

**EFFECTIVENESS OF VALUE ADDED TAX  
(VAT) IN REVENUE COLLECTION  
IN NEPAL**

**By:**

**RAGHU NANDAN AGRAWAL**

**Kankai College**

**Roll No: 378**

**T.U. Regd. No: 7-1-205-48-2000**

**A Thesis Submitted to:**

**Office of the Dean**

**Faculty of Management**

**Tribhuvan University**

**In partial fulfillment of the requirement for the Degree of  
Master of Business studies (MBS)**

Birtamode, Jhapa

September, 2009

**RECOMMENDATION**

This is to certify that the thesis

Submitted by

**Raghu Nandan Agrawal**

Entitled

Effectiveness Of Value Added Tax (VAT)

in Revenue Collection in Nepal

Has been prepared as approved by this department in the prescribed format of the faculty of management. This thesis is forwarded for examination.

Thesis Supervisor  
MBS

Name: Mr. Shakher Sharma

Signature.....

Signature.....

Programme Incharge,

Name: Mr Raju Kafle

Campus Chief

Name :Mr Suresh Chapagain

Signature:.....

# VIVA-VOCE SHEET

We have conducted the Viva-Voice Examination of the

Thesis Presented by

Raghu Nandan Agrawal

Entitled

**Effectiveness of Value Added Tax (VAT)**

**in Revenue Collection in Nepal**

and found the thesis to be the original work of the student and  
written

according to the prescribed format. We recommend the thesis to be  
accepted as partial fulfillment of the requirement for:

Master's Degree in Business Studies (MBS)

## VIVA-VOCE COMMITTEE

Chairperson, Research Committee.....

Member(Thesis Supervisor):.....

Member (External):.....

Date:.....

## ACKNOWLEDGEMENT

This study was undertaken as the dissertation work for the partial fulfillment of the requirements for the Master's Degree course in Management. I have selected the topic "Effectiveness of VAT in revenue Collection in Nepal" for my research work because of the considerable and important role of VAT in overall economic development of country. I have studied about the effectiveness of VAT to overall revenue generation in Nepal from its implementation. During the course of my study, I received a good deal of help and inspiration from various persons and institutions. so, I would like to express my sincere thanks to all of them.

I would like to express my sincere appreciation to faculty of management Kankai Campus for providing me the opportunity to work on such topic.

I have a great pleasure to express my heartiest and sincere thanks to my thesis advisor, Mr Shaker Sharma, lecturer of Kankai Campus, for his valuable suggestions, encouragement and guidance while supervising my research work. He has provided me much of his valuable time in the completion of the work. His wise counsel and guidance provide me the inspiration to go ahead with the work.

I am also grateful to Mr....., head of research committee, Kankai Campus for his constructive comments and suggestions. I want to pay my sincere appreciation to Mr.....lecturer of Kankai Campus For his support, co-ordination and encouragement in my efforts.

I have to thank to the librarian of Kankai Campus, Mr Mahendra Mishra for providing me the related books and material to complete this study. Similarly, I would like to thank Mr....., head of Inland Revenue office, Chandragadi, all officers staff of this department, all respondents who sincerely filled out the questionnaire is thankful for their help.

I would like to thank my friends Raju Sapkota, Pawan Agrawal, Bishnu Gurung who provided me books and relevant data for this study. I am very thankful towards them for their support.

At last, but not the least, my sincere thanks goes to Mr Sumit Mangal Birtamode for computer setting and printing while preparing this dissertation is highly valued.

Date: September, 2009

Agrawal

Raghu Nandan

Kankai College

# List of contents

<b>Recommendation</b>	<b>i</b>
<b>Viva Voce Sheet</b>	<b>ii</b>
<b>Acknowledgement</b>	<b>iii</b>
<b>List of Contents</b>	<b>iv-viii</b>
<b>List of Tables</b>	<b>ix-x</b>
<b>List of Figure</b>	<b>xi</b>
<b>Abbreviations</b>	<b>ii-xiii</b>
<b>CHAPTER - ONE</b>	<b>1 - 8</b>
<b>INTRODUCTION</b>	
1.1 Background	1
1.2 Statement of the problem	5
1.3 Objective of the study	6
1.4 Signification of study	6
1.5 Limitation of the study	7
1.6 Organization of the study	8
<b>CHAPTER TWO</b>	<b>9- 17</b>
<b>REVIEW OF LITERATURE</b>	
2.1 Review of Journals ,Books and Articles	9
2.2 Review of Past Dissertation (Thesis)	15
2.3 Research Gap	17

**THEROETICAL ANALYSIS OF VAT**

3.1	Theoretical Analysis of VAT	18
3.1.1	Background and Introduction	18
3.1.2	Evolution and Development of VAT	20
3.1.3	Types of VAT	21
3.1.4	Method of Calculation of VAT	23
3.1.5	Principal of VAT	26
3.1.6	Structure of VAT	27
3.1.6.1	Tax Base	27
3.1.6.2	Freeing From VAT	28
3.1.6.3	Tax Rate	31
3.1.6.4	VAT as a Substitute of Sales Tax	32
3.1.6.5	Reasons for Growing Popularity of VAT in the World	33
3.2	Overview of Nepalese VAT	34
3.2.1	Preparation Made for the Introduction of VAT	34
3.2.2	Reasons for Adopting VAT in Nepal	36
3.2.3	Basic Features of Nepalese VAT system	40
3.2.4	Structure of VAT	40
3.2.4.1	Rate and Coverage	40
3.2.4.2	Exemption	41
3.2.4.3	Zero-Rating	42
3.2.4.4	Threshold	42
3.2.4.5	Taxable Supply	42
3.2.4.6	Place of Supply	43
3.2.4.7	Time of Supply	43
3.2.4.8	Taxable Value	43
3.3	Operation of VAT	44
3.3.1	Registration	44
3.3.2	Invoicing	45
3.3.3	Books of Account	47
3.3.4	Debit Note and Credit Note	48
3.3.5	Submission of Return	49

3.3.6	Payment of TAX	49
3.3.7	TAX Assessment	49
3.3.8	Collection of VAT	51
3.3.9	TAX Credit	51
3.3.10	TAX Refund	52
3.3.11	Penal Provision	53
3.3.12	Appeal System	54
3.3.13	VAT Administration	54

## **CHAPTER – FOUR** 56-60

### **RESEARCH METHODOLOGY**

4.1	Introduction	56
4.2	Research Design	57
4.3	Period Covered	57
4.4	Population and Sample	57
4.5	Types and Sources	57
4.5.1	Primary Data	58
4.5.2	Secondary Data	58
4.6	Data and Information Gathering Technique	58
4.7	Method of Data and Information Analysis	59
4.7.1	Simple Percentage	59
4.7.2	Simple Average (Mean)	59
4.7.3	Trend Analysis (Regression)	59
4.7.4	Compound Growth Rate	60
4.7.5	Various Graphs and Diagrams	60

## **CHAPTER - FIVE** 61-98

### **DATA PRESENTATION AND ANALYSIS**

5.1	Government Revenue ,Expenditure and Deficit	61
5.2	Revenue Structure of Nepal	62
5.2.1	Total Revenue , Tax Revenue and Non-Tax Revenue in Nepal	63

5.2.2 Structure of Tax Revenue in Nepal	65
5.2.3 Indirect Tax Revenue	67
5.2.4 Tax and GDP Ratio in Nepal	69
5.3 Implementation of VAT	70
5.3.1 VAT Registration	70
5.3.2 Revenue Collection from VAT	72
5.3.3 Contribution of VAT	75
5.3.3.1 Contribution of VAT in Nepalese Economy	75
5.3.3.2 Contribution of VAT in Total Revenue	77
5.3.3.3 Contribution of VAT in Total Tax Revenue	78
5.3.3.4 Contribution of VAT in Indirect Tax Revenue	79
5.3.3.5 Trend of Revenue Collection After Introduction of VAT	81
5.3.3.6 Analysis of Trend Value of Indirect Tax ,GDP and VAT	83
5.4 Empirical Finding	84
5.4.1. Views on Knowledge About VAT	85
5.4.2 Views on VAT as an Appropriate Means of Raising the Govt. Revenue	86
5.4.3 Views on Superiority of VAT than Sales Tax	87
5.4.4 Views on Raising Price Due to VAT System	87
5.4.5 Views on Causes for price Due to VAT System	88
5.4.6 Views on Revenue Collection From VAT is Satisfactory as it has been Expected	89
5.4.7 Views on Existing Rate of VAT	89
5.4.8 Views on VAT was been Discouraging Illegal Business	90
5.4.9 Views about Billing System	91
5.4.10 View on Effectiveness of VAT at Present Time	92
5.4.11 View on Demand for Bills	93
5.4.12 View on Problem in the Process of VAT Implementation	94
5.4.13 View on Major Problems on Effectiveness of VAT in Nepal	95
5.5 Major Findings of the Study	96



<b>CHAPTER-SIX</b>	99-104
--------------------	--------

## **SUMMERY, CONCLUCION AND RECOMMENDATION**

6.1 Summary	99
6.2 Conclusion	101
6.3 Recommendation	102
<b>BIBLIOGRAPHY</b>	105-106

## **APPENDICES**

Appendix – 1	: Questionnarire	107
Appendix –2	: Calculation of Growth Rate of Revenues	109
Appendix –3	: Trend Value of Indirect Tax	111
Appendix –4	: Trend Value of GDP	113
Appendix –5	: Trend Value of VAT	115

# LIST OF TABLES

Table no.	Title of the Tables	Page no.
3.1	Process of collecting VAT	20
3.2	Calculating VAT Liability Under Addition Method	24
3.3	Calculating VAT Liability Under Subtraction Method	25
3.4	Calculating VAT Liability Under Tax Credit Method	25
3.5	Calculation of Sales Tax	32
3.6	Calculation of VAT	33
3.7	IRD Offices	55
4.1	Group of Respondent and size of Samples of Each Group	57
5.1	Government Revenue, Expenditure and Deficit	61
5.2	Composition of total Revenue, Tax Revenue And Non –Tax Revenue	63
5.3	Structure of Tax Revenue in Nepal	66
5.4	Composition of Indirect Tax Revenue	68
5.5	Tax and GDP Ratio in Nepal	70
5.6	Trend of VAT Registrants	71
5.7	Revenue Collection from VAT	72
5.8	Contribution of VAT to GDP	75
5.9	Contribution of VAT to Total Revenue	77
5.10	Contribution of VAT to Tax Revenue	78
5.11	Contribution of VAT in Total indirect Tax Revenue	79
5.12	Trend of Revenue Collection	81
5.13	Compound Growth Rate of Revenue After the implementation of VAT	82
5.14	Expected Trend Values of Indirect Tax, GDP and VAT	83
5.15	Sample size of the Field Survey	85
5.16	Views of Knowledge about VAT	86
5.17	Views on VAT as an Appropriate Means of Raising Govt. Revenue	86
5.18	Superiority of VAT than Other types of slale Tax	87
5.19	Views on raising Price Due to VAT System	88

5.20	Views on Causes for Price Raise Due to VAT System	88
5.21	Views on revenue Collection from VAT is Satisfactory as it Has been Expected	89
5.22	Views on Existing Rate of VAT	90
5.23	Views on VAT has been Discouraging illegal business	91
5.24	Views about billing system	92
5.25	Views on effectiveness of vat at present	92
5.26	Percentage of customer demand for bill	93
5.27	Views of customer on demand for bill	94
5.28	Views on problem in the process of VAT implementation	95
5.29	Views on most important factor for the effectiveness of vat in Nepal	95

# LIST OF FIGURE

<b>Figure no.</b>	<b>Title of the Figure</b>	<b>Page no.</b>
5.1	Trend of government revenue, expenditure and deficit	62
5.2	Trends of tax and non- tax revenue in Nepal	64
5.3	Trend of direct tax and indirect tax revenue	67
5.4	Composition of indirect tax revenue	69
5.5	Figure of vat registrants	72
5.6	Revenue collection trend of vat	75
5.7	Contribution of vat in GDP	76
5.8	Contribution of vat to total revenue	77
5.9	Contribution of vat in total tax revenue	79
5.10	Contribution of vat revenue in total indirect tax revenue	80
5.11	Expected trend values of indirect tax, GDP and vat	84

# ABBREVIATION

AD	: After Death
CBS	: Central Bureau of statistics
CEDA	: central for economic development and administration
COL.	: Column
DANIDA	: the Danish international development agency
ESAF	: enhanced structure adjustment finance
EU	: European Union
FNCCI	: federation of Nepal chamber of commerce and industry
FY	: fiscal year
GDP	: gross domestic product
Govt.	: Government
HIID	: Harvard institute for international development
i.e.	: that is
IBFD	: international bureau of financial fomentation
IBID	: ibiden (the same work)
IMF	: international monetary fund
IRD	: inland revenues department
Ltd.	:limited
MBS	:Master in business studies
MOF	: ministry of finance
NCC	: Nepal chamber of commerce
NGO	: non-government organization
Nov.	: November
NRB	: Nepal Rastra bank
Pp.	: Page
Pvt.	: Private
Rev.	: Revenue
Rs.	: Rupees
RST	: Retail level sales tax
SAARC	: South Asian Association for Regional co-operation
SAFTA	: south Asian free trade agreement
TPIN	: tax payer identification number

TU : Tribhuvan University  
UK : United kingdom  
USA : United State of America  
USAID : United State Agency for International Agency  
VAT : Value Added Tax  
Viz. : “videlicet” namely  
Vol. : Volume  
WTO : World Trade Organization  
WWW : World Wide Web

## **CHAPTER – ONE**

# INTRODUCTION

## 1.1 Background

Nepal is an agriculture based country. The major portion of population live in village and most of them are below the poverty line. Being one of the least developed countries in the world, the role of government is still vital to build up infrastructure provide social social servies and alleviate poverty. Rapid population growth low income level of people unemployment, inadequate infrastructure, foreign dependency, unutilized resources, inequitable distribution of wealth and income, lake of adequate industries and adverse balance are the main characteristics of Nepalese economy. To fulfillment of these problem, the government of Nepal collects revenue from various sources i.e. revenue from public enterprises, special assessment fees, fines grants assistance and tax among them tax is a main source of government revenue.

The nation will be able to achieve maximum social welfare if it has sufficient financial resources at its disposal .availability of external funds is uncertain .in addition to this dependency on external fund is not good for healthy development .it is beggar eye to donors .

Equal growth and stabilization have long been accepted as the major objective of any economy. The underdeveloped countries have to accelerate their economic growth rates, eradicate absolute poverty, and reduce inequalities and environmental balance. For this government needs more resources. Taxation is the most effective and powerful tool reserved in the hands in the government of country for collection revenue. Tax means compulsory contribution from a person to the government to defray expenses incurred in the common interest of all without reference to special benefit conferred<sup>1</sup>.

---

<sup>1</sup>P.R., Kandel, (2006); "Tax Laws and Tax Planning in Nepal", Buddha Academy, Kathmandu

---

Next we can say, tax is compulsory contribution imposed by public authority using the rights given by the law. In ancient time tax was collected from haves and it was utilized from the interest of those have not but, in modern age the purpose of tax has shifted from security to economic development. Tax is the main sources of financing government activities. In every country the largest part of government revenue is raised through taxation.

Tax may be imposed on person's income or wealth. Tax may be different types, rates and nature. It may be direct tax and indirect tax, there is a pre-dominant role of indirect taxes in Nepalese tax structure. Income tax and other taxes did not seem to play effective role in revenue mobilization due to their inefficient operation. Sales tax however provides a considerable amount of revenue but suffered from its narrow base, cascading and pyramiding effects which create distortions without generation potential amount of revenue.

In the case of the taxation, value added tax is most important innovation in the field of indirect tax in 20 century in the economic filed and adoption of VAT is being a major step of tax reform in the world since the decade of the 1980s. different tax such as contract tax, hotel tax sales, entertainment tax, sales tax etc. were developed. But they were proved less effective and unscientific in course of time because they very disadvantage process by these previous taxes modern economic thinker developed the VAT system . VAT is modern transparent scientific and systematic tax system. It is levied on value added of goods and services at each stage in the process of production and distribution chain. It is not a genuinely new form of taxation but merely a sales tax. it is developed by dr. Wilhem Von Siemens of Germany in 1919 A.D. then it was developed further in 1949 by tax mission to Japan headed by prof.carl s. shoup . it was remained as only topic of academic interest until 1953 . However ,the credit of raising VAT at first goes to France on 1954 A.D. By the end 1960s only eight countries including France had introduce VAT. It has been introduced by at least one country each year and by now it has been adopted by more than 130 countries . however ,the concept of this tax in Nepal was introduced in 1990s after long discussion , interaction preparation and debate Nepal Finally implemented VAT , From 16 November 1997 .(1 Mansir 2054) .



Nepal has decided to adopt VAT by VAT act 1996 instead of sales tax and services based tax i.e. hotel tax, entertainment tax , contract tax and hopping VAT is consumption type and the calculation method employed is tax credit method . it is based on destination principle .

### **From the economist points of view**

According to Indian taxation inquire committee, "VAT is a broad based tax on the business designed to measure net value generation in a country . it is a tax system that aims to minimize tax evasion and increase resource mobilization ." <sup>2</sup>

"Value added is the value that a producer adds to his raw materials or purchases before selling the new or improved product or services. A tax based on this base is called VAT . Theoretically , value added can be defined in terms of earning of factors of production i.e. land , labour , Capital , and entrepreneur . Each factor receives rent , wage, interest and profit respectively " <sup>3</sup>

To conclude , VAT has been the most essential choice for the most developing countries as an ingredient of their tax reforms because it is the most improved from of sales tax ,which leads to revenue enhancement and economic efficiency .

### **As Such Definitions :**

- ) Tax is a compulsory levy imposed by govt.
- ) Tax is levied on people as per the prevailing laws.
- ) Tax payer will get not any direct personal benefits .

---

<sup>2</sup>Rup Bahadur Khadka, (2001); "VAT in Nepal"UBS publisher and Distributers ltd

<sup>3</sup>Narayan Silwal, (2002); "Value Added Tax": A Nepalese Experience, Kathmandu, Indu Silwal

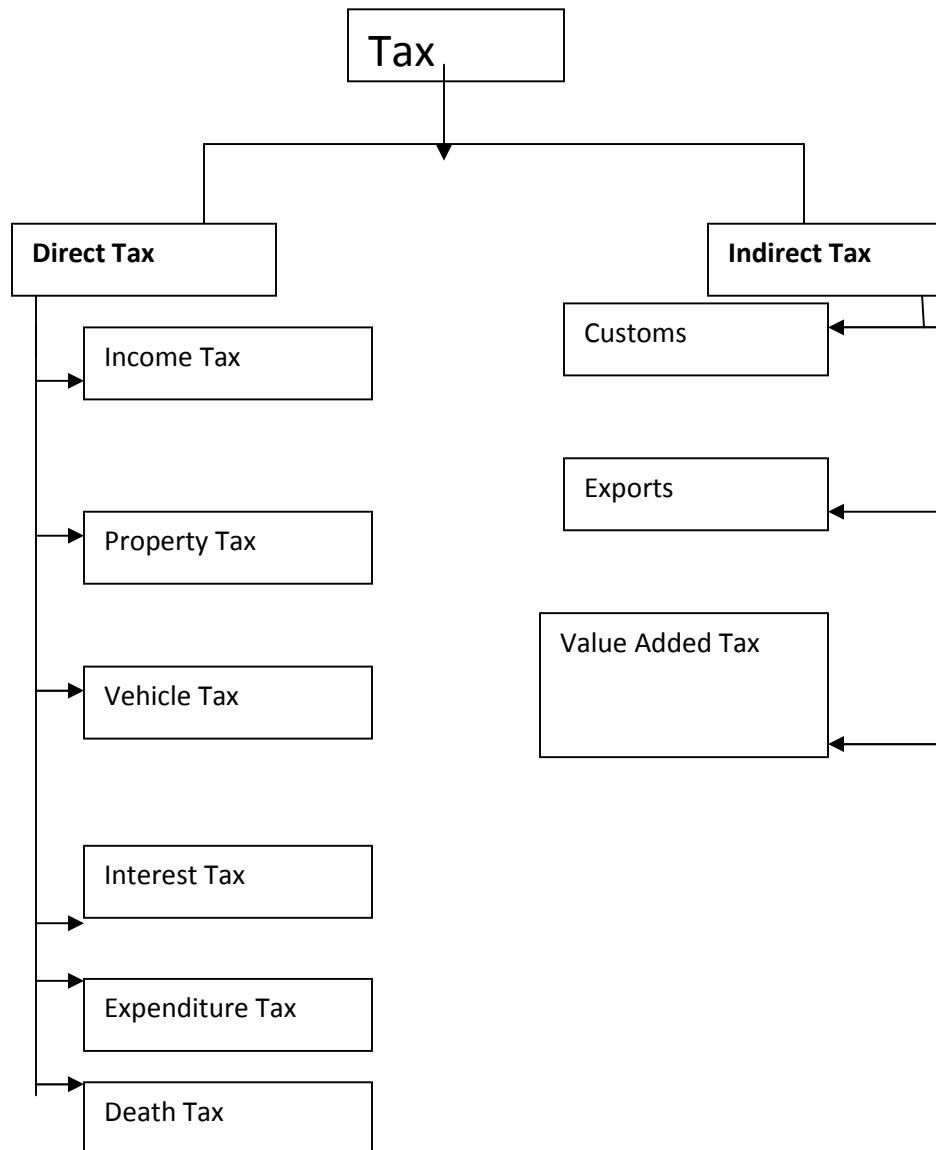
) VAT is indirect tax which is levied on value added of goods and services at each stage in the process of production and distribution chain .

) It is a modern , transparent ,scientific and systematic tax system .

) It is develop by Dr. Wilhelm Von Siemons of Germany in 1999 ad A.D.

) In Nepal, it is implemented in November 1997 A.D.

There are various types of tax and classified in two ways :



## 1.2 Statement of the problem

The world is now stepping the 21st century but Nepal is still one of the poorest and least developed countries in the world. Five decades have passed by planned development , the Nepalese economy is still suffering from general poverty , stagnation and other serious problem and resources gap e.g. resources expenditure saving investment ,import – export gaps and dependency of foreign aid and loan .

Revenue mobilization is still poor that does not cover the growing expenditure. Because of deficit Financing and external loan the economy has to face the resources gap.

Nepal's lower revenue mobilization is due to poorly designed and deficit tax system where the tax are less productive , less responsive and distortion .So, there was a strong need of scientific and modern tax system in Nepal to develop the economy and increase the life standard of people by economic growth and maximum mobilization of resource . That's the way the government of Nepal had planned to adopt the VAT in Nepalese tax system and it was introduced in Nepal from 16<sup>th</sup> November 1997 A.D.

The VAT system planned and operation in Nepal is a positive process on revenue collection that helps to increase the government although the system has practiced a hot debate among the businessman, government and academic regarding its good and bad effort in Nepalese economy. So, its effectiveness depends on its implementation. Only proper implementation yields better revenue collection. Beside the reality, Nepal is suffering from the scarcity of skilled administrators to implement it effectively Other requirement for its effective implementation are The knowledge, agreement, essential information and consciousness about VAT on people's mind . In addition the other serious problem is that public of concerned filed is not aware of and informed of its positive and negative aspect as a result that target of the government is not fulfilled. There are some major issues is the implementation of VAT to approach on its targeted aim.

The following questions arise in the analysis of the effectiveness of VAT in Nepal.

- (i) Is the present position of VAT in Nepal satisfactory?
- (ii) How much is the contribution and significance of VAT in GDP, tax revenue, indirect tax and total revenue?
- (iii) Is the contribution of VAT revenue to total revenue satisfactory?
- (iv) What are the problems in the proper implementation of VAT in Nepal?
- (v) What factors are responsible for the unsuccessful implementation of VAT in Nepal?

### **1.3 Objectives of the study**

The general objective of the study is to examine various issues relating to its difficulties and problems to make it ineffective and to find out the reality and to provide a useful view as well as suggestions. The specific objectives of the study are as follows:

- (i) To evaluate the trend of revenue of revenue collection after the introduction of VAT in Nepal.
- (ii) To evaluate the potentials of revenue collection in Nepal from VAT
- (iii) To analyze the overall effectiveness of VAT and sales tax.
- (iv) To analyze the overall effectiveness and problems of VAT as a tool of revenue collection.

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

Nepal is a developing country and has not achieved the goal of economic development. There is a serious problem on resource gap; the existing internal resources are not utilizing properly and mobilize effectively. In such case VAT may be helpful for Nepal to develop the economy by mobilization of resource effectively. VAT is an important instrument of effective mobilization of resource. Twelve years have passed, since VAT came into effect but many people are unknown about various aspects of it. Theoretical and practical knowledge are required to implement VAT

properly. This study is analyzed Nepal's VAT system with effectiveness in revenue collection and its problem.

Because of this reason the study will directly beneficial to policy maker, provide sector, researchers, general people, scholars, tax administrator, and tax payers. It will also provide a clear idea and knowledge to those people who are interested but confused about people and policy maker towards VAT.

### **1.5 Limitation of the study**

Data collection of related field is very difficult in Nepal. In order to keep research work feasible, to keep study in track and to go according to plan budget, periodic data, and time constraints, the research has to barricade from some limitation. The major limitations of the study are follows:

- (i) This study will be concerned only VAT aspect.
- (ii) VAT in Nepal is in the process of implementation from past few years, therefore this study is limited on that period only.
- (iii) The study will be based mainly on secondary data put primary data will also be used. So, correctness of data will be depending upon the sources.
- (iv) Due to non-availability of sufficient data the use of other relevant technique are not application in this study.
- (v) The samples in the study may not dully represent as a whole.
- (vi) The filed survey is conducted in certain period.
- (vii) Due to time limit and other difficulties filed survey will be done in Chandragadi and Birtamode.
- (viii) Opinions of the respondents have been taken as sense of truth which may not be correct at all time due to the changing trends of thinking of people.

### **1.6 Organization of Study**

This study will be divided into six chapters they are as follows:

#### **1. Introduction :**

In this chapter, the background of the study, statement of the problem, Objective, significance and limitation of the study are included.

## **2. Review of Literature**

In this chapter review of books and articles of former studies are presented.

## **3. Theoretical Analysis of VAT:**

This chapter includes the theoretical aspect of VAT and overview of Nepalese VAT, operation of VAT.

## **4. Research Methodology:**

In this chapter, introduction of research design, population of sample, data gathering technique and method of data and method of data and information analysis.

## **5. Summary Conclusion and Recommendation:**

In this chapter, data and information are analyzed with the help of different statistical tools, tables, diagram and other necessary figure.

## **6. Summary Conclusion and Recommendation:**

Conclusions and Recommendation, summary and conclusion of the study and further suggestions are included in this chapter.

A Bibliography and appendix has also been included in last part of the study.

# CHAPTER – TWO

## REVIEW OF LITERATURE

### 2.1 Review of Journals, Books and Articles

VAT is a new innovation in the field of indirect tax. VAT is the younger member of sales tax family. It was humming sound around few year back. It is more scientific, modern and progressive as compared to sales tax. But very few studies have been done on the topic concerning Nepal. An attempt has been made in this chapter to review various literatures on VAT.

Dr. Rup Bahadur Khadka, an expert of Nepalese tax system in his book, entitled, “**VAT in Asia and the Pacific region**”<sup>4</sup> writes VAT is the most recent innovation in the field of taxation. It levied on the value added of goods and services; the tax is board based as it covers the value added to each commodity by a firm during all stages of production and distribution.

This book has covered all aspects of VAT including, reasons for the growing popularity of VAT, development of VAT etc. This apart, the report examines the structure and operation also explores the possibility of introducing VAT in Nepal probably he is the person observer of VAT abroad and the firstly proposed VAT for Nepal with micro studies of Nepalese economy and system.

“The Value Added Tax (VAT) is a tax imposed upon the value that activities of a business firms adds to the value of goods and services, it purchases from others firms. That is, upon the excess of the sales during a period over the amount paid for the goods and the services acquired from business firm during that period”<sup>5</sup>

Encyclopedia of taxation and policy says, “Value added tax is a broad based tax on business designed on producer, whole seller, retailer and consumers also.

---

<sup>4</sup>Rup Bahadur Khadka, (2001): "VAT in Asia and Pacific Region" International Bureau of Fiscal DocumentationF.

<sup>5</sup> Due John, (1976); "Value Added Taxation in Developing Economies in Taxation and Development", USA: N.T. Wang Praeger Publisher.

It is related to both the goods and services. It is levied on industry as well as commerce, accordingly, it measures net value generated in a country. i.e. GDP. Indian tax institution defines "VAT as a tax imposed on the seller of goods and services based on value added by their respective units".

"Value added tax is also known as goods and services tax or added value tax. It is a tax system that aims to minimize tax evasion and increase resources mobilization.

It is imposed on value added amount in each stage and therefore, is equivalent to multi stage sales tax.<sup>6</sup>

Michele Guerard (1973) in her unpublished doctoral dissertation submitted to Columbia University in 1972, illustrated that, it is not easy to say to implement VAT in developing countries, open border along with least experience of border based tax implementation in developing countries likely to face initially a more difficult problem.

Early revenue collection was satisfactory in Brazil. In the first year of its introduction, revenue increases by 54 percentages. Out of 54 percentages it was realized 30 percent was due to price increase. Manufacturing industries accounted for 60 percent of total collection VAT although it generated less than one fourth of GDP. It is learned that most inputs were exempted whereas output was taxable. Due to this reason industries sector increase the VAT.<sup>7</sup>

IMF staff undertook a study of seven developing countries, i.e. Brazil, Ecuador, Ivory and Coast, The Malagasy republic, Morocco, Senegal, and Uruguay, in 1973 that had adopted VAT in their respective countries. From the empirical study of seven developing countries, it was found that

---

<sup>6</sup>P.R.Khandel, (2003); "Tax laws and Tax Planning in Nepal", Buddha Academy Publishers, Pp. 178

<sup>7</sup>Michele Guerard, (1973); "The Brazilian State Value Added Tax", IMF Staff Papers, Vol. XX, Pp.1



the effectiveness of VAT largely depends upon the administrative ability .The study shows that VAT produces between 10 to 30 percentages of growth in revenue<sup>8</sup> .

Silwal Narayan says, “ VAT is an all stage non cascading tax system. It extends to all levels of production and distribution. Similarly, it covers all stages and services. Any discrimination in taxing goods or services or exempting any of them renders VAT ineffective.” His book , “Value Added Tax: A Nepalese experience , mostly concentrates on Nepalese tax system .The book clearly analyze why the government announced retail level sales tax at the rate of 10% covering the whole range of goods and services .There was no procedural law to administer it when retail level sales tax (RST) introduced in Nepal . Literacy level was just meager and billing and record keeping was fanciful. In this situation, required revenue cannot take place, which in turn into the development expenditures. So, that a modern, efficient and natural tax like VAT was, therefore, preferred, to get rid of part anomalies.

The writer also expressed that, “The government of Nepal does not have the option of doing nothing .major changes must be made in order to make tax administration fair, efficient and effective .The hostility, harassment and corruption that currently exist between the tax office and business community must end if Nepal is to have a modern tax. The business wants the system change and willing to pay a reasonable tax but they want the system transparent and fair<sup>9</sup> .

Khadka , points out the need to introduce VAT in Nepal . In his book, there are several resources to introduce VAT in Nepal. One of the important reasons was to develop a stable source of revenue by broadening trade taxes for its revenue in the future. Since, it will no be in a position to levy import duties on trade that take place with in the South Asian Association for regional co-operative ( SAARC) region after the implementation of the South Asian free Trade Area (SAFTA). Nepal has the member of the

---

<sup>8</sup>George E.Lent, Casaneqra Milka And Guerard MIchele, (1973); "The Value Taxation in Developing Countries", IMF Paper

<sup>9</sup>Narayan Pd. Silwal, (2002); "The Value Added Tax: A Nepalese Experience",Kathmandu, Indu Silwal

World Trade Organization (WTO), Which will also have to be considered in this context<sup>10</sup> .

Ministry of Finance (1995)<sup>11</sup> conducted a study by preparing a 'Task Force'. After studying for six month, by the member of task force it mainly analyzed the magnitude of the Nepalese tax system and recommended various measures for tax reforms.

The study was depended on theoretically bases and the study reached the conclusion that 'There is no possibility of any other great measures to introduction a tax rates than introducing VAT in Nepal .

The major findings of the study area:

- (i) The necessary of VAT in Nepal.
  - a. To increase revenue collection by broadening the tax base.
  - b. To make the tax system more buoyant.
  - c. To discourage the tendency of tax evasion.
  - d. To make a tax system efficient.
  - e. To promoted the export.
- (ii) The exiting tax system of Nepal generates less amount of revenue, so alternatives for the system should be searched. In this context the VAT appears at the best alternatives.
- (iii) Some aspects for consideration of VAT are price level, equity the condition of tax payers and small vendors.
- (iv) A special consumption tax on luxuries should be introduced as a supplementary tax for that VAT.
- (v) There must be fully and detailed preparations before implying VAT.

---

<sup>10</sup>Rup Bahadur Khadka, (2000); "Nepalese Tax System", Kathmandu: Sajha Prakashan.

<sup>11</sup>Ministry of Finance, (1995); "The Report of Taxation System Re-observation Task Force"

A study of **Nepal Chamber of Commerce (1997)**<sup>12</sup>, Analyze the possible effects of VAT on Nepalese economy, they have made some observation , which are

- (i) Adverse effect on price level.

- (ii) Increase in the price of imported goods which hit the import business and re – export of imported goods leading to decline in the revenue from import tax.
- (iii) The amount keeping requirement of the VAT would increase the tax compliance cost and cost of doing business, it would adversely affect the small traders.
- (iv) VAT would be unjustifiable on social ground; it would worsen the income distribution.
- (v) Avoiding of protection policy under VAT makes the adverse effect on domestic production.
- (vi) Negative effects in revue collection because the present administration of failure of VAT in Nepal.

The study suggested that a practical VAT on some commodities should be implemented on experimental basic to know its pros and cons after that a fully VAT that may be consider. “ Value added tax: Four year of implementation ”<sup>13</sup> edited by Rup Bd. Khadka, published by inland revenue department and value added tax project Kathmandu, 2001 in currently published the most comprehensive evolution made by the prominent authorities, top scholars and concerns. It consists of twelve important articles and forty one comments.

In a article written by Govinda Bahadur Thapa, “Implementation of Added Tax in Nepal : An Evaluation “,stressed that in Nepal the full implementation of VAT till the retailers level has reached its fifth year but still the revenue collection has not been able to increase as expected. VAT was implemented to replace the existing sales tax, contract tax, hotel tax and entertainment tax. Therefore, VAT should have been able to successfully displace the revenue that these sector have been paying in the past; otherwise, there was no need to bring in a new tax system by abolishing the old ones. But after the

---

<sup>12</sup>Nepal Chamber of Commerce, (1997); "Study Report on Possible Effects of VAT on Different Areas.", Kathmandu, NCCI.

<sup>13</sup>Rup Bahadur Khadka, (2001); "Four Years of Implementation" implementation of VAT, the revenue received through VAT is approximately 30 percent of total tax revenue, where as before the Implementation of VAT the revenue collection from four taxes replaced by VAT maximum of 53 percent and minimum of 33.2 percent of total tax

revenue . This indicates that VAT collected less revenue than the four taxes that it displaced. This proves collection. So, that the following weakness which leads to less revenue collection from VAT.

- (i) Lack of stable and strong government
- (ii) Lack of motivated tax administrator at the time of introducing the VAT .
- (iii) Carelessness to the long open borders, with India and Tibet.
- (iv) Poor accounting system in the market.

In an article “value added tax: The concept, international experience and its application in nepal ,” Rup Khadka ,concluded that , VAT is a recent and an important innovation in the field of modern taxation system . Thus, so far, VAT has already been adopted by more than 125 countries and is under active consideration in other countries .VAT was adopted after the following preparation in Nepal. Preparation of VAT act and regulations, establishment of an appropriate organizational structure and personnel system. Computerization system is important knowledge regarding various aspects of the society etc.

Rup Khadka stress on VA , VAT as a modern tax that is based on the principle of self assessment . Therefore, the tax return, filed by the tax payers by assessing his/her tax liability have to be accepted by the tax administration not only in principle but also in practice . He added that VAT is transparent tax system that is based on the tax payment tax system that is based on the tax payer’s transaction. VAT is not only transparent in itself but also demands transparency in other tax system as well. So the fact that VAT is not only a good tax in itself but also helps to improve the structure and operation process of other taxes.

## **2.2 Review of Past Dissertations**

Prem Upadhaya (2004)<sup>14</sup> , in his Dissertation finds that although some achievements has been realized in the field of registration and refund and in reducing the number of non filers the result are still far from satisfaction . He also finds that the implementation part of value added tax is not working properly. He has found the following problems in the VAT implementation.

Following problems in the VAT implementation.

- (i) Proper invoicing system has not been established.
- (ii) Under valuation of imported goods in customs point.
- (iii) There is no proper co-ordination between tax collecting departments of government of Nepal .
- (iv) The fixation of threshold has been a debatable issue between tax payer and administration.
- (v) Controlling the exemptions of tax on goods and services has been also a challenging job for VAT administration.
- (vi) All the consumers are not aware of VAT.

Kuinkle , rabin (2004)<sup>15</sup> , in his study paper conclude that achieve higher growth of revenue every country needs to reform some of its tax system in the context of present world VAT is one of the best alternative of tax reform process . implementation of VAT in Nepal is both a compulsion and necessity the revenue collection from VAT is not bad but practically it depends on its environments where it exists to get potential target from VAT the environment relating of VAT must be required . it is only the preliminary stage of VAT implementation in Nepal so the more effective as it has expected . despite early objection for the implementation of VAT by business community lack of proper invoicing system , lack of accounting system and tax audit , valuation of invoice , narrow tax compliance ,existence of large amount of small trader/retailers , geographical disturbances ,political instability , lack of good administrative design .Scarcity of qualified skilled and trained man power are these main issue fined by kained and he suggest that to improve it by his recommendations are compliance tax net should be extended to small traders and retailers to make the buyer and seller aware so,

---

<sup>14</sup>Prem Upadyay, (2002); "Performance of VAT in Nepal', A Dissertation Submitted to the Central Department of Economics, T.U

<sup>15</sup>Rabin Kuinkel, (2004); "Effectiveness of VAT in Revenue Collection in Nepal", A dissertation submitted to Central Department of Management T.U.

publicity and tax payer equation is necessary to follow the code of conduct more effectively for employers and co-operation goods in markets , government should develop billing software and should make it freely available to the vendors to use the proper invoices , tax

administration should be very wrathful to prevent any kind of mal practices fraud and tax evasions voluntary compliance should be encouraged , government should provide services to their approach , VAT refund system must be made more effective ,must be taken for implementation the threshold accurately , government should be start some incentive mechanism ,government should make strong administrative mechanism .Sapkota kishor kumar, (2007)<sup>16</sup> in his dissertation finds that value added tax put greater significance in revenue collection in Nepal . Before the introduction of VAT the revenue contribution the areas replaced by VAT was gradually increasing .This study shows that there will be improvement in revenue mobilization due to VAT , The study shows that the main problems effective of are so many business having taxable transaction existing now without register in VAT office , not easy to implement VAT effectively in Nepal , because many obstacles and constraints still exist there, lack of clear tax laws , acts and regulation and board coverage , inefficient manpower and administration , improper billing system ,lack of proper accounting inadequate manpower , consumers are not much interested in taking bills due to misconception of increase in the price o f goods and services , ineffective of VAT catch up system practice by tax administration , lack of political commitments ,long open boarder , geographical structure is rugged .The study concludes that for the effective implementation of VAT system .The study recommends following suggestions.Tax education programmes must be done to make buyers and sellers aware of long term benefits billing system.

- (i) Formulating VAT policies must have deep knowledge about VAT. The VAT policy markets have to see it long term effect.
- (ii) To strict working should be given by government to businessman about issue false bill.

---

<sup>16</sup>Kishor Kumar Sapkota, (2007); A Dissertation on "Effectiveness of VAT in Revenue Collection in Nepal", Submitted to Faculty of Management T.U.

- (iii) The government should develop software and make it freely available to the vendors.

- (iv) Informative programmes such as seminars, training discussions should be organized to make tax affairs skilled, capable in their job and services minded attribute needs to be developed the mind of tax officers.
- (v) Tax administration should be very watchful to prevent any kind of malpractice, fraud and tax evasion.
- (vi) VAT refund system is made more effective in order to refund the tax without delays.
- (vii) The government should be simplification and improvement of appeal and other possible means.
- (viii) Exemption, existing threshold should be reviewed and minimized gradually.
- (ix) The government should be differentiated the VAT rate with the higher rate on luxurious goods and lower rate on essential goods.

### **2.3 Research Gap**

Now it is the 9<sup>th</sup> year of VAT implementation but few studies and experiments have been undertaken on VAT. But very few studies have been done on the topic concerning Nepal. So, an attempt has been made in this study to analyze the effectiveness of VAT in revenue collection in Nepal. This study is slightly different than the former studies because the study mainly evaluates the effectiveness of VAT in revenue collection in Nepal. And the study also analyzes the problem relating VAT and the factors required for the effectiveness of VAT with the help of include and evaluate the data and information available, So, the objective of the study and the conclusion of new data, statistics and information make the study different than the former studies.

# CHAPTER-THREE

## THEORETICAL ANALYSIS OF VAT

### 3.1 Theoretical Aspects of VAT

#### 3.1.1 Background and Introduction

Value Added Tax (VAT) is the latest innovation in the field of indirect tax system. VAT is the youngest member of sales tax family. It is more scientific, modern and progression as compared to sales tax. Sales tax levied on sale of goods and services is commonly divided into three groups viz. turnover tax, single-stage tax and VAT. Turnover tax is levied at all stages of the production and distribution process. The single stage tax may be imposed at the manufacturing level or at wholesale or at retail level and tax is known as manufactures tax, whole sales tax and retail tax. On the other hand VAT is imposed on the value added at each stage of production and distribution.

VAT is multiple stage tax, which has grown as a uniqueness of turnover tax and retail level sales tax. It is similar to turnover tax in the sense that both these taxes are imposed from each stage in the production and distribution process. VAT however, differs from the turnover tax as the latter is imposed on total value of each stage while the former is imposed only on value added at the stage. VAT is similar to the retail level sales tax because the base for VAT (the consumption type) of the retail level sales tax in the sense that the former is imposed at each stage of production and distribution.

While the latter is imposed only at one stage which is the final stage. Theoretically, VAT is broad based on it covers the value added to each commodity by a firm during all stages of production and distribution.

It is based on self assessment system and provides the facility of tax credit and tax refund. It avoids cascading effect existed in sales tax and contents catch up effect. It is based on value added principle value added can be obtained either by adding payments to factor of production.

$$\text{Value added} = \text{wages} + \text{rent} + \text{interest} + \text{profit}$$

**Or,**

$$\text{Deducting cost of inputs from sales value}$$

$$\text{Value added} = \text{sales value} - \text{cost of input}$$

VAT is newly developed modern and scientific tax system which is recently innovated in the field of taxation VAT has been considered as an attractive

---

<sup>17</sup>Rup khadka,(2001,pp1):"Vat in Nepal:UB Publication and Distributors



alternative to indirect tax system. It has been emerging as a main element of the world wide tax reforms although it is the latest form of taxation innovated in the record half of twentieth century.

VAT is based on goods and services. It is also considered to be a tax that is based on consumption. The burden of this tax has to borne by the consumers. This tax is levied on the value addition at each stage from the time of production to consumption of all goods and services. The burden of VAT depends upon the final price irrespective to the proportion of value added at different stages in the process of import/production and distribution; it places an equal burden on both imports and domestic products and on the item which have a high value added at the import/manufacturing level or in the distribution.

We know that a production process has many stages high from the manufacturer to the retailer before the goods finally reach the consumer. In this respect, VAT is imposed on each stage of transaction such as production, import and distribution stages of goods and services. It affects only the addition portion of price i.e. the value of goods and services added in the various stages of transaction. VAT is levied in the accordance with their price rise at different levels from the production of goods and services raise in each stage of distribution because they has been incurred the expenses in labor, capital and they also includes the profit amount that is due to the risk taking by them. Therefore, the value addition includes the entire expenses and profit incurred in the process of preparing the goods or services for sales after its purchase. The VAT collected from sellers on the basis of their value added. Thus, the same value is never taxed twice and never produces cumulative effect.

The value added for a firm is the gross receipts from sales minus all expenditure on the production purchased from other firms. In the production and distribution process, a firm buys material from other firm. These materials may include principle raw materials, auxiliary raw materials, chemical, electricity and capital goods, such as machinery, equipment, building, furniture vehicles etc. The firm adds value to these purchased materials by processing or handling them with the help of its own factors of production, such labor and capital. This increase in the value of output over inputs is the value added by a firm. This value added is the base of VAT.

The following table shows simple process of calculating VAT where the rate of VAT is 13 percent.

Table No. 3.1  
**Process of Collecting VAT**

Production and Distribution Stages	Cost (1)	Expenses (2)	Total (1+2=3)	Selling Price (4)	Value Added	VAT Payable to Government (13% of 5)
Raw Material Producer	-	-	-	5,000	5,000	650
Raw Material Producer to Manufacturer Company	5,000	5,000	6,000	7,000	2,000	260
Manufacturer to Dealer	7,000	500	7,500	8,000	1,000	130
Retailer to Consumer	9,000	250	9,250	9,500	500	65
<b>Total Collected to Government</b>						1235

*Source:- Estimated during the study*

**For Example:**

VAT collected by raw material producer 13% of 5,000	= 650
VAT collected by manufacturer company 13% of 2,000	= 260
VAT collected by dealer 13% of 1,000	= 130
VAT collected by retailer 13% of 1,000	<u>= 130</u>
<b>Total VAT paid by customer</b>	<b>1,235</b>

From this example, we can say that value added tax is the tax collected in various steps of the production or distribution as a piece seal.

**3.1.2 Evolution and Development of VAT**

In the field of indirect tax, VAT is the younger member. It is very important tax since second half of twentieth century. The tax generates interest in both the academic and non-academic field. Because of tax cascading and vertical integration in previous taxes. VAT is levied in accordance with the price rise at different levels from the production of goods and services to their distribution.

In 20<sup>th</sup> century, VAT a latest and emerging tax, is one of the successful experiments in the tax system. It has no long historical journey to be developed from the crude concept. The concept of VAT was first proposed by Dr. Wilhelm Von Siemens in Germany in 1919 to replace the multi stage sales tax in order to avoid the undesirable effect. Particularly cascading and vertical integration of the latter tax (MST). German government seriously considered to introduction of administrative system at first.

A mission lead by Professor Carl. S. Shoup proposed the value added tax (VAT) for Japan to give suggestion for improvement on tax system and developed its' structure in 1949 but Japanese government did not use it promptly because it was new and latest concept and necessary of further study.

After there and half decades of the evolution of the concept of VAT, France took the courage to put VAT into practice introduced VAT in 1954 at the wholesales

level in the industrial sector, Up to 1959 this tax was confined to the boundary of France.<sup>18</sup>

In 1960 this tax was adopted by the Ivory coast, in 1961, Senegal followed suit and in 1967 Brazil and Denmark adopted this tax system. There after many countries started adopting this tax. The tax has gathered further momentum as it was made a standard form of sales tax required for the countries of the European Union (then European Economic Community). In 1968 France extended VAT to retail level while Germany introduced it in tax system. The Netherlands and Sweden imposed this tax in 1969 while Luxemburg adopted it in 1970, Belgium in 1971, Ireland in 1972 and Italy, the United Kingdom and Austria in 1973 of the other member of the European Union, Portugal and Spain introduced VAT in 1986, Greece in 1987 and Finland in 1999.

VAT has been spreading in the Asian region as well Vietnam adopted VAT bravely in 1973. South Korea introduced VAT in 1977, China in 1987 Indonesia in 1986, Taiwan in 1986, Philippines in 1988, Japan in 1989, and Thailand in 1992 and Singapore in 1994 While Mongolia has been implementing this tax since 1998.

In the South Asian Association for Regional Co-operation (SAARC) region, Pakistan is the first country for VAT introduction and this country adopted VAT in 1990, similarly Bangladesh, Sri Lanka and Nepal have introduced VAT in 1991, 1998 and 1997 respectively. Bhutan and Maldives has not introduced VAT until now. But India introduced VAT from 2004.

As VAT is less distort and more revenue productive. It has been spreading all over the world. In present situation more than 130 countries have been adopted VAT it is considered in many other countries. In fact VAT has becomes a popular topic for tax reform in recent years.

### **3.1.3 Types of VAT**

The types of VAT have been classified on several bases. The most important base for the classification of VAT is the way the capital goods. Capital goods are such goods, which are used more then a year in order to serve or produced revenue goods. VAT can be classified in three categories according to the capital goods are treated. There are three types of VAT

---

<sup>18</sup>Khadka, Rup Bd.(2001, Pp.10-17):"VAT in Nepal"India:UBS Publication and distributor

**(a) The Consumption Type:**

Under consumption type VAT, all capital goods purchase from other firms, in the year of purchase, are excluded from the tax base while depreciation is not deducted from the tax base in subsequent years. The base of tax is consumption since investment is relieved from taxation under this type.

*Thus, consumption type = Gross national product – Gross investment = Total consumption expenditure*

*Or,*

*Consumption type VAT = Gross domestic product – Cost of intermediate goods – cost of capital*

**(b) The Income Type:**

Under this income type VAT, capital goods purchase from other firms are not deducted from the tax base, however, the depreciation in the subsequent years are allowed to deduct from the tax base. The tax falls both on consumption and net investment and conceptual tax base of this variant is the national income. In other words are payers are not free from tax base in the purchasing of capital goods from others firms but the trader can get chance to deduct depreciation from tax in the subsequent year.

*Thus, Income type of VAT = Gross National Product – Depreciation = Net Investment + Consumption = Net National Product.*

*Or,*

*Income type VAT = Gross Receipt – Cost of Intermediate Goods – Depreciation*

**(c) The Gross National Product Type:**

In both consumption type and income type a tax is liable to pay in single way either in subsequent year or in running year. That's way these two types of VAT are considered as single effect value added tax. The gross national product type of VAT is not single effects tax system. In this type tax payers will be liable to pay tax on purchase of capital goods in purchasing time. Similarly, the tax payer does not get the provision of deduction the depreciation from the tax base in succeeding year. From this way we can said that this type of VAT is double effect tax system. Under this variant capital goods purchased by a firm from other firms are not deductible from the tax base in the year of purchase. This variant does not all too deducting depreciation from the tax base in the subsequent year.

*Base of VAT = Gross Domestic Product = Consumption + Gross Investment.*

*Or,*

*GDP type of VAT = Gross Receipts – Cost of intermediate Goods*

Among these three types of VAT consumption type of VAT is superior due to following reasons.

- This variant does not affect decisions regarding investment and growth since it relieves investment from any tax burden.
- Likewise, the consumption variant is attractive from the point of view of tax administration as there is no need to distinguish between the purchase of intermediate goods and goods under this variant which is necessary under the other two variants. Unlike the consumption variant, the other two variant stimulus firms to classify their purchases of capital good as intermediate goods, leading to complication from the administration.
- Further more, the consumption variant is more attractive than income variant from the consideration of foreign trade because the consumption variant is compatible with the destination principle of taxation which has been used by many countries.

The Consumption variant, thus, possesses several advantages over the income and the gross product variants. That is way, the consumption variant has been widely used in several countries in Europe and Else where in recent years. The Nepalese VAT system is also based on this consumption variant.

### **3.1.4 Methods of Calculation of VAT**

Value added tax can be collected using different methods of computation. The VAT can be computed by the following methods.

#### **(a) Addition Method:**

This method is also known as the direct value added computation method. Under this method the tax base is obtained by adding the incomes produced by the firm. In other words, the tax base is computed by adding the payments made by the firm to the factors of production employed in turning out the product, such as wages, interest, rent, royalties and profits. This method is appropriate for the income type of VAT that includes in its base its reward to all factors.

$$VAT = t (Wage + Rent + Interest + Profit)$$

Table No. 3.2  
Calculating VAT Liability Under Addition Method (VAT Rate 13%)  
(in Rupees)

Item	Stage of Production and Distribution				Total (A+B+C+D)
	Raw Material Producer	Manufacturer	Wholesaler	Retailer	
Purchase input (1)	(A)	400 (B)	650 (C)	775 (D)	1825 (E)
Wages (a)	200	100	50	25	375
Rent (b)	50	50	25	25	150
Interest (c)	50	50	25	25	150
Profit (d)	100	50	25	25	200
Total value added (e) (a+b+c+d)	400	250	125	100	875
Vat liability (13% of e)	52	32.150	16.25	13	113.75
Sales output (1+e)	400	650	775	875	2,700

*Source: Estimated figures during the study*

Value added can be estimated in two ways:

(a) *Deducting purchase from sales of output (Rs. 2,700 – 875 = 1,825)*

*Or,*

(b) *Adding input by the firm itself (excluding inputs supplied by others (i.e. wage + rent + interest + profit))*

**(b) Subtraction Method:**

In this method value added is determined as net turnover which is obtained by subtracting the cost of materials from sales proceeds. Thus, that VAT is levied on the amount which is determined by subtracting purchases from sales. This method is suitable for the consumption method of VAT.

Subtraction method (T) = f (outputs – inputs)

**Table No. 3.3**  
**Calculating VAT Liability Under Subtractions Method**  
**(VAT Rate 13%)**

(In Rs.)

Stages	Raw Material Producer	Manufacturer	Wholesaler	Retailer	Total
Items	(1)	(2)	(3)	(4)	(1+2+3+4)=(5)
Sales (a)	400	650	775	875	2,700
Cost of materials (b)	-	400	650	775	1,825
Value added (a-b) = (c)	400	250	125	100	875
Tax liability VAT (13% of c)	52	32.50	16.25	13	113.75

**(c) Tax Credit Method:**

This method is also known as the invoice method. Under this method, that is levied on the total value of sales and tax payers are permitted to deduct from their gross tax liability, the taxes already paid by their suppliers and passed on to them. Thus, in contrast to the subtraction method which deducts purchase from sales and levies taxes on the differences, tax on purchase is subtracted from sales the tax on sales under the tax credit method.

$$VAT = Tax\ Paid\ on\ Sales - Tax\ Paid\ on\ Purchase$$

Or,

$$Tax\ Credit\ Method\ (T) = t\ (Outputs) - t\ (Inputs)$$

**Table No. 3.4**  
**Calculating the VAT Liability under Tax Credit Method**  
**(VAT Rate 13%)**

(in Rupees)

Stages Item	Raw Material Producer	Manufacturer	Wholes Seller	Retailer	Total
(a) Sales of output	400	650	775	875	2,700
(b) VAT on sales (13% of a)	52	84.50	100.75	113.75	351
1) Total sales value	452	734.50	875.75	988.75	3,051
(c) Purchase	-	400	650	775	1,825
(d) VAT on purchase (13% of d)	-	52	84.80	100.75	237.25
2) Total purchase value	-	452	734.50	875.75	2,062.25
Net VAT liability (b-d)	52	32.50	16.25	13	113.75

*Source: Estimated figure during the study*

Above tables show that VAT liability calculated by using three methods get same VAT liability (i.e. 113.75), there should be equality between the rates applied under each of the methods.

Among the three methods of computation of VAT, the tax credit method is widely used in the world. In Nepal, tax credit method has been adopted. The reason behind this is that method possesses several advantages over addition and subtraction methods. Businessman are required to state the tax on invoices under the tax credit method it facilitates border tax adjustments. This implies that the amount of tax levied on exports can be returned to exporters. Similarly, this method is effective under the destination principle where exports are zero-rated and tax credit chain is not broken. It also provides the facility of cross checking.

### **3.1.5 Principle of VAT**

While considering the international trade, the principles of VAT have great significance whenever international trade between two countries is considered, cross border adjustment is necessary. There are two principles for levying VAT. They are origin principle and destination principle, choice between these principles largely depends on the goals and the policies of nation, accession of international trade computing methods and types of VAT.

In case of international trade, mainly two alternatives appear while implementing VAT in any country. One is taxing all domestically produced goods including exported ones and exempting all imports and another is taxing all the imports and making exemption for all exported goods and services for all foreign countries<sup>19</sup>.

#### **(a) Origin Principle:**

Under origin principle, goods and services produced in a country are subject to tax at the place where they are produced or rendered wherever, they are consumed and the goods and services imported from the abroad are beyond the tax base. Hence, this principle is in the favor of imports and against exports where there is open boarder and cross country trade. Thus, the principle affects balance of payment of the country negatively, specially, for those who have a poor performance in the world economy. The principle could be followed with appropriate changes in the exchange rate but countries are reluctant to attempt this approach.

As the country can enforce jurisdictions over firms located within its jurisdiction, the principles is much simple and there would be no rebates on safe for delivery



within the common market countries rather each country would give credit for tax imposed in the country of origin under such situation, the origin principle has

method-subtraction, addition and tax credit are all equally adopted to use of single rate origin principle value added tax with respect to exports. Imports, in contrast, are bound to present a difficult problem for the origin principle if the tax credit method is used.

### **(b) Destination Principle:**

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

In conclusion, VAT can be implemented under either the origin principle or the destination principle. Under the former the VAT is imposed on the value added of all taxable products. (Hence, forth taken to encompass both goods and services) that are produced domestically under the latter; the VAT is imposed on the value added of all taxable products that are consumed domestically.

Obviously, the above two principles are identical in a closed economy. In an open economy, the difference between them laid safety in their treatment of imports and exports. Exports are taxed but imports are not under the origin principles while just the converse holds under the destination principle.

## **3.1.6 Structure of VAT**

### **3.1.6.1 Tax Base**

Theoretically the taxable base of VAT is all types of expenditure on final consumer goods. Hence, the aim of the VAT is to reach much of the consumption expenditure making the tax base as broad as possible. The tax base of VAT depends on its scope or coverage, which defines what kind of goods and services or business activities are included into tax base. The scope or coverage of value added tax is defined with reference to both taxable transitions

and taxable person. Taxable transitions are defined broadly as suppliers made by the person engaged industrial and commercial activities. Taxable persons are those who independently engage in supplying goods and services including imports.

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

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

In many countries, particularly in developing countries, agriculture sector (or sales by farmers) is exempted. It is because taxing agriculture is not administratively feasibly and economically desirable similarly; services are generally exempted or taxed on selective basis. Exclusion of services is mainly due to administrative applicability problems. Many services e.g. financial services are exempted because they are difficult to take under VAT due to conceptual difficulty in determining VAT liability and inapplicability of tax credit principle. However, some selected services like telephone, electricity, entertainment, advertising, hotels and restaurant etc. are taxed. The inclusion of construction industry, which generates a substantial portion of GDP into VAT bade, also creates a host of problems as mentioned for agriculture and services. In many cases, the construction industry is exempt from VAT, where as the construction materials are subject to VAT. Even-though the scope of VAT is limited by the exception of agriculture, services, construction etc, a substantial part of output of the exempted sector is taxed indirectly as the output of exempted sector enters into the production process of taxable sector as its input and its brings no credit with it. For example, when agriculture output further goes into processing stage it comes into the VAT net.

### **3.1.6.2 Freeing From VAT**

#### **(a) Exemption:**

Some goods and services are left free of VAT or they are not taxed. The theoretical base of VAT is largely reduced because of such exclusions from the scope of VAT. Freeing from VAT may be justified from three sets of reasons pure administrative reason (That taxing some goods is administratively very difficult, equity reason (That taxing some goods makes the tax system much inequitable) and economic reasons (That production and consumption of some sort of goods and services are induced). In general, these are three methods of freeing from VAT. They are:

Exemption: Exemption simply means the goods and services free from a tax jurisdiction. Under this approach goods service is subject to exemption and input tax incurred there is not refundable, on the other words, where a supply of a commodity or service is exempt from VAT, the input tax is not deductible or cannot be refunded. So, in short, exemption from VAT means the condition where the trades do not pay VAT.

"The exemption, at one of the stages, may be granted only to small firms in that stage as a means of reducing administrative costs relative to revenue. Exemption of the final product may be intended not as a completed exemption but only as an exemption of value added to the particular product at that final stage. The tax credit can be restricted according. Such a product may be termed quasi exempt.

Commonly, 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, services or transactions such as products of agriculture, forestry, financial services and very small vendors are exempted basically due to the administrative reason. Similarly, exemptions is given to basic necessities like food stuffs improve equity aspect by introducing progressively because some of rich may spend respectively large while some of poor may spend little on necessities depending on their habits, choices etc. Exemption of basic necessities increases their demand and, thus relative prices, the full beneficial impact of such exemptions are questionable. Likewise, 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 encouraged their production and consumption. However, exemption needs to be minimized since it creates several undesirable effects.

First point is a VAT system with exemptions given an incentive to producers as well as consumers to divert their resources from taxed to tax-exempt goods and services, resulting in economic inefficiency. Secondly, exemption has at significant role to make the tax administrative more complicated. Thirdly the need of separate records to taxed and tax exempt goods and services creates inconveniency to tax payers. Further, firms selling both exempt and taxable goods much claim only the portion of credits that equal to the ratio of taxable to total sales, which increase burden to tax payers. Fourthly, tax evasion is easier under many exemptions, fifthly, when exemption is granted the principle of vertical equity is violated as "People with identical incomes and needs but with different preferences for taxed and untaxed goods, pay different amounts in tax. Lastly, it is clear that there will be loss of revenue by exemptions.

**(b) Zero-rating:**

Zero-rating simply means a zero percent tax rate on goods and services. If Zero rating is granted for a particular goods, the goods is technically taxable and the tax payer (supplies of goods) is required to fulfill all the formalities like that

of a regular tax payer with or difference that the supplier of zero-rated goods is not required to pay tax and is allowed to claim back the tax, if any on their purchases. For example, if exports are zero rates, the exporter is able to get the refund of the tax on his purchase which he has used for producing the tax export items.

Theoretically, zero-rating is applied to ensure for freeing tax truly. For example, if exports are zero rated, the tax payers will be granted to refund the VAT paid on his export on the basis of the exportation and he will also be created the tax, before paid. On his inputs i.e. raw materials capital goods etc. This means, the tax payer does not pay any VAT on the value of his exports. He will be fully compensated for the tax he pays in inputs and therefore it is truly exempt from VAT.

Zero-rating is an actual rate of VAT against which credit for VAT paid on inputs can be claimed and thereby a full rebate obtained. So, zero rating has a rate of zero percent which is imposed on the selected goods and services. It is nothing except a tax free provision of VAT especially for the selected goods and services.

However, zero-rates are applied on various grounds especially on social welfare. Such goods and services especially categorize under the goods and services for basic necessities to make live survival i.e. foods, medicines clothes. In other words, in practice zero rates are applied of the three reasons.

- To provide basic necessities fully free from tax.
- To make export promotion in order to correct balance of payment in international trade,.
- To support economic growth freeing goods completely from VAT.

Thus, zero rating is obviously used for making certain goods and services or transactions completely from VAT.

### **(c) Threshold:**

Threshold means minimum exemption limit of taxable transaction. It is a point at which an indexation provision becomes operative. Thus, threshold is a VAT of an upper limit beyond which VAT system is in operation. The traders which have low level of transaction will have a lower revenue yield relative to the compliance cost and or either they are capable to fulfill the formalities of VAT. Further it will create administrative complexity if all the small vendors are registered in VAT. In such a situation, threshold is also an important provision of VAT which keeps the small vendors beyond the tax net. Thus, threshold is a kind of exemptions which is based on the amount of the transactions but not on the kinds of goods and services. So, threshold must be set the basis of the nature of the production and distribution system in a country, concerned and extend of education and records keeping at various levels of volume among business firm.

### **3.1.6.3 Tax Rate**

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

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

#### **(a) Single VAT Rate:**

Single VAT rate means a VAT of which rate is fixed only at once number. In other words, of tax rate of VAT is fixed at less than two rates for all level including the wholesaler the producer and the retailer, it is said to be single tax rate. For example, suppose it tax rate is 10 percent and fixed for all level of VAT purpose. The fixed VAT rate is then known as only single VAT rate.

In practice, almost countries with Nepal of the world favored single VAT rate rather than multiple VAT rate. Because it has many merits, like simplicity understand VAT administration and traders, reduces the cost of VAT administrative operation, easy to understand to customer and transparency.

#### **(b) Multiple VAT Rate:**

Multiple VAT rate means more than two kinds of VAT rate which are fixed on the basis or the commodities and the services nature. In other words, If VAT rate are fixed on the ground of goods and services nature for all level including the producer/importer, wholesaler and retailer, such number of VAT rate are said to be multiple VAT rate i.e. VAT rate are 1 percent, 2 percent and 3 percent for first, second, third goods respectively for VAT purpose. Those fixed rate are known as multiple VAT rate I also favorable on the basis of the following reasons.

- It makes tax burden to the higher incomes class more than to the lower income class so that vertical progressive may be stored in the society.
- It discourages luxurious life and unproductive expenditure and encourages social welfare for the lower income class by imposing two different VAT rate.
- In enlarges it tax coverage by including all kinds and services, the estimated services level may be collected. The higher ratio of revenue collection supports the additional development activities.
- It is suitable instrument that is applied for discourage imported goods and encourages domestic goods, so, differentiate VAT rate is protective umbrella for domestic goods.]

### 3.1.6.4 Value Added Tax as a Substitute of Sales Tax

A tax based on the sale of goods and services imposed basically for generating revenue is sales tax. There are three types of sales taxes, namely, multiple stage sales tax, single stage sales tax and value added tax. The tax imposed on only one stage is single stage sale tax where as the tax imposed on manufacture, wholesaler and retailer it is multistage sales tax. In contrast where the tax is imposed either on manufacture, wholesaler or retailer, it is single stage sales tax. The nature of sales tax is that the tax incase of sales tax is levied on total amount of cost of sales and the tax amount of earlier stage also become the cost of the goods and services for next stage value added tax. In opposite, is levied not on the total amount of cost of sale but on the amount of value added in each stage.

Sales tax is in the world of taxation was introduced the First World War. Before that war, sales tax wax only in Philippines and Mexico. However, due to severe need of revenue, many countries used sales tax had been indispensable point of most of the tax system in the world. However after 1995, this tax was gradually replaced by value added tax. Right now, there are scant numbers of countries that are using sales tax to collect the revenue. Value added tax has replaced the sales tax in most of the countries in the world. In Nepal, VAT is a substitute for sales.

Tax, hotel tax, contract tax and entertainment tax. It is not genuinely new form taxation but merely a sales tax administrated indifferent form. Following example will clearly that VAT does not increases the price of goods or services.

#### Sales Tax:

**Table No. 3.5**  
**Calculation of Sales Tax**

(Assumed sales tax rate 13%)

(in Rs.)

Channel	Cost	Profit/markup	Selling price	Sales tax@13%	Selling price including sales tax
Importer to Wholesaler	1,000	100	1,100	143	1,234
Wholesaler to retailer	1,234	123.30	1,367.30	0	1,367.30
Retailer to consumer	1,36.30	136.73	1,504.03	0	1,504.03

Source: Bhattarai I. and Koirala G.P., Tax Laws and Planning.

Above table shows that,

- ) Sales tax collected = Rs. 143 (tax levied on import level)
- ) Cost price to consumer = Rs. 1,504.30

## VAT:

**Table No. 3.6**  
**Calculation of VAT**

(assume VAT rate 13%)

(in Rs.)

Channel	Cost Price	Value Added	Selling price Excl. VAT	VAT @ 13%	Selling price	VAT Payable to government
Imported goods	1,000	-	-	130	-	130
Importer to Wholesaler	1,000	100	1,100	143	1,243	13
Wholesaler to Retailer	1,100	110	1,210	157.30	1,367.30	14.30
Retailer to consumer	1,210	121	1,331	173.03	1,504.03	15.73

Source: Bhattarai I and Koirala G.P., Tax laws and planning.

- VAT collected = Rs. 173.03
- Cost price to consumer = Rs. 1,504.03

It can be concluded that:

- Sales tax is levied on a single stage where as VAT is levied on multi stage (i.e. production to sale)
- VAT is scientific, modern, and progressive as compared to sales tax.
- Sales tax is levied on total amount of cost of sales and tax amount of earlier stages is included in cost of sales. On the other hand, VAT is levied not on the total cost of sales but on the amount of value added in each stage.]
- Unlike in sales tax, under the VAT system the consumer know the amount of tax contributed by them.

### **3.1.6.5 Reasons for Growing Population of VAT in the World**

VAT is definitely a new and modern tax in comparison with other traditional taxes. Actually, VAT is considered as the most important tax reform in the twentieth century. All the indirect taxes developed in the past. VAT is properly the best tax system. Never before the popularity of any tax and gained prominence in such as short period. Ever since its adoption for the first time by France in 1954, value added tax system has gradually and convincingly earned popularity and is in vogue at present in about 130 countries big and small, developed and developing countries.

Even though VAT is a new system comparing to other traditional tax system its popularity is being increases day by day. There are number of reasons for the growing popularity of VAT.

- VAT is based on the most modern theories.
- It is more informative.

- It raises considerable revenue and sustains it.
- Increment of tax payers are also advanced in it.
- It is less tedious.
- It is free from cascading effect due to the input tax credit.
- It is effective to control price raise and reduce tax evasion due to its catch up effect.
- It is more equitable in the sense that it falls equally on all goods that gather a different proportion of value added at various stages.
- It is attractive from the point of view of foreign trade consideration.
- It is an efficient tax system. It does not cause any distortions, in production and consumption.

## **3.2 Overview of Nepalese VAT**

### **3.2.1 Preparation Made for the Introduction of VAT**

After the transition of multiparty democracy in Nepal, different economic reform program were lunched and VAT can be considered as a part of such reform. Such reforms were done to realize the growing resources need. To bring sustainability in internal resource mobilization Nepal government adopted ten policy to integrate the prevailing commodity taxes under VAT within the period of 8<sup>th</sup> five years plan. In the budget speech of the fiscal year 1993/94 and speeches there after the intention to introduce VAT was declared. After declaration to implement to implement VAT, preparation for it started to began from September 1993 with creating VAT task force in order to make necessary preparation for introduction of VAT. A VAT steering committee was also set up to evaluate and monitor the VAT preparatory activities. Technical and financial assistance was provided by various development agencies i.e. United States Agency for International Development (USAID) Harvard Institute for International Development (HID) of the hazard University USA. Government of Nepal started exploring donors for the continuation of VAT programs. The Danish International Development Agency (DANIDA) accepted the government's request and pledged to support VAT project. The DANIDA has been extending technical assistance since 1997. Due to the change in government the preparation process slightly affected. But the new government also continued to implementation of VAT from September 1997 through finance provided by the donnish development agency. The VAT prop ration work began from the preparation of draft VAT Act.

### **) Legal Basis:**

Various discussion programmers were held regarding on draft of VAT act and this draft act was sent to varies business groups i.e. federation of Nepal chamber of commerce and industry (FNCCI) and Nepal chamber of commerce (NCC), journalists, charted accountants association and several other professional



groups. Afterward, the VAT bill was presented to the parliament passed the VAT bill on 30 Decembers 1995 where as the upper house of parliament passed it on forth January 1996 and the seal on the VAT act was affixed of 20 March 1996. VAT regulator was approved by the cabinet on 27 January 1997. In this way Nepal government passed VAT act. The manual has been prepared in nine volumes cornering all aspects of VAT from the low through the investigation of offsets. They are (i) organization and management (ii) charging and accounting for VAT (iii) VAT registration (iv) collection and enforcement (v) payments of claims for refund (vi) verification and audit (vii) fraud investigation (viii) VAT computer system (ix) VAT act and rules.

### ) **Administrative System:**

A New organizational structure and personnel system was adopted to administer VAT. Under the new system, several sections and subsections were created on basis of the function of VAT administrations. A large tax payer section was created to deal with the large tax payers and an internal monitoring section was created to monitor various sectors of the VAT department and VAT officers.

An officer oriented personnel structure was created to administer VAT. Under the new system, higher-level positions were increased while lower level positions were decreased and additional personnel were recruited numerous training programmes were also organized for tax officials system was developed to run VAT. Several modules such as registration, return, payment, refund, assessment, collection, audit etc were developed, tested and implanted. A number of computer user manuals were prepared and tax officials were provided with the appropriate training. All activities regarding VAT are now operated using a computerized system.

### ) **Tax Education:**

As VAT was new to Nepal, a comprehensive VAT educational programme was launched to educate the public on the various aspects of VAT. In this context, seminars, public speeches and interaction programmes were organized in different parts of the country. VAT presentations were also made during programmes arranged by various local and international bodies and organization, such as the chambers of commerce, Bar Association etc. Other VAT awareness methods utilized include the use of explanatory brochures, media, advertisement, visits by tax officers etc.

### ) **Adjustments in Other Taxes:**

Some adjustments were made in other taxes in order to create a congenial environment for the implementation of VAT. For example, as started earlier, excise duties were reduced on a number of revenue unproductive items. The number and level of sales tax rates was lowered and brought down to a

uniform rate of 10 percent. The rates of customs duties and income tax were also reduced. Similarly, a system of levying import duties on transaction value, in place of administratively fixed value, was introduced in the field of customs duties and a practice of accepting books maintained by tax payers in place of the neglected assessment system in respect of income tax was adopted to ease the VAT implementation.

The final date of the introduction of VAT was set for November 16, 1997 and came into the practice. The existing sales Tax Act 2023, Hotel Tax Act 2018, Contract Tax Act 2023 and Entertainment Act 1\2017 were replaced along with the implementation of VAT. Soon after its going into live, something was wrong. Despite all preparations, introduction phase ran into many problems. The business community staged protest. Several rounds of negotiations were had to reach in an amicable settlement. Such negotiation with business communities were divided between 'No VAT and Yes VAT'. The most significant of all events at that time was vertical separation between FNCCI and NCC staffs. The traders dominated the full fledged implementation of VAT. The whole environment was poisoned. The process of implementing a full-fledged VAT was showed down. Considering the situation, VAT technical group was formed in order to solve VAT implementation problems. Several new provisions relating VAT were introduced through the finance bill 1998, and September 2001. To sum up, in pursuit of this policy, which has been a world wide movement, government of Nepal has made several policy announcements, laid down several laws, formed many task force, produced volumes of reports; it will remain true for future too.

### **3.2.2 Reasons for Adopting VAT in Nepal**

VAT is a modern and scientific tax system in indirect tax system. VAT is considered as the most important tax reform in the twentieth century. VAT is probably the best tax system. Never before the popularity of any tax has gained prominence in such a short period. It has gradually and convincingly earns popularity in the world. A part from world wide recognition of VAT in Nepalese tax system represents some specific reasons for adopting VAT. They are as follows:

#### **(a) Revenue Enhancement:**

The first and foremost reason adopting VAT in Nepal was to develop a stable source of revenue by broadening the tax base to meet the growing revenue need of the nation. Generally, the base under VAT is broadened in two ways, firstly by formulating a modern tax law based on wider coverage of goods and services, the tax base is much broader even a small rate of tax can provide a very high yield of revenue. There is no doubt that revenue can be maximized through a system of tax, which can low rate but high yield. VAT is the workhorse to provide such in revenue that's way there was no choice but to introduce VAT in

Nepal to generate revenue required for improving its deteriorating macro economic performance. VAT is a very scientific and transparent tax that will definitely enhance revenue collection.

**(b) Tax Reform:**

Another most important reason behind introducing VAT was to reform the existing tax policy. A good tax policy has several features. Out of them important ones are simplicity, elasticity's broad base, low rate, transparent, easy to administer fair etc. which the existing system was lacking. Except VAT, all taxes by design have narrow base. Higher tax rate leads to tax evasion. Nepal, by adopting VAT, has tried to overcome this problem. Thus, VAT system was a part of an overall tax reform package.

**(c) Administrative Efficiency:**

The tax system of Nepal seriously lacks administrative efficiency. The general impression is that the administration is indifferent, inefficient and corrupt. Wide spread use of discretionary measures and lack of transparency in a day to day administration have resulted into, arbitrary tax assessments, harassment of genuine tax payer and provides opportunities for corruption. It is therefore, necessary to effect changes in all aspects of taxation i.e. policy, law, procedures and administration in order to implement tax reform in a meaningful way. The way VAT operates influence the working of all other taxes. Operation of VAT, thus, transforms other tax administration. Since the implementation of VAT render transparency at all levels and enhance tax compliance, administrative efficiency in tax system will be ensued.

"The introduction of VAT provides an opportunity to sweep away the cobwebs and revamp a substantial part of the tax administration."<sup>20</sup>

**(d) Transparent Tax System:**

Nepalese economy is not based on accounting system. Some part of the economy is under ground, whereas the part, which is over ground is also not under real accounting. The business persons use to keep double accounting one for tax purpose and another for its own purpose. In economy where most part of economic activities is not within transparent accounting system, tax evasion is pervasive. Nepalese economy is also not an exception in this respect. Since, value added tax is an account based tax system, the objective of using is to make the tax system more transparent.

**(e) Remove Cascading Effect:**

Cascading in tax system means tax on tax with in sales tax system, tax paid at one stage becomes the cost for another stage. And so, there is tax on tax. This case happens within multistage sales tax system. However, within value

added tax system, the tax at one stage does not become the part of the lost for another stage. The value added item and tax item are kept separate within this tax system is free of cascading.

**(f) Tax Base Increment:**

Nepalese economy is small. The tax evasion in Nepalese tax system is very common. It is estimated that about 50 percent of the Nepalese tax is avoided. This situation has made the Nepalese tax not very small. Only a small part of the Nepalese supposed tax payers is within the tax net. Tax GDP ratio in Nepal is only 10 percent in comparison to up to 50 percent in some countries in the world. That way the main objectives of value added in Nepal to increase the tax base.

**(g) Global Economy:**

Globalization has forced many governments to change economic policies including tax policies in the recent years. "The emergencies of multi-lateral institution like WTO have necessitated a member country to reduce customs duties at par with international community leading to competitive trading. In the same way, scarcity of finance and need to attract international fund to meet development needs has forced countries to consider their tax policy. Any reduction in prevailing

---

<sup>20</sup>Narayan Pd.Silwal,(2000):"VAT : Its Prospects in Nepal",Rajashwa'Vol 2.15  
rate of taxes would invariable require same amount of revenue from other sources of tax. In this respect, VAT is considered as an alternative to make up for the revenue loss from the reduction in their taxes. VAT has been taken as the most effective and powerful tool to rationalize internal rate and safeguard revenue.

In the context of globalization especially with respect to South Asian Free Trade Area (SAFTA), WTO provisions, tax rates are supposed to be drastically lowered to make these compatible with globalization. This major challenge to Nepal's tax system in the context of sustainable internal resource mobilization that will decline with the new tax regime.

**(h) Encouragement of the Export:**

Another reason of replacing sales tax by VAT is to encourage the export. Within VAT, under original principle, the tax for export becomes 0 percent. In contrast, the goods are taxed under destination principle. It means the goods and

services are not taxed on the basis of production. Instead, they are taxed where consumption occurs. Zero rating is different from exemption. In case of zero rating, tax payer can get refund of tax that he pays in purchasing the raw materials and interrelated goods. In such way, VAT can promote the export.

**(i) Donors Preference:**

In the present context, economic development is one of the formidable challenges for developing countries like Nepal, where infrastructure development is very poor. The developing countries needs funds, to initiate development projects for national development. Almost 80 percent of Nepal's development financing is met by foreign loans, grants and aid (Budget Speech 2006/07). Donor countries would like to see that encourage effort is put to mobilize internal resources so that government is able to match the development financing. In Nepal, the possibility of getting foreign aid is its background that donors find it difficult to convince their government for more financial aids. The change in the structure of foreign aid of Nepal over years itself it fact. Many countries are now competing with same amount of fund for not in terms of poorness but not in terms of fiscal prudence. This fact has put pressure in each government to keep their economy in order to financial discipline is maintains. One way of achieving this goal is possible only by mobilizing higher internal resources. If the country cannot mobilize domestic resources than the changes of getting higher foreign aid are becoming slim day to day. The IMF under its Enhanced Structure Adjustment Finance (ESAF) program has put the implementation of VAT as conditionality. The government of Nepal, thus, adopted VAT for domestic revenue collection, which will fulfill donor's preference too.

### **3.2.3 Basic Features of Nepalese VAT System**

Nepal has adopted a general consumption type of VAT on destination principle. It has adopted a conventional VAT similar to that implemented over 130 countries around in the world. It has injected some special features into VAT system to make it uniquely Nepalese. Some of them are as follows:

- The adoption of consumption type of VAT.
- The consumption of VAT through tax credit method.
- The principle of destination.
- The provision of exemption and zero-rate goods and services.
- The application of VAT to all business turn over through the retail stages i.e. broad base.
- The allowance of tax credit for taxable supplies including the zero rate supply.
- The facility of tax refund.
- The use of single positive rate of 13 percent.

- The level of threshold of Rs.2 million and importers having commercial imports less than 2lakhs annually or less than Rs.10,000 at a time.

### **3.2.4 Structure of VAT**

This topic is mainly based on VAT Act and different bulletins published by Inland Revenue department at different times.

#### **3.2.4.1 Rate and Coverage**

Coverage of VAT is issue while designing a VAT structure. The coverage of VAT includes both forward and backward and backward coverage-the coverage of retail at one extreme, and of farmers, fisherman and the like at the other. Thus, the coverage of VAT may be defined with reference to both taxable transactions and taxable person's taxable transactions are defined broadly as suppliers made by the persons engaged in business activities. Taxable persons are those who independently engage in supplying the taxable goods and service including imports.

In Nepal, VAT is levied on all types of goods and services, both imported and domestically produced, except those specifically extended by law and it is extended right through to the retail level. So, value added at each stage by each firms in the process of production and distribution is subject to the taxable amount.

However, small vendors, whose annual transaction below the registration threshold irrespective of their place in the production and distribution chain- are not required to register for VAT and hence the tax will not be levied to goods and services sole by the corresponding vender.

The government of Nepal increased the VAT rate 10 percent to 13 percent from Magh 1, 2061, So Nepalese VAT is subjected to a standard rate of 13 percent, however, a few transactions or good and services are zero-rated some are exemption from VAT.

#### **3.2.4.2 Exemption**

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

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

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

- Basic agriculture products
- Goods of basic needs
- Live animals and animals products agriculture inputs
- Medicine, Medical and similar health services
- Education
- Books, newspapers
- Artistic and cultural goods and services
- Personal or professional services
- Other goods and services
- Land and Building
- Betting, Casinos, Catteries

### **3.2.4.3 Zero Rating**

Nepalese VAT is subjected to a standard rate of 13 percent; however some a few transactions or goods and services are zero rated. Zero rating simply means that some selected items are subjected to a tax but a zero percent rate. It the objective is to free certain goods and services or transaction completely from the burden of VAT, it is desirable to zero rate item. If exports are zero rated, for example, exporters are required to register and comply with VAT. They collect VAT on exports at the rate of zero percent meaning that they do not collect any tax on exports but can claim for input tax. Thus, further means that exports do not bear any element of VAT. That's way, zero rating applies only to exports and certain exports related to activities. This technique has been used commonly in European Union (EU) and other developing countries.

Nepal has taken care to relative exports from the burden of taxation. Since, the common world wide method to relative exports from the VAT is to apply zero rates to them. Nepal has also zero for the exports goods and services. In present situation, the following supplies are zero rated.

- Exports of goods
- Exports of services
- Imports of goods and services by accredited diplomats.

#### **3.2.4.4 Threshold**

Small vendors having an annual turnover up to a certain amount are not required to register under VAT. The amount fixed for this purpose is known as threshold. Relating to simplification of VAT administration, Nepal has provided a threshold level even for taxable supply. A threshold would keep off traders from VAT who sell below the prescribed level. A threshold applies to taxable supply and there is an option to register voluntarily in VAT. Any one selling below a level of threshold. It gets into VAT voluntarily in VAT. Any one selling below a level of threshold. It gets into VAT voluntarily; he/she would be getting a treatment equal to other registered tax payers.

In Nepal, the existing level of threshold is Rs.20 Lakhs. Also importers having commercial imports less than 2 lakh annually or less than Rs.10,000 at a time are not required to register.

#### **3.2.4.5 Taxable Supply**

VAT is levied on a taxable supply which is defined as the process of selling, exchanging or delivering goods and services, or the grant of permission there to or a constant there of for a consideration. To be a taxable supply the consideration can be in money or money's worth.

#### **3.2.4.6 Place to Supply**

Under the Nepalese VAT system, the following places are considered as the place of supply.

- For movable goods, the place where the goods were sold or transferred.
- For immovable goods, the place where the goods are located.
- For the imported goods, the customs points of Nepal where the goods first enter into Nepal.
- For the goods supplied by producer or vendor to himself, the place where the producer or vendor of the goods resides.
- For services, the place where the benefit from service is received.

#### **3.2.4.7 Time of Supply**

The time of supply is also important under VAT in order to establish the VAT liability. For most of the practical purpose, the time of supply will be date of billing. However, under the Nepalese VAT, the time of supply will be that one, which happens earlier among the following.

- The time of issue of an invoice by the supplier.
- The time, when the supplier receives the payment for goods and services.
- In case of the goods, the time when they receive or take away the goods from the transaction place of the supplier.



- In case of the services, the time when the services are performed.

### **3.2.4.8 Taxable Value**

Taxable value is an object in which VAT is levied. A taxable value of any transaction is the total price charged by the seller, but it does not include the VAT itself. If there are any price adjustment such as discounts, rebates at the time of the sale are taken into account while calculating the taxable value. If the adjustment is essential after the sales, it needs to be made in subsequent determination of the tax or credits. The taxable value of a transaction is the price paid by the recipient to the supplier, provided that supplier and recipient are independent of each other. The supplier should include all the expenditure borne by him while supplying the goods and services in its price.

If the goods are imported, the taxable value is the sum of import value, freight, transport costs, insurance, commission, import duties plus any other charges paid by the importer. If the transaction is between associated persons, or goods being exchanged or bartered, or at any time when the value declared is lower than the prevailing market value, the taxable value of the transaction shall be the market value of the goods or services. In case of goods which has already been used, taxable value calculated by subtracting purchase value from sales value. If a tax audit is not satisfied that the declared value is significantly below than the market value, he may determine the value of the disputed transaction to the best of his ability.

## **3.3 Operation of VAT\***

This topic is mainly based on VAT Act, Budget speeches of different years and different operational manual published by IRD at different times.

### **3.3.1 Registration and De-registration**

The first step towards VAT operation is registration of vendors who are legal tax payers. Suppliers of taxable goods and services are required to register under the VAT Act to collect this tax. In other words, all vendors carrying on taxable business must be required to register for VAT. However, the vendors having the transaction of only exempted goods and services or falling below the registration threshold are not required to register voluntarily. Like other registered vendors, small vendors, who are registered voluntarily, will be able to claim back input tax paid on their purchase to collect on their sales and to hold the collected tax until its payment to the concerned tax offices.

The existing threshold limit of Nepalese VAT is Rs.20 lakhs. The importers having the annual volume of imports below 20 lakhs remain beyond the tax net and so are not required to register. If any vendor is supplying mixed goods and services i.e. taxable as well as non taxable goods and services, he will have to register only when the transaction of taxable supply exceeds Rs. 2 lakhs.

However, vendors having annual turn over below the registration threshold can register voluntarily.

Group registration is not allowed under Nepalese VAT. Similarly, there is not necessary to register the branch or division of any production or distributor. VAT liabilities collected by such branches or divisions are calculated along with the head Nepalese VAT follows the following registration procedures:

- Fill in VAT registration application form.
- In case of partnership, fill also next form designed for partnership firm.
- Attach it with the copies of business and income tax registration certificates.
- Submitted it to the concerned VAT office so that gives a temporary certificates and allocates tax payer. Identification Number (TPIN) and forwards the details to the VAT department.
- By processing the information, VAT department prepares a VAT certificate with TPIN and provides it to the concerned tax payers through the corresponding VAT office.
- Tax payers has to display the original certificate at main place of his transaction and certificated copies at other places so that intended person can see easily.
- In the process, tax payers have to furnish information within 15 days. Income of changes in the information mentioned in the VAT application form.
- Every tax payer is required to mention the TPIN in the following documents.

- ) Tax invoice/abbreviated invoice.
- ) Purchase and sales books.
- ) Documents for the corresponding to the VAT office.
- ) Documents relating to income tax.
- ) Documents relating to customs duties.
- ) Documents relating to imports and exports and
- ) Documents relating to obtain a loan from a bank or any financial institution exceeding Rs.1 lakh.

**\* De-registration**

A VAT registered firm can apply for de-registration under the following conditions:

- In case of incorporated firms if the incorporated firm is close down, sold or transferred.
- In case of the personal ownership, if the owner dies.
- In case of partnership firm, if it is dissolved.
- If a registered person ceases to be engaged in the taxable transaction.

- If registration is done in error. However, if they have already been taken the tax credit facility, tax would be determined on the stock (including capital equipment) and demanded to pay to the VAT office.

### **3.3.2 Invoicing**

Invoices are the initial documents for VAT control and are most essential under VAT system. Every registered producer or vendor is required to issue an invoice for each taxable sale. There are two types of invoices: Tax invoices and abbreviated invoices.

#### **\* Tax Invoice**

Tax invoice established both the liability of the supplier and the amount of the deduction allowed to the registered purchaser. A VAT registrant is required to issue a tax invoice in the prescribed form whenever a transaction takes place. A tax invoice should be issued by VAT tax payers and contains the following information.

- A sequential identifying number
- The date of transaction
- The date of issue of the invoices, if it is different from the date of transaction.
- The name, address and TPIN of the vendor or producer.
- The name, address and TPIN of the buyer, if registered.
- The type of transaction (e.g. sale, hire, rental, exchange).
- A description sufficient to identify the goods and services supplied.
- The quality of goods or the extent of services for corresponding description.
- The rate of VAT and the amount of payable, excluding VAT for each description of goods and services.
- The value of any goods or services provided in part exchange.
- The total amount payable, excluding VAT.
- The rate and amount, if any discount offered.
- The total amount of tax charged.
- The total amount charged including VAT.

A minimum of three copies of each invoice is essential. The original copy must be given to buyer and remaining two copies must retain by vendor or producer. It can be made available to a tax officer for inspection at any reasonable time. The invoice must be issued in a sequential, numerical order. However, invoices must be prepared with different number for branches or sections with prior approval of the VAT office.

#### **\* Abbreviated Invoice**

If a registered vendor is retailer of any items, may apply to use an abbreviated invoice for his sales. The tax office may allow its use subject to the following conditions.

- The recipient of goods and services for which an abbreviated invoice is used shall not be entitled to input tax credit on that purchase.
- The abbreviated invoice shall not be used for transaction exceeding Rs.5,000 including VAT.
- The registered persons keep a daily record of sales.
- Any bills rolls or cash rolls used by the retailer must be totaled daily and retained for inspection at any reasonable time.

The following information must be recorded on the abbreviated invoice.

- An identifying address and registration number of the vendor.
- The date of transaction.
- The sufficient description to identify the goods or services supplied.
- The total amount of money paid including VAT.

In case of sales made under the abbreviated invoice, VAT is calculated by multiplying the sales by the VAT quotient. The VAT quotient is found by dividing the rate of VAT by 100 plus the rate of VAT.

### **3.3.3 Books of Account**

All VAT registrant requires keeping records of all invoices either received or issued, including the serial number and date of issue. In general, VAT liability is determined on the basis of the account kept by the tax payer himself. The records should be kept in such a way that VAT authorities are able to check the accuracy of the VAT returns. Such records are kept for fairly long time generally 4 to 6 year.

In VAT system, tax payers may be considered as a part of administrative body and list all the sales and purchase in the corresponding book. They are also required to prepare for a VAT account.

#### **(a) Purchase Book:**

Every VAT registrants are required to maintain an account of their business purchases from vendor, or producer for VAT purpose. A purchase book means the account of the VAT registrant, which includes all the transaction for business purchase. They, record their purchase transaction on the basis of invoices of business purchases. At the end of each accounting period, VAT registered must total the amount of taxable purchase, imports, tax exempt purchase/imports and the tax paid on purchase/imports.

#### **(b) Sales Book:**

VAT registrants are also required to maintain an account of their sales for VAT purposes. Sales account means the account of the VAT registrants, which includes all the transaction for business sales. The transaction must be kept on the basis of invoices. At the end of each accounting period, VAT registrants need to total the taxable amount (standard and zero-rated) and tax exempt sales they have made in that period and tax collected on sales. If they make both taxable and tax exempt purchases and sales, they are then required to calculate the proportion of input tax they are entitled to the period.

**(c) VAT Account:**

Every VAT registrants must be kept to the VAT account. VAT account means a monthly summary for the transaction of tax paid on taxable purchases and tax charged on taxable sales.

**(d) Others:**

Every VAT registrants can maintain their business accounts on computer with a prior approval of the VAT administration. VAT registrants must take their accounts available to the VAT officer for inspection at all reasonable times. In most instances they will be produced at the VAT registrants premise but their production can be demanded at any time. The VAT officer may take possession of account at any reasonable time and they may be removed, copied or takes possession of as necessary. VAT registrants are required to retain all the documents and accounts to their business for a period of six years.

The VAT registrants require using the purchase and sales books verified by the tax officers. However, the VAT officer needs to verify purchase and sales books in the following cases.

- When the tax payer apply to verify the purchase and sales book in the office.
- In the period of the tax auditing or checking.
- In the time of supervision.

### **3.3.4 Debit Note and Credit Note**

If VAT registrants need to issue debit not or credit note, because of the change in price of the supplied goods and services, the note must be prepared by writing debit credit clearly. Further, such debit not or credit note must be include the following subject matter to their notes.

- Serial number
- Date of issue
- Name, address and registration of supplier.
- Name, address and registration number of the recipient, if registered.
- Number and date of tax invoice related to the transaction.
- Description of goods or services and reason from credit and debit.

- The amount of credit or debit amount.
- Tax amount of credit or debit amount.

This prepared credit or debit note must be totaled by the tax payers.

### **3.3.5 Submission of Return**

Every VAT registration must be complete a VAT return and submit their returns to be concerned VAT office within 25 days following the end of the account period. Compulsory registrants are required to submit return every month while voluntary registrants have to submit a return for period of four months. The head office is required to submit tax returns for the transaction carried out by its branches and sub-branches, if any. There are no special rules, for example for seasonal business or others. Even if there is no transaction, it is necessary to submit a zero return. Zero return is possible when input and output taxes of the tax payer are equal. Moreover, when the input tax exceeds the output tax, the return will be credit return or zero returns. However, there is no need to attach purchase and sales invoices or any other documents relating to the tax with the returns.

If tax payers do not submit return within stipulated time, he will be subjected to a penalty. The amount of penalty will be 0.95 percent of payable tax per day or Rs. 500 which ever is higher.

### **3.3.6 Payment of Tax**

In Nepalese VAT system, every VAT registrant having output tax liability greater than the input tax credit is required to submit the difference to the government with 225 days from the close of the month in which the tax liability occurred. Compulsory registrant has to pay tax every month while voluntary registrants can pay tax on trimester basis.

There are some circumstances that are beyond the control of a tax payer which can prevent tax due within the prescribed time. These include natural disaster such as floods and other unfortunate circumstances such as fire or death in the family. Under such circumstances, the law grants the authority to the director general to waive the payment of the penalty. On the other hand, if the input tax credit exceeds the output tax liability, the balance of credit is to be carried forward for the next month. However, a VAT registrant who have more than 50 percent of his sales as exports can apply for refund instead of carry forward of the excess credit.

### **3.3.7 Tax Assessment**

VAT is a self assessed tax. Tax payers determine their tax liability themselves and pay tax. Tax assessment is a process of determining the amount

of tax individual or company is liable to pay. This may be done by either two ways. One is that the tax payers make returns, listing their income from various sources and any facts affecting their entitlement to tax allowances and then tax authorities make the actual assessment. The alternative method is self-assessment besides supplying information on their income and entitlement to allowances, a tax payers produces their own assessment applying the rule to their own figures. Then assessments are checked by the tax authorities. However, not all the VAT registrant may file the correct returns and pay the correct amount of tax. There could be different situation regarding the importer tax assessment as follows.

- Tax return is not filed.
- Tax return is late.
- Tax return is incomplete.
- Tax administration has significant reason to believe the tax liability otherwise that is declared.

In such cases, VAT official may have to prepare a tax assessment. Such assessment could be computer or management assessment.

**(a) Computer Assessment:**

If a VAT registrant not assess his income himself and does not file his return with them specified time, he is termed as non filer. The computer prints out the list of such non filers after 45 days of the expiry of the tax period and VAT office gives notice to each non-filer. If they not file return the specified period even after the issue of the notice of non filer, the computer makes monthly or trimester assessment, depending upon the state of a particular tax payer. The process regarding computer assessment is designed in the following way:

- Find out the highest amount of declared by the tax payer in his return during the previous 12 month from the VAT payable.
- If a tax payer has not filed any return, find the turn over amount states on the year and then multiply by the VAT rate.
- Pick the highest figure in (1) or (2) above. Add the amount found in (3) to the 30 percent of itself to get the assessment amount.

**(b) Management Assessment:**

Tax officer do manage assessment when a tax payer receive undated information after submitting his returns and informs. It to tax officer or in the case of that tax payers where tax officers find errors during the tax audit. The management assessment is done through the following procedures.

- Tax officer assessment tax and determines interest and penalties.

- Tax officer prepares management assessment on a monthly basis in case of compulsory registrants and on trimester basis in case of other.
  - Management assessment requires be batching and submitting to the computer section.
- VAT assessment will only normally extend back four years from the time the tax payers is given a notice of assessment.

### **3.3.8 Collection of VAT**

The VAT administration collects tax from VAT debtors due through the following methods.

- Tax offices are empowered to recover tax dues from the credit in a VAT debtor's accounts.
- Tax officers can also issue to a third party who is indebted to the VAT debtors, a demand for the payment of the money owed by the third party to the VAT debtor.
- Tax officers can also authorize to suspend the transaction of a VAT debtor.
- Tax officers also can with hold import export of VAT debtor.
- Tax dues can also realized by seizing and selling the property of the VAT debtor.
- Tax officers can collect tax arrears within 6 years of their establishment but due cannot be collected after that period of the tax due determination.

### **3.3.9 Tax Credit**

#### **(a) Tax credit on Taxable supply:**

Under this system, VAT registrant having taxable supplies including the zero rate supplies are entitled to claim input tax credit. It is allowed to those purchase goods and services sold in taxable transactions. Small vendors falling below the registration threshold and not registered for VAT neither requires paying VAT on their purchase nor can claim an input tax credit. Input tax credit is allowed only when the following requirement is fulfilled:

- The goods and services supplied to the VAT registrants must be solely for use in his business of making taxable sales.
- The registrant must sold and be able to produce a valid tax invoice for the goods and services for which credit is desired.
- The claim for deduction must be made within one year of date invoice.

#### **(b) Tax Credit on Mixed Supply:**

A person involved in mixed transaction i.e. both taxable and exempt transaction is entitled to claim input tax credit in on the purchases related to his exempt sales. Only the purchases, for which VAT registrant can identify as taxable sales. Will be subject to the tax credit. The purchase of basis requirement such as diesel, telephone charge, stationary, etc may be used jointly for both



taxable and exempted sales. In such purchase, a registrant can claim a proportion of his input tax based on the proportion of the taxable sales to total sales.

**(c) Partial Credit:**

Some goods are used for both the purpose of the business and personal use. In such cases, it is very difficult to ascertain the proportion used in the taxable and tax exempt transactions. These include such items as computers and cars. In these credit may be claimed on aero planes and automobiles and 60 percent may be claimed on computers.

**(d) No Credit:**

In certain goods and services, it is very difficult to ascertain whether they have been used for the purpose of the business or for personal use. These include such items as business entertainment, beverage, alcohol or alcohol-mixed beverages such as liquor and beer and light petroleum fuel for vehicles. In this case no input tax credit can be taken.

### **3.3.10 Tax Refund**

Under the Nepalese VAT system, there is a provision for the refund of VAT. Such situations generally arise in the case of zero-rated supplies such as exports. This is because exports of taxable goods do not have to collect tax on their exports but entitled to claim tax paid on inputs of exports. Refund may arise in other situation.

**(a) Refund to Exporters:**

There is not tax due on exports since they are zero rated and hence there is not tax due. A person is defined as an exporter for any month if his export sale of that month exceeds half of his total sale of the same of the same month. An exports needs to apply to the concerned to get the tax refund. Then, the tax office will process the refund claim and forward it to the VAT refund. Then, the office will process the refund claim and forward it to the VAT refund section of the VAT department for the final approval and issuance of the refund cheques.

**(b) Refund to Non-Exporters:**

There is also situation where it will be necessary to refund in the case of registrant who is non-exporter. A registrant may have excess credit even if he is not an exporter. In this case, he can carry forward his excess credit. He can claim for a refund may arise in the case of new business, an inventory building up or the purchase of large for a period of six consecutive months he may submit an application for refund of VAT to the concerned VAT refund offices. After being proceed refund application are to be forwarded to the VAT refund section of the

VAT department that is fund section of the VAT department that is responsible of approval and issuance of cheques.

**(c) Refund to Diplomats etc:**

Diplomats are also subject to the refund of VAT on a reciprocal basis. In case of importation, they do not have to pay VAT since their imports are zero-rated and in case of domestic products, they are subject to VAT but can claim for refund. Besides, other officials of international organizations that entitled to claim for refund. Similarly, the project under bilateral or multilateral agreements also gets the facility.

**(d) Other Refunds:**

Refunds are also provided on some situation where VAT may be collected by mistake, for example on a product that either zero-rated or exempted. However, refund will not be provided if there is not application attached with necessary documents within a period of three years after the date of final account of the concerned transaction.

### **3.3.11 Penal Provisions**

Value added tax act of Nepal has made the following provision of penalties:

- A tax payer who fails to register such taxable business within 90 days of commencement of VAT Act or who fails to register the business before commencing such transactions, such tax payers is liable to pay tax amount due in each tax period and Rs.10,000, 25 percent of tax due is imposed if the tax payer violets the Act or rules.
- A tax payers who fails to use registration number or to clearly display the registration certificates or to inform the changes, if any, regarding business transaction within 15 days of such change, such tax payers is liable to pay 1,000 for each offence.
- If any registered person does not issue an invoice to the recipient, such person is liable to pay Rs.5000 for each offence. If a person, who is not registered, issues the invoice or other document showing the collection of tax or collects tax, such person is liable to pay 100 percent of the tax amount at penalty.
- If any tax payer who is unable to keep an up to date account of transaction of the tax period. Such tax payer is liable to pay Rs.10, 000. The tax payer who obstructs the audit of transactions is liable to pay Rs.5,000 for each offence.
- The tax payer, who fails to include the information such as the date of transactions, the value of each transaction and other prescribed matters related to transactions, is liable to pay as penalty up to Rs.5,000.

- A penalty of Rs.10,000 is imposed on a registered person who does not use the certified purchase book and sales book for the purpose of keeping accounts or does not preserve the account of transactions for a prescribed period.
- If a tax payer registered businessman fails to assess, file return and pay the tax in the period as prescribed by law, the tax payer is liable to pay either 0.05 percent per day of the due tax amount or Rs.10,000 whichever ever is higher as penalty for each tax period.
- If a tax payer makes obstacles or objections regarding the investigation and audit of his business tax related matters by the tax officers, such tax payer is liable to pay a penalty of Rs.5,000 each time.
- If a tax payer is found to have issued an invoice by under invoicing, the tax officer may impose a penalty of Rs.2,000 for each invoice or 100 percent tax or a maximum of 6 months imprisonment or both whichever ever is higher.
- If the tax payer violates VAT Act or rules made under this Act, the tax payer should pay Rs.1,000 each time.
- If a person commits any of the following offences, a tax officer may impose a fine not exceeding 100 percent of the amount of tax or an imprisonment up to 6 months or penalize with both fine and the imprisonment.

### **3.3.12 Appeal System**

A tax payer who is aggrieved by the decision made by the tax officers regarding tax assessment or order of punishment and penalty or decision made by the director general to suspend business transactions for a maximum of 7 days, may appeal to the revenue tribunal within 35 days against such decision. In these cases, the tax payer should pay the undisputed tax amount and should have to deposit or issue a bank guarantee for full amount of penalty and fifty percent of the disputed amount.

### **3.3.13 VAT Administration**

Administration means the management of affairs. Its organization should be strong and reached to the grass level so that, the government policy and programme can be functioned to the people. VAT is operated by Inland Revenue in Nepal. There are 21 VAT offices under IRD which are given below:

**Table No. 3.7**  
**IRD Offices**

<b>S.N.</b>	<b>Office</b>	<b>S.N.</b>	<b>Locate place offices</b>
1.	Bhadrapur	12.	Kathmadu (1)
2.	Bhairahawa	13.	Kathmandu (2)
3.	Bhaktapur	14.	Kathmandu (3)
4.	Bharatpur	15.	Krishnanagar
5.	Biratnagar	16.	Lahan
6.	Birgunj	17.	Lalitpur
7.	Dang	18.	Mahendranagar
8.	Dhangadi	19.	Nepalgunj
9.	Dharan	20.	Pokhara
10.	Hetauda	21.	Simara
11.	Janakpur		

Source: Annual Report 2004/05 IRD, Lajimpat, Kathmandu

VAT officers are primarily responsible for the execution of the program like assessment, tax payer's education, registration collection the verification of tax payer's books and records, conduct a survey on potential tax payers in time to time. They also responsible for enhancing the compliance level of the tax payers and to be involved in tax audits and investigation.

# CHAPTER-FOUR

## RESEARCH METHODOLOGY

### 4.1 Introduction

Human nature is always curious to learn, understand investigate about the phenomenon by raising questions like why, how, what, when and the like to find the answer of any problem whatever he/she does is research.

Research methodology is the combination of two words research and methodology. Research means to search again to find out something new and more about a phenomenon. It is systematic and organized effort to inquire about a specific problem that needs an answer, this process of gathering, recording, analyzing and interpreting data with the purpose of finding solution to the problem is called research methodology is a systematic rules and procedures upon which research is based. It is the science of method or rules of the game.

Research and methodology are the two sides of the same coin. To search again various tools, techniques and methods are used systematically that is caused research methodology in simple way. Research methodology assists to formulate the way to get the predetermined objective. So, it is the strategic formulas, which helps to study a problem smoothly and scientifically closer to truth. Research methodology is a format or a set of methods that has to be followed as guiding principles in scientific study.

This study was undertaken to evaluate the effectiveness of VAT, in Nepal. Actually this is a review of VAT implementation since its conception, decision, preparation, implementation of VAT. Conduct this study opinion survey was the major focus is on the effectiveness of VAT in revenue collection in Nepal. More national revenue may be collected through efficient administration. After performing analytical study on these matters, it tries to recommend of tax administrator for making VAT more effective regarding the revenue collection and to solve the problem of VAT effectively. To achieve these objectives a research methodology has been designed in this chapter.

Both primary and secondary sources of data are used to conduct this study. Opinion survey technique was adopted while collecting the primary data to find out the views of respondents representing different groups related the value added tax (VAT). The empirical investigation was inducted to final practical aspect of VAT. While conducting the opinion survey, questionnaire were distributed to different group of people i.e. tax experts, tax administrators, businessman/traders and consumers.

## **4.2 Research Design**

Research design is a plan, structure and strategy of investigation conceived so as to obtain answers to research questions and control variance. Thus, it is not possible for the researcher to conduct a research work without research design. Most of the data and information of the study were concerned with the past phenomena of the performance either they are numerical or opinions. For studying the stated objectives exploratory and diagnosis research has been applied.

To achieve the specific objective study descriptive and analytical research has been carried out in terms of effectiveness of VAT in revenue collection in Nepal. For an empirical investigation, an opinion survey has been conducted the opinions of the various 65 respondents associated with distinct groups. i.e. tax exports, tax administrators. Businessman and consumers were collected through structured questionnaire. It follows analytical and descriptive research design but basically descriptive analysis has been followed the research design includes.

- Descriptive analysis , tabulation
- Primary data
- Interaction with resource persons

## **4.3 Period Covered**

The study covers a period of 11 years. The analysis is done from the date of 1997/1998 to 2007/2008.

## **4.4 Population and Sample**

In order to benefit this study, primary data are based on the questionnaire, 65 questionnaire were distributed, i.e. tax administrators/ exports/lecturer 20, businessman 20, consumes 25. But only 52 responded to it 52 sample size from Birtamode and Chandragadi are selected by consulting for this study. The following table shows the groups of respondent and the size of the samples.

## **4.5 Type and Sources of Data**

Data is the foundation of all the research. Research is a systematic study of the certain specific problem. That is why the study requires relevant

qualitative and quantitative information. Data collection is the most essential aspect of any research because the whole result of research depends on the adequacy and relevancy of the data/ information. Both primary and secondary source of data has been collected in order to achieve the real and fact full result from this research. All the available data have been collected the particular sources of data are as follows:-

#### **4.5.1 Primary Data**

The major tools used for the collection of primary data are distribution of a close structure questionnaire schedule to collect the views of tax experts, tax administration, businessman, consumer etc opinion and information are collected from discussion and interaction with intellectual person, and related persons.

#### **4.5.2 Secondary Data**

Further needed for study is collected from the secondary sources. The information obtained from books, journals, newspapers, reports, dissertation etc. The major sources of secondary data are from economic survey and budget speeches, ministry of finance, publication of CEDA, publication of T.U., publication of Inland revenue department, publication of Nepal Rastra Bank, Newspaper such as The Gorkhapatra, The Rising Nepal, The Himalayan Times, The Kantipur Daily, Magazines Journals of Accountancy, International Monetary Fund, Dissertations related to VAT available at library of Kankai college Birtamode , News from F.M. Radio, VAT act and regulations.

#### **4.6 Data and Information Gathering Technique**

To fulfill the objective of research work both primary and secondary data have been collected. For the collection of primary data, a schedule consisting number of different questions related to research questions have been put forwarded in front of tax officers, tax experts, lecturers, businessman, consumers to, identify problems related to research questions (see appendix I).

Most of the secondary data this study has been obtained from the yearly report of Inland Revenue department, Lajimpat, Economic survey and different publication of world bank, Nepal Rastra Bank, quartely bulletin Ministry of Finance, National Accounts Statistics of Nepal published by central bureau of statistics etc.

Primary data has been generated to answer the research questions has been followed by following tools:

**(a) Interviews and Discussion:**

The researcher interviewed and discussed the different businessman, tax experts, intellectual persons and other related persons directly connected with VAT.

**(b) Written Questionnaire:** To finding the problems of VAT in Nepal structured questionnaire has been prepared and requested to fill up the questionnaire to different tax officers tax experts, lecturer, businessman, consumer for the propose.

#### **4.7 Method of Data and Information Analysis**

With reference to the research methodology different tools and techniques is used by the researcher firstly tabulated the information into separate format systematically in order to get the desired objectives. After that these data are presented and analyze the effectiveness of VAT in revenue collection in Nepal. Basically the tools and techniques used to analyze and present are as follows:

##### **4.7.1 Simple Percentage**

In this study, simple percentage has been used which is obtained from:

(i) For the calculation of in total share to see of covering parts in the year, the study has taken the following formula:

$$\text{Percentage (in year)} = \frac{\text{Share of Proportion}}{\text{Total Share}} \times 100$$

Total Share

(ii) For the calculation of percentage of VAT revenue, on various heading of revenue to see that what percentage cover in their revenue respectively, the study has applied the following formula:

$$\text{Percentage (in year)} = \frac{\text{VAT Revenue}}{\text{Related Heading Revenue}}$$

##### **4.7.2 Simple Average (Mean)**

The average is the simplest of all averages and it is most widely used in practice. In fact, when the term 'mean' is used alone, it almost always refers to the arithmetic mean. The arithmetic mean is defined as sum total of all observations divided by the number of the observation.

$$\text{Mean} = \frac{\text{Sum of Total Value of Variables}}{\text{No. of Observation (No. of years)}}$$

##### **4.7.3 Trend Analysis (Regression)**

It is a statistical device, with the help of which, we can estimate or predict the value of one variable when the value of other variable is know. The unknown variable which we have to predict is called dependent variables and the variable whose value is known as independent variables.



Trend equation is also known as estimating equations. There are two trend equations. The Equation of x and y and equation of y on x the equation of y on x has been used in this study.

$$y = a + bx$$

Where,

y = Dependent variable

x = Independent variable

and b = Numerical constants

The study has been made to analyze the total tax revenue, total indirect tax revenue, VAT revenue, and GDP from 11 years data i.e. 1997/98 to 2007/08 and forecast for next 5 years till 2012/13.s

#### **4.7.4 Compound Growth Rate**

It measures compounded growth rate of the given data.

$$A = P (1 + i)^n$$

Where,

A = Amount in final year (2005/06)

P = Amount in base year (1997/98)

n = no. of years

i = Growth Rate

#### **4.7.5 Various Graphs and Diagrams**

The pictorial representation of the data is known as chart and diagram. Graphs, Charts and Diagrammatic representation of data enable to delineate and attractive and clear picture of the data and make the comparison easy. In this study different graphs, chart and diagrams presented to analyze the available data. Bar-diagram (Multiple, Percentage) Trend line has been shown in chapter five.

# CHAPTER-FIVE

## DATA PRESENTATION AND ANALYSIS

### 5.1 Government Revenue, Expenditure and Deficit

Nepal is a developing country where 30.80 percentage of total population live under poverty line. At present some years, the government expenditure is raising but the revenue is not growing as per expenditure. That's why, Nepal is facing deficit financing problem. The present status of government expenditure, revenue and deficit from fiscal year 1997/98 to 2007/8 presented below:

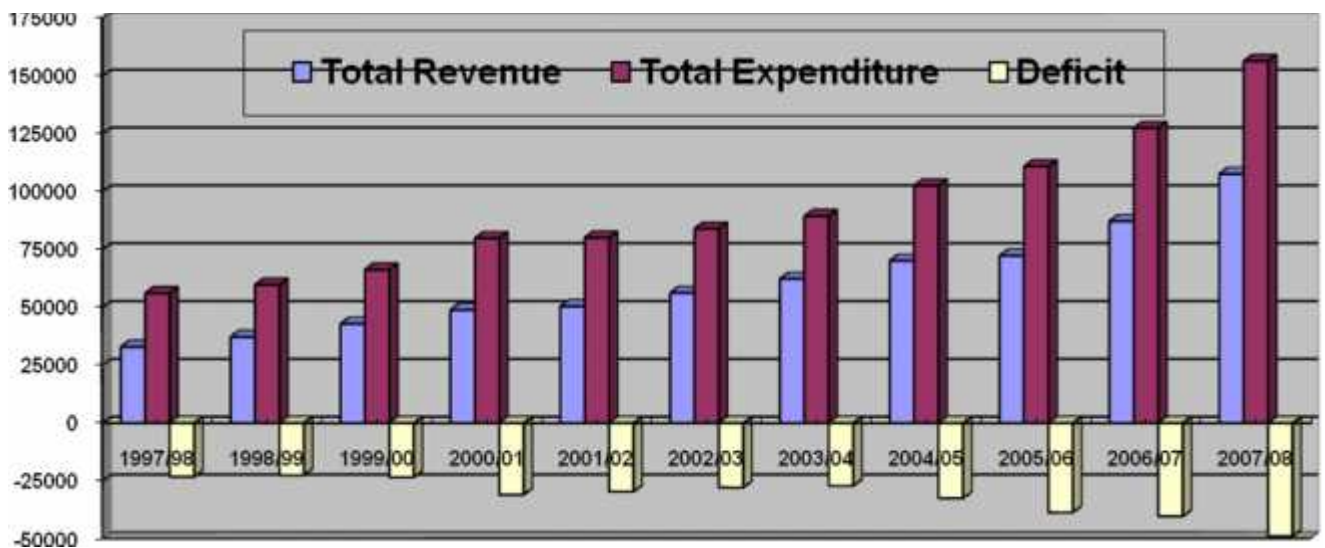
Table No. 5.1

Government Revenue, Expenditure and Deficit  
(Rs. in million)

Fiscal Year	Total Revenue	Total Expenditure	(+) surplus/(-) Deficit
1997/98	32937.9	56118.3	-23180.4
1998/99	37251.0	59759.0	-22508.0
1999/00	42893.7	66272.5	-23378.8
2000/01	48893.9	79835.1	-30941.2
2001/02	50445.6	84006.1	-277776.4
2002.03	56229.7	84006.1	-27776.4
2003/04	62331.0	89442.6	-27111.6
2004/05	70122.7	102560.4	-32437.7
2005/06	72282.1	110889.2	-38607.1
2006/07	87199.7	127456.9	(-)40257.2
2007/08	107622.5	1,56,392.4	-48769.9
Average	60746.3	92073.1	31326.80

Source: - Economic survey, 2003/04 and 2007/08, Ministry of Finance.

Figure No. 5.1  
Trend of Government Revenue, Expenditure and Deficit



Source: Table no. 5.1

Source: Table No. 5.1

## 5.2 Revenue Structure of Nepal

The existence of government proofs by the activities of government which enhance the economic and social status of people. In order to perform such social oriented activities government needs huge amount of resources. Such types of economic revenue are collected either from internal and external source. Total revenue may be divided into two main headings.

- (a) Tax revenue
- (b) Non tax revenue

Tax revenue consists of customs, taxes imposed upon consumption and production of goods and services, land revenue and registration fees and taxes on property, profit and income.

Non-tax revenue is a composite of government charges, fees and forfeitures. receipts from sale of commodities and services, interest receipts, dividend receipts royalties and sales of assets and other miscellaneous receipts. Nepal is depending on foreign source in order to match its expenditure and revenue gaps as an external source.

### 5.2.1 Total Revenue, Tax Revenue and Non-Tax Revenue in Nepal

Total revenue, tax revenue and non-tax revenue structure of Nepal in different fiscal years are presented below:

Table No. 5.2

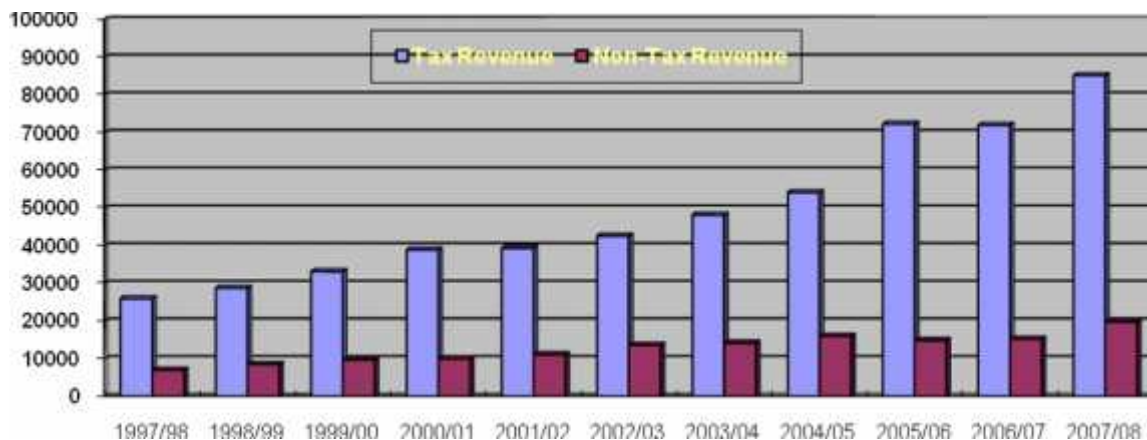
Composition of Total Revenue, Tax Revenue and Non-Tax Revenue  
(Rs. in million)

Fiscal Year	Total revenue		Tax Revenue		Non-Tax Revenue	
	Amount	%	Amount	% as total rev.	Amount	% as total rev.
1997/98	32937.9	100	25939.8	78.75	6998.1	21.25
1998/99	37251.0	"	28752.9	77.19	8498.1	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	77.74	13642.7	24.26
2002/03	56229.7	"	42587.0	75.74	13642.7	24.26
2003/04	62331.0	"	48173.0	77.29	14158.0	22.71
2004/05	70122.7	"	54104.7	77.16	16018.0	22.84
2005/06	72282.1	"	57430.4	79.45	14851.7	20.55
2006/07	97199.7	"	71973.4	82.53	15226.3	17.47
2007/08	107622.5	"	85155.5	79.12	19784	20.88

Source: Economic survey 2003/04 and 2007/08, MOF, Government of Nepal.

From the above table, we come to know that the share of tax revenue. In the year 1997/98 and 1998/99 the share of tax revenue was 78.75 and 77.19 percent and share on non-tax revenue was 21.25 and 2.81 percent. Likewise, in the year 2007/08 the share on tax revenue was 79.12 and non-tax revenue was only 20.88 percent. The average share of tax revenue from the period 1997/98 to 2007/08 was 78.63 and average share of non-tax revenue was 21.37 percent. This indicates that the role of tax revenue is very much important in resource mobilization of Nepal to meet the increasing government expenditure. So, that we can say that tax revenue is a major source of government revenue.

Figure No. 5.2  
Trend of Tax and Non-Tax Revenue in Nepal



Source: Table No. 5.2

From the year 1997/98 to 2000/01 the amount of tax revenue has been increasing slowly every year with amount of 25939.8 million to 38865.10 million but figure in percentage of tax revenue in total revenue has been fluctuating in different years. In the fiscal year 1997/98 the percentage of total tax revenue was 78.75. But in fiscal year 1998/99 to 2000/01 the percentage contribution of tax revenue increased up 79.49 percent from 77.19 percent. In the year 2001/2002 its contribution decreased to 75.74 percent. Then, in the year 2003/04 to 2006/07 it contribution was increased to 81.91 percent. Likewise, the trend of non-tax revenue collection was 8498.4. In the year 2000/01, the non-tax revenue collection decreased then 1998/99. After the year 2000/01, the non-tax revenue collection has been fluting in different years. From the year 2001/2002 the non-tax collection revenue increased from 20.51 percent to 22.84 percent up to 2004/05. But the percentage decreased in 2005/06. After 2004/05 the non-tax collection percentage in total revenue has been decreased.

In the year 2006/07 the non tax revenue decreased to 17.47% with slightly increment of 20.88 in 2007/08.

From the above table and figure what we come to know that the amount of both tax revenue and non-tax revenue has been increasing but the percentage contribution is fluctuation in different years.

### **5.2.2 Structure of Tax Revenue in Nepal**

Tax is a compulsory contribution made by tax payers to the government without having any direct personal benefits. "A compulsory contribution from a person to the government to defray the expenses incurred in the common interest of all without reference to special benefit conferred" (Silgam) 30 Taxation is the main source of income of the government excluding foreign aid. Tax revenue comprises compulsory un-required, non-payable receipts collected by the government for public purpose. It includes interest collected on tax arrears and penalties collected on non-payment or late payment of taxes. Tax revenue is the principle source of the government revenue. In Nepal, tax revenue is major source of government to mobilize internal source effectively and properly as it has been dominating the government revenue by contributing around three quarters of total revenue.

Nepalese total tax revenue is divided broadly into direct tax revenue and indirect tax revenue. Direct tax revenue includes revenue from land revenue and registration, taxes on property, profit and income where as indirect tax revenue is composed of taxes like customs on export and import, taxes on consumption and production of goods and service. The structure and trend of tax revenue for the fiscal year 1997/98 to 2007/08 are given in the table below.

Table No. 5.3  
Structure of Tax Revenue in Nepal  
(Rs. in million)

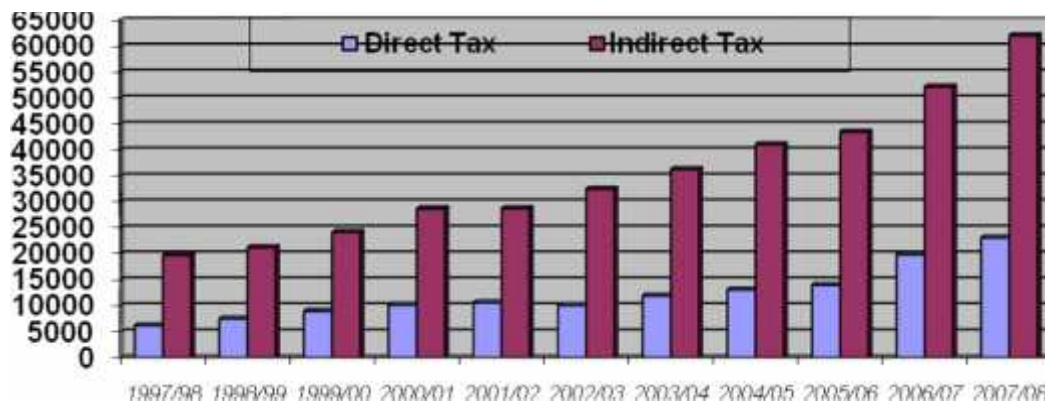
Fiscal year	Total tax Revenue	Direct tax		Indirect tax	
		Amount	% as total revenue	Amount	% as total revenue
1997/98	25939.8	6187.9	23.85	19751.9	76.14
1998/99	28752.9	7516.1	26.14	21236.8	73.86
1999/00	33152.1	8951.5	27.00	24200.6	73.00
2000/01	38865.1	10159.4	26.14	28733.1	73.06
2001/02	39330.6	10597.5	26.94	28733.1	73.06
2002/03	42587.0	10105.8	23.73	32481.2	76.27
2003/04	48173.0	11912.6	24.73	36260.4	75.27
2004/05	54104.7	13071.8	24.16	41032.9	75.84
2005/06	57430.4	13968.1	24.32	43462.9	75.68
2006/07	71873.4	19890	27.6	52146.4	72.4
2007/08	85155.45	23087.759	21.11	62067.698	72.89
Average	40926.1	10274.5	25.61	30651.65	74.38

Source:- Economic survey 2003/04 and 2006/07 Ministry of Finance

From the above table, we can say that the total revenue, direct tax and indirect tax is increasing every year that it was 25939.8, 6187.9, 19751.9 million in fiscal year 1997/98 and reached to Rs.57430.4, 13968.1, 43462.3 in fiscal year 2005/06 respectively.

The share of direct tax to total tax revenue was 23.85 percent in fiscal year 1997/98 and reached to 27 percent in fiscal year 1999/2000. In fiscal year 2000/01 the share of direct tax to total revenue is decreased by 0.86 percent compare with previous fiscal year but it was again increased in fiscal year 2001/02 and reached to 26.94 percent and it was again decreased in fiscal year 2002/2003. The share of direct tax to total tax revenue was then increased in fiscal year 2003/04 by 1 percent in comparison with its previous year 2002/2003 and reached to 24.73 percent and again decreased to 24.16 percent in fiscal year 2004/05 and it again increased to 24.32 percent on fiscal year 2004/05 and it again increased to 24.32 percent on fiscal 2005/06 0.16 percent in comparison with its preceding year. Likewise the share of Direct tax to total revenue increased to 27.6% and 27.11% respectively in the year 2006/07 and 2007/08. Moreover the share of Indirect tax decreased to 72.4% and 72.89% respectively in the year 2006/07 and 2007/08. The average share of direct tax to total tax and indirect tax to total tax was 25.61 and 74.38% respectively during the study period. It shows that the whole Nepalese tax structure is dominated by indirect tax revenue.

Figure No. 5.3  
Trend of Direct Tax and Indirect Tax Revenue



Source: Table No. 5.3

### 5.3 Indirect Tax Revenue

An indirect tax is imposed on one person but paid partly or wholly by another. The person who pays tax does not pay directly to the government but pay through different mediator, that's way this tax is known as indirect tax. The main feature of indirect tax are convenience to pay, mass participation, limited evasion, consumer pay the tax to the businessman not the government etc.

The major components of indirect tax in Nepalese tax structure constitutes custom duty, excise duty, sales tax/VAT and contract tax. Custom duties are entertainment tax, hotel tax and other contribute very normal share because they are included in VAT since 1997 other form of indirect tax includes of Indian excise duties road bridge tax and other taxes.

In Nepal, large portion of tax revenue is collected by indirect tax. Among the indirect tax custom duty on imports and exports take share of huge amount. Tax on consumption and production of goods and services includes VAT occupied the second contribution to indirect tax.

The contribution of customs, tax consumption and product of goods and services to indirect tax are shown in table.

Table No. 5.4



## Composition of Indirect Tax Revenue

(Rs. In million)

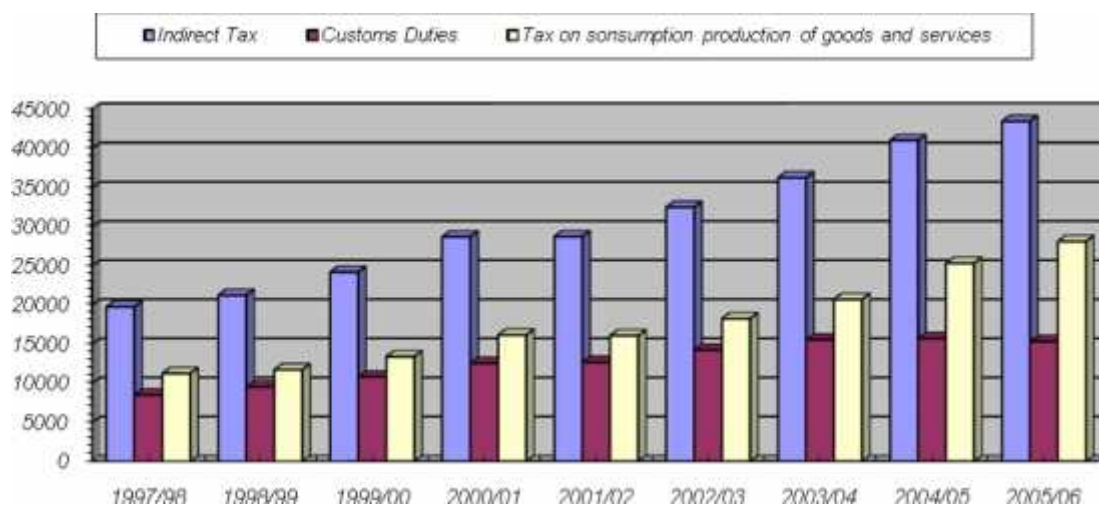
Fiscal Year	Indirect tax		Customs Duties		Tax on consumption & Production of Goods & Services	
	Amount	%	Amount	% as total Indirect tax	Amount	% as total indirect tax
1997/98	19751.9	100	8502.2	43.05	11249.0	56.95
1998/99	21236.8	,,	9517.7	44.82	11719.1	55.18
1999/00	24200.6	,,	10813.3	44.68	13387.3	55.32
2000/01	28705.7	,,	12552.3	43.73	16153.6	56.27
2001/02	28733.1	,,	12658.8	44.06	16074.3	55.94
2002/03	32481.2	,,	14236.4	43.86	18244.8	56.17
2003/04	36260.4	,,	15554.8	42.90	20705.6	57.10
2004/05	41032.9	,,	15701.6	38.27	25331.3	61.73
2005/06	43462.3	,,	15344.0	35.30	28118.3	64.70
Average	30651.6		12764.5	41.64	17887.3	58.36

Source: Economic survey 2003/04 and 2007/08 Ministry of Finance.

\*Customs duties includes imports, exports, Indian excise refund, others.

In above table, the share of customs and tax on consumption and product of goods and services to total indirect tax was Rs.8502.20 million (43.05) percent and Rs.11249 million (56.95%) respectively in fiscal year 1997/1998. After the eight year period in fiscal year 2004/2005, 2005/2006 the share of customs in total indirect tax was decreased to 38.27% and 35.3% respectively and share of tax on consumption and product of goods and services to total indirect tax was increased to 61.73% and 64.70% respectively. The contribution of customs and tax on consumption and product of goods and services to total indirect tax revenue is almost same during the study period. The average share of customs and tax on consumption and production of goods and services to total indirect tax was 41.64 and 58.36% during the study period.

Figure No. 5.4  
Composition of Indirect Tax Revenue



Source: Table No. 5.4

#### 5.2.4 Tax and GDP Ratio in Nepal

The average tax to GDP ratio has remained 16-19% in developing countries and 30-40% in developed countries. The same ratio in low economics is very nominal of 7-10% on average (World Bank Development Report-1997) but the fact in Nepal is different; Tax/GDP ratio exceeded 10% only in the year 2006/07 with 10.60% and 10.37% in the year 2007/08.

Table No. 5.5

#### Tax and GDP Ratio in Nepal

Fiscal year	GDP(current price)	Tax revenue	Tax/GDP ratio (%)
1997/98	289798	25939.8	8.95
1998/99	330018	28752.9	8.71
1999/00	366251	33152.1	9.05
2000/01	394052	38865.1	9.86
2001/02	406138	39330.6	9.68
2002/03	437546	42587.0	9.73
2003/04	472424	48173.0	10.19
2004/05	504101	54104.7	10.73
2005/06	582950	57430.4	9.85
2006/07	670588.7	71127	10.60
2007/08	820814	85155.45	10.37
Average	479516.42	47692.55	9.79

Source: Economic survey, 2003/04 and 2007/08, National account 2003, 2006, CBS

Above table shows that the increasing range of tax and GDP ratio during the selected period fiscal year 1997/98 to 2004/05 but decreased in fiscal year 2005/06. During the fiscal year 1997/98 the tax to GDP ratio 8.95 and it reached 10.73% in fiscal year 2004/05. The ratio in 1998/99 reached 8.71 it was decreased by 0.24 than previous year. In 1999/2000 the ratio increased by 0.34% and then decreased in fiscal year 2001/02 by 0.20% in comparison with previous year. But it has again started to increase and reached to 9.73% in fiscal year 2003/04, 10.14% in fiscal year 2003/04 and 10.64% in fiscal year 2004/05. In fiscal year 2005/06 the ratio was decreased by 0.88% in comparison with previous year. Again in the year 2006/07, it increased by 0.75% and lastly decreased by 0.23% in the year 2007/08. The average tax to GDP ratio was 9.79% for 11 years between 1997/98 to 2007/08.

### 5.3 Implementation of VAT

#### 5.3.1 VAT Registration

In order to operate under VAT system, registration in government office is compulsory. Collection of VAT is largely determined by the number of registrants and their transaction. Under the VAT law of Nepal, there is a threshold limit, the business, traders whose transaction is above the threshold transaction is lower than the threshold limit can register voluntarily. Under the existing sales tax system, there were nominal registrants but VAT was introduced in 1997/98, there was strict opposition from the business community so, VAT could not be implemented its full form. But after adjusting different provisions and aspects of VAT, business community and government reached to a agreement in 1999/2000 and there after number of VAT registrants highly increased to 59707 from 5237 during the period of FY 1997/98 to FY 2007/08. The trend of VAT registration is shown in the table.

Table No. 5.6

Trend of VAT Registrants

Fiscal year	Total No. of VAT registrants	No. of new VAT registrants	% of change
1997/98	5237	5237	-
1998/99	9642	8512	85.06
1999/00	18204	8512	87.82
2000/01	21781	3577	19.64
2001/02	25149	3368	15.46
2002/03	28354	3205	12.74
2003/04	34174	5820	20.52
2004/05	39776	5602	16.39
2005/06	46831	7055	17.73
2006/07	52965	6134	13.09

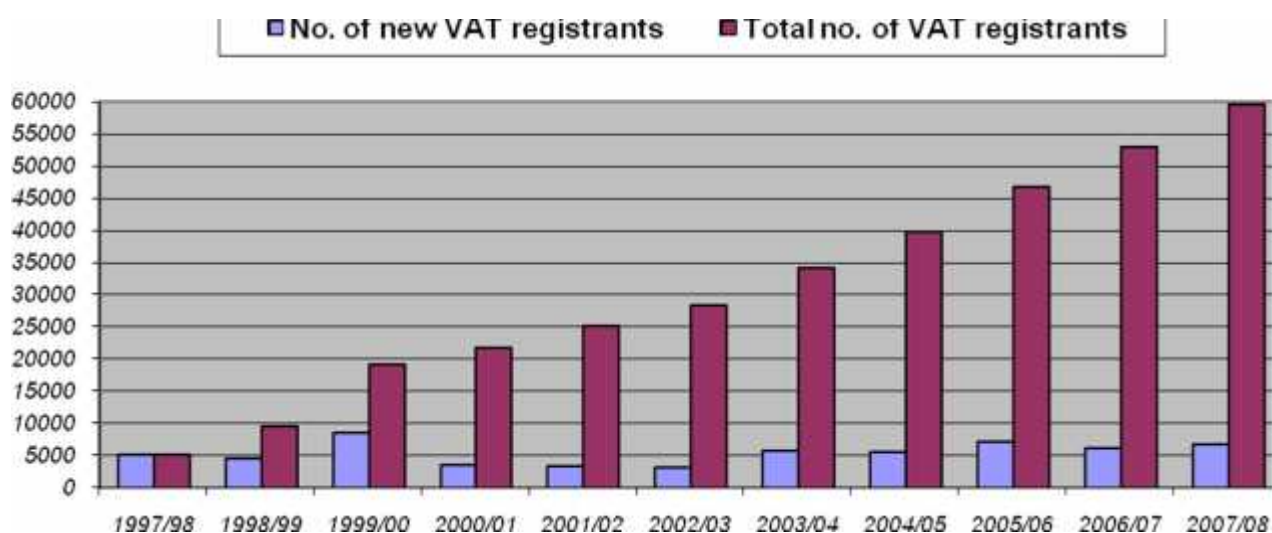
2007/08	59707	6742	12.73
Average	31074.5	5796.7	

Source: Annual report 2003/04 and 2007/08 I.R.D., Katmandu

From the above table and figure, it is clear that the no. of new VAT registration is increasing every year. In the year 1997/98, the total no. of VAT Registration was only 5237 which increased to 18204 in the year 1999/2000 with 87.82% growth than the previous year. After this period the ease of growth of VAT Registration was down and in the year 2000/2001, the percentage growth was only 19.64. This growth rate remained nearly constant with small fluctuations. At present in the year 2007/08 the total no. of VAT registration reached to 59707 with increase of 6742 new registration and a growth of 12.73%.

The average growth percentage of new registration for the study period is 17.46%.

Figure No. 5.5  
Figure of VAT Registrants



Source: Table No. 5.6

### 5.3.2 Revenue Collection from VAT

Value added tax (VAT) is the youngest family member in sales tax. It is the best form of sales tax which is neutral regarding method of production and helpful in generation of more revenue collection and less distortion. Nepal has adopted VAT since fiscal year 1997/98.

VAT implementation in Nepal has been passed 11 years, the share of VAT revenue to the total revenue is increasing in Nepalese economy. The revenue collection from VAT in different fiscal year is presented in table below.

Table No. 5.7

Revenue Collection from VAT

Fiscal year	Revenue collection from VAT	Percentage change
1997/98	7122.6	-
1998/99	8765.9	23.07
1999/00	10259.7	17.04
2000/01	12382.4	20.69
2001/02	12267.3	-0.93
2002/03	13449.1	9.72
2003/04	14478.9	7.57
2004/05	18894.6	30.43
2005/06	21610.7	14.43
2006/07	26704.18	21.68
2007/08	31154.63	16.67
Average	16099	

Source: Economic survey 2003/04 & 2006/07, MOF

VAT generated Rs.7122.60 million revenue in fiscal year 1997/98. In fiscal year 1998/99 it reached up to Rs.8765.90 millions as increased by 23.07% to preceding year 1998/99. Similarly revenue collection from VAT in fiscal year 1999/2000,2000/2001,2001/2002,2002/2003,2003/2004,2004/2005and2005/2006 are 10259.70,12382.40,12267.30,13449.70,14478.90,18894.60 and 21946.01 millions respectively. The trend of VAT collection increased only FY 1999/2000. In 2000/2001 the revenue not increased then 1999/2000 it is increased only 17.04%. But in fiscal year 2001/2002 it is decreased by 0.93% to previous year. Likewise, in the fiscal year 2002/2003 the revenue collection from VAT is increased by 9.72% in fiscal year 2003/2004, it is increased by 7% to previous. During the fiscal year 2004/2005 it is increased by 30.43%. During the fiscal year 2005/06, the revenue collection from VAT is increased only 14.43% to previous year.

In the last two years i.e. 2006/07 and 2007/08, the revenue collection from VAT is 26704.18 and 31154.63 millions respectively. In the year 2006/07 the revenue increased by 4758.17 million which is about 21.68% increased than previous year. Likewise in the year 2007/08 the total revenue from VAT increased but the growth of revenue again decreased from 21.68% to 16.67% where total VAT revenue being 31154.63 millions.

Through the trend of revenue collection from VAT is fluctuating the collection trend of revenue the VAT is not so bad. The average collection from

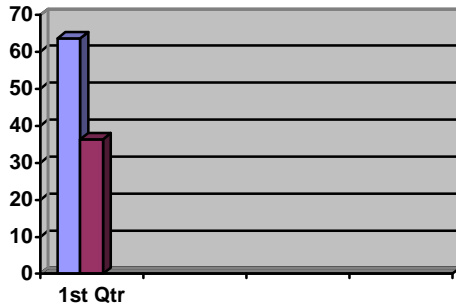
VAT is 13248.07 millions. It is expected that VAT will generate more and more revenue in the days to come when it is implemented effectively and efficiently.

The revenue collection from VAT in different fiscal year is also shown in the figure.

#### Composition of VAT Revenue

VAT collection: Internal Source and Import.

##### 5.6.1

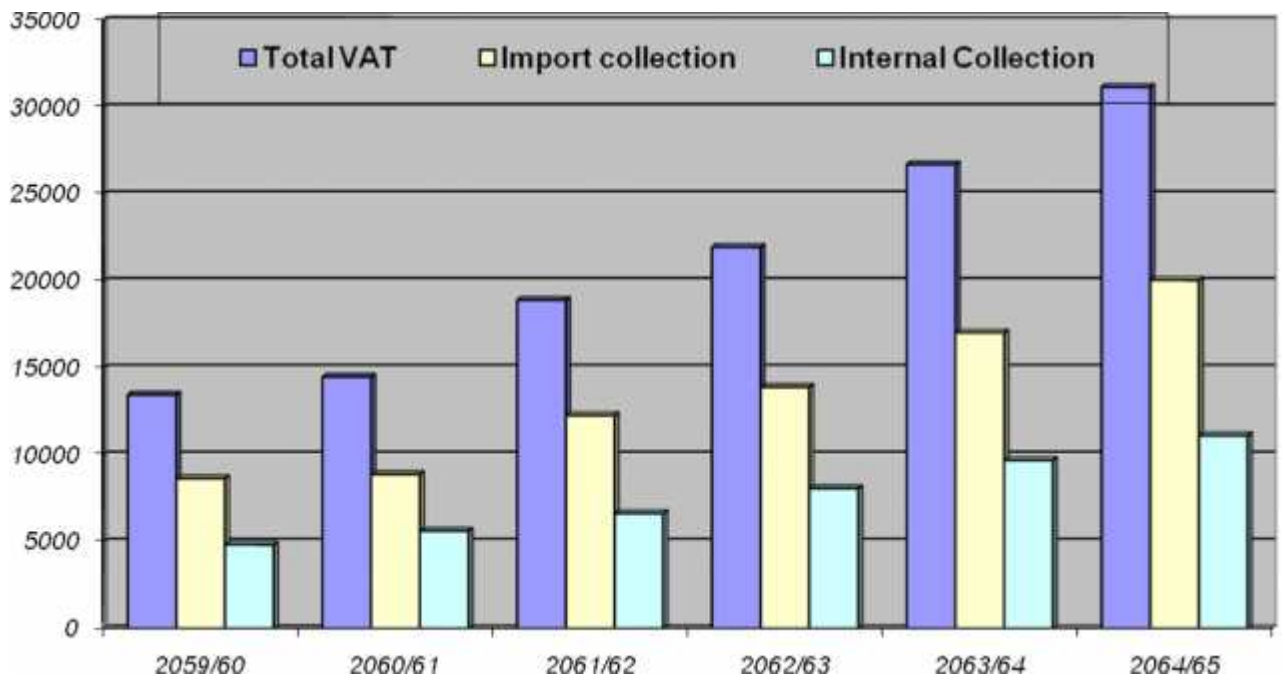


■ Import  
■ Internal

In the figure, the collection of VAT revenue from Import is much higher i.e. about 63.63% in average where as from internal collection is only about 36.37%. Although the total VAT collection is increasing every year, there is slight fluctuation in the collection of VAT revenue from internal as well as from import.

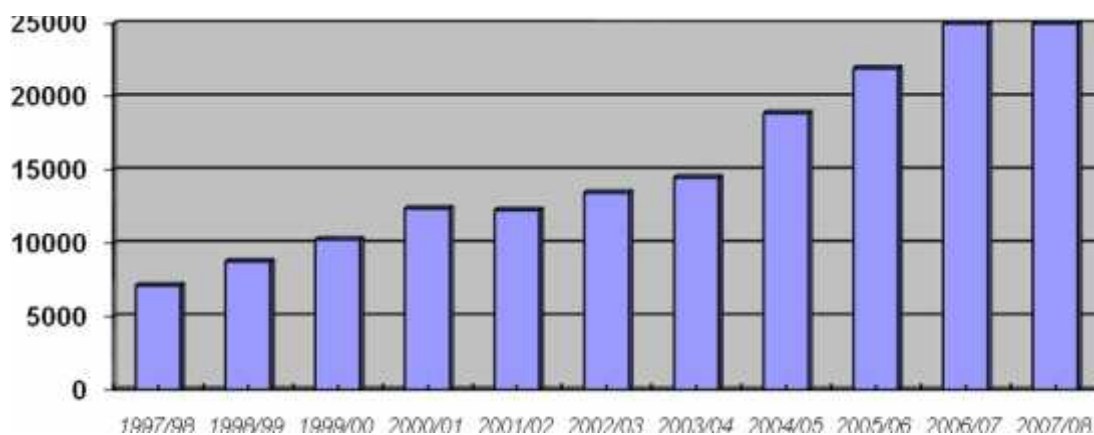
In the year 2060/61 the total VAT collection from internal source is highest i.e. 38 to where as in case of collection from export is highest in the year 2061/62 with 64.95%. However the average collection of both from internal as well as from import is similar and even throughout the study period with slightly fluctuation only.

Collection of VAT, import and internal



Source: annual survey report 2007/2008

Figure No. 5.6  
Revenue Collection Trend of VAT



### Contribution of VAT Revenue

This section has tried to analyze the contribution of VAT with major indicator such as GDP, Total Revenue, Total Tax revenue & indirect tax Revenue.

#### 5.3.3 Contribution of VAT in Nepalese Economy

Table No. 5.8  
Contribution of VAT to GDP

Fiscal Year	GDP		VAT collection	
	Amount	Percent	Amount	VAT as% of GDP
1997/98	289798	100	7122.6	2.46
1998/99	330018	100	8765.9	2.66
1999/00	366251	100	10259.7	2.80
2000/01	394052	100	12382.4	3.14
2001/02	406138	100	12267.3	3.02
2002/03	437546	100	13459.7	3.08
2003/04	472424	100	14478.9	3.06
2004/05	504101	100	18885.4	3.74
2005/06	582950	100	21610.7	3.70
2006/07	670588.7	100	26704.18	3.98

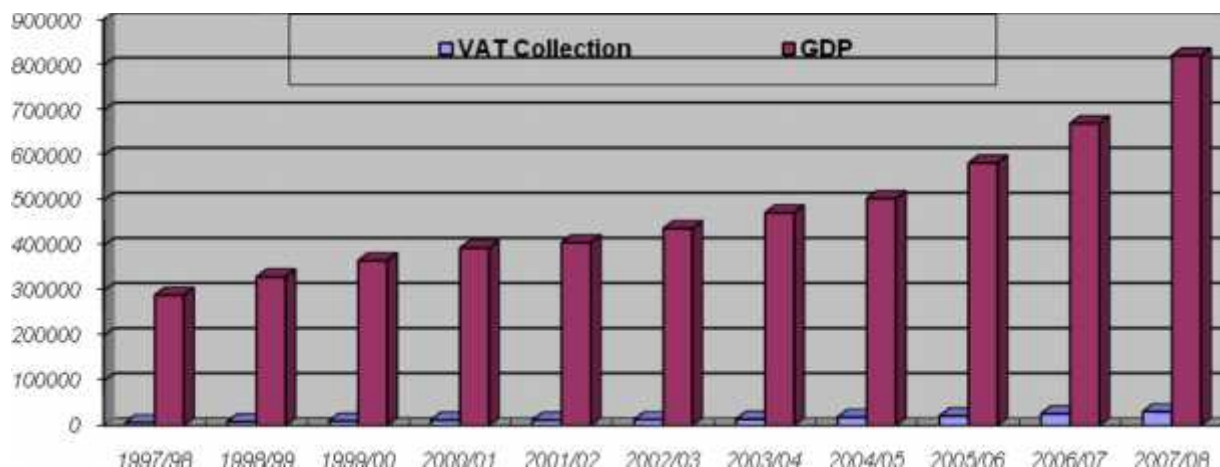


2007/08	820814	100	31154.63	3.22
Average	479516.42	100	16099.21	3.16

source:annual survey report 2207/8

Above table shows GDP and percentage of VAT to GDP. During the study period the GDP has increased from Rs. 289798 million to Rs. 820814 million between the periods of fiscal year 1997/98 to 2007/08. The share of VAT in GDP is very low the average of only 3.22% between the fiscal year 1997/98 to 2007/08 with fluctuation between the range of 2.46 to 3.98 percent of VAT to GDP and the ratio was increased 2000/01 and reached to 3.14 percent. But it was decreased in 2001/02 by 0.12 percent comparison with previous year. In fiscal year 2002/03 the ratio increased slightly by 0.6 percent than previous year. The ratio of VAT to GDP in 2003/04 was decreased by 0.02 percent with ratio was slowly increased in fiscal year 2004/05. Again in the year 2005/06, the ratio decreased by 0.04%. In the year 2006/07, the highest contribution in GDP was recognized with contribution of 3.98% but again in the year 2007/08 the contribution decreased by 0.19% and rest at 3.97%. So, VAT contributes out 2 percent to 4 percent in GDP. The average VAT revenue as percentage of Gross Domestic Product is 3.22 during the study period of 11 years.

Figure No. 5.7  
Contribution of VAT in GDP



Source: Table No. 5.8

### 5.3.3.2 Contribution of VAT in Total Revenue

Table No. 5.9

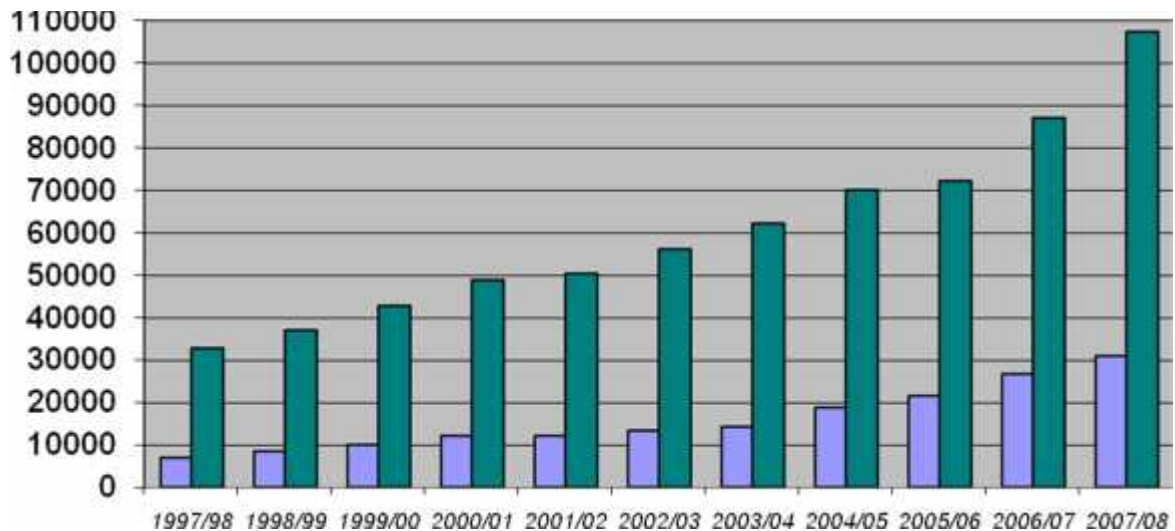
#### Contribution of VAT to Total Revenue

Fiscal Year	Total Revenue	Total VAT Revenue	VAT Revenue as %of Total Revenue
1997/98	32937.9	7122.6	21.62
1998/99	37251.0	8765.9	23.53
1999/00	42893.7	10259.7	23.92
2000/01	48893.9	12382.4	25.33
2001/02	50445.6	12267.3	24.32
2002/03	56229.7	13459.7	23.94
2003/04	62331.0	14478.9	23.23
2004/05	70122.7	18885.4	26.93
2005/06	72282.1	21510.7	29.90
2006/07	87199.7	26704.18	30.62
2007/08	107622.5	31154.63	28.94
Average	607446.35	16090.12	25.66

From above table shows that the percentage of VAT revenue to total revenue increased from 21.62 percent to 25.33 percent in FY 1997/98 to 2000/01. But in the FY 2001/02,2002/03 it is decreased to 24.32 and 23.94 percent respectively. Again it increased to 26.93 and 30.62% in FY 2004/05, 2005/06 and 2006/07 respectively. So VAT contributes about 21 to 30 to total revenue of the country. But again it decreased to 28.94% in the year 2007/08 respectively.

Figure No. 5.8

Contribution of VAT to total Revenue



### 5.3.3.3 Contribution of VAT in Total Tax Revenue

The percentage contribution of VAT revenue in total tax revenue is presented in table below:

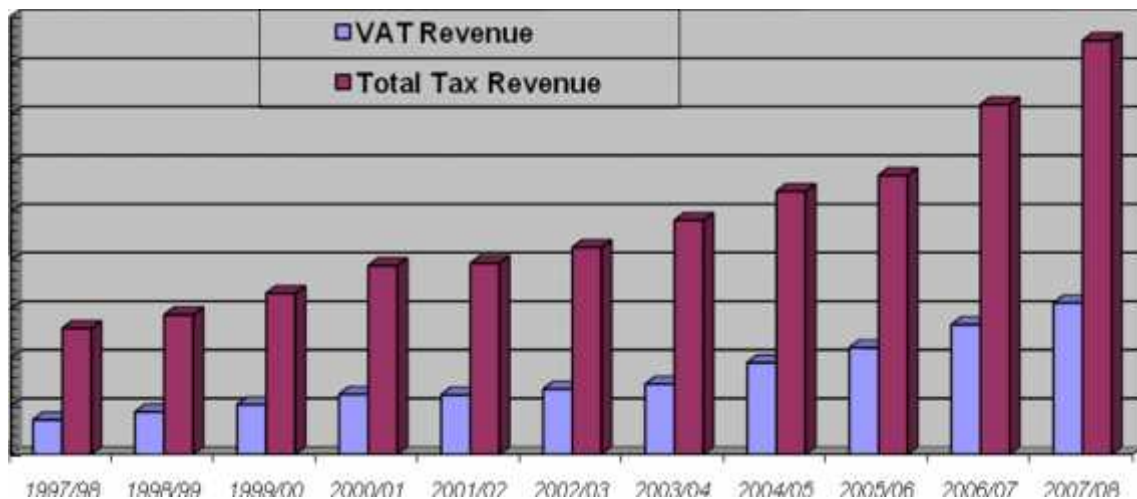
Table No. 5.10  
Contribution of VAT to Total Tax Revenue

Fiscal year	Total Tax Revenue	VAT Revenue	%as on Total Tax Revenue
1997/98	25939.8	7122.6	27.46
1998/99	28752.9	8765.9	30.49
1999/00	33152.1	10259.7	30.95
2000/01	38865.1	12382.4	31.86
2001/02	39330.6	12267.3	31.19
2002/03	42587.0	13449.1	31.61
2003/04	48173.0	14478.9	30.06
2004/05	54104.7	18894.6	34.91
2005/06	57430.4	21946.01	37.63
2006/07	71973.4	26704.18	37.10
2007/08	85155.5	31154.63	36.58
Average	47769.56	16129.57	32.71

--	--	--	--

As indicated in above table VAT revenue contributes nearly 33 percent in average during the study period. The percentage trend of VAT revenue to total tax revenue is in fluctuating trend from FY 1997/98 to 2005/06. The share of VAT revenue in total tax revenue increased from 27.46 percent to 37.63 percent in FY 2005/06. Thus the contribution of VAT to total tax revenue has increasing trend during the study period 2005/06 and slightly decreased during the year 2006/07 and 2007/08 respectively. The contribution of VAT revenue to total tax revenue are shown in figure also:

Figure No. 5.9  
Contribution of VAT in Total Tax Revenue



Source: Table No. 5.10

#### 5.3.3.4 Contribution of VAT in Indirect Tax Revenue

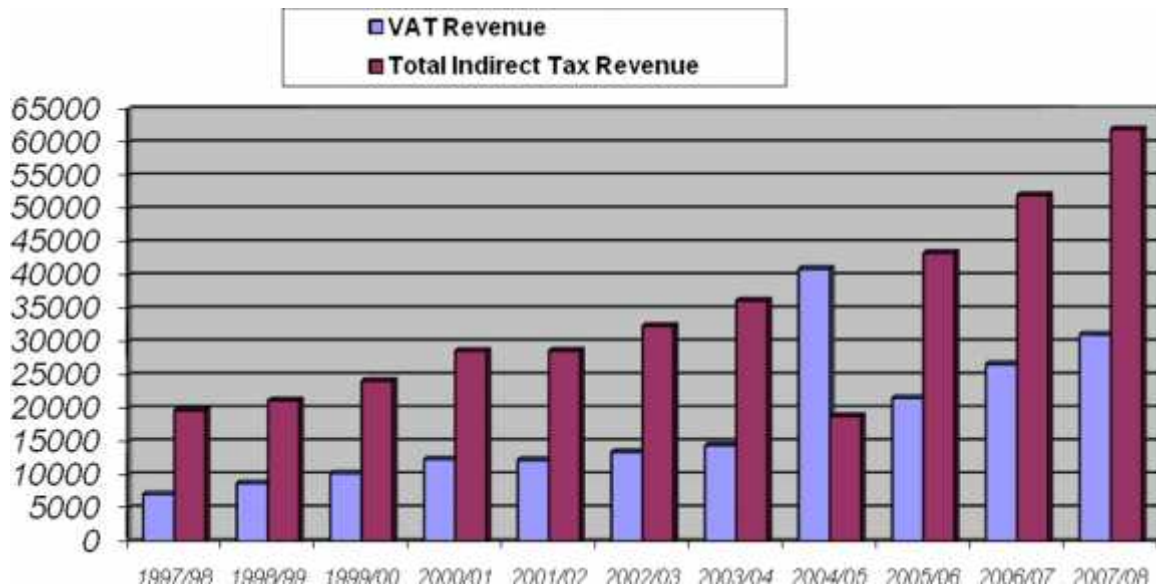
The percentage contribution of VAT revenue in total indirect tax revenue is presented in table below.

Table No. 5.11  
Contribution of VAT in Total Indirect Tax Revenue

Fiscal Year	Total Indirect Tax	VAT Revenue	%of VAT of Total Indirect Revenue
1997/98	19751.9	7122.6	36.06
1998/99	21236.8	8765.9	41.28
1999/00	24200.6	10259.7	42.39
2000/01	28705.7	12382.4	43.14
2001/02	28733.1	12267.3	42.69
2002/03	32481.2	13459.7	41.44
2003/04	36260.4	14478.9	39.93
2004/05	41032.9	18885.4	46.03
2005/06	43462.3	21610.7	49.72
2006/07	52146.4	26704.18	51.21
2007/08	62067.69	31154.63	50.19
Average	35461.72	16099.21	44

Since the implementation of VAT, VAT is becoming an important contributor to indirect Tax of Nepal. The above table shows that the average contribution from VAT to indirect tax is 44% during the study period. In fiscal year 1997/98 contribution from VAT to total indirect tax in Nepal was only 36.06 and that reached to 51.21 in fiscal year 2006/07. Till the fiscal year 2000/01. The contribution of VAT was increasing trend but in fiscal year 2001/02 such share decreased slightly and reached to 42.69%. In fiscal year 2002/03, 2003/04 again, the share of VAT to indirect tax has decreased by 1.25% and 1.5% respectively comparison with previous year. After 2003/04 the contribution of VAT on indirect tax is increasing trend. Lastly, during the study period in 1997/98 to 2007/08 the contribution on VAT on indirect tax was reached from 36.06% to 51.21%.

Figure No. 5.10  
Contribution of VAT Revenue in Total Indirect Tax Revenue



Source: From table No. 5.11

#### Analysis of figure 5.10

As presented in the figure 5.10, the shaded area indicates the VAT revenue and the dotted area indicates the total tax revenue.

In the year 1997/98, the VAT revenue is 36.06 which is the starting year of VAT implementation gradual the contribution of VAT increases till the year 2000/01 after having certain disputes in the implementation in the year 2001/02, it gradually decreased in the year 2001/02 till 2003/04 to only 39.93%. After this period the collection of VAT revenue is increasing which reached to more than 50% in the year 2005/06 and 2006/07. Which is clearly presented in the table.

#### 5.3.3.5 Trend of Revenue Collection After Introduction of VAT

The given below tables are presented to show the trend of revenue collection after the introduction of VAT. As VAT was introduced in the year 1997/98 it has replaced sales tax, entertainment tax, contract tax and hotel tax. Although it has replaced above four taxes, sales tax was main area VAT has replaced. The analysis tries to find out the growth rate of revenue during the study period from 1997/98 to 2007/08.

Growth rate (both simple and compound) is the tool used for this analysis. For the base year 1997/98 where growth rate is nil.

Table No. 5.12  
Trend of Revenue Collection

Fiscal Year	Total Revenue		Tax Revenue		Indirect Revenue		VAT Revenue	
	Amount	Growth Rate	Amount	Growth Rate	Amount	Growth Rate	Amount	Growth rate
1997/98	32937.9	-	25939.8	-	19751.9	-	7122.6	-
1998/99	37251.0	13.09	28752.9	10.84	21236.8	7.52	8765.9	23.07
1999/00	42893.7	15.39	33152.1	15.30	24200.6	13.95	10259.7	17.04
2000/01	48893.9	13.75	38865.1	17.23	28705.7	18.62	12382.1	20.69
2001/02	50445.6	3.17	39330.6	1.20	28733.1	0.095	12267.3	-0.93
2002/03	56229.7	11.47	42587.0	8.28	32481.2	13.04	13459.7	9.72
2003/04	62331.0	10.85	48173.0	13.11	36260.4	11.64	14478.9	7.57
2004/05	70122.7	12.50	54104.7	12.31	41032.9	13.16	18885.4	30.43
2005/06	72282.1	3.08	57430.4	6.15	43462.3	5.92	21610.7	14.43
2006/07	87199.7	20.63	71973.4	25.32	52146.4	19.98	26704.18	23.56
2007/08	107622.5	23.42	85155.5	18.31	62067.6	19.02	31154.63	16.67
Average	607446.35		47769.5		35461.72		16099.2	

### Analysis of Figure 5.12

As we can see in the table VAT generated 7122.6 million revenue in the year 1997/98 where the total revenue is 32937.9 million. Likewise revenue

collection from VAT is gradually increasing every year except in the year 2001/02 where there is a slightly negative growth rate of 0.93% after the year VAT revenue increase by 9.72% in the year 2002/03 and again decreased to a growth rate of 7.57% in the year 2003/04. After this year in the year 2004/05 there was a great increase in the revenue of VAT of 30.43% which was not stable and slowly decreased to 14.43 in the year 2005/06. Again the VAT revenue increase in the year 2006/07 by 23.56% with total VAT collection of 26704.18 million, in the year 2007/08 the total VAT collection was 31154.63 which was about 16.67% increase than the previous years collection.

The average collection of total revenue is 11.57 tax revenue is 11.64%, indirect tax revenue of 11.17 and VAT revenue the highest of 14.75%. This provides us the base that the implementation of Vat has contributed a lot to increase the total revenue of the country. After the implementation of VAT, total revenue of the country is also constantly increasing.

Table No. 5.13

Compound Growth Rate of Revenue After the implementation of VAT

Revenue	Compound Growth Rate of Fiscal year 1997/98-2006/07
Total Revenue	11.36
Tax Revenue	11.41
Indirect Tax Revenue	10.96
VAT Revenue	14.37

Source: Self calculated as per fig. of economic survey 2003/04, 2006/07

Note: Calculation is included in Appendix-II

From above table we can see what the trend of increment of revenue is in decreasing trend. But the amount has been increasing continuously. In case of compound growth rate after the implementation of VAT, growth rate of total revenue is 11.36%. In case of total tax revenue the growth rate the study period was 11.41% after the implementation of VAT. In case of indirect tax revenue the growth rate for the study period in 1997/98 to 2007/08 was 10.96%. The growth rate of VAT during the fiscal year 1997/98 to 2007/08 was 14.37%.

After the implementation of VAT the growth rate of total revenue, tax revenue and indirect tax revenue has been little lower but the growth rate of VAT has been little higher. It shows that although the other sources of revenue are decreasing but the revenue collection from VAT is increasing.

If it is properly implemented then VAT will be the highest contributor of national revenue.



### 5.3.3.6 Analysis of trend Value of Indirect Tax and VAT

In this topic, we deal on the most powerful tools of statistics, which being used in the estimation of strength of relation between two variables.

Thus, it is a statistical device with the help of which, we can estimate on forecast the value of one variable when the value of the other variable is known. The unknown variable which we have to forecast is called dependent variables and the variable whose value is known is called independent variables.

The study has been made to analyze the indirect tax, GDP and VAT from 11 years data i.e. from 1997/98 to 2007/08 and forecast till 2012/13.

The following table shows that trend values of indirect tax, GDP and VAT for 5 years 2008/09 to 2012/13.

Table No. 5.14

Expected Trend Values of Indirect Tax, GDP and VAT

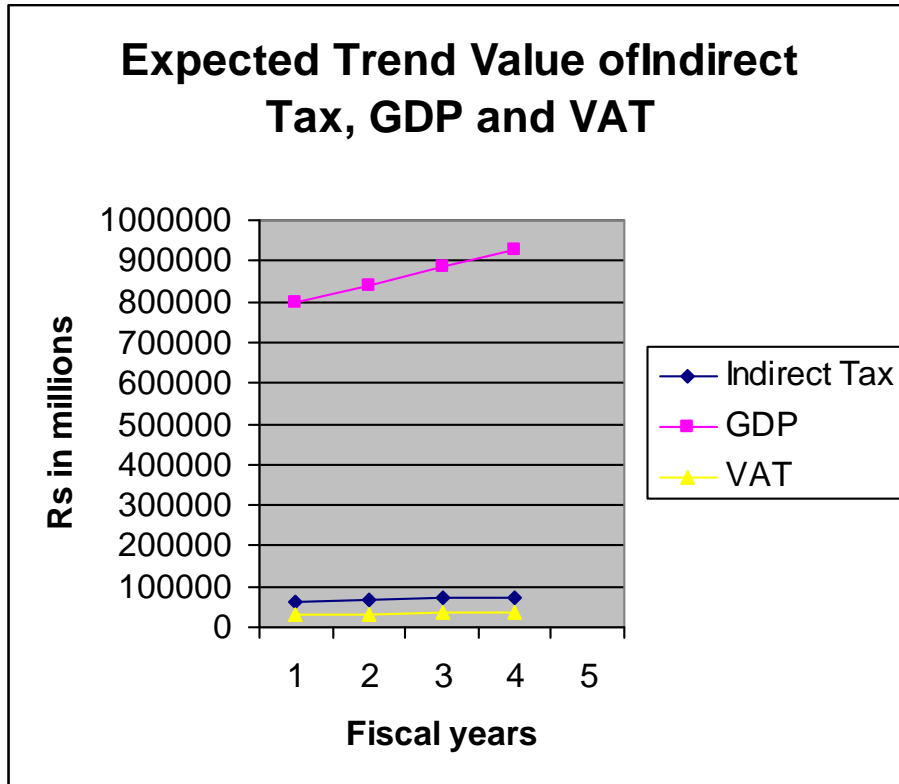
Fiscal Year	Expected Trend Value of Indirect Tax	Expected Trend Value of GDP	Expected Trend Value of VAT
2008/09	58652.86	749725.88	29254.69
2009/10	62518.17	797460.80	31447.27
2010/11	66383.48	839795.72	33639.85
2011/12	70248.79	884830.64	35832.43
2012/13	74114.10	929865.56	38025.01

Source: Appendix III, IV, V

Note: Self calculation is included in Appendix-III, IV, and V

Figure NO 5.11

Expected Trend Values of Indirect Tax, GDP and VAT



From the above table, it is visualized that indirect tax, GDP and Vat is increased trend. Others things remaining the same, the indirect tax will be Rs 74114.1 million in fiscal years 20143. In the case of GDP, others things remaining same, the GDP will be Rs 929865.25 million and in the case of VAT, others things remaining the same, VAT will be Rs 38025.01 million in the period of fiscal years 2110/11.

#### 5.4 Empirical Findings

Many empirical studies have been conducted before and after the implementation of Vat systems in Nepal. It is the noticed that this system has not been implemented effectively as expected. Despite the strong opposition from the business

Community during the easier period, VAT with implementation, there was lack of skilled and trained manpower; administrative structure was not set up

properly. But now, different informative, awareness programs were held to make businessman, consumers and people know to the VAT.

Currently business community is also in favor of VAT and further demanding to identify all the traders having taxable capacity and include into the net. In such situation an empirical study is also done to know the view of persons of different field on different aspects of VAT.

For the purpose of survey, different questionnaire were prepared to know the option of the various persons of different fields including tax exports, tax administrators/ officers, businessman/ traders and customers about various aspects of VAT.

The sample for this survey is taken only from different fields as given in the table below:

**Table No.5.15**

**Sample size of the field Survey**

Respondents	Sample Size	Percent
Tax administrator/ Exports	20	38.46
Business man	20	38.46
Consumers	12	23.08
Total	52	100

Source: - Option survey, 2009

The result and interpretation of the survey result have been presented below:

**5.4.1 View on Knowledge about VAT**

The first question is prepared to know the percent activity knowledge about VAT with the tax officers/exports, businessman and consumers. The responses received from respondents are tabulated as follow:

**Table No: 5.16**

**View on Knowledge about VAT**

Respondents	Yes		No		Total
	NO	%	No	%	No
Tax officers/ Experts	20	100	-	-	20
Businessman	20	100	-	-	20
Consumers	10	83.33	2	16.67	12
Total	50	96.15	2	3.85	52

Source: - option Survey 2009

Among 52 respondents 96.15 respondents have the knowledge on VAT 3.85 percent have no idea about VAT. Above that the most of the respondents have knowledge about VAT.

**5.4.2View on VAT as an Appropriate means of Raising Govt. Revenue**

In Nepal, government expenditure is continued to show increasing trend but the revenue collection is not increasing as required to finance the government. Expenditure of fiscal years 2005/06 totaled Rs 110 billion 889.2 million revenue met expenditure increased by 17.7 percent. The impact of VAT has not seen properly. Theoretically VAT is the best form of taxation but, practically it depends on the environment provided by the country for its implementation. It is necessary to know whether VAT is an appropriate means of rising found or not in the views of its appropriateness regarding its revenue collection can be show in the following table.

**Table No.5.17****Views on VAT as an appropriate means of Raising Govt. Revenue**

Respondents	Yes		No		I Don't Know		Total
	No	%	No	%	No	%	
Tax officers/ Experts	20	100	-	-	-	-	20
Businessman	10	50	-	10	10	50	20
Consumers	5	41.67	5	2	2	16.67	12
Total	25	67.3	5	12	12	23.08	52

Source: Option Survey 2009

From the Survey it is clear that above 67 percent respondents agreed in this matter appropriate means of rising government revenue. 100 percent of each of tax officers and tax exports, 50 percent businessman and 41.67 percent consumers take VAT as an appropriate mean of rising govt. revenue 23.08 percent respondents including 50 percent businessman, 41.67 percent consumers are unknown about this matters and 9.62 percent including 41.67 percent consumers conclude against this matters.

**5.4.3 Views on Superiority of VAT then Sales Tax**

VAT is a modern, scientific, transparent system among indirect tax and it is also productive in economy then others forms of sales tax. VAT does not have cascading effect and its stage wise count and collection of revenue makes VAT superior then other types of sales tax. The question is designed to know the view of respondents about VAT in comparison with other types of sales tax. The survey result on this aspect is summarized in the table below:

**Table No: 5.18**

**Superiority of VAT then other types of Sales Tax**

Respondents	Yes		No		Total
	No	%	No	%	
Tax Officers/ Experts	20	100	-	-	20
Businessman	15	75	5	25	20
Consumers	10	83.33	2	16.13.46	12
Total	45	86.54	7	13.46	52

Source: Opinion survey, 2009

From the study it is clear that above 86 percent of total responded including 100 percent of each of tax officer/experts 75 percent businessman, 83.33 percent consumers agreed to the VAT is superiority then others types of sales tax only 13.46 percent of total respondents preferred other forms of sales tax rather than VAT. The table shows that most of the respondents favor of VAT.

**5.4.4 Views on Rising Price Due to VAT System**

In the table stage of VAT implementation, there was a strong opposition from business community regarding the possibility of rise in price of commodities due to VAT system. There was a vice from different people on price rising on goods and services. Consumers also complain that businessman change more price without following the act of VAT. The study has been made to get the information from the respondents to find out weather there will rise in price due to VAT system.

**Table No: 5.19**

**Views on Rising Price Due to VAT System**

Respondents	Yes		No		Total
	No	%	No	%	
Tax Officer/ Experts	5	25	15	75	20
Businessman	10	50	10	50	20
Consumers	8	66.67	4	33.33	12
Total	23	44.23	29	55.76	52

Source: Option Survey, 2009

The above study show that 55.75 percent respondents including 75 percent tax officer / experts, 50 percent businessman , 33.33 percent consumers says that there is no raise in price due to VAT system and 44.23 percent including 25percent tax expert / officers , 50 percent businessman , 66.67 percent consumer clam that there is a rise in price . So, concluded that almost respondents clear that VAT is no causes to raise price of goods and services .

**5.4.5 Views on causes for price Rise Due to VAT system**

Some respondents agreed that there will be raised price due to VAT system. So the causes behind the raise in the price are given below:

**Table No. 5.20**

**Views on causes for Price Rise Due to VAT system**

Respondents	Compliance Cost	High Profit	Non- Awareness	All	Total
-------------	--------------------	----------------	-------------------	-----	-------

	No.	%	No.	%	NO.	%	No.	%	
Tax Officers/ Experts	-	-	1	20	4	80	-	-	5
Businessmen	10	100	-	-	-	-	-	-	10
Consumer	3	37.5	3	37.5	2	25	-	-	8
<b>Total</b>	<b>13</b>	<b>56.52</b>	<b>4</b>	<b>17.4</b>	<b>6</b>	<b>26.08</b>	-	-	<b>23</b>

Source: Opinion survey, 2009

From the survey , respondents who agreed that there is rise in price due to VAT system so that , compliance cost is the main reason for price increment .56.52 percent respondents view that it the main cause 17.04 percent respondents say that high profit of businessmen is creating price raise due to VAT system.

#### **5.4.6 Views on Revenue Collection from VAT is Satisfactory as it has been expected**

VAT was introduced in Nepal from 16<sup>th</sup> November, 1997 to get the higher revenue mobilization and to avoid the problems of existing tax system. As VAT is the best tax system to get greater revenue productivity but to the main problems relating to its implementation the revenue collection from VAT is not satisfactory as it has been expected. Here, an investigation has been made to get the information from the respondents to find out whether it is satisfactory or not.

**Table No.5.21**



## Views on Revenue Collection from VAT is Satisfactory as it has been Expected

Respondents	Yes		No		I don't know		Total
	NO.	%	No.	%	No.	%	
Tax officers/ Experts	2	10	13	65	5	25	<b>20</b>
Businessmen	5	25	5	25	10	50	<b>20</b>
Consumer	1	8.33	8	66.67	3	25	<b>12</b>
<b>Total</b>	<b>8</b>	<b>15.38</b>	<b>26</b>	<b>50</b>	<b>18</b>	<b>34.62</b>	<b>52</b>

Source: Opinion survey, 2009

Above opinion survey, 50 percent respondents say that revenue collection from VAT is not satisfactory as it had been expected. 34.62 percent respondents are unknown about this matter and 15.38 percent respondents say that VAT is achieving expected amount of revenue from VAT.

### 5.4.7 Views on Existing Rate of VAT

VAT is very significant and sensitive from revenue mobilization. The success of VAT system is determined by the degree of VAT rate. Earlier sales tax rate was 15 percent which replaced by VAT rated on 10 percent. Later, the VAT rate was received to 13 percent. Due to broader base and coverage, VAT was expected to have a greater revenue yield on passed and coverage; VAT was expected to have a greater revenue yield on present rate structure. However, this expectation is not achieved in practical basically due to its weak implementation aspect. In such context, field survey was conducted to identify the view on rate structure of VAT.

**Table No.5.22****View on Existing Rate of VAT**

Respondents	High		Normal		Low		Total
	No	%	No	%	No	%	
Tax Officer/Experts	2	10	18	90	-	-	20
Businessman	12	60	8	40	-	-	20
Consumers	10	83.33	2	16.67	-	-	12
Total	24	46.15	28	53.85	-	-	52

Source: Option Survey 2009

The above table shows that most of the respondents 53.85 percent (out of 90 percent tax officer / experts, 40 percent. Businessman, 16.67 percent consumers) say it is normal range of existing rate 13 percent. However, 46.15 percent of respondent (out of 10 percent tax effacers/ exports, 60 percent businessman, 83.33 percent consumers) says that the existing VAT rate is high. No one respondent says that the existing rate is low.

So, the field survey shows that the rate of structure is the presents is normal range however unless and until tax system is not implemented well, the rate structure is not only an instrument to rise the revenue from tax system.

#### **5.4.8 Views on VAT has been Discouraging illegal Business**

Adoption of VAT in Nepal is to prevent corruption ,illegal trade and tax evasion

But it would increase the base of corruption and tax evasion. Corruption is one of the most important Problems, which is bringing so many challenges for effective implementation of vat in Nepal .it is deeply Orated in the ground of all sector of government in Nepal a few types of smuggling or methods of evasion Of imports, because they are transported covertly with or without the

complicity of the customs officials through Official parts of the entry .Secondly goods may come through the customs checkpoints, but are falsely declared

The view of various respondents on this aspect is presented below in the table

**Table No.5.23**

**Views on Vat has been Discouraging illegal Business**

Respondent	Yes		NO		I don't know		Total
	No	%	NO	%	NO	%	
Tax officers	16	80	4	20	-	-	20
/experts	14	70	3	15	3	15	20
Businessmen	5	41.67	3	25	4	33.33	12
Consumer							
Total	35	67.30	10	19.23	7	13.46	52

Source: opinion survey 2009

From the above tables shows clearly that 67.30 percent including 80 percent tax officers /experts ,70 percent businessman,41.67 percent consumer view that the vat should discourage the illegal Business but effective and effective implementation is necessary .but 19.23 percent respondent Including 20 percent tax officers/experts, 15percent business ran, 25percent consumer urged that. The Vat is still unable to discharge the illegal business where as 13.46 percent responding including15percent businessman, 33.33 percent consumer had no knowledge on this matter.

**5.4.9 View about Billing System**

Billing System of the most important aspects of VAT system. All the businessman have to received the bill of actual transition while importing or buying the businessman have to received the bill of actual transaction while importing or buying the goods. In this bill, the price of goods with and without VAT has to be maintained. Will selling the goods purchaser should compulsory be given the specific VAT bill? The businessman has to play difference between

tax collected in sale and paid purchased to the VAT officer. Thus, the billing system plays important role in the field of VAT system. Therefore, it should be compulsory implemented as it one of burning problems in Nepal.

The view on various respondents on this aspect is presented in the table.

**Table NO 5.24**

**Various about Billing System**

Respondents	Possible		Impossible		Costly		Total
	NO	%	No	%	No	%	
Tax officer/ Experts	17	85	1	5	2	20	
Businessman	10	50	2	10	8	20	
Costumers	8	66.67	2	16.67	2	12	
Total	35	67.30	5	9.62	12	52	

Source:- Option survey, 2009

From the above table 67.3 percent of respondents( Out of the 85 percent tax officers/ exports, 50 percent businessman, 66.67 percent consumers says that the billing system is possible, 23.08 percent of respondents includes 10 percent tax officer/experts, 40 percent businessman, 16.67 percent consumers clime that it is costly and 9.62 percent consumers clam that it is possible. ON the basis of above table, it can say be concluded that VAT billing system is possible in Nepal if it is perfectly and effectively implemented.

**5.4.10. Views on Effectiveness of VAT at Present**

Although it has 12 years from implementation of VAT, however it has not yet secured the expected result. There are many problems existing in the implementation of VAT. It is necessary to identify the existing problems and solve them successful to make the VAT more successful.

VAT has been imposed in Nepal despite of various problems that problems create the solution.

The view on various respondents on this aspect is presented in the table.

**Table No. 5.25**

**Views on Effectiveness of VAT at Present**

Respondents	Yes		No		Total
	No	%	NO	%	
Tax officers/Exports	18	90	2	10	20
Businessman	15	75	5	25	20
Consumers	7	58.33	5	41.67	12
Total	40	76.92	12	23.08	52

Source: Option survey 2009

From the above table 76.92 percent represents have positive responses on this aspect. It means they agreed that VAT is effective in Nepal now. 23.08 percent respondents did not agree this answer and they said that it is not effective now.

From above it is concluded that the result of VAT is effective on this day but still have more space to make it more effect

**5.4.11 Views on Demand for Bills**

This question was designed to ask each for businessman/ tax payers and consumers to know many consumers acquired for the bills. Are the buyer's conscious for issuing not?

The table shows the percentage of the customers demand for the bill.

**Table No 5.26**

**Percentage of Customers Demand for Bill**

<b>Customers Demand</b>	<b>No of Respondents</b>	<b>Percentage</b>
None	2	10
Less then 25%	3	15
Between 25% to 50	9	45
Between 51% to 75	4	20
Above 75%	2	10
<b>Total</b>	<b>20</b>	<b>100</b>

Source: Option survey 2009

From the above table it shows that 2 (10 percent) businessman comment that customers don't demand bill their purchase 3 (15 percent) businessman comment between 25 percent customer only demand the bill 9 (45 percent) businessman comment between 26 percent to 50 percent customer demand bill on their purchase 4 (20 percent) businessman comment between 51 percent customers demand bill on their purchase and only 2 (10 percent) clime that more then 75 percent of the consumers demand for the bill on their purchase.

## View of Consumers

The table given below shows the percentage of the customer demand for the bill.

**Table No: 5.27**

### Views of Customers on Demand for Bill

Consumers	No of Respondents	Percentage
Yes	3	25
Sometimes	6	50
No	1	8.33
I don't care on bill	2	16.67
Total	12	100

Source: Option survey 2009

From the above table shows that 3 (25 percent) customers of them demand bill on their every purchase of commodities, 6 (50 percent) customers of them sometimes demand the bill on their purchase of goods and service, 1 (8.33 percent) customer never demand bill on their purchase of goods and services and 2 (16.6 percent) customers of them don't care on their purchase.

From above tables it concluded that most of the weakness of the VAT is billing system today. It is the causes of unawareness of customers towards the billing system of VAT.

## Views on Problems in the process of VAT implementation

This question is designed to ask for the businessman and tax officers to know the problems in the VAT implementation process The tax payers and

collectors both have to know and conscious about the recording keeping and process of VAT system Though the 9 years have been already passed, but still it has a great challenge in this aspect.

The field survey has been conducted to know the view of different respondents about to explore the problems on the process of VAT records. The study shows registration, collection and tax refunds are the main problems for the implementation.

**Table No: 5.28**

**Views on the problem in the process of VAT implementation**

Respondents	Registration		Collection		Refund		Others		Total
	No	%	No	%	No	%	No	%	
Tax /officers	4	20	35	15	10	50	3	15	20
Businessman	5	25	5	25	6	30	4	20	20
Total	9	22.5	8	20	16	40	7	17.5	40

Source: option Survey 2009

Above survey shows that 16 respondents (out of 50 percent tax officer/ exports, 30 percent businessman) seemed to unsatisfied with tax refund program, 9 respondents including 20 percent tax officers 25 percent businessman give their option on the problem on reiteration, 8 respondents ( out of them 15 percent tax officers/ exports \, 25 percent businessman) seemed the problem on collection and 7 respondents includes 15 percent tax officers / exports, 20 percent businessman viewed problem on theirs.



### 5.4.13 View on Major problems on Effectiveness on VAT in Nepal

This question was designed to ask each tax officers/ exports, businessmen to know their responses on their given choice of important factor for effectiveness of VAT in Nepal.

**Table No: 5.29**

#### Views on Most Important Factor for the Effectiveness of VAT in Nepal

Respondents	Proper Implementation		Broad coverage		Tax Education		Effective and Efficient Administration		Clear VAT laws and regulation		Total
	No	%	No	%	No	%	No	%	No	%	
Tax officer/	-	-	-	-	-	-	-	-	-	-	-
Experts	-	-	2	10	10	50	3	15	5	25	
Businessman	3	15	-	-	4	20	7	35	6	30	20
Total	3	7.5	2	5	14	35	10	25	11	27.5	20
											40

Source: Option Survey 2009

From the above table is visualized that 14 (35 percent) respondent has commented that tax education is the most important factor that effectiveness of VAT, 11 (27.5 percent) of respondents has commented that clear VAT law and regulation is the most important factors for the effectiveness of vat, 10 (25 percent) respondents told that effectiveness of VAT, 3 (7.5 percent) respondents said that proper implementation is the most important factor for effectiveness of VAT. And 2 (5 percent) respondents seemed that broad coverage is the most important factor and effectiveness of VAT and 2 (5

percent) respondents seemed that the broad coverage is the most important factor for effectiveness of VAT.

From the above table we can conclude that tax education is the most important factor for the effectiveness of VAT in revenue collection. From the result obtain factor the investigation the important factors for the effectiveness of VAT can be ranked as follows:

1. Tax education
2. Clear VAT laws and regulation
3. Effective and efficient administration
4. Proper implementation
5. Broad coverage

### **Major Finding of the Study**

ON the basic of previous chapter and data presentation and analysis, some important finding can be drawn. The major findings views are viewed below:

Nepal has facing resource gap from years. Tax revenue resources are not able to maintain in every regular budget. The major cause of persisting fiscal default in Nepal is due to properly designed and defective tax system. Which cause inadequate mobilization of resources?

Tax attain has an important role in the country economy development,. In recent decades, many developing countries around the world have begun to focus their attention on reforming tax system.

Tax system reforms have been established as a new trade. One of such trend is the increased acceptance of VAT as an important part of their tax reform programmers in the world. It has becoming most popular tax in sales tax family and more then 130 countries of the world have implemented VAT as a tax reforms programme. Nepal have been implanted VAT from 16<sup>th</sup> November 1997 AD

In context of Nepal total revenue collection above two third of such revenue is contributed by tax revenue and balancing about one third of the contributed by non tax revenue during the study period.

Tax revenue is composed of direct tax revenue and indirect tax revenue. Average contribution of indirect tax is above 74.38 percent and direct tax shares only about 25.62 percent and the contribution of indirect tax in the beginning of study period was greater than latest years of the study.

The contribution from the tax revenue to GDP is always in between 8.95 percent to 10.73 percent and average contribution of 11 years was 9.79 percent to 10.73 percent and average contribution of non-tax revenue is always in between 6.81 percent. Here, contribution from tax and indirect tax revenue to GDP is very low.

It has found the collection of VAT has been increased except 2001/02. In fiscal years 1998/99 collection of VAT has increased by 23.53 and in fiscal years 2007/08 collection of VAT has increased by 28.94 percent highest in among the study period. The negative increase in the fiscal year 2001/02 was 0.93 percent.

In Nepal revenue collection from VAT has been increased trend every year. Revenue collection from VAT reached from 21610.7 to 71226 million from the fiscal years 1997/98 to 2005/06. The contribution of VAT revenue as percentage of the GDP remained 2.46, 2.66, 2.80, 3.14, 3.02, 3.08, 3.05, 3.74, 3.70, 3.98, 3.79 percent respectively performance of VAT.

Registration of VAT payers has increased trend every year after the implementation of VAT. In the year 1997/1998, 5237 registrants registered in VAT system, and have reached to 59707 registrants till fiscal year 2007/2008

The average share of VAT revenue in total revenue was 25.66 percent in the study period of 11 years. The share of VAT revenue to the total revenue is about one third through out the study period of 1997/98 to 2007/08.

The average tax to GDP ratio has remained 16 to 19 percentages in developing countries and 30 to 35 percentages in developed countries. The same ratio in law economics is very nominal of 7 to 10 percentage on average (World Bank Developing Report 1997) but in Nepalese case such ratio never crossed 11 percent and average of such ratio is 9.79 percent in the study period of 11 years.

From the field survey it has found that VAT is an appropriate mean of raising government revenue 67.3 percent respondents viewed in support of the aspect that VAT is an appropriate mean of rising government revenue, 23.08 percent respondents mean the rising government revenue. 23.08 percent respondents viewed unknown about this aspect 9.62 percent respondents went against this view. Most of the respondents are in the favor about the view a supervisory of VAT to the areas it has replaced as it is 86.54 percent and 13.46 percent respondents are against the issue.

55.76 percent of respondents reached to the conclusion that VAT will not raise price of the commodities but 44.23 percent claimed for price increment from VAT.

From the option survey as statistical show that VAT is not able to generate its revenue potential 50 percent of them respondents demanded bill sometimes, 83.33 percent respondents never demand bill and 16.67 percent respondents not care demand for their purchase time. We conclude that most weakness of the VAT is billing system today. The main cause of this weakness is awareness of customers on VAT system.

Option survey shows that main problem in the process of VAT implementation is tax refund process. 40 percent respondents take it as a main problem in the process of implementation.

There are so many problems in the environment which are creating the obstacle in the effective implementation on VAT. Lack tax consciousness of

people is the main problem. The other problems are improper billing system, smuggling and undervaluation, lack of skill manpower, tax evasion.

Empirical study shows that most effective factor for the effectiveness of VAT is the availability of educational programmers relating VAT. Others Vat is the availability of educational programmers relating VAT. Other factor mainly its clear VAT laws and regulation, effective and efficient factor mainly its clear VAT

Laws and regulation, effective and efficient administration, proper implementation, effective administrator, proper implementation; broad coverage can play the great role for the effective implementation of VA.

VAT could not fully implement. In our environment where the tax carelessness in minimal, the practical of maintaining tax account accounts is negligible or improper, smuggling and undervaluation is done by traders, tax leakages take place with negotiations between the tax payer and tax administration. It was not easy implement VAT and the political instability are situation and it made more complex.

# CHAPTER SIX

## SUMMARY, CONCLUSION AND RECOMMENDATION

### 6.1 Summary

Tax is a compulsory contribution by people to the government to defray expenses incurred in the common interest of all without reference. In another words, tax is a compulsory contribution imposed by public authority using the rights given by the law. Taxation is the main source of financing government activities. Taxation and economic development are interrelated. Taxation has an important role in countries' economic development. In recent decades, many developing countries around the world have begun to focus their attention on reforming their poorly designed defective tax structures as an integral part of their development efforts. Taxation may be imposed on person's income or wealth and consumption and production of goods and services. On the basis of its nature, tax can be classified in direct and indirect tax.

The value added tax (VAT) is a broad base indirect tax. VAT is the most recent innovation in the field of taxation. The concept of VAT was developed by Dr. Wilhelm Von Siemens of Germany in 1919 A.D. It is the most important tax reform in the 21<sup>st</sup> century as it has already been implemented popularity in more than 130 countries in the world. It is a modern tax system intended when fully implemented to improve the collection of tax, to increase efficiency and to lesser the tax evasion. VAT is multi staged, commodity and service based tax which is imposed on goods and services at each stage of production and distribution. It is imposed only on value added amount VAT is not perfectly new form of taxation. It is a commodity based refined form of sales tax.

In the context of Nepal, VAT system is completely new system of taxation. Nepalese government introduced VAT since November 16, 1997. Before the implementation of VAT, VAT task force was created in September, 1993 with the technical assistance form USAID. But due to the mid term election 1994, VAT was not implemented as it was suggested by the task force. Then after another Task Force was formed and it recommended the VAT should be introduced. In the earlier stage of VAT implementation, there were strong oppositions the business community about the implementation of VAT. But with the flow of time VAT was slowly accepted by the business community. Nepal has introduced a consumption type invoicing method. VAT based on the destination principle with a single stage positive rate of 10% (Now changed 13%) combined with zero on exports with exemption on specified transaction on goods and services. The registration threshold is Rs.2 million and 2 lakh for exports. VAT with tax credit mechanism extending right through the retail level. VAT very narrow tax base, creating cascading efforts, high burden on domestic

products and inefficiency are its principles features needing prompt rationalization.

VAT is levied on each level of sales from production and import to distribution of all goods and services except exempt one. But business persons engaged in the sales of goods and services below specified threshold level, it is not mandatory for them to register under VAT. The transaction of tax exempt goods and services remains outside the overview of VAT. Those dealing in such transaction do not have to fulfill any formalities, including registering under VAT. In case of zero-rated supplies such as export, there is a provision of tax refund of VAT. Such registration has to collect VAT at the rate of zero percent on their sales and can deduct the tax incurred on their purchase or imports. In this system, every person or business firms which are above threshold limit should compulsory be registered in VAT office. Registered person/business firms get credit facility on tax paid, on their purchases. Purchasers pay VAT to the sellers and sellers transfer it to the government deducting VAT paid on their business purchases.

Nepal introduces VAT system for several reasons. It was necessary to introduce such a tax to develop a stable source of revenue to broaden the tax base to promote economic growth to generate revenue required for improving its deteriorating macro economic performance, to established an account based modern transparent tax system to make the tax system more scientific, to gain confidence of donors, to make the Nepalese tax system effective. Empirical as well as theoretical analysis shows that VAT is superior to other types of sales tax. Comparison of VAT with other forms of sales tax on the ground of: a) Economic efficiency or neutrality b) Revenue productivity c) Supporting economic growth d) Excess burden e) Equity norms h) price stability, VAT proves far more superior to turnover tax, Import/manufacturing level Such Tax (MST), Wholesalers level Sales Tax (WST) and Retail Level Sales Tax (RST). Although the base of RST and consumption type; VAT extended capability. The check-up effects also cannot be enforced automatically. It needs administrative efforts. Since the implementation of VAT, it has been generating reasonable amount of revenue despite having too many challenges regarding the implementation of VAT. The tax revenue structure shows that the share of indirect tax in total tax has continuously declined but the share of VAT to indirect tax has been increasing with some fluctuation. VAT is contributed more than 50.19% to indirect tax on fiscal year 2007/08. The contribute average above 44% to indirect tax revenue during the study period. The contribution of VAT in GDP ratio is 3.79% in FY 2007/08 and average contribution of VAT in GDP ratio is 3.22%. The trend on VAT to GDP ratio is increasing tendency with some fluctuations every year. The numbers of VAT registrants are increasing order every year.

The empirical study, the analysis has been done about VAT on the basis of information collected from administrators/experts, businessmen and consumers. The tool that is basically used the structured questionnaire. The questions are asked to 52 individuals related to the field. Out of them 20 are tax experts; 20 are businessmen and 12 are consumers. Their responses in various questions are tabulated and analysis in chapter five.

Although the amount from VAT revenue has been increasing but it is unable to achieve its potential. The reasons behind there are various problems relating its implementation are yet to be eliminated. In proper billing system, lack of required number of qualified and trained tax administration, lack of awareness about VAT, compliance, open, burden, unauthorized trade, lack of co-ordination between tax payers and tax officers, unclear laws and regulation, open boarder, lack of courage to take accountability by different group, lack of political commitment.

To avoid above challenges some steps are required to get positive effect from VAT. There is a need of effective monitoring system, awareness program, clear VAT act and regulations, effective management, tight in boarder. If the problem relating to VAT system can be solved and resources are effectively utilized then only the effectiveness of VAT in Nepal will be right.

## **6.2 Conclusion**

VAT is one of the best alternatives of tax reform process. To achieve higher growth of revenue to increase efficiency and to lesser tax evasion every country needs to reform some of its tax system. In the context of Nepal the process of tax reform, Nepalese government adopted VAT by replacing four other tax system i.e. sales tax, hotel tax and entertainment tax and adopted VAT a broad-base consumption type of VAT using tax credit method. Under this system the tax is levied on all types of goods and services on their production or distribution stages both imported goods and domestically produced except specially exempted by the law. VAT system is transparent and discourages tax evasion. It is the most innovative, scientific and powerful tax with worldwide application for both developed and developing economics. Nepal adopted VAT because VAT is more revenue generator and highly instrumental for resource mobilization.

Empirically, it is found that VAT has high revenue potential power. The narrow tax base of the previous sales tax failed to generate the minimum required amount of revenue because it included only import and manufacturing unit. The liberalization and globalization concept has also affected Nepalese tax system. Customs duties have been curtailed in worldwide span in order to increase free flow of goods and services. Huge parts of revenue were used to collect from custom duty in Nepal and by the above reason of cutting custom duty alternative source of revenue mobilization was necessary in Nepal and as a result VAT was implemented.



In the Nepalese context, the trend of revenue contribution is fluctuating but the amount has been increasing reasonably. It is only the 12<sup>th</sup> year of VAT implementation but the revenue collection from VAT is not so bad. Theoretically VAT is the best alternative to gain high revenue collection. But practically it depends on its environment where it exists to get potential target from VAT the environment relating to VAT must be as required. VAT implementation in Nepal so the revenue contribution from VAT is not as high as expected. But in future VAT will be more effective as it has expected.

Empirical investigation shows that VAT is an appropriate mean of raising government revenue and VAT will be more effective in future. So, there is no need to think about the performance of VAT right now as it is unable to get required amount of revenue. After the establishment of strong tax structure and smooth environment for the implementation of VAT, VAT will give the revenue as it has been expected.

For the effective implementation there must be sound surroundings. But being a developing country, Nepal has too many difficulties to implement the VAT properly. These problems are now limiting the effectiveness of VAT. To get the positive effect from VAT implementation first of all the problems relating to implementation of VAT must be minimized or removed.

The major problems relating VAT is lack of proper invoicing system, narrow tax compliance, existence of large amount of small traders/retailers, political instability, lack of good administrative design, lack of qualified, honest, trained manpower, open boarder, unclear VAT law and regulation, lack of regular monitoring, unawareness of general people, unhelpful traders businessmen, tax leakages take place with negotiation between tax payers and the tax administration, geographical disturbances. To take them in a better track of VAT education system is required to get informed about the positive effect of VAT to every person relating to VAT. But we don't have that better education system to make people conscious, availability of clear VAT laws and regulations, efficient administration, honest tax payers good education programmed establishment of proper invoicing mechanism and extension of tax coverage are most important factors which increase the revenue mobilization through VAT and effectiveness of VAT can be achieved.

At last, problems relating to VAT system in Nepal can be solved, properly implemented VAT then the VAT would definitely play the significant role in the overall economic development of country in coming year.

### **6.3 Recommendation**

Since the implementation of VAT is a great jump from the traditional tax system to a modern tax system. Several things are still lacking to be done for the successful implementation of VAT in Nepal to make its effective result in economic activities. In such circumstances, on the basis of major findings and

conclusions, following recommendations have been made to make VAT effective and more effective which could be fruitful to concerned authorities while reforming Nepal's VAT system.

) VAT act and regulation (rules) should be clear and timely revision. The language of act and regulation should be simple, phase out unnecessary provisions. VAT registration procedure, VAT collection process, VAT refund process should be made clear, easier, quicker so that VAT payers would be encourage paying VAT.

) To minimize VAT evasion, jointly participation between policy maker and businessmen should be creating in formulating of VAT policies.

) The threshold of VAT should be decreased instant of increasing the rate of VAT in order to increase the tax amount under VAT.

) Government may provide VAT education regularly to general people, tax payers to make them believe that the collected VAT from them will utilize in proper way for the development of their own country through making hoarding board, publication of journals, pamphlets, seminars, discussions, Television interview with tax experts, researchers, professors and economists about VAT. Similarly, the students at school and campus level should be given knowledge about VAT and curriculum should be including tax education and social obligation of paying tax.

) A collection strategy needs to be developed and implemented effectively in order to collect the increasing amounts of arrear. To improve billing condition in the market needs regular supervision, audits and investigation. Consumer education is required to promote the use of bill in every purchase of goods and services.

) To establish VAT invoices in the firm of campaign college students could be hired and mobilized. This programmed provide the student part-time employment and also enhance publicity. If group of students are placed in busy market places. It creates

Psychological pressure on the vendors to issue invoices and strictly warning should be given businessmen, who use to issue false bills.

) To make VAT effective and transparent, unnoticed inspection on the road of goods and bills in being transported from time to time would discourage incorrect business transaction. Unreal business transaction should be punished to promote real business.

) An efficient, strong and fair administration is the most crucial for the proper implementation of VAT. But VAT administration is still weak, traditional, corrupted in nature. There is lack of expertise, well-trained and skilled officers in VAT administration. So, informative programmed such as seminars, training discussions, should be organized to make the tax officers skilled and capable in their field of job and services.

) Separate VAT department should be established so that the specialization should be achieved in the matter of VAT and the burden of tax officials could be reduced.

) Tax personnel should be encouraged, punished, rewarded and transferred on the basis of their behavior of work and experience. It should help to motivate them on their job.

) Except the most essential goods and services which are directly related to the poor people, the goods and services should not be exempted. So, should be minimized the tax exempt goods gradually.

) Rate discrimination higher rate for luxurious goods and lower rate for necessity goods is better than flat rate, although it is more complicate to implement and more costly to collection.

) Many business persons having taxable capacity are still beyond the tax net. So, enforcement should be made more effective and voluntary compliance.

) The existing long open boarder is the main reason of smuggling and under valuation system. So, regulation of all imports y established checking mechanism by co-ordination between army force and revenue personnel (Rajasho Gasti toil). Similarly, it should necessary to make custom administration more strong and efficient to open boarder.

) The proper co-ordinations among various government departments, private sectors and involved in revenue collection must be maintained.

) Computer networking system should establish in all the customs point and all revenue office with department. So, that related information can be accessed to all the concerned officials. Internet facilities must be provided to concern offices for the access of international price and to make data base system effective.

) Effective and regular monitoring system in market by VAT administration should be made from which tax payers are discouraged for tax evasion work.

) Government political parties, citizen society create strong commitment for effective and successful implementation that will make VAT implementation effective in coming year.

In this way this study has been completed with the achievement of the stated objectives.

# BIBLIOGRAPHY

- ) Adhikari, C.M., (2003); Value Added Tax in Nepal; Theory and Practice. Katmandu: Piravi Prakashan.
- ) Adhikari, Santosh (2007); Value Added Tax as Revenue Mobilization in Nepal. An Unpublished Dissertation Submitted to Faculty of Management, Kathmandu: Tribhuvan University.
- ) Bhattarai, Ishwor and Koirala, Girija Prasad (2007); Tax Laws and Planning (3<sup>rd</sup> edition), Kathmandu: Dhaulagiri Books and Stationeries.
- ) Due, John F. (1976); Value Added Taxation in Developing Economics in taxation and Development, USA: N.T. Wang Praeger Publication.
- ) Gupta, S.P. (1991); Statistical Method (26<sup>th</sup> edition), New Delhi: Sultan Chand and Sons.
- ) Guerard, Michele (1973); The Brazilian State Value Added Tax, IMF Staff Paper (Vol xx No. 1), Washington D.C.: IMF.
- ) Joshi, P.R. (2001); Research Methodology, Kathmandu: Buddha Academic Publication
- ) Kandel, P.R. (2006); Tax Laws and Tax planning in Nepal, Kathmandu: Buddha Academic Pulication.
- ) Khadka, Rup Bdr. (2000); The Nepalese Tax System, Kathmandu: Sajha Prakashan.
- ) Khadka, Rup Bdr. (2001); VAT in Nepal, India: UBS Publication and Distributors.
- ) Kuikel, Rabin (2004); Effectiveness of VAT in Revenue Collection in Nepal, An Unpublished Dissertation Submitted to Central Department of Management, Kathmandu: Tribhuvan University.
- ) Panta, P.R. (1998); Field work Assignment and Report Writing, Kathmandu: Veena Academic Enterprises Pvt. Ltd.
- ) Poudel, Ratna Prasad (2004); Effectiveness of VAT in Nepal, An Unpublished Dissertation Submitted to Faculty of Management, Kathmandu: Tribhuvan University.
- ) Sapkota, Kishor Kumar (2007); Effectiveness of VAT in Revenue Collection in Nepal, An Unpublished Dissertation Submitted to Faculty of Management, Kathmandu: Tribhuvan University.
- ) Shoup, Carl S. (1969); Public Finance, London: Widefield and Nicholson
- ) Shoup, Carl S. (1988); The Value Added Tax in Developing Countries (vol. 2), Research observer, London: Widefield and Nicholson.
- ) Shoup, Carl S. (1996); Value Added Tax and Developing Countries (vol. 3); Research Observer, Washington D.C.: The World Bank
- ) Silwal, Narayan Pd. (2002); VAT: Its Prospects in Nepal (vol. 2.15), Rajashwa.

) Silwal, Narayan Pd. (2002); Value Added Tax: A Nepalese Experience, Kathmandu: Indu Silwal

) Tait, Alan A. (1991) VAT: Administrative and Policy Issue, Occasional Paper, Washington D.C. : IMF

) Upadhya, Prem (2002); Performance of VAT in Nepal, An Unpublished Dissertation Submitted to Control Department of Economics, Kathmandu: T.U.

#### Government Publications

\*Annual Report 2005/06, Financial Controller General Office, MOF. Gov. of Nepal

\*Annual Report of Various Year, Inland Revenue Department MOF, Gov. of Nepal

\*Budget Sheet of Various Year, Ministry of Finance, Gov. of Nepal

\*Economic Survey Various Year, Ministry of Finance, Gov. of Nepal

National Accounts 2003, 2007, Central Bureau of Statistics, Gov. of Nepal

\*VAT Act 1996 and Regulation 1997, Ministry of Law Justice and Parliamentary affairs

#### Web sites

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

\*[www.fcgo.gov.np](http://www.fcgo.gov.np)

\*[www.mof.gov.np](http://www.mof.gov.np)

\*[www.nrb.gov.np](http://www.nrb.gov.np)

\*[www.cbs.gov.np](http://www.cbs.gov.np)

\*[www.fncci.org.np](http://www.fncci.org.np)





## Appendix-II

### Calculation of Compound Growth Rate of Revenue

i) Calculation of Compound growth rate for the period of fiscal year 1997/98 to 2007/08

**a) Total Revenue**

Here, Amount in base year (p) = 32937.9

Amount in final year (4) = 107622.5

No of years (h) = 11 years

Using formulae,  $A = P (1+i)^h$

$$\text{Or, } 107622.5 = 32937.9 (1+i)^{11}$$

$$\text{Or, } (1+i)^{11} = \frac{107622.5}{32937.9}$$

$$= 3.2676$$

$$\text{Or, } (1+i)^{11} = (1.1136)^{11}$$

$$i = 11.36\%$$

**b) Tax Revenue,**

Here, Amount in base year (p) = 25939.8

Amount in final year (4) = 85155.5

No of years (h) = 11 years

Using formulae,

$$A = P (1+i)^h$$

$$85155.5 = \frac{25155.5}{25939.8}$$

$$= 3.2824$$

$$(1+i)^{11} = 3.2824$$

$$(1+i)^{11} = (1.1141)^{11}$$



$$I = 11.41\%$$

**b) Indirect tax revenue**

Here, Amount in base year (p) = 19751.90

Amount in final year (A) = 62067.70

No of years (h) = 11 years

Using formulae,

$$A = p(1+i)^h$$

$$62067.70 = 19751.90 (1+i)^{11}$$

$$(1+i)^{11} = 3.1423$$

$$(1+i)^{11} = (1.1096)^{11}$$

$$I = 10.96\%$$

**d) VAT Revenue**

Here, Amount in base year (p) = 7112.60

Amount in final year (a) = 31154.63

No of year (h) = 11 years

$$A = p (1+i)^h$$

$$31154.63 = 7112.60 (1+i)^{11}$$

$$(1+i)^{11} = \frac{31154.63}{7112.60}$$

$$= 4.379$$

$$(1+i)^{11} = (1.1437)^{11}$$

$$(1+i)^{11} = 1.1437$$

$$I = 14.37\%$$

## Appendix III

Let, the trend line between the dependent variable  $y$  and the independent variable  $x$  (i.e. time) be represented by  $y = a + b x \dots$

Since the no of the years is 11 years, the disastrous are taken from fiscal year 2002/03. Account are

In million Trend value of indirect tax (1997/98 to 2007/08)

Fiscal Year (X)	Indirect Tax (Y)	Mid value X=2002/ 03	X <sup>2</sup>	XY
1997/98	19751.90	-5	25	-98759.5
1998/99	21236.80	-4	16	-84947.2
1999/00	24200.60	-3	9	-72601.8
2000/01	28705.70	-2	4	-57411.4
2001/02	28733.10	-1	1	-28733.10
2002/03	32481.20	0	0	0
2003/04	36260.40	1	1	36260.40
2004/05	41032.90	2	2	82065.80
2005/06	43462.30	3	3	130386.90
2006/07	52146.40	4	4	208585.60
2007/08	62067.69	5	5	310338.45
$\sum N=11$	$\sum Y=390079.99$	$\sum X=0$	$\sum X^2=110$	$\sum XY=425184.15$

$$a) \frac{\sum x^2 \sum XY}{N \sum X^2} = \frac{110 \times 390079.99}{11 \times 110} = \frac{42908798.9}{1210} = 35461.81$$

$$b) \frac{\sum N \sum XY}{N \sum X^2} = \frac{110 \times 390079.99}{11 \times 110} = \frac{4677025.65}{1210}$$

$$= 3865.31$$

Fiscal Year	Y=a+bx	Y= indirect tax
2008/09	35461 +6x3865.3	58652.86
2009/10	35461 +7x3865.31	62518.17
20010/11	35461 +8x3865.31	66.383.48
20011/12	35461 +9x3865.31	70248.79
20012/13	35461 +10x3865.31	74114.1

## Appendix IV

Let the trend line between the dependent variable  $y$  and independent variable ( $x$  i.e. time) be represented by  $y = a + bx$ .

Since the no of the year are 11 the deviation is taken from the year 2002/2003, amounts are million.

Fiscal year (x)	GDP (Y)	Middle Value  X- 2002/2003	X <sup>2</sup>	XY
1997/98	289798	-5	25	-1448990
1998/99	3300181	-4	16	-1320072
1999/00	36625	-3	9	-1098753
2000/01	394052	-2	4	-788104
20010/02	406138	-1	1	-406138
2002/03	4375546	0	0	0
2003/04	472424	1	1	472424
2004/05	504101	2	4	1008202
2005/06	582950	3	9	1748850
2006/07	670588	4	16	2682352
2007/08	820814	5	25	4104070
	$\sum y = 5274680$	$\sum X = 0$	$\sum X^2 = 110$	$\sum XY = 495384$

$$a) \frac{\sum x^2 \sum XY}{N \sum X^2} = \frac{110 \times 5274680}{11 \times 110} = 479516.36$$

$$b) \frac{N \sum XY}{N \sum X^2} = \frac{11 \times 4953841}{11 \times 110} = 45034.92$$

Fiscal Year	Y=a+b+x	Expected GDP
2008/09	479516.36 +45034.92x6	749725.88
2009/10	479516.36 +45034.92x7	7947.60.8
2010/11	479516.36 +45034.92x8	839795.72
2011/12	479516.36 +45034.92x9	88.4830.64
2012/13	479516.36 +45034.92x10	92986.5.56



## Appendix V

Let the trend line between the dependent variable  $y$  and the independent variable  $x$  (i.e. time) be represented by  $y = a + bx$ .

Since the no of the year is 11 years, the boisterous are taken from fiscal year 2002/03. Amount are in million

Trend value of VAT (1997/98 to 2007/2008)

Fiscal Year (X)	VAT (Y)	Mid value (X) $X = X - 2002/03$	$X^2$	XY
1997/198	7122.60	-5	25	-35613
1998/99	8765.90	-4	16	35063.60
1999/00	10259.70	-3	9	30779.10
2000/2001	12382.40	-2	4	24764.80
2001/2002	12267.30	-1	1	12267.30
2002/2003	13459.70	0	0	0
2003/2004	14478.90	1	1	14478.90
2004/2005	1888.5.40	2	4	37770.80
2005/2006	21610.70	3	9	64832.10
2006/2007	26704.18	4	16	106819.72
2007/2008	31154.63	5	25	155773.15
	$\sum Y = 177091.41$	$\sum X = 0$	$\sum X^2 = 110$	$\sum XY = 241183.87$

$$a) \frac{\sum x^2 X - Y}{NX^2} = \frac{110 \times 177097.41}{11 \times 110} = 16099.21$$

$$b) \frac{\sum x^2 X - Y}{NX^2} = \frac{11 \times 241183.87}{11 \times 110} = 2192.58$$

Fiscal Year	Y=a+bx	Expected VAT
2008/09	16099.21 + 2192.58X6	2925469
2009/10	16099.21 + 2192.58X7	31447.27
2010/11	16099.21 + 2192.58X8	33639.85
2011/12	16099.21 + 2192.58X9	35832.43
2012/13	16099.21 + 2192.58X10	38025.01