertainment tax, contract tax and hotel tax the government of Nepal has introduced VAT. In 1997 especially it is supplementary of sales tax or improving sales tax. The goods are passed through different channel (i.e. producers-agent-wholesale-retailer-consumers) by adding the value in each channel. In this process government charges 13% on the added value which is called value added tax (VAT). For example producers sold some

telephone sets @Rs. 500 each to the whole seller who sold it on for Rs. 800 by adding Rs. 300 extra charge and the retailer also sold that telephone set @Rs. 1000 each to the customer by adding Rs. 200 each stage that is called value added tax.

From this illustration, we find that producers pay Rs. 65 to the government. The difference excess amount between producers and whole seller is Rs. 300 than whole seller pays Rs. 39 by subtracted already paid producers Rs. 65 and like this retailer also should be paid Rs. 26 to the government.

1.2 Statement of problems

Nepal's position in the world according to GNP, in terms of per capita income is 9th from the bottom. (World Development Report 1997) it shows that Nepal still remains at one of the tenth poorest country in the world. In spite of more 4 decades of the planned development the Nepalese economy is persistently suffering from general poverty and stagnation. It has led several economic and serial disturbances in the country.

Therefore widespread poverty and illiteracy are the main causes of the effective implement action of VAT in Nepal. "VAT" regime is extremely challenging in a burgeoning economy like Nepal where with long open boarder, a large segment of the economy is to be monetized.

"While introducing a new concept and system opposition's surfaces due to apprehension because of lack of information a hence confusion and ignorance regarding its effect." After this tax was implemented due to the absence of clarity regarding the tax. It was apposed by the businessmen, professional and other sectors. FNCCI the apex tax body of the private sector, which is represented mainly by the industrialist, has been advocating the introduction of VAT with full preparation. The business community particularly importance have been very hostile to VAT from very

beginning and made strong voice against VAT some said is a regressive inflationary, it is complicated and will encourage corruption early application will bring disasters administration is inefficient many business on and tax collectors are ignorant about this Nepalese government has horridly introduced VAT without preparation and is now consulting the business community preparation are inadequate etc. various issues have resin and practical regarding VAT and its effect in Nepalese economy. "The reason for the opposition against VAT in the initial stage was not due to its weakness or any difficulty arising out of it. It was because of the years of harassment from the tax administration particularly the tax income and custom administrations and the fear that the revenue employees would make decision of their own will and collect taxes. (Dahal, 1993:75)

So, Nepalese government considered various issues which were previously raised and most of them were solved before implementation a VAT. However "Resistance from the business community, ignorance of general people and the lack of full support and commitment from politicians and government officials forced the Authority responsible for the implementation VAT to make compromise in various aspects of VAT which has weakened the process of its implementation right from the beginning.

The expensiveness of VAT implementation could be defective in Nepalese context because it requires more manpower, expensive computer difficult to work business and only total population of 40% are educated among which only 25% retailers use to keep up their amount transactions properly (The Kantipur Daily, 1997).

Due to high custom duty, administrative procedure and with the objective of evading tax, the imports under invoicing the goods and accordingly fornicates the invoices right up of the level of retail sale and this make it difficult to collect the actual tax. While several tax pays have been maintaining two set of amounts issuing two types of invoices collecting VAT from the buy but not depositing them to the treasury and collecting VAT without being registered seen as a major problem in current scenario

similarly open border with neighboring country is major problem with VAT. Due to which goods are coming through illegal means and government lose of revenue.

Another problem in the principle of VAT due to political instability and frequent changes in the government VAT could not be fully implemented. Therefore, strong political commitment with political stability is required for the effective implementation of VAT. For the limited business and employees and the influential people backing them, including politician who have been taking undue advantage from the non-transparent tax system will never appeal to them. Since those who opposed VAT took advantage of this situation it proved even more difficult.

Additional problem have emerged owing to the lack of sufficient awareness among the tax payer regarding the importance of issuing invoice and the lack of Necessary initiation and effectiveness in the tax administration in making the issuance of invoice compulsory. "The awareness amongst the Nepalese that this nation government and the people are our and therefore we need to conserve and develop is lacking: consumers to demand the invoice on the purchase and sellers to issue invoice on the sale of goods is key for the successful implementation of VAT in retail level is seen as major problem.

1.3 Objectives of the Study

The general objective of the study is to examine effectiveness of VAT in Nepal and suggest and useful alternative solution to the wide range of problems. The specific objectives.

-) To examine the historical background of VAT.
-) To evaluate effectiveness of VAT.
-) To find out the problem faced by government in effective implementation of VAT.
-) To provide suggestions for making VAT effective and efficiently in Nepal.

1.4 Signification of the Study

Though the system of VAT in existing tax system has widely been recognized and accepted, but the success or failure of this system can be gauged after getting the feedback of its implementation. Theoretical soundness will not only deserve the criteria for the success.

After a long discussion, interaction, preparation and debate VAT has finally been implemented from 1997 in Nepal. Implementation of VAT system itself will not be sufficient its performance is yet to be evaluated.

In the context of tax reform in Nepal, the adoption and implementation of VAT is a right step in the history of taxation as it checks tax evasion and avoidance, it creates board base of taxation and thereby generating more revenue. So significance of this study is to find out whether its implementation has enabled the government to achieve the above mentioned objectives or not.

Although a lot of attempts are made to focus the newly adopted tax system, but empirical study is hardly carried in Nepal. This study mainly concentrates on the analysis of its impact on different areas of so that suitable suggestions can be made for making VAT system more effective.

1.5 Methodology of this study

The data and information in this study will collected both from primary and secondary sources. Primary data will be collected through questionnaires distributed and interview. In this empirical study through questionnaire, its distributed to selected respondents will categorized in few categories. While the secondary data are taken from various books, journal, magazine, annual report, budget speech, economic survey, economic planning and various websites related to VAT. The data collected

- Chapter II Review of Literature:- Concept of Value Added Tax, Historical Background of VAT, Types of VAT, Exemption and Zero rating, Operation, Review of Related Studies
- Chapter III Research Methodology:- Types of Research, Population and Sample Source of Data Data Collection processing and analysis procedures
- Chapter IV Presentation and Analysis of Data:- Secondary data, Primary data Major Finding
- Chapter V Summary, Conclusion and Recommendations

CHAPTER TWO

REVIEW OF LITERATURE

2.1 Concept of Value Added Tax (VAT)

The major tools of internal resource of government is tax from which government can mobilize in the sector of economic and social development. Tax levied for economic development and for reducing the inequality in income distributions. A tax is compulsory levy paying or to be paid by natural or artificial person to the government. The tax payer doesn't get equality benefit from the government for the payment tax. The tax payer doesn't have any right to service the direct benefits from the tax paid. These are two types of Tax (i.e. direct and indirect tax). Value Added Tax (VAT) is a part of indirect tax.

Tax revenue may be classified as direct tax and indirect tax. Direct taxes comprise of income tax, land revenue tax, vehicle tax etc. their taxes are directly imposed on a person for an organization that bears the tax burden ultimately. The revenue generated by these taxes in Nepal is limited. Indirect taxes comprise of excise duty, custom duty, sales tax, entertainment tax, VAT etc. These taxes are shifted to other people. In a developing economy like Nepal indirect tax plays a vital role as compared to direct tax.

Hence the need to introduce a more scientific taxation tool was felt and thus VAT came in to implementation in Nepal.

Due to the limitation of direct tax and its low performance in revenue collection indirect tax has been given preference by Nepalese government. So to enhance for revenue mobilization VAT was introduced in Nepal. Income tax and custom administrations made more transparent and supportive, attracting all entrepreneurs and the business communities to come under the Network of VAT. Since the VAT

is one of the components of indirect taxes developed in past, is probably the best tax system that had never been at the top of tax system.

2.2 Historical Background of VAT

In the history of Taxation value added tax is the latest and the emerging tax. Value added approach was discussed as early in 1918. However, this tax was first recommended by William von Siemens in 1919 in Germany replaced Simens in 1919 in Germany to replaced the multi stage turnover tax in order to avoid the undesirable particularly cascading and vertical integration of the later tax. The VAT proposal was seriously considered by the then German government but as the tax was new and through to be complicated. It decided to reduce the rate of a improved from the turnover tax in the literature "The improvement consisted in the subtraction of previous outlays from taxable sales with the result that the tax base of each firm would be reduced to the value which it added to the product. (Regmi, 1906:42)

In 1921 VAT was suggested by Professor Thomas S. Adams for the United State of America. Similarly, proposals are periodically made to have the federal government to adopt a VAT either as a supplementary revenue sources or as replacement of some taxes i.e. parole or corporate income tax in America in 1953 the State of Michigan enacted a form of VAT as a compromise between groups, seeking and opposing a state corporation income tax. The firm was required to calculated Valued Added and apply the rate to this figure, rather than using the tax credit method regarding the tax as a change for privilege of business and, it was replaced by the corporate income Tax.

A mission led by Professor Coul S. Shoup proposed a value added tax for Japan and developed its broad structure. This mission suggested the Fuka Kaci Zie (VAT). For Japan in order to avoid the undesirable and unintended effects of the then Japanese enterprises and turnover taxes, the tax was considered very seriously. It was decided

by the Japanese government not to introduce it promptly, showing the cause of further study. Although, the Michigan state of USA introduced a limited feature of VAT, the tax was not introduced by any country till 1953. (Due, 1997:64)

In the real practice France lunched the value added tax. The term value added tax on its origin to France phase tax *Aur la Value Ajoutec*. The father of the modern VAT is Mc Maurice Laueer who in his capacity as an officials of French Ministry of Finance developed the French Levy. The VAT adopted in France was the result of the modification of the French production tax. The change involved two elements. (a) Extension of the tax through wholesale level (until 1968) before Jumping to retailer level. (b) Exclusion of capital equipment on a current basis instead of materials and parts alone.

Thus, the French Levy of this tax initially replaced the turnover tax, converging industrial sector and limited up to the wholesale level. Despite this pioneer work, VAT could not cross to the boundary of France Until 1959. (Sullivan, 1995:75)

The speed of introduction VAT was geared up in early sixties, while Ivory Coast Followed France by adopting it in 1960 and Senegal in 1967. The success of France Levy and the realization that the cascade type multiple stage taxes (turnover taxes) were incompatible with European Common Market Lead the Financial and Fiscal Committee of the European Economic Community to recommend in 1962 that all member countries shift to the VAT and it was approved by EC Council of Minister. They considered VAT as a standard form of sales tax. Brazil and Denmark introduced VAT in 1967 and France extended it through retail level in 1968, while Germany followed the route in the same year by adopting VAT through retail level and Luxembourg and Sweden in 1969. (Khadka, 1996)

The pace of VAT further accelerated in 1970 and after while its adoption as a requirement of member in Ec has given the great prestige and has estimated in other

countries. Rapid spread in subsequent year was primarily the product of the evils of the turnover tax, which the Ec countries previously used. Belgium and Ireland coincided in the flow of adopting VAT in 1971 and 1972 respectively Austria, Bolivia, Italy, United Kingdom and Vietnam pioneered in the move, being the First country in the Asian region and United Kingdom imposed the tax as she became a member of the Ec. Despite a stagnant in 1974, the tax remained explaining as Chile, Argentina, Costa Rice, Nicaragua and Colombia introduced VAT in 1975. Honduras Israel and Peru in 1976, and followed the line by South Korea and Panama in 1977 meanwhile, the sixth Ec VAT directive of 1977 step up a common VAT structure. (Manual, 1992)

The continuous flow of adopting VAT stopped in 1978 and 1979 and started to move slowly from 1980, while Mexico culminated it at same years and by people republic of China in 1984 while Indonesia and Turkey adopted VAT in 1985.

Table No. 2.1**Value Added Tax in the world years Countries**

S.N.	Name of country	Year
1.	France	1954 A.D.
2.	Ivory Coast	1960 A.D.
3.	Senegal	1961 A.D.
4.	Brazil & Denmark	1967 A.D.
5.	Germany	1968 A.D.
6.	Nether land & Sweden	1969 A.D.
7.	Ecuador, Luxembourg & Norway	1970 A.D.
8.	Belgium	1971 A.D.
9.	Ireland & Uruguay	1972 A.D.
10.	Australia, Bolivia, Italy, Vietnam & UK	1973 A.D.
11.	Costa Rica, Nicaragua, Chile, Argentina & Colombia	1975 A.D.
12.	Honduras, Isarel & Peru	1976 A.D.
13.	South Korea & Panama	1977 A.D.
14.	Maxico	1980 A.D.
15.	Haiti	1982 A.D.
16.	Guatemala	1983 A.D.
17.	China	1984 A.D.
18.	Indonesia & Turkey	1985 A.D.
19.	Morocco, New Zealand, Niger, Portugal, Spain & Taiwan	1986 A.D.
20.	Grenada & Greece	1987 A.D.
21.	Hungary, Philippines & Tunisia	1988 A.D.
22.	Japan and Malawi	1989 A.D.
23.	Iceland, Kenya, Pakistan, Trinidad & Tobago	1990 A.D.
24.	Bangladesh, Benin, Canada, Jamaica, Mali, South, Africa & Estonia	1991 A.D.

25.	Tajikistan, Paraguay, Belorussia, Algeria, Fiji, Thailand, Ukraine, Cyprus, El-Salvador, Moldova, Kazakhstan, Kyrgyzstan, Russia, Dominican Republic, Uzbekistan	1992 A.D.
26.	Burkina Faso, Poland, Romania, Czech Republic, Slovakia, Venezuela, Turkmenistan, Azerbaijan, Armenia Georgia	1993 A.D.
27.	Bulgaria, Finland, Lithuania, Singapore, West Samoe, Congo Niger & Madagascar	1994 A.D.
28.	Gabon, Ghana, Swaitzerland, Malta, Latvia, Liechtenstein Mauritania, Togo & Zambia	1995 A.D.
29.	Albania, Belize, Uganda & Guinea	1996 A.D.
30.	Barbados & Nepal	1997 A.D.
31.	Croatia, Surinam, Mauritius, Tanzania, French, Polynesia Vanuatu, Sri Lanka, Mongolia	1998 A.D.
32.	Solvenia, Namibia, Mozambique, Papua New Guinea	1999 A.D.
33.	Macedonia, Dominica Botswana, Rwanda, Australia	2000 A.D.
34.	India	2005 A.D.

Sources : Rup B. Khadka "Probability of VAT in Nepal"

Among the nations of SAARC region Pakistan and Bangladesh have already adopted VAT. The VAT has been considered great in India and introduction of the VAT is now figuring prominently in agenda of government, both at the center and states voices toward VAT in India are increasing day by day. However this country introduces VAT in different ways under the name of modified Value Added Tax (MODVAT) since 1986, which is designed to collect excise duty. The tax reforms committee, India headed by Professor Raja J. Chelliah has recommended a genius VAT in place of central excise which is in course of time, could be extended down to the wholesale level. The scope of MODVAT was extended 1994/95. (Bajchi, 1995)

However awareness towards VAT was created before five year in Nepal but it faced many pitfalls and facets. The Eighth plan announced to apply VAT in Nepal at the end of the plan. The budget speech of F/Y 1993/94 extended its compliments towards VAT saying that to make sales tax as a principal sources of revenue mobilization, governments attempts will be directed to change sales tax into VAT will be directed to change sales tax into VAT gradually, "A task force was set up in the sales tax and excise duty department to make necessary preparations for an early introduction of VAT. The task force prepared a draft of VAT law and made other few studies during a period of one year after political change of 1994. The ordinance budget of 1994/95 repeated its compliments to make VAT preparations complete within 1995 giving continuity in preparation. But the budget speech of 1994/95 presented by the government of CPN (UML). lengthened the move towards VAT showing the need for more study. The task force came to an automatic stop. But the government formed a task force on re-observations of the Nepalese tax system, headed by professor Dr. Madan Kumar Dahal and assisted by Dr. Rup B. Khadka. A study was conducted which reached a conclusion that "there is not any other reliable measure without changing the existing sales tax to VAT.

The budget speech of 1995/96 announced that VAT will be introduced from the next fiscal year in apparent to make sales tax opportune in Nepal. "Now the value added tax Act 1996 and value added tax rules 1997 have been approved. Ultimate Nepalese government has decided to adopt VAT from Nov. 16, 1997. Somewhat hurriedly in the light of its preparation. It is facing the transitional problem as well as Sharp opposition from the business Community. so it will be implemented from 13 February 1998 in Nepal.

2.3 Types of VAT

There are three types of VAT which are as follows:

-) The consumption type

) The income type

) The gross National product type

(VAT and its relevancy to Nepal, Ratna Pustak Bhandar 1997:1)

2.3.1 The consumption type

Under this type of VAT, no discrimination is made with respect to capital or consumable goods. Whatever is purchased for the use of business is traded at par. This implies that full credit of inputs is provided it is indeed the most superior form of VAT and is universally practiced. The tax base under this type is the total private consumption, be it durable or non-durable consumption. Consumption does not imply its true consumption but only expenditure for consumption. Since no discrimination is made, this system is neutral and does not lead to alteration or substitution between methods of production.

2.3.2 Income type

When capital goods used for method of production are not fully deductible but only a portion relevant to a particular period is allowed to deduct and the remaining portion is carried over for the next period, then it is termed as income type of VAT. Here the capital equipments are divided over a period on the basis of their useful life. Such method is called depreciation. Since the tax base equals to private personal income type of VAT. Similarly, since only a portion of capital purchases are allowed for input tax credit, this type of VAT includes two categories all purchase of capital goods as current expenditure. This type of VAT is suffered within the same difficulties as we face in calculating income for a particular period. As a result not many countries practice this type of VAT.

2.3.3 Gross product Type

Under this type of VAT, no input tax credit for capital goods used in production are allowed i.e. there is cascading effect. Corollary to this, it can be said that this type of

VAT provides incentives for labor intensive production. Here the principle of neutrality of tax is defeated. That is why, of all the types, this is the uncommon and is rarely practiced in any country, it has only academic value.

From an economic growth perspective both the income and gross product VAT has an anti-investment bias. The distinction between the purchase of capital goods and intermediate goods is not needed under consumption type VAT where as it is essential under income type and gross product type of VAT.

2.4 Method of Computation of Consumption type of VAT

The net tax base under a VAT system is the value added by the business entities. In practical sense value added is the difference between sales and purchases by business firms. The specific modalities on how the tax basis established and the liability computed will influence the administration of VAT.

There are principally three methods of calculation to ensure VAT base:-

2.4.1 Addition method:-

Under this method the tax base is obtained by adding the incomes produced by the firm, "In other towards the tax base is computed by adding the payments made by the firm to factors of the production employed in turning out the product, such as the wages, interest, rent, royalties and the profits". (Columbia University Press New York and London 1965 page 7). This method is appropriate for the income type of the VAT that includes in its base the rewards to all.

Table No. 2.2**Calculating VAT liability under Additional Method**

Stage of production and distribution					
Items	Primary Producer	Producer	Whole Seller	Retailer	Total
Wages	1200	200	400	170	1970
Rent	450	60	130	80	720
Interest	300	50	100	60	510
Profit	950	190	270	190	1600
Value Added VAT	2900	500	900	500	4800
Liability 13%	377	65	117	65	624

Additional : $T = t$ (wages + rent + interest + profit)

2.4.2 Subtract method :-

Under this method value added tax is determine as net turnover, which is obtained by subtracting the cost of the materials from the sales proceeds. Thus the VT is levied on the amount, which is derived by subtracting purchases from the sales. This method is appropriate for the consumption variant of VAT.

Table No. 2.3**Calculating VAT liability under subtraction method**

Stage of production and distribution	Net purchases price A	Sales Price B	Value Added B-A = C	VAT liability @ 13%
Primary product	-	30000	3000	390
Producer	3000	3600	600	78
Wholesaler	3600	4500	900	117
Retailer	4500	5700	600	78
Total	11100	16200	5100	663

Subtraction method $T = t$ (output - input)

2.4.3 Tax Credit Method

Credit approach is also known as the indirect subtraction technique or invoice method. Tax liability of a firm is determined based upon its sales value, after deducting its VAT paid on its purchases more obviously, to the firms total sales, without any deduction. Whatever there is applied the tax rate from which tax paid on its inputs is deducted. For this, since the tax on sale must be stated on invoices to provide documents evidence for the credit claimed by the registered buyers. More clearly, the VAT liability is calculated by deducting tax on inputs from the tax on outputs during a taxable period, under this method or net VAT liability = tax on sale - tax paid on purchases. Under this method, excess of input tax over the output tax is refundable or can be claimed as a tax credit, generally, value added tax is not to be included in the base. Calculate of VAT payable in there method may be expressed as follows. (Khadka, 1989)

Table No. 2.4

Calculation of VAT liability under Tax Credit Method

Stage of production and distribution					
Items	Primary Producer	Producer	Whole Seller	Retailer	Total
Purchase	-	3000	3600	4500	11100
Tax on purchase	-	390	468	585	1443
Sales	3000	3600	4500	5700	16200
Tax on sales	390	468	585	663	2106
Net VAT liability 13%	390	78	117	78	663

Tax credit method $T = t$ (output - input)

2.5 Exemption and Zero Rating

These are two approaches for fleeing tax on some goods and service on the ground of social welfare consideration as to reduce complexities in admonition which are exemption, zero rating method.

2.5.1 Exemption

Exemption is granted when a particular product or transaction is desired to exclude from the tax base on the grounds of administrative complexity, social welfare and equity. Certain goods, service or transactions such as products of agriculture or forestry financial services, very small vendors are exempted basically due to the administrative reason. Similarly, exemption is given to basic necessities like foodstuffs to improve equity aspect by introducing progressivity in VAT. However, exemption is not an effective measure to achieve progressivity because some of the rich may spend relatively large which some of poor may spend little on necessities depending on their habits, choices etc. In the similar manner, there are some goods and services such as goods for children, educational and medical services, cultural activities etc. Which demand exemption to encourage their production and consumption? However, exemption needs to be minimized since it creates several undesirable effects. Firstly, a VAT system with many exemptions gives an incentive to produces as well as consumers to divert their resources from taxed to tax- exempt goods and a service creates inconvenience to taxpayers. Further, firms selling both exempt and taxable goods must claim only the portion of credits that is equal to the ratio of taxable to total sales, which increases burden to taxpayer. Fourthly, tax evasion is easier under many exemptions. Lastly, it is clear that there will be loss of revenue by exemption. It is, therefore, desirable to limit exemptions only to those goods or services or transactions that are extremely difficult to bring into the tax net from the administrative point of view. (Aaron, 1981:7)

2.5.2 Zero-rating

Zero rating simply means that VAT is levied at a zero percent rate on some selected goods and services. The provision of Zero-rating in VAT is guided by the two basic purposes, to promote social welfare and to stimulate the exportable industrial products. If zero-rating is applied, credit for VAT paid on inputs can be claimed and thereby a full rebate is obtained. Thus, it is the total relief from the burden of VAT. (Ashar, 1988)

In most of the country's exports are zero-rated so that the exporter is able to get the refund of the tax paid on his purchases that he has used for producing the exportable items. As zero-rated items or transaction are within the tax net, although effectively they do not attract any VAT a purchaser will obtain a repayment of input tax borne on his purchase of goods and services, meaning that zero-rated items or transactions don't bear any tax. So it is better to choose zero-rating instead of exemption if the objective is the full exemption. A zero-related goods does not bear any tax at all while exempted goods may bear a tax element in its price. Further, differentiation between these two aspects is based on the administrative work. Business enterprises concerned with the zero-rated goods and services are the formal member like all other VAT registered members and hence they have to fulfill all the formalities associated with the VAT operation. But business enterprises having the tractions of only exempted goods and services have no concern with the VAT administration.

2.6 Operation

2.6.1 Registration

The first step in the actual operation of a VAT is the registration of firms. In this process, all the vendors having a taxable business require to register for VAT. Any business enterprises if they desire to register can register voluntarily. However, there is no compulsion to register for the small vendors who have an annual turnover below the threshold.

The registration procedure starts with a notice to the potential tax payers through extensive publicity campaign. Then registration forms are distributed so that the vendors will fill up to be a formal member of the taxpayer under the VAT system. Then the registration form is returned back to the VAT department and their coding is made. These registered taxpayers may be unknown, about VAT in details, So on informative visits need to be made and check whether the details provided by the taxpayers are correct or not. Although all the vendors having the transaction of taxable capacity may not be registered, so it is almost essential to make a door to door check, especially in developing countries. The newly hired staffs of inspectors and enforcement officers can be used for this purpose. However, vendors may desire to come to the VAT net since an unregistered vendor can neither claim back input paid on his purchases nor collect output tax on his sales and hold it until it is required to be paid to the government. Further, as the traders do not want to appear excessively small in the eyes of their customers, they may intend to register. Vendors may hesitate to register due to illiteracy in developing countries. Hence vendors can be attracted towards VAT registration by providing knowledge careful and penalty system.

2.6.2 Tax invoices

The tax invoice is crucial document for VAT as it establishes the seller's liability for tax and the purchaser's entitlement to tax credit. A VAT registrant is required to issue a tax invoice when ever a transaction takes place. In addition. It is not always desirable to require that tax invoices be issued, particularly on smaller transactions. However, it is desirable to require that invoices be issued on all sales to other registered firms, and on all sales in excess registered firms, and on all sales in excess of a certain monetary sums. In the case of the small transactions made with the unregistered purchases (i.e. consumers) it is better to use the abbreviated invoice if this facility is allowed by the VAT administration.

Tax invoices are the basis for claiming the credit of the tax on purchases. So tax invoices are needed to issue to the sales to registered taxpayer. In general, three copies of each invoice are prepared among which one is given to the purchaser. The remaining two needs to be kept by the seller himself so that he could provide one copy to the tax administration any time if demanded for the purpose of inspection and cross checking.

2.6.3 Accounting

VAT registrants are required to maintain purchase and sales book and list all sales and purchases in these books. They are also required to prepare a VAT account.

2.6.3.1 Purchase book

VAT registrants are required to maintain an account of their business purchases for VAT purpose. They have to record of purchase by invoice. At the end of each accounting period VAT registrant must total the amount of taxable purchase/imports, tax-exempt purchase/imports and the tax paid on purchase/imports.

2.6.3.2 Sales Book

Similarly, VAT registrants are requiring maintaining account of their sales for VAT purpose. Like purchase, sales also required to be recorded per invoice basis. At the end of each accounting period VAT registrants are required to total the amount of taxable (standard rated and zero rated) and tax exempt sales they have made in the period and the tax collected on sales. If they make both taxable and exempt purchases and sales they are then required to calculate the proportion of input tax they are entitled to the tax period.

2.6.4 Audit of VAT

Audit in VAT system is a selective review of the tax payer books of account and other records including year -end statements, balance-sheets and profit and loss

accounts to ensure that the major area of purchase, sales and stocks are sustainably correct and that the taxpayer has filed a perfect return. The purpose of VAT audit is to find out according to the law and regulations, the actual VAT liability of tax payers. A VAT audit, which is based on the principle of self - assessment by taxpayers, may be integrated with that of income tax or may be conducted separately. However, the integrated audit is more desirable and popular. The types of a VAT audit may be divided into field audit and office audit where the former includes advisory visits, verification of records and fraud investigation and the latter includes desk audits checking the return for arithmetical accuracy and completeness. The office audit is desirable to check each return for probable inaccuracy, as a basis for selecting accounts for audit.

2.6.5. VAT Number

VAT number is issued from Inland Revenue Office after registered in VAT. VAT number must be assigned to each tax payer for identification. After provided the number, the registration certificate is issued to all taxpayers. Each taxpayer should display his VAT registration certification at his business place in the case of all other places of business, copies of this certificate shall be displayed so that inspectors and consumers can early know whether the vendor is registered or not.

2.6.6 Tax Return and Payment.

Taxpayer must file VAT return and pay the tax within 25 days of the end of each tax period. In the case of import, VAT must be paid at the customs points together within the import duties by all sort of importers, whether registered or not. It is the liability to pay VAT by the seller or the importers, but purchasers will give to be made liable to pay VAT in such circumstances where it will be difficult or impossible to level VAT on sellers. If tax is not paid within the determined period, he will be the subject to the additional 10 percent tax as penalty.

Tax is returned when deductible tax is more than collect tax on sales. This increment tax is adjusted in the next month and so on remain increment according to sec 24 of VAT Act, 2052 and Regulation rule 39 after 6 month. It is adjusted if there is left any amount again, that amount is returned to the registered person after giving a letter of application according to sec 24 of VAT Act.

2.6.7 Penalties.

As has been mentioned above, penalties are useful measure to encourage firms to file and pay on time and hence to recoup the revenue losses due to malfunctions of tax payers. Actually, penalties are designed to punish the taxpayers who do not follow the legal provisions of the VAT system. Penalties are considered essential, as they create an incentive to taxpayers to deter evasion and not compliance, for smooth functioning and producing a full revenue potential of a VAT system. However, penalty taxes become inequitable if they are imposed heavily on some defaulters but not on others, so all defaulters should be treated equally.

2.7 Review of related studies

In the Nepalese VAT system, various studies have been done by different researcher. We find seminar, reports, articles master level thesis and Ph.D level dissertations and so on. The major studies on VAT are useful and related with this study have been reviewed in the following

2.7.1 Rup Khadka (1997)

He has given a useful concept of VAT in his book "VAT and its relevancy to Nepal". According to him, it is necessary to introduce VAT in Nepal for many reasons. Broadening the tax base, reducing the tax rate and making the tax system transparent, fairer and less distortionary have been the important features of recent tax reforms in the international arena. So VAT is only the potential option, which can fulfill the need of reforming prevailing tax system. Mainly the three reasons behind implementation

of VAT in Nepal are to broaden the tax base, to promote economic growth and to establish a fairer tax system, he observe.

Rup Khadka has highlighted the following matters regarding challenges and strategy ahead.

(A) **Administration:** VAT demands a strong tax administration as it is a broad based tax that covers a large number of goods and services at all stages of production and distribution. VAT is expected to generate about 40 percent of the total tax revenue but existing administration

(i) To create a VAT sub-group within the revenue group and recruit officials exclusively for this administration. It is also necessary to create opportunities, including overseas training for VAT officials, to make working in the department desirable.

(ii) To combine various revenue offices into one office. It would be much better to have a single revenue office dealing with all taxes in one district with adequate space, required furniture and computers in the context of modernizing the tax administration.

(iii) To provide extensive training on various aspects of VAT to both new entrants and existing VAT staffs before they are assigned particular job.

(B) **Taxpayer Education:** A comprehensive training on registration, invoicing, maintenance of accounts, submission of returns and payment of tax must be given to potential taxpayers in order to minimize their compliance costs similarly information relating to various aspects such as the date of introduction of VAT, the period within which taxpayers must register, the date of submission of returns and payment of tax, and penal provisions etc must be advertised widely through media.

(C) **Tax reform package:** It is extremely necessary to examine the potential effect of VAT together with other taxes. Including income tax and custom duty on the Nepalese economy. The total burden of tax in different sectors in the pre-VAT

regime must be calculated and a tax package must be developed in such away that the total tax burden does not increase in the post-VAT regime.

In conclusion, it is necessary to make full preparation before the introduction of VAT. The international experience also indicates that a detailed process of preparation should be a prerequisite for the introduction of a VAT. The introduction of a VAT should be considered in the light of reforms of the overall tax system and tax administration, not in isolation. The tax reform package should be designed in such a way that the competitiveness of the Nepalese economy will increase, not decrease in the post VAT regime.

2.7.2 Shoup, Carl S., (1998)

In an article on "The Value -Added Tax and Developing Countries, Carls S. Shoup points that "a VAT is a tax on the value that a business firm adds to things it buys from other firms in producing its own products. A VAT is comprehensive if it covers all economic activities from the earlier stage of farming or mining right through to the retail the speed with which the VAT has spread around the world is unmatched by that of any other tax in the modern time VAT reduces vertical integration because of its nature, which is taxed on the value added but not on turnover. VAT offers more revenue and coverage than other forms of sales taxes. It exempts exports well. Considering the problem of deducting the capital goods, consumption type of VAT is superior than other forms. In calculation tax-credit method is the universal one. In the VAT system, the tax payer's responsibility spread much better exempt's producer's goods. VAT is more revenue productive, self in forcing and it foods and basic necessities are to be zero-rated regressively may be reduced. Similarly, on the other hand, its complexity is difficult both in case of compliance and administration or collection, inflationary in nature, more problematic in developing countries and its regressively are also point out.

2.7.3 Michele Guerard (1973)

In her paper adopted from her unpublished doctoral dissertation submitted to Columbia University in 1972, describes analyses and evaluates the Brazilian VAT against the background provided with two broader issues: one as a case study of the VAT in a developing country and other as an illustration of the problem posed by inter-state tax co-ordination in special setting of a federation caused by huge regional disparities. The Brazilian States adopted a broad based single rated (i.e. 15%) VAT in 1976 in the place of existing heterogeneous taxes to secure a greater degree for tax coordination among the federal states. The VAT was based on the modified origin principle and it extended to retails level with minimum exemption. The administration of the tax did not appear burden some. Her finding is also follows.

In the first year of its introduction revenue increased by 54%, 30% of which was due to the increase in price and 17% was the real increase. The industrial sector bore a heavier tax impact then the rest of the economy in relation to its own value added because of the non deductibility of tax on inputs used by the industrial sectors from the exempt sector manufacturer accounted for 60% of estimated VAT. Generates less than one fourth of the GDP. Brazilian experiences do suggest that the VAT techniques can be applied to the condition in developing countries without any great difficulty. The administration of VAT could be expected to pose initially a non difficult problem in developing countries which previously have no experiences in operating a broad based sales tax.

2.7.4. A Study made by Nepal Chamber of Commerce (1997)

To analyze the possible effects of VAT on Nepalese Economy makes some observations. The observation are: (a) Adverse effect on price level, (b) Increase in the prices of imported goods would hit the import business and re-export of imported good leading to a decline in the revenue from import tax (c) the account keeping

requirement of the VAT would increase the tax compliance cost and cost of doing business, it would adversely affect the small traders, (d) adverse effects on domestic production due to the abolition of protection policy under VAT (e) VAT would be unjustifiable on social ground, it would aggravate the income distribution. (f) Negative effects in revenue collection and (g) Changes of failure of a VAT in Nepal are great because the present administration incapable of handing a VAT.

The study concludes that a VAT in Nepal should not be implemented in haste. A partial VAT on some commodities should be implemented on experimental basis to know its pros and cons and after that a full VAT might be considered.

Nepal chamber of commerce organized a nationwide discussion programme on VAT. According to a report of discussion programme (Nepal Chamber of Commerce, 1997) the various views express about VAT in Nepal may be summarized in the following way:

- a) Government Machine is not capable for implementing a VAT.
- b) The business community has no confidence in the administration because it has failed to implement many other taxes effectively and fulfill its own commitments even previously.
- c) VAT will hamper genuine trade and as a consequence, illegal trade will prosper. Rise in the price of domestic products will make them less competitive, import and export of imported goods will get a negative impact leading to a decline in government revenue.
- d) VAT will inhibit the growth of newly developing trade and activities in the country.
- e) The modern account keeping system is required by the VAT but difficult to keep due to the raise in the expense of the current business.
- f) There will be a sharp price rise if a VAT is introduced. Consumers will badly be affected due to the rise in price. Nepalese markets in boarder areas will dry up due to the increasing VAT.

To sum up, it is not possible to implement a VAT in Nepal and if implemented, it will have adverse effects on the role economy.

2.7.5 Krishna Prasad Sharma (1998)

In this dissertation, found the following findings.

Nepal has been undergoing through a service fiscal crisis due to limited sources of revenue and increasing government expenditure. Due to the narrow tax base, the sales tax is not productive and classic. Adoption of the full-fledged VAT replacing the sales tax would largely broaden tax base. Adoption a VAT would be helpful in removing the production distortions and other undue pressures on economic activities caused by the inherent defects of sales tax. The VAT would increase the competitiveness of Nepalese products. Lack of administrative capability is the greatest problem of implementing a VAT in Nepal under developed business structure, practices and distribution, system is the second biggest problem for the applicability of a VAT in Nepal. Due to the existence of a large proportion of small traders in trading activities unfavorable business structure and practices and weak administration, there would be anarchy in the tax system. The existence of open boarder and a large amount of unauthorized trade from India to Nepal poses a great threat to the success for a VAT in Nepal. The existing under valuation of imports in other big obstacles for implementing a VAT. A VAT is bound to have poor results than expected due to the various applicability problem.

2.7.6 Ghimire, Lalmani (1998)

In his dissertation "Value Added Tax: Key issues in Nepal" explains great importance for the effective implementation of VAT administrative capability in Nepal. Organizational structure, audit and inspecting system, reward and punishment, political intervention, selection of skilled and experienced manpower are needed to improve for effective implementation of VAT. VAT is considered as a board based

tax and potential advantages of it can be attained fully if the tax is extended through retail level. For the period of time, he suggested to improved following aspects:- (a) Administrative power and creditability (b) identification of tax payer (c) registration (d) educational programmes (e) incentives for small trades.

He also find some difficulties in implementives VAT in Nepal. These are (i) Rate structure (ii) Small trader in large proportion (iii) lack of accounting records (iv) illiteracy and high compliance cost (v) existence of open boarder. Strong administration educational programme, registration programme existence trading programme, technical data base system, combination of various, revenue offices, high level VAT implementation term, co-ordination of VAT department. Close co-operation between government and private sector etc. are essential prerequisites for the successful implementation of VAT in Nepal. Focusing on the ever increasing resource gap inefficiency in sales tax and need of revenue for handing developmental works, VAT should be implemented in Nepal.

2.7.6 Singh Amit (2007)

In his dissertation "Value Added Tax: its problem, prospects and suggestion in Nepal", considered VAT as broader based tax system. He puts the reason for the adoption of VAT as :- (a) It is based modern theory (b) It raises the revenue (c) It is more informative (d) It is free from cascading effect (e) It is based on self - assessment system. (f) It is likely to reduce tax evasion.

Prior to its implementation he advise to incorporate various suggestions. Some of them are : (a) long term policy with clear vision (b) updating taxpayer's profile (c) Transparency and uniformity in the tax rules, regulations and circulars. (d) Data based computer system must be introduced. (e) Simple book keeping system should be provided.

CHAPTER THREE

RESEARCH METHODOLOGY

This chapter is developed to the research methodology applied in the study for the achievement of desired objectives. Both primary as well s secondary sources of data are used to conduct this study. Opinions are described to know the fact of VAT. Questionnaires were distributed to the VAT Experts, VAT officers, businessman, consumers and students.

3.1 Types of Research

This study includes three types of research as descriptive, analytical as well as empirical

- a) Descriptive research includes survey and fact finding inquiries of different kinds. The major purpose of descriptive research is the description of the state of affairs, as its exists at present.
- b) In analytical research has to use facts or information already available and analyze these to make a critical evaluation of the material.
- c) The empirical research relies on observation alone often without due regards for system and theory, it is data based research coming up with conclusion, which is capable of being verified by observation.

3.2 Population and Sample

In order to benefit this study, sample size from Kathmandu is selected persons included in the sample are carefully selected by consultation with tax experts, tax officers, businessman, consumers and students. The following table shows the groups of respondents and the size of samples.

Table No. 3.1

Group of respondents and size of sample from each group.

S.N.	Respondents	Number of respondents
1	Tax Experts	15
2	Tax Officers	10
3	Businessman	10
4	Consumers	20
5	Students	15
	Total	70

3.3 Sources of Data

Both Primary as well as secondary data have been collected in order to achieve the real and factual result out of this research. All the possible and useful data as far available have been collected. The major sources of data are as follows:

(A) Primary Data

The major tools used for the collection of primary data are the administration of a questionnaire to responsive of person a set of questionnaires was developed and distributed to the selected respondents in order to obtain accurate information. The questionnaire was distributed to different groups i.e. tax experts, tax officers, businessman, consumers and students.

(B) Secondary Data

The secondary sources of data are the information serviced from books, journals, newspapers reports and dissertations etc. The major sources of secondary data from economic survey and budget speeches, ministry of finance, Tribhuvan University. Reports and records of department of taxation, ministry of finance, dissertations related to VAT available at central library, publications of VAT projects, publication of VAT department, economic review and indicators from Nepal Rastra bank, world

Development Report, published documents of Nepal Rastra Bank and National Planning Commission, Books related to VAT and websites etc.

3.4 Data Collection processing and analysis procedure

A total 70 sets of questionnaire were distributed to the selected respondents in order to get actual and accurate information distribution work is done personally rather than sending by any means to get accurate and actual information in time.

The information received from primary and secondary sources are firstly tabulated in to separate format symmetrically in order to achieve the desired objectives. After that these data are tabulated and analyzed. For the purpose of analysis generally simple statistical tools have used which are simple percentage method, ranking method, graphs, charts and diagrams.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

For analysis of primary data, which are based on the questionnaire almost 100 questionnaire were distributed. Among them only 80 questionnaire were collected. Some responses among them were not clear for the purpose of the analysis. Those questionnaires, with incomplete response, are not included in this study.

Presentation and Analysis of Secondary Data

4.1. Performance of VAT

4.1.1 Registration

Registration is the entry point of the tax system. Participant of taxpayer to the tax system can be assessed by the trend of the registration. All vendors whose taxable transaction is above the threshold are required to register for VAT. The current threshold is fixed Rs. 2 million. Those vendors whose transaction is below the threshold could also register voluntarily. The trend of VAT registrants is as follows:

Table No. 4.1
Trends of VAT registration

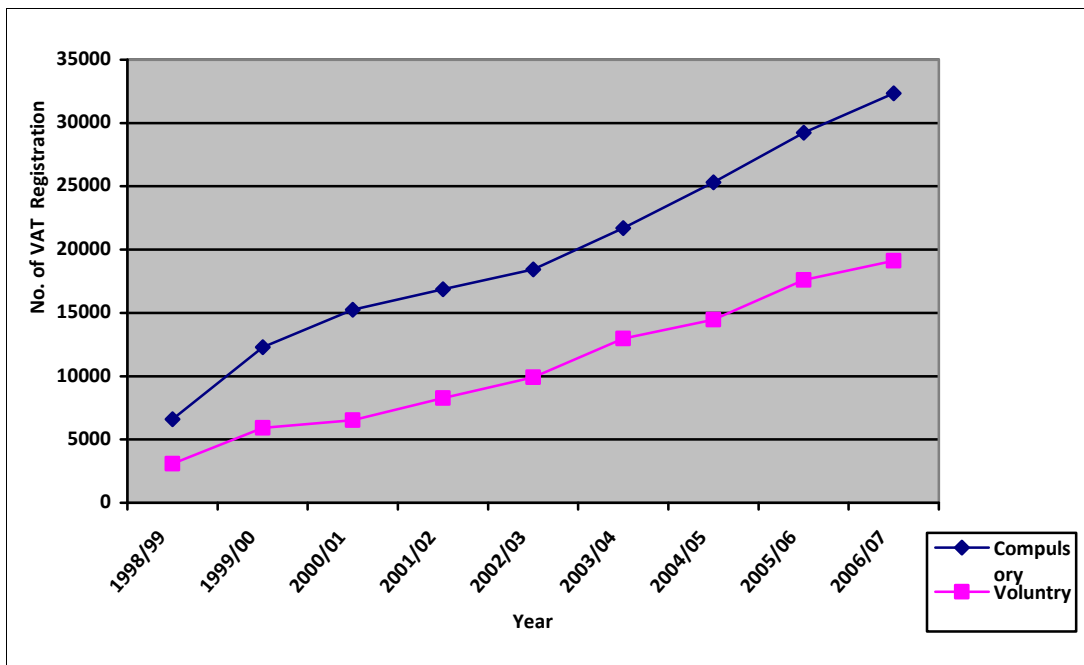
Year	Compulsory		Voluntary		Total
	No.	Increase %	No.	Increase %	
1998/99	6613	-	3079	-	9692
1999/00	12284	85.75	5920	92.27	18204
2000/01	15248	130.58	6533	112.18	21781
2001/02	16877	155.21	8272	168.65	25149
2002/03	18441	178.86	9913	221.96	28354
2003/04	21686	227.93	12979	321.53	34665
2004/05	25311	282.74	14465	369.79	39775
2005/06	29225	341.93	17606	471.80	46831
2006/07	32352	389.21	19131	521.33	51483

Source: Inland Revenue Department (IRD)

The above table shows no. of entities and organizations registered into VAT office compulsory and voluntary form FY 1998 to FY 2006/07. Both compulsory and voluntary registrants are increasing trend. To calculate increase percents are based on the fiscal year 1998/99. Increasing trend of voluntary registrants is growing rapidly to compulsory registrants. In FY 1999/00 increasing percentage of compulsory and voluntary registrants are 85.75% and 92.77% respectively. In fiscal year 2006/07 no. of compulsory and voluntary registrants are 32352 and 19131 and their increasing percent is 389.21% and 521.33% respectively.

Figure No. 4.1

Trend of VAT Registrants



4.1.2 Non-Filers

There is a legal provision in VAT law that the registrants are required to submit their tax return after 25 days of completion of tax period. It does not matter whether transaction is done or not in any tax period. It is necessary to submit the tax return within specified time. Registrant who became fall to submit their tax return are known as non-filer.

Table No. 4.2
Status of Non-Filers

Year	Total Registration	Non-Filter	Percentage
1998/99	9692	1352	13.94
1999/00	18204	2083	11.44
2000/01	21781	5402	24.80
2001/02	25149	3680	14.63
2002/03	28354	4076	14.38
2003/04	34665	5487	15.83
2004/05	39776	7022	17.65
2005/06	46831	8275	17.67
2006/07	55471	10234	18.45

Source: Inland Revenue Department (IRD)

The above table shows the status of non-filers. In fiscal year 1998/99 total no. of non-filers were 13.94 in fiscal year 200/01 no. of no filer was high percentage of total no. of registrants which was 24.80%. In fiscal year 2005/06 and 2006/07 no. of non-filers were 17.67% and 18.45% respectively. This table shows that the non-filers were increasing every year.

4.1.3 Trend of VAT collection.

VAT is a most scientific, innovation and powerful tax with the quality of universal application for both developed and developing economics. The biggest virtue of VAT is that it is revenue buoyant and highly instrumental for resource mobilization especially in an economy with actual shortage of resources. Now VAT rate increased from 10% to 13% has a fairly comprehensive base including goods and services. It is consumption based and has a reasonable threshold that renders VAT administration practicable. Nepalese VAT system has already come a long way and that it should experience further revenue productivity in the future.

In spite of preliminary resistance, VAT is currently well received by the consumers as well as businessmen and industrial communities of Nepal. For this is account based tax that lead to transparency and accountability both on the part of tax payers and tax collectors. The trend of Nepalese VAT collection was shown in the following table.

Table No. 4.3

Trend of VAT collection

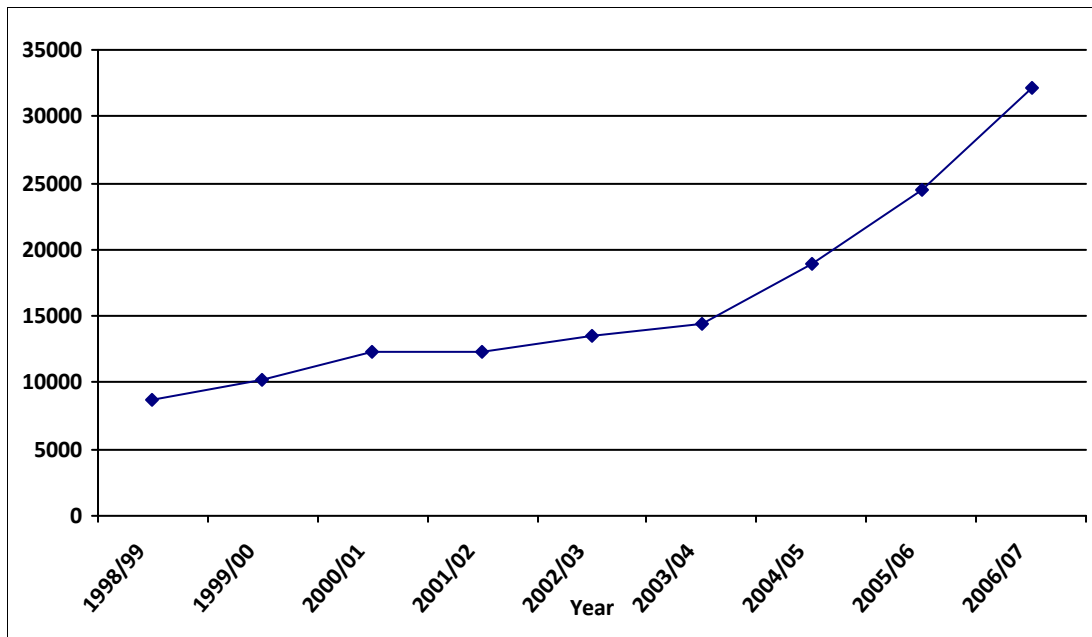
In million

Year	VAT Collection	Increasing
1998/99	8765.9	-
1999/00	10259.7	17.04
2000/01	12382.4	20.68
2001/02	12267.73	0.93
2002/03	13459.7	0.97
2003/04	14478.9	7.57
2004/05	18885.4	30.43
2005/06	24460.21	29.52
2006/07	32145.41	31.42

Source: Inland Revenue Department (IRD)

The above table shows that VAT revenue collection was an increasing trend. Besides fiscal year 2001/02, in this fiscal year, the revenue collection was decreased in comparison of the past. This decrease in percentage was -0.93%. The net VAT revenue collection in the first VAT implementation fiscal year 1998/99 was Rs. 8765.9 million. The highest increasing percentage of VAT revenue collection was in the fiscal year 2004/05 which was 30.43%. The revenue collection in the fiscal year 2006/07 was Rs. 32145.41 million and increasing percentage was 31.42%.

Figure No. 4.2
Trend of VAT Collection



4.1.4 Contribution of VAT in government revenue

The income of the government through all sources like taxes, fees, fines, donation, etc is called government revenue. Government revenue may be divided into two main headings: tax revenue and by non tax revenue. Tax revenue contributes about three quarters of total revenue while non-tax revenue respondents about one quarter of total revenue of the central level. The trend and composition of tax revenue and non-tax revenue in the recent year are given is following table.

4.1.4.1 Contribution of direct and indirect tax on total revenue

Table No. 4.4

Composition of Tax and Non-tax

Year	Total Revenue	Tax Revenue		Non-Tax Revenue	
		Rs.	% of TR	Rs.	% of TR
1998/99	37251.3	28752.9	77.19	8498.4	22.81
1999/00	42893.7	33152.1	77.29	9741.6	22.71
2000/01	48893.9	38865.1	79.49	10028.8	20.51
2001/02	50445.6	39330.6	77.97	11115.0	22.03
2002/03	56229.7	42587.0	75.74	13642.7	24.26
2003/04	62331.0	48173.0	77.28	14158.0	22.72
2004/05	70122.6	54104.6	77.16	16018.0	22.84
2005/06	77040.0	59486.0	77.21	17554.0	22.79
2006/07	80390.8	62785.2	78.10	17605.5	21.9

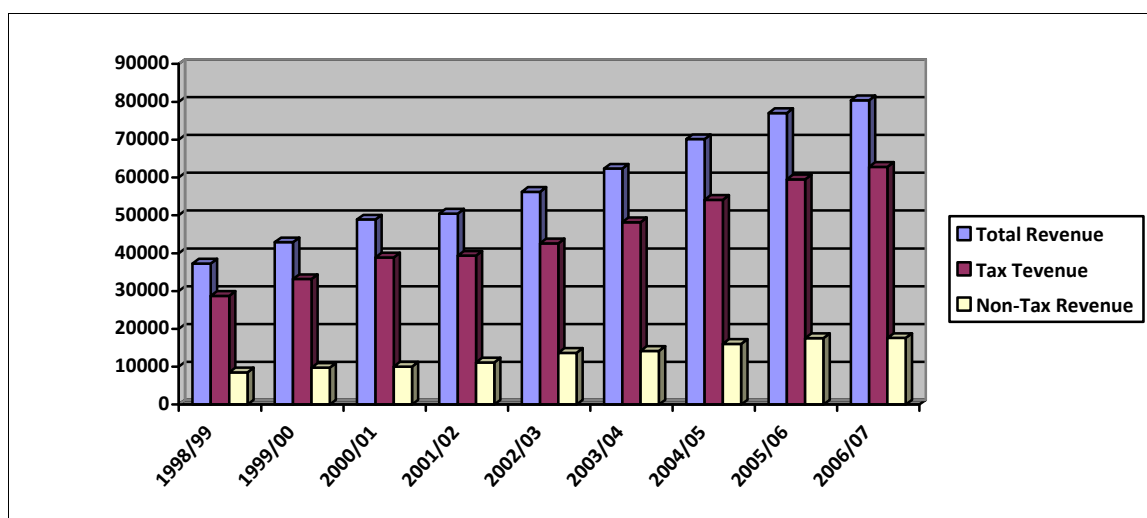
Source: Economic Survey (MOF)

The above table shows the composition of Nepal's total revenue, which constitutes tax and non-tax revenue from the fiscal year 1998 to 2006/07. The share of tax revenue has always been greater than the share of non-tax revenue. This indicates that the role of tax revenue is very much important in revenue mobilization of Nepal and to meet the increasing government expenditure.

In the Fiscal year 1998/99, the total revenue collection was Rs. 37251.3 million in which the contribution of tax and non tax revenue was 77.19 and 22.81 respectively. In the fiscal year 2006/07 the total revenue collection was Rs. 80390.8 million in which the share of tax and non tax revenue was 78.10 and which indicates that the contribution of both tax and non tax revenue total revenue seem to be growing simultaneously.

Figure 4.3

Composition of Total Revenue



4.1.4.2 Contribution of VAT in total revenue

VAT plays a vital role for revenue generation. The share of VAT in the total revenue is shown in the following table.

Table No. 4.5

Contribution of VAT in total revenue in million

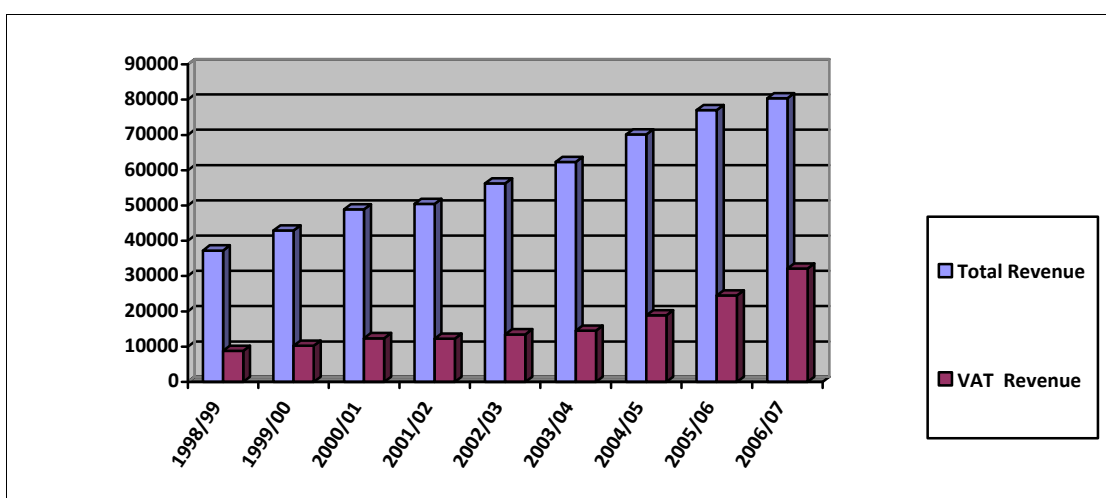
Year	Total Revenue	VAT Revenue	% of TR
1998/99	37251.3	8765.9	23.53
1999/00	42893.7	10259.7	23.91
2000/01	48893.9	12382.4	25.32
2001/02	50445.6	12267.3	24.31
2002/03	56229.7	13459.7	23.93
2003/04	62331.0	14478.9	23.22
2004/05	70122.6	18885.4	26.93
2005/06	77040.0	24460.21	31.75
2006/07	80390.8	32145.41	39.98

Source: Economic Survey (MOF)

The above table shows the contribution of VAT in total revenue. In fiscal year 1998/99 contribution of VAT in total revenue was 23.53%. In fiscal year 1999/00, 2000/01, 2001/02, 2002/03, 2003/04, 2004/05, 2005/06 and 2006/07 contribution of VAT in total revenue was 23.91, 25.32, 24.31, 23.93, 23.22, 26.93, 31.75 and 39.98 respectively. Which indicates that the contribution of VAT in total revenue seems to be growing simultaneously.

Figure No. 4.4

Contribution VAT in Total Revenue



4.2 Empirical Investigation of VAT in Nepal

4.2.1 An Empirical Investigation

There have been various empirical studies conducted before and after the VAT implementation of VAT system in Nepal. It is viewed that this system has not been implemented effectively as expected. There was a strong opposition from the business community during the earlier period of VAT implementation. In that time, there was a negotiation between private sector and government on the different aspects and provisions of VAT. After that, VAT was extended through the retail level and thus implemented in its full-fledged form. In the beginning period of VAT implementation, there was lack of skilled and trained manpower and setup properly. But currently different informative programmes, seminars and meeting were held to

make the businessmen. Consumers and people know to the VAT currently business community is also in favour of VAT and further demanding to identify and include into the tax net. In such situation an empirical study is done to know the views of person of different field on different aspects of VAT. For the purpose of survey, different questionnaire were prepared to know the opinion of the various persons of different field (i.e. tax experts, tax officers, businessman, consumer and student). The responses received from various respondents have been arranged tabulated and analyzed in order to facilitate the descriptive analysis of the study.

The questionnaires were asked either for a yes/no response or for ranking of choice according to number of alternatives, where first choice was most important and last choice was least important for analysis purpose. Choices were assigned to weights according to number of alternatives. If the number of alternatives were seven, then the first preferred choice got seven points and the last preferred choice got one point. Any alternatives, which were not ranked did not get one point. The total points available to each choice were converted into percentage in reference to the total point available for all choices. The choice with the highest of score of percentage was ranked as the most important choice and one with the lowest percentage being ranked as last choice.

4.2.2 View of Billing System

Billing System is one of the most important aspects of the VAT system. All businessmen have to receive the bill of actual transactions, while importing or buying the goods. In the bill, the price of goods with and without VAT has to be mentioned explicitly. While selling the goods purchase should compulsorily be given the same types of bill. The business has to pay the difference between tax collected in sale and paid in purchase to the VAT office. In other words, he gets back the tax paid in purchase. The profit is determined on the basis of sale and purchase bill and has to pay income tax in terms of that profit. At the same time the tax department also has to collect the tax on the basis of the very profit. Thus the billing system plays a crucial

role in the field of VAT system. Therefore, it should be compulsorily implemented, through it is one of the burning problems in Nepal, the respondents related to different fields have given their views on billing system on the basis of ten years experience in the country as well as the experience from different countries.

Table No. 4.6

View of Billing System

Respondent	Possible		Impossible		I don't know		Total
	No.	%	No.	%	No.	%	
Tax experts	15	100					15
Tax officers	10	100					10
Businessman	5	50	3	30	2	20	10
Consumer	5	25	10	50	5	25	20
Student	9	60	6	40			15
Total	44	63	19	27	7	10	70

Field Survey

From the field survey, it is found that all tax experts and officers advocate for the possible of billing system in VAT system. 50% businessman claimed that billing system is possible at the same time 30% argue that it is impossible and 20% are unknown about it. 25% consumers says that there is possibility, 50% say impossible and 25% say I don't know. Similarly 60% students says possible and 40% says impossible about it.

4.2.3 Demanding of VAT bill

As while introducing VAT there is fear amount the consumer and organization that it will raise the price of goods and services. So consumer, businessman and organization always make excuses to demand bill due to lack of education that VAT bill doesnot allow the increment of price. Government has provided limitations for payment of VAT but consumer always went to stay below the level to escape from the VAT. This

trend seems in the context of Nepal. It is necessary to key the revenue of the nation transparent.

Table No. 4.7

Percentage of Customers Demanding VAT bill

Respondent	Around 10%		Upto 20%		20 to 60%		Above 60%		Total
	No.	%	No.	%	No.	%	No.	%	
Tax experts	12	80	3	20					15
Tax officers	10	100							10
Businessman	6	60	4	40					10
Consumer	12	60	8	40					20
Student	8	53	7	47					15
Total	48	69	22	31					70

Field Survey

According to the VAT bill demanding by consumer is it too low in practice. Out of 70 respondents 69% agreed around 10% consumer demand VAT bill where as 31% respondent around 20% ask for VAT bill. They also mention that the governmental and other clients, which is forced to need VAT bills by their rules and regulation only demand VAT bills.

4.2.4 Problems in the process of VAT implementation.

The tax payer and the tax collectors both have to be well known and conscious about the record keeping and process of VAT system. Through 10 years have been already passed, but still it has a great challenge in this aspect. The respondents were asked for their views to explore the problems that implementation aspect is facing. The study shows registration collection, tax refund are main problems for the implementation.

Table No. 4.8**View on Problem in the process of VAT**

Respondent	Registration		Collection		Tax refund		I don't know		Total
	No.	%	No.	%	No.	%	No.	%	
Tax experts	9	60	3	20	3	20			15
Tax officers	4	40	4	40	2	20			10
Businessman	2	20	3	30	5	50			10
Consumer	6	30	4	20	8	40	2	10	20
Student	5	33.33	6	40	3	20	1	6.67	15
Total	26	37	20	29	21	30	3	4	70

Field Survey

60% tax experts, 40% tax officer, 20% businessman, 30% consumer and 33.33% student agreed around 37% in total showed registration as the problem while for 20% tax expert, 40% tax officer, 30% businessman, 20% consumers and 40% students in total 29 collections in problem. Similarly for 20% tax expert and tax officers, 50% businessman, 40% consumer and 20% students in total 30% refund in problem. 10% consumers and 6.67 students unknown about it.

4.2.5 Major weakness of VAT implementation

The VAT should be introduced after a considerable level of the preparation creating infrastructure organizing a proper and the efficient administration and providing minimum required level of taxpayer education in Nepal. If the VAT is implemented hurriedly on presumptive basis without making the full presumptive basis without making the full and adequate preparation the VAT system could be distractive and counter productive in least developed country like Nepal.

In order to know the major weakness of VAT implementation, respondents were requested to rank their responses on the given choice. the question was "What are the major weakness of VAT implementation?"

Table No. 4.9

Major Weakness of VAT implementation

S.N.	Weakness of VAT	No. of Respondents	%	Rank
a.	Costly system in management	18	26%	2
b.	lack of consciousness of tax payers	20	29%	1
c.	Administration corruption	10	14%	4
d.	Government has do proper home work	15	21%	3
e.	Lack of canalized impact export system	7	10%	5

Field Survey

The major weakness of VAT implementation ranked in the order of preference of the respondents are as follows.

1. Lack of consciousness of tax payers.
2. Costly system in management
3. Government has to do proper home work.
4. Administration corruption
5. Lack of canalized import export system.

4.2.6 Responsible for Tax Evasion in Nepal

Any tax system may not provide the expected yield when there exist tax evading loopholes. Evasion of tax not only loses the revenue but also creates economic distortions, market imperfect etc. However tax evading practice is a general phenomena on in any country and it cannot be solved perfectly but it must be minimize as far as possible. Generally business enterprises may not take responsibility for tax evasion but it is not true in all the cases and time. There are other group such as consumers, tax administration who may be supporting, helping or encouraging business enterprises for tax evasion, for their direct or indirect benefit and thus may be more responsible for tax evasion. The opinion survey was conducted to provide the views on most responsible group for tax evasion among business enterprises, consumers, administration or all and the outcomes is presented in table below.

Table No. 4.10
Responsible for Tax Evasion

Respondent	Business Enterprises		Tax Administration		Consumers		All		Total
	No.	%	No.	%	No.	%	No.	%	
Tax experts	15	100							15
Tax officers	3	30	2	20	5	50			10
Businessman	2	20	5	50			3	30	10
Consumer	7	35	4	20	3	15	6	30	20
Student	7	47	2	13	6	15			15
Total	34	49	13	18	14	20	9	13	70

Field Survey

From the above outcomes 100% tax experts 30% tax officers, 20% businessmen, 35% consumers and 47% students supported that the most responsible group for tax evasion is business enterprises. Similarly 20% tax officers, 50% businessman, 20%

consumers and 13% students viewed due to tax administration. Likewise 50% tax officers 15% consumers and students claims that consumers is responsible for tax evasion. 30% business and consumers greed due to all the responsible group. Out of total respondents 49% opinioned due to business enterprises, followed by 18% tax administration 20% consumers and 13% by all groups.

4.2.7 Most important factor for Effectiveness of VAT

Although it has been ten years from the implementation of VAT. However it has not yet secured the expected results. There are many problems existing in the implementation of VAT. It is necessary to identify the existing problems and solve them successively to make the VAT more successfully. Hence, there are so many factors for the effectiveness of VAT. These are proper implementation, broad coverage, tax education, effective and efficient administration and clear VAT laws and regulation. In order to know the most important factor for effectiveness of VAT in Nepal respondents were ranked their responses on the given choice. The questions was "what is the most important factor for effective of VAT in revenue collection. The opinion survey on this context is summarized in the table.

Table No. 4.11

Important factor for effectiveness of VAT in Revenue Collection

S.N.	Factor	No. of respondents	%	Rank
a	Proper implementation	13	19	3
b	Broad coverage	6	9	5
c	Tax education	20	29	1
d	Effective and efficient administration	12	17	4
e	Clear VAT laws and regulation	15	21	2
f	If other	4	5	6

Field Survey

The important factor for effectiveness of VAT ranked in the order of preference of the respondents are as follows.

1. Tax education
2. Clear VAT laws and regulations
3. Proper implementation
4. Effective and efficient administration
5. Broad coverage
6. Other specify

Other important factors for effectiveness of VAT specified by some of the respondents are as follows:

- a) most professional people are required in tax department as well as in tax offices.
- b) Reduction in the discretionary power of tax officers.

It can be conclude that clear rules and regulations and tax education to the public are the most important factors for the effectiveness of VAT in revenue collection.

4.2.8 Major problem of VAT in Nepal

The questions of problem of VAT in Nepal were asked and given to rank from 1 to 10. The response has been received out of 70 respondents. The outcomes of the field survey in this aspect is given below.

Table No. 4.12**View on problem of VAT in Nepal**

S.N.	Problem of VAT	No. of respondents	%	Rank
a	Problem on billing system	10	14	2
b	Problem on open boarder with India	3	4	9
c	Problem on tax refund	6	9	6
d	Weak and traditional economic policy	5	7	7
e	Weakness in government economic policy	4	6	8
f	lack of awareness in public	15	21	1
g	Shortage of taxpayer participation	8	11	4
h	Lack of mutual understanding between taxpayer and tax administration	7	10	5
i	Lack of Launching enough special programmes	9	13	3
j	Difficult account system	3	4	10

Field Survey

The major problems of VAT in Nepal ranked in the order of preference of the respondents are as follows.

1. Lack of awareness in public
2. Problem on billing system
3. Lack of Launching enough special programmes
4. Shortage of taxpayer participation

5. Lack of mutual understanding between taxpayer and tax administration.
6. Problem on tax refund.
7. Weak and traditional economic policy
8. Weakness in government economic policy
9. Problem on open boarder with India.
10. Difficult account system.

4.2.9 View on Rising in price due to VAT system.

In the beginning years, there was a beter protest against the VAT system. One of the reasons was that the businessmen thought that there would be rise in price in goods and services because of VAT. In recent years the consumers have complained that the businessmen charge more prices without following the act of VAT. here an endeavor has been made to get the information from the respondents to fidns out whether there will be raise in price due to VAT system.

Table No. 4.13

View on rising in price due to VAT system

Respondent	Yes		No		I don't know		Total
	No.	%	No.	%	No.	%	
Tax experts	6	40	9	60			15
Tax officers	5	50	5	50			10
Businessman	6	60	3	30	1	10	10
Consumer	12	60	5	25	3	15	20
Student	6	40	5	33.33	4	26.67	15
Total	35	50	27	39	8	11	70

Field Survey

The study shows 40% tax experts, 50% tax officers, 60% businessmen, 60% consumers and 40% students claiming that there is a raise in price because of VAT

system. While 60% tax experts, 50% tax officers, 30% businessmen, 25% consumers and around 33% students says that there is no raise in price similarly 10% businessmen, 15% consumers and around 27% students unknown about it.

4.2.10 Views of single VAT rate:

because of multiple rates, tax reform become much more complicated to both tax payer and tax officers. Despite this reasons different countries already implemented various tax rate according to their economic condition but all tax administrators prefer to use single rate of VAT to effective implementation. Likewise, Nepal has preferred a single VAT rate be effective or not. The outcomes is presented in the table below.

Table No. 4.14

View of Single VAT Rate

Respondent	Effective		No Effective		I don't know		Total
	No.	%	No.	%	No.	%	
Tax experts	12	80	3	20			15
Tax officers	6	60	4	40			10
Businessman	5	50	3	30	2	20	10
Consumer	6	30	12	60	2	10	20
Student	4	26.67	6	40	5	33.33	15
Total	33	47	28	40	9	13	70

Field Survey

According to the survey 47 % of the total respondents were concluded that the single VAT rate is effective. In contrast 40% of total respondents disagree with current single VAT rate. Remaining 13% of of Total respondents seemed to be unknown about it.

4.2.11 Effective of VAT in future

According to the internal experience VAT is effective to the revenue mobilization and strong tax administration. However, it can't be said properly that it is advantageous and effective in future until effective implementation. In Nepalese context the smuggling trade level is at peak point tax leakage is at higher magnitude, the revenue collection is at the lower level, the effectiveness and administrations is weak so without proper implementation there is big doubt whether VAT will be effective in future or not. The views of various respondents on this aspect is presented in the table below.

Table No. 4.15
Effectiveness of VAT in Future

Respondent	Yes		No		Total
	No.	%	No.	%	
Tax experts	15	100			15
Tax officers	10	100			10
Businessman	6	60	4	40	10
Consumer	6	30	14	70	20
Student	9	60	6	40	15
Total	46	66	24	34	70

Field Survey

According to the field survey 66% of the total respondents were totally optimistic that VAT will be effective in future but 34% of total respondents were pessimistic that VAT will be effective in future.

4.2.12 Knowledge about VAT

The questions was "From which media you know about VAT" the opinion survey on this context is summarized in the table.

Table No. 4.16
Knowledge about VAT

Respondents	Radio/FM		TV		Hording Board		Pamphlets		Daily Newspaper		Total
	No.	%	No.	%	No.	%	No.	%	No.	%	
Tax experts	4	26.67	5	33.33					6	40	15
Tax officers	3	30	2	20					5	50	10
Businessman	2	20	3	30	1	15	1	10	3	30	10
Consumers	8	40	6	30	1	5	2	10	3	15	20
Student	4	26.67	3	20	1	6.67	1	6.67	6	40	15
Total	21	30	19	27	3	4	4	6	23	33	70

Field Survey

According to the survey 30% of the total respondents were known about it from Radio/FM. Similarly 27%, 4%, 6% and 33% of the total respondents get idea about VAT from TV, Hording Board, Pamphlets and Daily Newspapers respectively.

4.3 Problem faced by the government in effective implementation of VAT

Theoretically, VAT is considered to the best fiscal tool through partially, it has many problems. VAT system entered in the both year of its implementation in Nepal but implementation of VAT is not proceeding a desired pace. It is facing many problems and challenging in effective implementation. In spite of the most popular fiscal tool, Nepal is still facing number of challenges poor administration, political instability, mal practices, corruption etc. These existing challenges in the implementation of VAT in Nepal are explained below.

(A) Problem of political instability:-

The government of Nepal has been facing the problem of political instability since the introduction of VAT in this country. Changing of government frequently creates many problems on VAT collection as well. Because different government have different attitudes and their own views that direct affect VAT collection, regulation and implementation.(The Kathmandu Post, 2002)

(B) Problem of non-cooperation between the government and private sector.

Government policies in Nepal are often formed and implemented without a due consideration and preparation with regard to VAT the government never taxes the private sector into confidence. Private sector is not much involved in designing the VAT structure rules, regulation and solving the wide range of issue on one hand, the private sector is actively opposing the implementation of VAT, at least at present on the other hand, the government is firm to implement the new tax such a divergence would lead to many undesirable consequences which would make the VAT and successful.

The VAT structure, rules and regulation formed without consulting and discussing with the private sector are likely to become unpractical and non-operational. International experience also shows that the VAT is less likely to be effective or successful where the private sector does not fully co-operate the government. (Crow, 1993)

(C) Public Consciousness level:

Public consciousness is a basic element that should be at higher level in the people so that the government policy and programme can be guided at the right direction for achieving objectives of any government policies and programmes. In the context of Nepal it has a poor public consciousness level relating to VAT, the business community has been misinterpreting and also misguiding VAT to the people by saying that VAT certainly raises the price level of goods. But there is no voice against

such misguidance and mis-interpretation. The consumers, who are really interested to make the VAT effectively successful, want to get VAT bills on their purchases but they are not getting such bill from business community. Most of the consumers do not demand VAT bills when they are asked by the businessman to pay a 10% more amount to get VAT bill. But they don't know the fact that businessmen are covering the VAT amount into the price of the product indirectly. Thus by non-issuing proper bills, businessmen are cheating revenue to the government as they are collecting VAT amount from consumers indirectly.(Neupane, 2004) So far as the consumers remain unfamiliar with the different theoretical aspect and existing rules and regulations of the VAT, the problem will remain is existence. Thus very weak public consciousness level about VAT is being one of most significant problem for the proper implementation of Nepalese VAT system.

(D) Geographical barriers:-

Geographical situation of our country has created an important issue about the applicability of VAT in Nepal. The land distribution seen to be extremely unequal. Such geographical condition has arisen several problems in the path of application of VAT in Nepal. In the remote areas where the people must bear the burden of higher prices of commodities due to service rendered by porters, animals and air transport. Because of these, the burden of VAT is higher in the remote areas than in other accessible areas which is clearly inequitable and unjustifiable. So the higher price level of commodities discourage completely the VAT. In spite of that, there are small scale business activities in the remote areas. The revenue collection in such areas would be negligible amount as compared to collection cost. Therefore, the high collection cost does not permit VAT to be the applicable in some of the districts in Nepal. Similarly controlling and mentoring system of VAT in far and remote areas is not easy due to the lack of transport, communication etc. It is difficult to control the many functions of VAT like inspection, audit, tax refund, penalty, appeals in the remote areas due to the lack of adequate tax officers.

(E) Tax Evasion:-

The large amount of illegal trade and other established tax evading practices pose a great challenge to a VAT in Nepal. Most of the tax evasion occurs at the import level. The existence of long open boarder, weak and easily corruptible tax administration are the major factors. Facilitating tax Evasion. There are several possible wasys and forms of tax evasions in VAT in Nepal. These are:

- (a) Non registration
- (b) Seller don't report their sale to the tax authority.
- (c) Un-recorded trade
- (d) Dummy business
- (e) Smuggled goods supply by the channel of exempted business.

(F) Narrow Tax Base

The base of VAT in narrow, both legally and administratively. For example several sources of income including agriculture, expert, capital gains, dividends, fringe benefit etc. Still have deliberately been kept out of VAT net. Sector, long cuts the tax base by almost 40% of GDP. An attempt was made to limit the number of exemptions under VAT until the introduction of VAT but the number of exemption increased substantially after the implementation of VAT. Many exemptions, deductions and rebate are granted under the industrial enterprise Act. Similarly, large number of exemptions are granted under the customs duties. Similarly, high exemptions are granted under the house and land tax. Excise duties currently levied only on domestic products, keeping imports only on domestic products, keeping imports outside the excise net. Almost 70% of the economic activities that account for GDP are virtually out of the tax net. Economic activities brought under tax, tax net also not tapped effectively due mainly to the lack of strong political commitment and weak tax administration. This has been reflected in the low number of tax payers and low revenue collection.

(G) Problem of Registration

Some businessmen, especially small traders, who are liable to register, may not register themselves as tax payers. It is administratively very difficult to discover all the legal tax payers under the VAT system because of the threshold limit. Tax evaders may take a good advantage of this difficulty. Further non-compliance of the tax from the registered taxpayers may also occur due to administrative weaknesses. (Adhikari, 2005)

(H) Weak Tax Administration

An effective and efficient administration is crucial for the proper implementation of VAT but in Nepal. VAT administration is still in traditional nature and corruption is being a major problem. Transparency is being only a nice slogan but lacking in real field. Tax officials are not given specialized training on various aspects of taxation. Some of the tax officers are still not familiar with the basic and essential concepts of VAT and even new entrance to the tax administration are directly posted to field officers without being given and basic training for their jobs. There is lack of adequate auditors, treaty negotiators and trained personnel on various aspects of taxation. there is also no system of performance based evaluation of the tax official for promotion to higher levels. Due to the weak tax administration, there is a big gap between legal system and its actual operation. Besides that administrative inefficiency is another most serious problems for implementing VAT. For effective implementation, qualified, intelligent, well-trained manpower are necessary even from the traditional period and system has not been still improved. Also there is not motivation for consumers to get bills on their purchases.

Under the VAT system whenever invoice is not issued corresponding to each sales, a part of revenue is lost to the government. Each invoice issued by a VAT registrant is just like a NRB cheque to the government. In current status of Nepalese economy either bills are not issued or they are not properly issued once the invoices are not issued properly in the initial stage, it encourages issuing invoices accordingly in the

successive stages of production and distribution. So that a significantly high volume of revenue is lost to the government. Thus, smuggling and under valuation that takes place in the earlier stages encourages the traders of successive stage to issue face invoices and thus both the problems are highly interrelated.

(K) Smuggling, Under Valuation and Unauthorized trade

Nepal has long border with both neighboring countries India and China. However the border with China is not being a serious problem due to the geographical inconveniences caused by mountain area. There is no easy way to pass through the Chinese border and hence level of illegal trade is negligible. But the open border with India is being most challenging issue and problem is still alarming. People of the India and Nepal may easily enter one another's country and buy goods not paying customs duties for personal use. However, major problem is due to the large volume of smuggling and under valuation transaction by business enterprises, rather than consumers. Once the goods are entered into the country by an undervalued billing, VAT revenue along with customs duties is lost and that can't be catch up in successive stage of distribution. Similarly the goods, which are entered through the illegal route, remain completely beyond the VAT net. Thus volume of smuggling and under valuation while importing goods from India. Besides that, there is not any measurement of unauthorized trade between Nepal and India. Many businessmen have claimed that only a little amount of goods from India come through customs. So it seems, unauthorized trade is very much organized and systematic in the border area. (Sharma, 1998:94)

(L) Fine, Penalties and Prosecution.

For any non compliance, penal provision has been made in the section 29 of the VAT act. Penalty may be imposed in the following circumstances.

- (a) In case of non-registration with VAT offices Rs. 10000 and the due tax amount for each tax period.

- (b) In case of failure to issue invoice or invoice not being in the prescribed format Rs. 2000 and the amount of tax collection.
- (c) In case the registered tax payers do not use the registration number in all the transaction related to VAT does not display the registration certificate Rs. 1000.
- (d) In case of collecting VAT without registration in VAT, amount of tax and 100 percent of such amount.
- (e) In case of not maintaining accounts as prescribed by act Rs. 10000 and now allowing tax officer for verification of accounts and other documents Rs. 500 for each default.
- (f) In case not mentioning date and price of transaction, VAT number of parties and other matters as prescribed Rs. 5000.
- (g) In case of Failure to submit prescribed format the statement of tax amount to be paid within 25 days after expire of the months irrespective of volume at transaction or nil transaction 0.05 percent per day or Rs. 1000 wherever is more.
- (h) In case of under invoicing, Rs. 2000 for each invoice or double at tax amount penalties whichever is more as per Finance Act, 2001.

4.4 The major findings

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

- a) VAT is an advance form of sales tax. it has been spread all over the world within a short span of time. It has gain huge popularity that any tax had gained earlier in the history of taxation in such a short period.
- b) From the study, it is found that, there are lots of the traders, businessmen and general public do not have any clear idea about VAT and its aspects. They have been facing many problems such as pricing problems, main training

account problem and more over billing problem. Businessmen and traders are not encouraged by the government and tax administration.

- c) Non-registration of business is no problematic most businessmen above the threshold level have now registered. The implementation of problem of registration, collection, tax refund and miscellaneous.
- d) There has been a notable increase in the number of registration. During the year 1999/00 the total number of registrants was 18204 while in the fiscal year the total number of registrants was 51483. Similarly the revenue is Rs. 8765.9 million and 32145.41 respectively in the year 1998/99 and 2006/07.
- e) 66% of the total respondents were totally optimistic that VAT will be effective in future but 34% of total respondents were pessimistic that VAT will be effective in future.
- f) 50% of the total respondents reached to conclusion that VAT will rise price of the commodities but 39% claimed not rise in price due to VAT system.
- g) 47% of the total respondent argued that current VAT rate is effective and 40% claimed that it has to be improved.
- h) Through ten years have been already passed but record keeping and process of VAT system has still a great challenges and problems for taxpayer. Most of the tax payers are unknown about the record keeping and process of VAT system. About 37% respondents provided their views on registration difficulty, 29% on collection process and 30% opinioned on problem of tax refund system.
- i) Out of total 49% respondents supported that the most responsible group for tax evasion is business enterprises, 18% respondents viewed due to tax administration and 20% respondents claims that consumers is responsible for tax evasion.
- j) Billing system is one of the major aspect of the effective implement of VAT but businessmen hardly issue bill to consumers, consumers too are not much interested in taking bills due to miss-concept of increase in the price of goods such practice has discouraged the consumers to demand VAT bill and is the

root cause of the failure of the billing system. 63% respondents claimed it is possible and 27% respondents claimed it is not possible in VAT system.

- k) Most of the taxpayers are not conscious about VAT system. Taxpayers are still unknown about its threshold, exemption, zero rating and related issues, which is essential criteria for VAT registration. It proves that government has no proper homework before its implementation.
- l) Smuggling business activities are increasing due to weak administration proper operation/ implementation. It is expected that VAT system help the government to control over these illegal activities.
- m) In the implementation of VAT in Nepal many problems arise which are as challenges in application of VAT. Narrow tax base, weak public conscious level, improved tax administration, political instability, geographical barriers, open boarder and unauthorized trade exist as problems in the implementation of VAT in Nepal.

CHAPTER FIVE

SUMMARY CONCLUSION AND RECOMMENDATION

5.1 Summary and Conclusion

The major tools of internal resources of government are tax form which government can mobilize the sector of economic and social development. Value Added Tax is a kind of direct or another. Form of Sales tax, which is the most recent innovation in the field of taxation. In recent decades, implementation of VAT has gained more popularity among the developing countries all over the world. Taxation has played an important role in the economic development of each country. VAT is a form of indirect taxation which is levied on the value added goods and services. VAT is imposed on each stage like import; production, whole sale distribution and on the retailer.

After the successful implementation of VAT in some developing countries, Nepal has adopted VAT by replacing sales tax since introduction of VAT is to avoid the demerits because of multi point level of sales tax. There are three types of the VAT like consumption type, income type, gross national type and methods of consumption. To adjust international trade VAT uses original or the destination principle. Theoretically VAT is natural among the methods of the production and the distribution as well as the consumer's choice. 'Thus' it does not distort the economic efficient.

Nepal follows the destination principles and consumption type of VAT. Which encourage the investment in the country as capital goods and exempted from the tax base in this type. The prevailing current rate of VAT is 13% and the registration threshold is Rs. 2 million. But at the time of introduction of VAT the rate was 10%.

As the VAT is collected wisely, it does not encourage evasion. The tax liability can't be reduced by changing the method of production and distribution. That is why VAT is considered neutral. By using the tax credit method of VAT "the capsizing/pyramiding effects" of turnover tax is fully avoided. VAT can also reduce capital goods exports from the tax base and excessive burden of goods. In the ten years period VAT has played a main role in the collection of revenue and has become the best alternative to sales tax and other forms, from the administrative point of view.

Trend of registration and revenue generation shown in table reveal VAT revenue in past years. It shows collection of revenue as 8765.9, 10259.7, 12382.4, 12267.3, 13459.9, 14478.9, 18885.4, 24460.21 and 32145.41 million in the year 1998/99, 1999/00, 2000/01, 2001/02, 2002/03, 2003/04, 2004/05, 2005/06 and 2006/07. It is seen that revenue is regularly increasing in the every year more than 45% of total internal revenue collection is contributed by VAT. It is necessary to issue the invoice at the time of sale under VAT system, maintaining purchase and sale book and submission of the statement of returns within 25 days of each month. In case of retail sales, VAT system also allows an abbreviated invoice upto Rs. 5000. The taxpayer has to assess the amount of VAT to be paid during month and should file the statement taxpayers may be fined if they fail to file the return within specified time.

The various effects on the Nepalese economy are considered here largely anticipatory in the nature. A general consideration or forecast is made by using whatever evidences are available at the present. It is tried to show what is likely to happen and what the trend of the effects would be in different areas. Qualification of such effect is generally much more difficult. Effectiveness of the VAT on the pricing level, revenue, compliance cost, announcement, supply, investment and the production, competition trend of the Nepalese products, business and the rate activities, import and the export, sales tax, collection of revenue, corruption, illegal trade and the tax evasion are considered broadly.

VAT is levied upto the retail level where as sales tax is on the sale of factory door or import point it means that it has wide range of revenue generation. VAT is self-enforcing in nature similarly; sale tax encourages artificial functions like advertising, packaging etc and induces producers to disintegrate business. Thus due to the wide range of revenue collection, transparency in the account and neutrality VAT is considered superior to the sales tax and other forms of tax.

5.2 Recommendation

- (a) Tax related information should be published regularly through journals, magazines. Newspapers, pamphlets, radios, television and cinema, interview programs with professors' researcher, tax experts economists. It should be conducted and published through media. Similarly, the students at school as well as campus level should be given the knowledge about VAT. The school as well as campus level curriculum should include tax education and social obligation of paying tax.
- (b) VAT laws should be effectively implemented. Timely revision should be made on unpractical acts, rules and regulation on the basis of experience gained.
- (c) The existing long open boarder is the main cause of smuggling trade under evaluation system. So border should be effectively controlled to prevent the illegal trade. There should be a effective checking system to prevent any kind of illegal trade in border side.
- (d) The billing should be made compulsory in business system should be developed in VAT system. The use of cash machines should be encouraged in the shops and departmental stores.
- (e) Monitoring system of the VAT administration is not so effective. Because of this, taxpayers are still encouraged for tax evading practices. Many businessmen don't issue invoice for their selling and even do, follow the other improper invoices. So, an effective and efficient auditing investigation and monitoring system should be developed.

- (f) Strong political commitment is necessary for modernization and effective implementation of the VAT system.
- (g) Separate VAT department should be established so that the specialization should be achieved in the matter of VAT and the burden of tax official could be reduced.
- (h) There should be a close co-operation between the private sector and government sector for the successful implementation of VAT. But in practice, there is a crisis of confidence between the private and government sector. There were made many agreements between VAT payer and VAT collector. Persons of each sector blaming to another. Due to lack of understanding between them, there is loss of revenue taxable amount is arbitrarily fixed by the tax authorities in many cases which is beyond the current feature of VAT system. Hence, it is necessary to co-operate the private sector with government. A proper co-operation between both sector should be established confidently.
- i) An efficient, strong and fair administration is the most crucial for the proper implementation of VAT. VAT administration is still weak, traditional, corrupted in nature. In spite of these, there is lack of expertise, well trained and skilled officers in the VAT administration. So, informative programmes such as seminars, training, discussion should be organized to make the tax officers skilled and capable in their field of job and service minded attitude needs to be developed in the mind of tax officers.
- j) Efficiency of Nepalese VAT system mainly depends upon its three major subsystems i.e. VAT policies VAT laws and VAT administration. So for the success of Nepalese VAT system in concerned, the emphasis should be given highly to these subsystems.
- k) Finally the effective and efficient implementation and development of VAT is only possible when there is fair understanding between the government tax administration, tax payers and other concerned parties. So they must have commitment, dedication, self-motivation to implement VAT in the future prospect. Apparently VAT cannot deliver the intended results unless these problems are addressed seriously.

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Questionnaire

Dear Sir/ Madam,

I would like to introduce myself as a student of MBS final year of Shanker Dev Campus. As per the partial fulfillment of the Master Degree of Tribhuvan University it is compulsory to submit thesis so I am preparing this entitled "**Effectiveness of VAT in Nepal**". I would like to share your valuable comment to make my study meaningful.

I assure you that this is only as academic research and your comment and suggestion will be kept confidential.

Sincerely

Bhim Prasad Pokhrel

Full Name :

Address:

Occupation :

(1) From which media you know about VAT?

- (a) Radio/F.M. (b) T.V.
(c) Hording Board (d) Pamphlets
(e) Daily Newspapers (f) If other

(2) What is your view about billing system?

- (a) possible (b) Impossible (c) I don't Know

(3) Could you please tell in percentage of the total customers demanding the VAT bills?

- (a) Around 10% (b) Upto 20%
(c) 20% to 60% (d) above 60%

(4) What are the problem in the process of VAT implementation?

- (a) Registration (b) Collection (c) Tax refund
(d) Miscellaneous (e) I don't know

(5) What are the major weakness of VAT implementation (Tick any one)

- (a) Costly system in management

- (b) Lack of consciousness of tax payers
- (c) Administration Corruption
- (d) Government has do proper homework
- (e) Lack of canalized import export system
- (6) Who is the most responsible group of the tax evasion?
- (a) Business enterprises (b) Tax Administration
- (c) Consumer (d) All
- (7) What is the most important factor for the effective of VAT in revenue collection (Tick any one)
- (a) Proper implementation (b) Broad coverage
- (c) Tax education (d) Effective and efficient administration
- (e) Clear VAT law and regulation (f) In others
- (8) What is the major problem of VAT in Nepal (Tick any one)
- (a) Problem on billing system
- (b) Problem on open boarder with India
- (c) Problem on tax refund
- (d) Weak and traditional economic policy
- (e) Weakness government economy policy
- (f) Lack of awareness in public
- (g) Shortage of tax payer participation
- (h) Lack of mutual understand between tax payers and tax administration
- (i) Lack of lending enough special programme
- (j) Difficult account system
- (9) Will price rise due to VAT system ?
- (a) Yes (b) No (c) I don't know
- (10) Do you think the single rate of VAT (13%) is effective?
- (a) efficient () (b) No efficient () (c)I don't know ()
- (11) Will the VAT be effective in future?
- (a) Yes (b) No

Thanks for your co-operation