

PROBLEMS AND PROSPECTS OF VALUE ADDED TAX IN NEPAL

A Thesis Submitted to

Central Department of Economics, Faculty of Humanities and Social
Sciences in Partial Fulfillment of the Requirements for the Degree of
Master of Arts
in
Economics

By

Raju Dhakal

Roll No. 243/062

T.U. Regd. No. 6-3-28-15-2005

Central Department of Economics
Tribhuvan University
Kirtipur, Kathmandu
April 2009

Date: 6/1/2066

LETTER OF RECOMMENDATION

The thesis entitled **Problems and Prospects of Value Added Tax in Nepal** submitted by Mr. Raju Dhakal as a partial fulfillment of the requirements for the Degree of Master of Arts in Economics is prepared under my supervision and guidance. I forward it with recommendation.

.....
Prof. Dr. Sohan Kumar Karna
Thesis Supervisor
Central Department of Economics
Kirtipur, Kathmandu

Date: April 19, 2009

Date: 14/1/2066

APPROVAL LETTER

The thesis entitled **Problems and Prospects of Value Added Tax in Nepal** submitted by Raju Dhakal has been accepted as partial fulfillment of the requirements for the Degree of Master of Arts in Economics.

Thesis Committee

Prof. Dr. Devendra Prasad Shrestha
Acting Head

External Examiner

Prof. Dr Madan Kumar Dahal

Thesis Supervisor

Prof. Dr. Sohan Kumar Karna

Date: 27 April, 2009

ACKNOWLEDGEMENTS

I express my heartiest gratitude to my thesis supervisor **Prof. Dr. Sohan Kumar Karna** for his constant encouragement, patience guidance and valuable suggestion at every step of work. This work would not have been materialized at the present form without their incisive observation and intellectual direction in the course of completion.

I owe a deep of gratitude to the staff of Central Department of Economics, Library, Central Library, T.U., Nepal Rasta Bank and ministry of finance.

I specially thank to my friend Govinda Pandit, Gyanendra Pandit and my brothers Rajendra Dhakal and Pradeep Adhikari for their insightful comments and suggestion.

Lastly I would like to thank Keshav Adhikari and Gokarna Prasad Aryal for their cooperation in computer typing and printing of the thesis neat and clean in time.

Date: April, 2009

Raju Dhakal

TABLE OF CONTENTS

Page No.

LETTER OF RECOMMENDATION

APPROVAL LETTER

ACKNOWLEDGEMENTS

LIST OF TABLES

LIST OF ABBREVIATIONS AND SYMBOLS

CHAPTER ONE: INTRODUCTION

1.1 General Background	1
1.2 Statement of the Problem	2
1.3 Objectives of the Study	3
1.4 Significance of the study	4
1.5 Limitations of the Study	4

CHAPTER TWO: REVIEW OF LITERATURE

2.1 International Context	5
2.2 Nepalese Context	10
2.3 Review of Related Literature	16
2.3.1 Review of Books and Published Dissertation	16
2.3.2 Review of Papers and Publications	17
2.3.3 Review of Unpublished Thesis	18

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction	20
3.2 The research Design	20
3.3 Source of Data	20
3.4 Method of data collection	21

CHAPTER FOUR: PRESENTATION AND DATA ANALYSIS

4.1 Introduction of VAT	22
4.1.1 Concept	22
4.1.2 Origin and Development	23

4.2 Types of VAT	24
4.3 Principal of VAT	26
4.3.1 Origin Principle	27
4.3.2 Destination Principle	27
4.4 Methods of computation of VAT	27
4.4.1 Addition Method	27
4.4.2 Subtractions Method	28
4.4.3 Tax credit Method	29
4.5 Structure of VAT	31
4.5.1 Tax Base	31
4.5.2 Freeing from VAT	32
4.5.2.1 Zero Rating	32
4.5.2.2 Exemption	33
4.5.2.3 Threshold	34
4.5.3 Tax Rate	34
4.6 Operation of VAT	35
4.6.1 Registration	35
4.6.2 Tax Invoice	36
4.6.3 Books of Account	37
4.6.4 Tax Return and Payment	37
4.6.5 Penalties	38
4.6.6 Audit of VAT	39
4.7 VAT and Other Forms of Sales Tax	39
4.7.1 VAT and RST	39
4.7.2 Value Added Tax and Manufactures Sales Tax (MST)	41
4.7.3 Value Added Tax and Wholesale Level Sales Tax (WST)	42
4.8 Public Expenditure and Revenue	43
4.8.1 Public Expenditure	43
4.8.2 Public Revenue	45
4.8.2.1 Tax Revenue	46
4.8.3 Non Tax Revenue	47

4.9. Nepalese Taxes	48
4.9.1 Customs Duty	50
4.9.2 Excise Duties.	52
4.9.3 Income Tax	53
4.9.4. Value Added Tax	55
4.9.5 Comparison of VAT and custom Duty	57

CHAPTER FIVE: STRUCTURE OF VAT IN NEPAL

5. VAT in Nepal	59
5.1 Evolution	59
5.2 Reasons for the Adoption of VAT in Nepal	61
5.3 An Outline of Nepalese VAT System	64
5.3.1 Characteristics of Nepalese VAT	64
5.3.2 Structure of Nepalese VAT	65
5.3.3 Implementation of VAT.	68
5.3.4 Contribution of VAT in Revenue Generation	72
5.3.5 Existing Problems	73
5.3.6 Current Efforts to make VAT Effective	76

CHAPTER SIX: PROBLEMS AND PROSPECTS OF VAT WITH RESPECT TO REVENUE MOBILIZATION

6.1 Problems for Revenue Mobilization	78
6.2 Prospects for Revenue Mobilization	80
6.3 Strategies and Policies in Tenth and Three Interim Development Plan	82

CHAPTER SEVEN: SUMMARY CONCLUSION AND RECOMMENDATIONS

7.1 Summary of Findings	86
7.2 Conclusion	88
7.3 Recommendations	92
BIBLIOGRAPHY	96

LIST OF TABLES

Table No.	Title	Page No.
Table 4.1:	Calculation of VAT liabilities under different method (10% VAT)	30
Table 4.2:	Ratios of Government Expenditure and Revenue of GDP (In Current Producer's price)	45
Table 4.3:	Contribution of Direct Tax and Indirect Tax Revenue	46
Table 4.4:	Relative Share of Non Tax Revenue and Tax Revenue on Total Revenue	47
Table 4.5:	Composition of Tax Revenue	49
Table 4.6:	Custom Duty as Percentage of Total Tax Revenue	51
Table 4.7:	Composition of Custom Duties in FY 2006/07	52
Table 4.8:	Contribution of Excise Duties in Total Tax Revenue	53
Table 4.9:	Contribution of Income Tax in Total Tax	54
Table 4.10:	VAT Revenue as the percent of GDP	56
Table 4.11:	Comparison of VAT and Customs Duty	57
Table 5.1:	Contribution of VAT Revenue in Total Revenue and Total Tax Revenue	73

LIST OF ABBREVIATIONS AND SYMBOLS

CEDA	Centre for Economic Development and Administration
CEDECON	Central Department of Economics
FNCCI	Federation of Nepalese Chamber of Commerce and Industries
FY	Fiscal Year
GDP	Gross Domestic Product
GNP	Gross National Product
IMF	International Monetary Fund
MOF	Ministry of Finance
MST	Manufactures Sales Tax
NCC	Nepal Chamber of Commerce
NPC	National Planning Commission
PAN	Permanent Account Number
RBB	Rastriya Banijya Bank
Rs.	Rupees.
SAARC	South Asian Association for Regional Cooperation
SAFTA	South Asian Free Trade Agreement
SAPTA	South Asia Preferential Trade Agreement
UDC _s	Under Developed Countries
VAT	Value Added Tax
WB	World Bank
WST	Wholesale Level Sales Tax
WTO	World Trade Organization