

CHAPTER I

INTRODUCTION

1.1 Background

Nepal is a small, landlocked Himalayan country having area of 147,181 Sq km and lying between two big emerging economic giants of Asia-China in the North and India in the East, West and South.

Nepal has a remarkable biological diversity, which is a reflection of her physiographic, climatologically and latitudinal variation. She hosts several thousand species of flora and fauna, many of which are endemic to the country. There are well over 5000 species of vascular plants, 170 species of fish, 175 species of mammals, 850 species of wet land, migratory and residential birds, and 180 species of dragon flies, 50 species of moths and 600 species of butterflies.

However, the greater attraction of Nepal is her people. A study of the people of Nepal may be regarded a study of human diversity as there are more than sixty ethnic/caste groups in Nepal. It is the people who have made Nepal the home of one the earliest civilizations of humankind.

Constraints that keep Nepal in a state of poverty include: hilly terrain resulting in a lacks of infrastructure, prevalence of subsistence farming, absence of irrigation facilities, inadequate agricultural markets, limited access to low-cost agricultural technologies, agricultural education not matched with farmers' needs and market demand, and population growth of 2.27 percent.

Poverty in Nepal reflects regional, gender, and caste dimensions. Increasing as altitude rises; poverty is especially severe in hills and mountains, which are characterized by lack of accessibility, heterogeneity, and marginality. Deprived ethnic groups, making up 15 percent of the population, are socially and culturally discriminated against. Women and girls are poorest among the poor because of discrimination in socio-economic and educational opportunities, ownership of assets, legal rights, and decision-making.

Inequality, means of subsistence and income is imminent at regional, sectoral, urban rural, gender and social ethnic levels. Headcount income-poverty measure is defined by the

Government shows that still 32% of the total population remains hardcore poor and cannot meet their basic needs.

Since 1975, improved government administration and rural development efforts have been emphasized. Agriculture remains Nepal's principal economic activity, employing 80% of the population and providing 37% of gross domestic product GDP. Only about 20% of the total area is cultivable; another 33% is forested; most of the rest is mountainous. Rice and wheat are the main food crops. The lowland Terai region produces an agricultural surplus, part of which supplies the food-deficient hill areas.

Nepal ranks among the world's poorest countries, with a per capita income of around \$386 in 2007. Based on national calorie/GNP criteria, an estimated 31% of the population is below the poverty line. An isolated, agrarian society until the mid-20th century, Nepal entered the modern era in 1951 without schools, hospitals, roads, telecommunications, electric power, industry, or a civil service. The country has, however, made progress toward sustainable economic growth since the 1950s and is committed to a program of economic liberalization.

Nepal launched its 10th five-year economic development plan in 2002; its currency has been made convertible; and fourteen state enterprises have been privatized, seven liquidated, and two dissolved. Foreign aid accounts for more than half the development budget. The Government of Nepal has shown an increasing commitment to fiscal transparency, good governance, and accountability. Also in 2002, the government began to prioritize development projects and eliminate wasteful spending. In consultation with civil society and donors, the government cut 160 development projects that were driven by political patronage.

Industrial activity mainly involves the processing of agricultural produce including jute, sugarcane, tobacco, and grain. Production of textiles and carpets has expanded recently and accounted for about 80% of foreign exchange earnings in the past three years. Agricultural production is growing by about 5% on average as compared with annual population growth of 2.3%. Since May 1991, the government has been moving forward with economic reforms, particularly those that encourage trade and foreign investment, e.g., by reducing business licenses and registration requirements in order to simplify investment procedures. The government has also been cutting expenditures by reducing subsidies, privatizing state industries, and laying off civil servants. More recently, however, political instability over the past few years - has hampered Nepal's ability to forge consensus to implement key economic

reforms. Nepal has considerable scope for accelerating economic growth by exploiting its potential in hydropower and tourism, areas of recent foreign investment interest. Prospects for foreign trade or investment in other sectors will remain poor, however, because of the small size of the economy, its technological backwardness, its remoteness, its landlocked geographic location, and its susceptibility to natural disaster. The international community's role of funding more than 60% of Nepal's development budget and more than 28% of total budgetary expenditures will likely continue as a major ingredient of growth.

In FY 2006/2007, Nepal's exports increased by 4.2%, compared to an increase of 2.8% in FY 2005/2006. Imports grew by 11.3% in FY 2006/2007 as compared to 9.8% in FY 2005/2006. Exports were constrained by political turmoil and a poor investment climate. The trade deficit for FY 2005/2006 was \$1.4 billion, which widened to \$1.8 billion in FY 2006/2007. Real GDP growth during 1996-2002 averaged less than 5%. Real growth experienced a one-time jump in 1999, rising to 6%, before slipping back below 5%. In 2002, GDP recorded a negative growth rate of 0.33%, largely because of the Maoist insurgency. GDP grew 3.1% in FY 2002/2003 and 3.6% in FY 2003/2004, and again slipped to 2.4% in 2004/2005 and to 2.4% in FY 2005/2006, according to the Central Bureau of Statistics. (World Bank Report, 2007)

Despite its growing trade deficit, Nepal traditionally has a balance of payments (BOP) surplus due to remittances from Nepalese working abroad. In FY 2006/2007, Nepal recorded a balance of payments surplus of \$83.4 million (0.9% of GDP), as compared to \$356.1 million in FY 2005/2006 (3.9% of GDP). The lower BOP surplus in FY 2006/2007 was mainly attributable to slower exports and remittances. While the current account decreased in FY 2006/2007, the capital account registered significant growth. Nepal receives substantial amounts of external assistance from India, the United Territory, the United States, Japan, Germany, and the Scandinavian countries. Several multilateral organizations--including the World Bank, the Asian Development Bank, and the UN Development Program--also provide significant assistance.

Agriculture remains Nepal's principal economic activity, employing over 71% of the population and providing 36.1% of GDP. Only about 25% of the total area is cultivable; another 33% is forested; most of the rest is mountainous. Rice and wheat are the main food crops. The lowland Terai region produces an agricultural surplus, part of which supplies the

food-deficient hill areas. Because of Nepal's dependence on agriculture, the magnitude of the annual monsoon rain strongly influences economic growth.

The fact that a majority of the workforce is still attached to low-productive agriculture shows that the spectral-structural shift in the economy has not been accompanied by substantive shift in the structure of employment and thus, in the economic life of the households and the people.

After the restoration of multiparty democracy in 1990, Government has been trying to adopt liberal open-market economic policies. Beside the Government, private sector, NGOs, and donor agencies are working on different sectors for the upliftment of the economic and social life of people. However, the economic as well social performance of Nepal is very low that shows regressive nature and direction.

There are several obvious reasons behind the economic problems facing the country for years. There are internal and external circumstances, including rugged topography, landlockedness, rampant corruption, and failure in identifying the economic strengths, lack of a detailed study to assess the nation's wealth and extent of poverty, among others.

More importantly, the economic, political, social and cultural forces in the country work in haphazard directions, countering each other's progress. The political and non-economic issues get priority than economic issues.

Furthermore, low revenue productivity, widespread poverty, rapid population growth, unemployment, social crime and insecurity, primary product-based export and the international vulnerability have been playing from side by side to halt the economic progress of the country.

Properly planned and properly implemented economic policies such as liberalization and globalization, sound monetary and fiscal policies, a well-developed financial system and a moderately sized Government are some of the basic instrument for rapid and sustained economic development. However, these seem a distant dream for Nepal. Also, redistribution of public spending, willingness and capacity to raise adequate revenue in order to canalize from less to more productive areas are the primary concerns for development but these seem lacking in Nepal.

In developing countries like Nepal, where vicious circle of poverty existed at its best, there is little scope of voluntary source of capital formation. The economy is hidden in low level of

equilibrium trap. Because of mismanagement of factor of production in the country, marginal productivity is extremely low, low productivity leads to low income, low saving, low investment and hence low level of capital formation again. This further shows regressive nature and direction of all macro economic variables.

Through fiscal policy, basically the taxation, Government can attain its basic objectives of stability with growth. Therefore, tax system must be designed to promote the investment by restricting luxurious consumptions. This will have positive impact on revenue collection, establish socially egalitarian society and canalize the resources from less productive to more productive sectors.

Indirect taxes, mainly customs duties and sales taxes heavily dominate tax revenue of Nepal as it does in all the developing countries. Such taxes are much damaging for the efficient allocation of resources. Since quick fixes have a tendency to become permanent, the cumulative effect of repeated short-term measures can seriously distort the tax system. As such, there is a strong requirement for fundamental reform on the taxation system in such developing countries.

The history of taxation in Nepal dates back to time immemorial. However, modern tax system begins with advent of democracy and manifestation of the consolidated budget comprising revenues and expenditures of the Nepal in 1951. E. Hems worth, the then technical mission advisor to Government of Nepal appraised of Nepal's fiscal system for the first time in 1956, through his publication titled 'Fiscal system of Nepal' that could be considered a pioneering work in the field of Government finance in Nepal. Thereafter, George Lent (1973), Y.P. Pant (1973), A. Premchand (1985), B. Khatri and Madan K. Dahal (1995) have proposed agenda for reforms in their reports and studies to improve to Nepal's tax system.

It shows Nepal's tax system has been reforming in different time periods. In this process a team was organized under the chairmanship of Prof. Madan K Dahal has proposed implement value added tax in 1995.

Value Added Tax is popularly known as "VAT" in short. VAT is propounded by Dr. Wilhelm Von Siemens of Germany for the first time in 1919 AD. He advised that the German authorities to implement the system in order to solve the problem of short Government revenue were found in those days.

In fact, a scientific & a feasible tax system is a must to any Government of any country at any time in order to establish good governance & lead a nation to progress & prosperity. For the first time the world, France introduced VAT System in 1954 AD. Ivory Coast & several continent of Africa are second and third countries who introduced the system in 1960 & 1967 AD.

Nepal introduces VAT in Nov. 1997. However, the concept of this tax in Nepal was introduced in early years 1990s. Nepal Government included the concept of introducing VAT in Nepal in its 8th Plan.

VAT is the most recent innovation in the field of taxation, Value added is the value that a producer (whether a manufacturer, distributor, retailer, advertising agent etc) adds to this raw materials or producer (rather than labor) before selling the new or improved product or service. A tax based on this base is called VAT or it is believed on the value added in goods service.

Value added tax (VAT), or goods and services tax (GST), is tax on exchanges. It is levied on the added value that results from each exchange. It differs from a sales tax because a sales tax is levied on the total value of the exchange. For this reason, a VAT is neutral with respect to the number of passages that there are between the producer and the final consumer. A VAT is an indirect tax, in that the tax is collected from someone other than the person who actually bears the cost of the tax (namely the seller rather than the consumer). To avoid double taxation on final consumption, exports (which by definition, are consumed abroad) are usually not subject to VAT and VAT charged under such circumstances is usually refundable.

The tax applies to the Value Added at successive stages of production & distribution i.e. to sales proceeds less purchases of materials inputs & certain services Value Added is equivalent to the sum of wages, salaries, interest, rent and profit. Hence, Value added for a firm is nothing but its gross receipts from the sales minus all expenditure on goods and services purchases from other firms.

1.2 Focus of the Study

The main purpose of this study is to identify and explain the problems in implementation of Value Added Tax (VAT) in the Nepalese perspectives. Problems are pinpointed in depth and discussed in meaningful way by which further research works can be carried out in coming future for the purpose of effective VAT implementation in Nepal.

1.3 Statement of the Problem

Nepal is among the poorest and least developed countries in the world with nearly half of its population living below the poverty line. Agriculture is the mainstay of the economy, providing a livelihood for over 80% of the population and accounting for 41% of GDP.

Nepal's revenue mobilization could not gain momentum for a long time. It is unable to reach at least 12% of GDP. All the improvements required and known in customs, excise duty, sales tax and income tax had already been put in place. The improvements identified by International Monetary Fund (IMF) and the world Bank (WB) had also been implemented. Still, the revenue mobilization cannot take any speed. Thereafter, new taxes were introduced instead to identifying problem with in the existing tax system and trying to rectify them.

Where the revenue collection did not increase even after improvement in the prevailing taxes, it should have been understood that only an effective tax system is not adequate for mobilization but it also requires capable and motivated tax administration, honest taxpayer, as well as political commitment. But in our context, instead of finding solution to these, effort was made to find a new tax system. VAT is one example. This was also natural at that time when VAT and its success were being widely discussed in the world, especially in the developing countries. The news that countries, implementing VAT were experiencing an encouraging level of increase in revenue collection was being relayed. Countries were competing with each other to implement VAT and in a short period of time more that 125 countries had implemented VAT. Negative aspect of this tax was not observed in none the countries in which VAT has been already implemented. Against this global scenario, Nepal had yet to implement VAT. Since the prevailing tax systems were not able to increase revenue collection even with all the improvement put in place. It was natural to expect that Nepal would benefit from implementing the revenue VAT system. In this context, Nepal put forward the intention to implement VAT.

VAT was implemented after several preparations program such as publicity, campaign, workshop, training advertisements, publication of articles discussion on radio and television, commenced various booklets and other materials were published. In this process only the positive aspect of VAT were discussed and publicized. The negative aspects were not taken into consideration. So that shortcoming that can enter on the process of VAT implementation could not be discussed. The tax was presented in such a manner that it seemed to be the solution to the entire problem related to revenue collection. People who expressed their

doubt the effective implementation of VAT were told that smuggling would automatically be uprooted, revenue leakages would automatically be controlled, exports would automatically increase and that revenue collection would increase so much that foreign aid would not be required with the implementation of VAT.

In Nepal, the full implementation of VAT till the retail has crossed its tenth year but still the revenue collection has 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 sectors had been paying in the past. In other words, the revenue collection from these sectors had been increases manifolds compared to the revenue collection in the past. Otherwise, there was no need to bring in a new tax system by abolishing the old ones. Whether, VAT has been beneficial or not can be cleared by comparing the total revenue collected from the four old taxes (i.e. sales tax, contract tax, entertainment tax and hotel tax) with the revenue collected from VAT.

The revenue collections from the four taxes that have been replaced by VAT (until 2053/054 besides the FY 2047/48) were maximum of 35% and minimum of 33.3% of the total tax revenue. But after implementation of VAT, the revenue received through this tax dropped to approximately 30% of the total tax revenue. Therefore, it can be said that there has been no real increase in revenue collection with the implementation of VAT. This proves that only a scientific and modern tax system is not sufficient to increase revenue collection. This present situation of VAT shows the need for understanding and commitment at the general taxpayer level, political level, and motivated tax administration, serious study of the negative aspects of the new tax system and honest and earnest attempts and environment to tackle the problems in order to make any tax system revenue productive. It seems its right time to make an assessment the VAT by identifying its problems that has been arisen are going to be arises in the due process of effective implementation and prospects of revenue mobilization through VAT in the country. At present Nepal has practiced a flat rate of 13% of VAT and the threshold level is Rs. 2 million on annual transaction. Now it is the time to review the existing provisions and problems which are the subject matter of this study.

1.4 Objectives of the Study

The main objective of the study is to identify the problems in VAT implementation in Nepal. The other objectives of the study are as follows:

- i). To review the resource gap in Nepal.

- ii). To examine VAT revenue collection.
- iii). To analyze the problems of VAT implementation in Nepal.
- iv). To provide suggestions for effective implementation of VAT.

1.5 Significance of the Study

As the VAT is an indirect tax, its major objective is to increase revenue to the nation coffer. It is not an exception in Nepal too. Therefore, the preamble of the present VAT Act has mentioned clearly. This has been emphasized by the plan document of the government as well. The Eighth, Ninth and Tenth Plan have also clearly stated that the VAT should be the major revenue source of the government. The Ninth and Tenth Plan resource mobilization strategies have also given importance on it. There were mainly four reasons to introduce VAT in Nepal. First reason was to develop VAT as a main and stable source of government revenue by broadening the tax base. Second was to address the issue of smuggling or understate the taxable value, since the former sales tax was collected only at source and value added below this point was not included. Third was to reduce the dependence on custom duty, since Nepal needed gradual reduction in imports tariff as its commitment to WTO, BIMSTEC, and SAFTA. Finally, it was argued to modernize the tax system by enhancing the accounting practice and transparency in business. Also it was being introduced in the country as a radical tax reform measure. However, business community strongly opposed VAT at the time of its introduction; the Government also did not take action against such business that did not register in VAT. The Government has made several compromises in response to strong opposition, and the tax has not been fully implemented yet.

VAT was expected to occupy an important part of Nepal's revenue. In the country, the base of the domestic trade taxes has been narrow as well since the share of the total economy that flows through market channel is relatively small. The potential tax base became even smaller as sales tax used to be collected at the import/manufacturing point.

The performance of VAT implementation for the past 10 years is a debatable issue. The supporters of VAT at the time of its introduction used to say that it is performing well. The increase in revenue collection and the rise in taxpayers seem quite satisfactory in a country like Nepal. Had there were peace in the country, it would have better what the country is experiencing in revenue mobilization front currently. Instead, the business community and those opposing VAT at the time of its introduction use to express the views that it has failed

to perform as per the as per the expectations. Some thought that the VAT as a gift box, those who can kindly contribute and those who are miser do not. VAT revenue collected by the government is completely gift amount. In such a situation, Government is required to identify the existing problems and shortcomings in VAT implementation and solve the problems accordingly. A successful implementation of VAT should have positive impact on our economy. In this regard, these shortcomings can be reduced by taking corrective measures for effective implementation of VAT and resource mobilization.

There are lots of researches on VAT in International Level but very few of these are concerned about countries like Nepal. So, the study will mainly focus on the difficulties for VAT implementation in Nepal. Besides this, the study will directly be beneficial for the policy makers, private sectors and researcher. It will provide the clear concept and ideas as well as knowledge to those persons (private or Government) who are interested and confused about VAT system. Similarly, it will be equally helpful to the researcher of indirect taxes.

1.6 Limitations of the Study

The main limitations of the study are as follows:

-) The required data are collected through both primary and secondary sources.
-) The period covered by the study will extend over five to ten years data.
-) Judgmental sampling is followed to draw the sample.
-) The consistency of the result is strictly based on the information provided by the respondents. Government tax authorities and business persons are not ready to provide all the required data; they want to keep some data confidential.
-) The figure after the decimal are kept as required.

1.7 Organization of the study

The organization of the study has followed five separate chapters which are as follows:

Chapter I:

This chapter includes background, focus of the study, statement of the problem, objectives of the study, importance of the study, limitation of the study & organization of the study.

Chapter II:

This chapter includes the conceptual framework & Literature review.

Chapter III:

This chapter includes the research design, the population & sample, the sampling procedure, the data gathering procedure, the statistical procedure & data analysis procedure.

Chapter IV:

Presentation and Analysis of data is presented in this chapter which includes total revenue structure, trends of VAT Register compositions of total Revenue TAX /GDP ratio, contribution of import VAT & Domestic VAT to VAT Revenue, resource Gap in Nepal, empirical study on issues on problems in VAT implementation in Nepalese perspective.

Chapter V:

This chapter includes summary, conclusion & recommendation of the research work.

CHAPTER II

CONCEPTUAL FRAMEWORK & LITERATURE REVIEW

2.1 The Concept

Introduction

Value added tax (VAT), or goods and services tax (GST), is a consumption tax levied on value added. In contrast to sales tax, VAT is neutral with respect to the number of passages that there are between the producer and the final consumer; where sales tax is levied on total value at each stage, the result is a cascade (downstream taxes levied on upstream taxes). By definition, exports are consumed abroad and are usually not subject to VAT; VAT charged under such circumstances is usually refundable. This avoids downward pressure on exports and ultimately export derived revenue. A VAT is an indirect tax, in that the tax is collected from someone who does not bear the entire cost of the tax.

Value Added Tax, or VAT, is a tax that applies to most business transactions that involve the transfer of goods or services. Once when business turnover reaches a certain level, the business will have to register for VAT. This means that whenever business house buy or sell anything in the course of its business, it will have to charge VAT on its sales, keep proper VAT records on its incoming and outgoing transactions and pay VAT to respective Inland Revenue Department (IRD). Even if the business turnover is below the registration threshold it could consider registering voluntarily for VAT.

VAT) is a broad-based tax as it also covers the value added to each commodity by a firm during all stages of production and distribution. It is a modern tax system to improve the collection of taxes, to increase efficiency and to lessen tax evasion. It is also regarded as the backbone of income tax system in Nepal. The current threshold for VAT registration is Rs. 2 million. Those vendors whose annual turnover is below the threshold can, however, register voluntarily.

Personal end-consumers of products and services cannot recover VAT on purchases, but businesses are able to recover VAT on the materials and services that they buy to make further supplies or services directly or indirectly sold to end-users. In this way, the total tax levied at each stage in the economic chain of supply is a constant fraction of the value added

by a business to its products, and most of the cost of collecting the tax is borne by business, rather than by the state. VAT was invented because very high sales taxes and tariffs encourage cheating and smuggling. It has been criticized on the grounds that (like other consumption taxes) it is a regressive tax.

Value added tax is a tax levied on value-added on goods and services by the enterprises at the successive stage of production and distribution. Value added tax is the gross receipt from sales after subtraction all expenditure on goods and purchase from other firms. Looking from one angle, value added by a firm is total of incomes paid put by the firm to factors employed and value is a processing or handling these purchased item with its own labor force and machinery, building, or other capital goods.

“From the economist point of view, a properly implemented VAT is equivalent to corresponding single stage tax, unlike the expenditure tax, the VAT is not a genuinely new form of taxation but merely a sales tax administered in different form.” (*Musgrave & Musgrave, 1976*)

“VAT in it’s comprehensive form is a tax on all goods & services (except export and government services), it’s special characteristic is being that it falls on the Value Added of each stage from the stage of production to retail stage.” (*Indian Taxation Inquiry Committee, 1993*)

Thus Value added tax is

-) a general tax that applies, in principle, to all commercial activities involving the production and distribution of goods and the provision of services.
-) a consumption tax because it is borne ultimately by the final consumer. It is not a charge on businesses.
-) charged as a percentage of price, which means that the actual tax burden is visible at each stage in the production and distribution chain.
-) collected fractionally, via a system of partial payments whereby taxable persons (i.e., VAT-registered businesses) deduct from the VAT they have collected the amount of tax they have paid to other taxable persons on purchases for their business activities. This mechanism ensures that the tax is neutral regardless of how many transactions are involved.

-) paid to the revenue authorities by the seller of the goods, who is the "taxable person", but it is actually paid by the buyer to the seller as part of the price. It is thus an indirect tax.

Clear concept can be attained through an example.

Let us consider a case of sugar production. A farmer produces sugarcane and sells it to the miller. Miller adds value in the process changing sugarcane into sugar. All the expenditure including profit made or incurred by miller is considered as value added. Miller sells his product (sugar) to wholesaler who, in turn, sells to the retailer with an increased value. Ultimately, sugar sold to the consumer with some additional value. Thus, at each stage of production distribution, value is added and sum total of all value added exactly equal to final sales value of the sugar.

VAT, like other sales taxes is classified as an indirect tax because it is a consumption tax and borne ultimately by the final consumer. It is not a charge on business firms. VAT is charged as a percentage of prices, which means that the actual tax burden is visible at each stage in the production and distribution chain. It is collected fractionally, via a system of deductions whereby taxable persons can deduct their VAT liability the amount of tax they have paid to other taxable persons on purchases for their business activities. This mechanism ensures that the tax is neutral regardless of how many transactions are involved.

Value Added Tax (VAT) is unanimously acknowledged to be a major reform in the indirect taxation system for the following reasons:

-) It eliminates the cascading effect of taxes;
-) It promotes competitiveness of exports;
-) It has a simple and transparent structure ; and
-) It improves compliance.

2.2 Origin and Development

Value-added tax, a recent innovation in the field of taxation, is being a major step in process of tax reform in many countries in the world. Such widespread popularity of VAT in last some years has become one of the most astonishing phenomenons of public finance. The evolution of VAT is the most significant event in the history of commodity taxes and the

speed with which the value added tax has spread around the world is unmatched by that of any other tax in modern time (Shoup, 1988:139)

While going to the origin point of the VAT, it was proposed for the first time by Wilhelm von Siemens for Germany in 1919 as an improved turnover tax. The improvement consisted in the subtraction of previous outlays from taxable sales with the result that the tax base of each firm would be reduced to the value, which is added to the product (Sullivan, 1965:12). Thereafter in 1921, Prof. Thomas S. Adams suggested the tax for the United States of America to replace the existing corporate income tax. Further, same tax was recommended in 1949 by the Shoup Mission for the purpose of reconstructing the Japanese economy by avoiding the existing defects of the turnover taxes. But, the purposed proposals and recommendations were never brought into practice. Argentina and Brazil instead, introduced a partial value added dorm to the existing manufactures' sales tax respectively in 1935 and 1948 by allowing manufactures to pay tax on the excess of sales over their purchase. However, VAT was not actually introduced by any country till 1953. Thus, the development of VAT remained limited only in theory up to the early years of 1950s.

In real practice, VAT was invented by a French economist in 1954 as *taxe sur la valeur ajoutée* (TVA). Maurice Lauré, joint director of the French tax authority, the *Direction générale des impôts*, was first to introduce VAT with effect from 10 April 1954 for large businesses, and it was extended over time to all business sectors. In France, it is the most important source of state finance, accounting for approximately 45% of state revenues.

After a gap of six years, Ivory Coast becomes first follower of France when it adopted VAT in 1960. Next African country, Senegal also implemented VAT since 1961. VAT in these both African countries limited to import and manufacturing stage only. Since the 1960s VAT become a popular subject matter of taxation in many countries. In the year of 1968, France redesigned the existing VAT system and extended to the retail level. Germany also adopted VAT in the same year. Since 1969, VAT was in operation in Netherlands and Sweden and also other three Ecuador, Luxembourg and Norway included VAT in their tax system. VAT was also effective in Belgium and Ireland since 1971 and 1972 respectively. Thus, the trends showed that VAT become most popular in the Europe, where VAT was suggested and implemented for the first time.

Vietnam was the first Country in Asia to introduce VAT, which introduced it in 1943. Pakistan introduced VAT in 1990 as the first among the SARRC countries. In this process

Nepal adopted VAT since 1997. However, India, the biggest in the SAARC, has following only MODVAT since 1996. The basic purpose of this kind of system is to relive inputs from taxation so that production distortional due to taxation is avoided. In the system of MODVAT, the excise duty and countervailing duty of custom in respect of inputs used in manufacturing process are allowed to subtract from taxes on outputs. Further, American tax system has not included VAT until now.

As the experience shows, VAT still, has not become a perfect substitute for the taxes like excise duties, special consumption tax etc. This further implies that VAT has not caught the fancy of the extent as it is claimed in theory. So far as developing countries are concern, the system of VAT adopted is less neutral and less comprehensive. Therefore, most of the developing countries are facing problems of Tax administration, tax evasion and high cost of collection. Besides, VAT has gaining a growing attraction in both the developed and developing countries. The countries adopting VAT are listed as follows:

Table 2.1

List of countries introducing VAT in chronological order

S.N.	Year of Introduction	Name of Country
1	1954	France
2	1960	Ivory Coast
3	1961	Senegal
4	1967	Brazil, Denmark
5	1968	Germany, Uruguay
6	1969	Netherlands, Sweden
7	1970	Ecuador, Luxembourg
8	1971	Belgium
9	1972	Ireland
10	1973	Austria, Bolivia, Italy, UK, Vietnam.
11	1975	Argentina, Chile, Colombia, Coastal Rica, Nicaragua
12	1976	Honduras, Israel, Peru
13	1977	Korea, Panama
14	1980	Mexico
15	1982	Haiti
16	1983	Dominican Republic, Guatemala

17	1984	China
18	1985	Indonesia, Turkey
19	1986	Morocco, New Zealand, Niger, Portugal, Spai, Taiwan
20	1987	Grenada, Greece
21	1988	Hungary, Philippines, Tunisia
22	1989	Japan, Malawi
23	1990	Iceland, Kenya, Pakistan, Trinidad and Tobago
24	1991	Bangladesh, Benin, Canada, Jamaica, South Africa, Egypt
25	1992	Algeria, Armenia, Azerbaijan, Belarus, El Salvador, Estonia, Fiji, Kazakhstan, Kyrgyz, Thailand, Republic, Moldavia, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan,
26	1993	Burkina Faso, Chez Republic, Mongolia, Paraguay, Poland, Romania, Slovakia, Venezuela
27	1994	Bulgaria, Samoa, Finland, Lithuania, Singapore, Tanzania, Western Madagascar, Nigeria.
28	1995	Gabon, Ghana, Sri Lanka, Switzerland, Zambia, Malta, Mauritania, Togo, Latvia.
29	1996	Albania, Guinea, Uganda
30	1997	Congo Republic, Nepal
31	1998	Croatia, Mongolia, Tanzania, Bhanu Atu,
32	1999	Cambodia, Cameroon, Mozambique, Netherlands, Antilles, Papua New Guinea, Slovenia
33	2000	Australia, Chad, Macedonia, Namibia, Sudan
34	2001	Rwanda
35	2002	Lebanon

Source: VAT project

Table 2.2

Standard VAT rates throughout the World

S.N.	Country	Standard Rate
1	Austria	20%
2	Belgium	21%
3	Bulgaria	20%
4	Cyprus	15%
5	Czech Republic	19%
6	Denmark	25%
7	Estonia	18%
8	Finland	22%
9	France	19.60%
10	Germany	19%
11	Greece	19%
12	Hungary	20%
13	Ireland	21.50%
14	Italy	20%
15	Latvia	18%
16	Lithuania	18%
17	Luxembourg	15%
18	Malta	18%
19	Netherlands	19%
20	Poland	22%
21	Portugal	20%
22	Madeira and Azores	15%
23	Romania	19%
24	Slovakia	19%
25	Slovenia	20%
26	Spain	16%
27	Canary Islands	5%
28	Sweden	25%
29	United Territory	15%

30	Albania	20%
31	Argentina	21%
32	Armenia	20%
33	Australia	10%
34	Barbados	15%
35	Bosnia and Herzegovina	17%
36	Brazil	12%
37	Canada	5%
38	Chile	19%
39	Colombia	16%
40	People's Republic of China	17%
41	Croatia	22%
42	Dominican Republic	16%
43	Ecuador	12%
44	Egypt	10%
45	El Salvador	13%
46	Fiji	12.50%
47	Georgia	18%
48	Guatemala	12%
49	Guyana	16%
50	Iran	3%
51	Iceland	24.50%
52	India	12.50%
53	Indonesia	10%
54	Israel	15.50%
55	Japan	5%
56	South Korea	10%
57	Jersey	3%
58	Jordan	16%
59	Kazakhstan	13%
60	Kosovo	16%
61	Lebanon	10%

62	Moldova	20%
63	Macedonia	18%
64	Malaysia	5.00%
65	Mexico	15.00%
66	Montenegro	17%
67	New Zealand	12.50%
68	Norway	25%
69	Pakistan	16%
70	Panama	5%
71	Paraguay	10.%
72	Peru	19%
73	Philippines	12%
74	Russia	18%
75	Serbia	18%
76	Singapore	7%
77	South Africa	14%
78	Sri Lanka	15%
79	Switzerland	7.60%
80	Thailand	7%
81	Trinidad and Tobago	15%
82	Turkey	18%
83	Ukraine	20%
84	Uruguay	22%
85	Vietnam	10%
86	Venezuela	9%

Source: Wikipedia

2.3 Origin and Destination Principle

While considering the international trade, the origin and the destination principle have greater significances. Choice among these two principles largely depends on the goals and the policies of the nation, accession to international trade, computing method and the type of VAT. In case of the international trade, two serious alternatives appear while implementing VAT in any country. They are taxing all domestically produced goods including exported ones and exempting all imports or taxing all the imports and making exempting for all exported goods and services to the foreign countries.

2.3.1 Origin Principle

Under this principle, goods and services produced in a country are subjected 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 broader and cross-country trade. Thus, this principle affects BOP 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 (Shoup, 1988; 143).

As the country can enforce jurisdiction over firms located within its jurisdiction, the principle is much simpler and there would be no export rebates on sale delivery within the common market countries, rather each country would give credit for tax imposed in the country of origin. Under such circumstances, the origin principle has gaining more importance in EEC countries to achieve the ultimate objectives. The three methods-subtraction, addition, and tax credit; are all equally well adopted to use of a 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 (Shoup, 1969:263). Administrative complexity widens when the tax credit method is adopted along with an origin-principle VAT having different rates at different stages.

Initial adoption of origin principle requires that the VAT rate should be more or less uniform among the countries; otherwise until such time as exchange rate or relative price levels are adjusted, manufacturers in the low-tax countries will have an advantage over those in the high-tax countries, which are unable to protect their firms by tariff barriers within a common market area (Due, 1976:119). Also, the principle origin does not need any adjustment among

subtraction and addition to reach the goal of taxing only domestic value that is added to the foreign imports at the tax rates identical to those applying to similar values added to the domestically produced goods. This principle will have negative impact for most of the developing countries where the tourism has a significant importance and the Government is intended to encourage tourism and domestic purchases by tourists. Further, the origin principle converts into the destination country, in the sense that the rate of tax of country of importation determines the combined tax of both countries.

2.3.2 Destination Principle

Destination principle includes all the imports in the tax net while exports are free from tax. As per this principle, imports are taxed at custom point and exports are completely exempt so it will have favorable effect on the country's BOP. Under these principles, tax would be collected at importation and the firm would receive credit for this tax and a refund when the products are exported. This means tax levied on the import of the basic raw materials, 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 than by the ultimate user. The broad result is that 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 the goods taxation, is provided by the destination principle by means of no discrimination between imported and domestic product.

VAT is universally established on a destination basis, imports being subject to tax at the time of importation (but not necessarily at the same rate) and on subsequent sales and exports being free of tax with full refund of all taxes paid on previous transaction in the goods in questions. At given exchange rates, the destination principle is the most satisfactory whereby to protect the country's position in the world market and ensure that within the country imports are not favored over domestic goods (Due, 1976; 119). Destination principle can be implemented easily and precisely for both rebate of cumulated tax on exports and compensating tax on imports. Under the destination principle, tax-credit method is superior to other two, since it provides the precise information on cumulated tax paid without breaking the credit chain. Administrative simplicity and the non-discrimination are the main reason for the popularity of the destination principle. However, this principle does not function smoothly in a common market area when the fiscal frontiers are abandoned. Difficulty arises to enforce payment of a tax when the sale is made to an individual.

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

2.4 Types of VAT

There are several bases to classify the different types of VAT. However, the classification of VAT on the basis of the treatment of capital goods is much important. Considering the treatment of capital goods, the following classification has been made in broad sense.

2.4.1 The Gross National Product Type

The base for this type of VAT includes capital goods along with the value added on the other raw materials, semi-manufactured goods etc, purchased from other firms. Hence, under these variants, capital goods purchased from other are not allowed to deduct from sales while calculating the tax base. Even the depreciation in subsequent years is not deductible from the tax base. Thus, the base of VAT consists of consumption and gross investment, which is equivalent to gross national product (GNP). The tax is therefore equivalent in its coverage, to a retail sales tax, which includes in its base durable capital goods. Therefore

GNP type VAT = Gross Receipts (GR) – Cost of Intermediate Goods (CIG)

2.4.2 The Income Type

Under the income type of VAT capital goods purchased from other firm are not deducted from the tax base, however, the depreciation in the subsequent years are allowed to deduct from the base. Similarly, it requires that an access of year-end inventory over year-beginning inventory over year-end inventory to be deducted (Shoup, 1969; 252). Thus, tax base under this variant, includes consumption and net investment, which is equivalent to the net national product (NNP). Therefore,

Income type VAT = Gross Receipt (GR) – Cost of Intermediate Goods (CIG) - Depreciation (D)

2.4.3 The Consumption Type

All capital goods purchased from other firms in the same tax year are allowed to deduct from the sales value while calculating the base under the consumption type VAT and depreciation is not deducted form the tax base in the subsequent years. As the consumption is only the

case of VAT, this type is known as the consumption type. Under the destination principle, this type of VAT has an identical base with the retail sale tax on consumer goods and service. No distinction is made between parts and materials physically incorporated into the product, supplies and fuel and durable capital goods. Among this three types VAT and GNP type has broader base than the remaining two and has received serious consideration in various countries. In GNP type both capital goods and depreciation goods are under the tax net while the income type exclude depreciation and consumption type excludes capital goods from the tax base, in the recent years, the consumption type of VAT has gaining popularity in several countries in Europe and elsewhere. The reason for the popularity of this type is that this variant doesn't affect decision regarding investment and growth since it relieves investment from any tax burden (Lindholm, 1970:1180). Since the tax does not discriminate against the capital intensive techniques in favor of labor incentive technique, there is no need for a firm to switch over from capital to labor incentive methods (Khadka, 1989:3). But GNP type of VAT discourage firm to use capital incentive methods of production and encourage using the methods, which does not involve frequent year to year fluctuation in physical volume of inventories. Moreover, this GNP type creates substantial disincentive for saving and investment for which reason the tax is not accepted by the countries. From the economic growth perspective both the income and gross product VAT has an anti investment bias (Crowford, 1993:6). The distinction between the purchase of Capital Goods and intermediate goods is not needed under consumption variant, which is essential under other two variant. The income type also needs the computation of depreciation in subsequent year, which further complicate administration. Thus consumption variant is attractive from the point of tax administration. Even from the consideration of foreign trade, consumption variant is more attractive than the income variant since the former is compatible with destination principle and later with origin principle. Thus, the consumption variant is most desirable than the other two variants in several respect.

VAT can also be classified on the basis of the vertical coverage through production and distribution stages. Under this classification extent of vertical coverage forwarded from manufacturing has more practical importance which has three sub-divisions with different bases. Firstly, the value-added principle may be used within the manufacturing sector only, with tax applying to each manufacturer on his value-added but not by wholesalers or retailers, except to a limited degree. Secondly, the tax may be extended through the last wholesale transaction usually called a pre-retail VAT. Lastly, VAT may be extended through the retail

level from the earlier stages of production. This type of VAT is known as comprehensive or full-fledged VAT. Under the same classification, next type is based on the extent of vertical coverage backward from manufacturer. Under this type, VAT may be extended to all producers of basic raw materials including farmers. However, this type creates administrative difficulties due to the large number of small establishments and scattered units.

2.5 Methods of Computing VAT

Value-added tax can be collected by using the different methods of computation however the choice of the appropriate method depends basically on the type of VAT employed and the principle under which VAT is adopted. The VAT can be computed by employing any of the three methods;

- i) addition method,
- ii) subtraction method, and
- iii) tax-credit method;

Among the above "the last method has never been utilized" (Due, 1976:71)

2.5.1 Addition Method

Under this method, value-added is the total sum of the factor payments made by the business firms, which is equivalent to the gross income received by the factors of production. The tax base is computed by adding the payments made by the firms to factors of productions employed in turning out the product, such as wages, interest, rent, royalties and profits (Sullivan, 1965; 7). Thus, VAT under addition method is the function of the total factor payments as given by;

$VAT = f(W+R+I+P)$; where W= Wage, R= Rent, I= Interest, P= Profit

If the firm constructs its own capital good rather than purchasing it, this addition method captures the value added by the firm. The capital method is readily applicable to the income type but clumsy for the consumption type of value-added tax (Musgrave and Musgrave, 1976:401). Virtually, no country uses the addition method, although, Argentina and Israel have applied it to selected economic activities, such as banking and finance, where value of inputs and outputs is difficult to measure. From the practical point of view, this method is more complex to compute. It would be awkward to use the addition method to compute the base of the consumption type of value-added tax, since to the net profit figure there would

have to be added depreciation and the excess of opening inventory over closing inventory (deducted, as a part of cost of goods sold, in computing net profits), with subtraction of capital goods purchased or produced within the firm and subtraction of an excess of closing inventory over opening inventory (Shoup, 1969:258).

2.5.2 Subtraction Method

Under this method, value added is determined as net turnover which is obtained by subtracting the cost of materials from sales proceeds (Khadka, 1989:5) and the procedure was used in the Michigan VAT (Due, 1976; 71). Value added is obtained by subtracting purchases of produced goods from the figure of sales during the period, as given in functional form by,

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

Where, f = function of, S_v = Sales value; P_v = Purchase value

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

2.5.3 Tax Credit Method

Tax credit method is also known as the invoice method and uses as indirect subtraction technique to compute the tax liability. Value added, as such, is never calculated at all, in this method, but the effect is exactly the same as if the figure was calculated and the tax rate applied. Since, the firm deducts the amount of the tax paid on its purchases during the period from the figure calculated by applying the tax rate to its figure of taxable sales for the period. Under this method, tax payers are allowed to subtract the taxes already paid by their suppliers and passed on to them from the gross tax liability which is levied on the total value of their sales. Thus, in contrast to the subtraction method, which deducts purchases from sales and levies taxes on the differences, tax on purchases is subtracted from the tax on sales under the tax credit method (Khadka 1989; 5). Hence, net tax liability is given by the following equation:

$$\text{VAT} = f(\text{outputs} - \text{inputs})$$

= (Tax paid on sales - Tax paid on purchases)

Among the three methods of computing VAT the tax credit method is widely favored in the countries of the European Economic Community and elsewhere. The invoice method is used generally in European countries and constitutes an advantage of the value added approach, especially in countries where tax compliance is otherwise poor (Musgrave and Musgrave, 1976: 402). The tax credit method is so superior to the other methods in terms of the application and enforcement, as well as adaptability to various rate modifications, which is now universally employed. The tax credit methods can be especially useful if it is desired to reduce the rate of the value added tax at some stage in the production and distribution process, say the raw materials or farm products stage, for administrative reason, without reducing the total tax paid on total value added (Shoup, 1969:259). However, this tax credit method fails to give credit for tax prior to the exempt that is given to either of pre-import domestic stages except the first stage, because the tax credit chain is broken. The tax credit method encounters still more difficulties under an origin principle value adder tax that imposes different stage simply for administrative reasons. Beyond this positive and negative aspect of tax credit method, it has a power to make the overall rate depend on the imposed at the stage of production or distribution. Whatever may be the rate at various earlier stages, the process of calculation VAT liability under different methods are shown in the table below:

Table 2.3

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

S.N.	Methods	Stage of production and Distribution			
		Manufacturer	Wholesaler	Retailer	Total
1	Addition method				
	a. Wages	1,000	550	750	2,300
	b. Rent	300	150	150	600
	c. Interest	150	100	50	300
	d. Profit	350	200	250	800
	e. value-added(a+b+c+d)	1,800	1,300	1,200	4,000
	f. VAT liability(13% of e)	234	130	156	520
2	Subtraction method				
	a. sales	8,600	9,600	10,800	29,000
	b. Purchase	6,800	8,600	9,600	25,000
	c. Value-added(a-b)	1,800	1,000	1200	4,000
	d. VAT liability(13% of c)	234	130	156	520
3	Tax credit method				
	a. Sales	8,600	9,600	10,800	29,000
	b. Tax on sales	1,118	1,248	1,404	3,770
	c. Purchase	6,800	8,600	9,600	25,000
	d. Tax on purchases	884	1,118	1,248	3,250
	e. Net VAT liabilities(b-d)	234	130	156	520

Note: All the sales and purchase are exclusive of Tax and figures are arbitrarily assumed.

Thus, all tax credit method has the following major benefits over the other two types of VAT computation.

- i). In the tax credit method, tax liability is attached to transaction that makes it legally and technically superior.
- ii). Tax collection is easy.
- iii). Cross-checking is possible.

- iv). It provides the benefit of catch up effect that makes under evaluation and evasion impossible,
- v). There will be no loss of revenue due to the exemptions granted to the small traders.
- vi). It never demands for the calculation of value-added total tax.
- vii). Liability entirely depends on the rate on the last stage, so rate differentiation is possible for the same revenue yield.

This mechanism is further desirable since it puts an equal burden of taxation on both imports and domestic products, irrespective of channels of distribution and proportion of value added at various stages. Thus, the tax credit method is desirable for several reasons and has been adopted by many countries of the world.

From the above table, it is clear that VAT liability calculated by any of the three methods is same that Rs. 520. In the table, VAT rate is same that is 13% for all methods. However, if there is rate differentiation in different stage VAT liability will differ for different method. Although, the change in the VAT liability will be same under both the addition and subtraction method, as there is same amount of value added at each stage of production and distribution. Assuming that the transactions(Figure) presented in the table are for economy as a whole in a specific period of time, a VAT of 13% rate gives Rs. 520 as tax under the first two methods having the amount of value added Rs. 4000. In tax credit method, value added, as such is never calculated, however VAT liability exactly equals to that by other methods. Thus, VAT is levied on the basis of value added but not directly.

2.6. Value-added Tax and Other Sales Taxes

2.6.1. VAT versus Turnover Tax

The turnover tax, the earliest form of the sales tax, offers the advantage of simplicity-all transaction are taxed, typically at a uniform rate, and the yields the maximum revenue for given tax rate. As the tax is imposed on the gross monetary value of a product at multiple stages of business activity, it is multistage and broad based in nature. The turnover tax or cascade tax is levied as a percentage of sales, regardless of value added, at each stage of sale right from the initial production of materials to the final sales to the consumers. Thus, the burden of tax as a percentage of consumer expenditures vary widely on different goods because of the varying number of transactions involved in different commodities between initial production and final sale to the consumer. Since, turnover is proportional to a firm's

turnover, gives an incentive to vertical integration, as the tax may make it cheaper to produce an intermediate product within a firm than to buy a similar input produced more efficiently by an outside supplier. In contrast, value added tax do not provide this artificial adjustment to vertical integration so have been very widely adopted in preference to turnover tax. Under the system of turnover tax, taxable value of any commodity depends on the number of stages it passes through the production and distribution process. This makes the larger base for the cascade tax so the revenue productivity is high. Instead, value-added tax is less productive since the base is only value-added.

Since the turnover tax applies to the total volume of transaction of the product at each stage of production and distribution, it creates a strong incentive for reducing the economic activities at earlier stages like performing many activities of production and distribution under a single roof. Thus, turnover tax encourages integration and discourages specialization. Such artificially encouraged integration results in loss of efficiency and lowers output and growth rate and many in any case lead to undesirable concentrations of economic power and monopolistic tendencies. There will not be any incentive for integration in a VAT system, since the total amount of tax on the product will be the production and distribution system, and the taxable price is always equal to the final price of the product. Thus, from the view point of neutrality VAT is so far superior to the turnover tax.

The turnover tax is comparatively easy to administer as it applies on gross sales so that there is no need of tax credit. The double-checking and several provisions associated with VAT create complicity however makes the tax system transparent, efficient and equitable. Comparative easiness and simplicity also can be found in turnover tax in the viewpoint of tax compliance. But due to the self-enforcing feature of VAT, it is more attractive to check the tax evasion. An uneven burden is also created on various commodities by turnover tax and further the burden varies with the typical number of transaction through which a commodity passes on its way to the final consumer. The cascade form of tax also tends to discriminate against domestically produced goods and compared with imports, since the former pass through a large number of taxable sales transactions within the country than the latter. VAT avoids this problem, since the imported goods will either bear tax on their full value at the time of importation or (under the tax credit method) have this value taxed at the first subsequent sale, and then subsequent value added will be taxed same fashion as with domestic goods (Due 1975; 85). Once the tariff protection is eliminated, the harmonization of

sales taxes becomes essential in a Common Market Area, which is served by VAT in a satisfactory limit rather than the turnover tax.

In Europe, the turnover tax was used afterworld war I, from Germany, France, Italy, Belgium, the Netherlands and Austria but has been superseded by the VAT. Similarly, in many developing countries, the turnover taxes have been replaced by other forms of sales tax. However, the turnover tax will do less harm where there is little manufacturing and exports consist of primary products or the output of integrated enterprises than in countries with more diversified economies (Goode, 1984; 154).

2.6.2. VAT versus Manufacturers' Sales Tax

Manufacturers' sales tax is levied on the sales value of manufacturers in case of the domestic product and on the import value in case of the imported product. Basically, the tax is not levied on the sale to other sales tax registered vendors, in such cases the sellers had to note on the invoices the buyers sales tax registration number and particular of the goods. Thus, sales tax registered manufacturers could purchase their raw materials, auxiliary raw materials and chemical becoming physical ingredients of taxable products free of tax. So, the tax base of a manufacturers' sales tax narrows too much as compared to VAT which covers value added in each stages. The broader base of VAT is not only due to the inclusion of value added of each stage but also due to the coverage of services as well. If the make-up system is introduced in the tax, it will cover the various costs including transportation and profit margin of the importers in the sales tax base. MST, however, being a single stage sales tax, will avoid the worst evils of the cascade tax, if it is properly designed. Under the MST, the exclusion of unprocessed foods and many artisans' products-either legally or because of noncompliance-mitigates the burden on the lowest income classes. Unlike the cascade tax, MST creates as incentive to the firms to push various functions beyond the point of impact of the tax in order to reduce the amount of the tax due. Thus, forward integration of the manufacturer is discouraged and helps for specialization. However, when the manufacturers transfer their own activities to dealers and wholesalers, establish artificial sales depots, undervalue sales etc, it brings inefficiency in the production and distribution channel.

The distribution of the tax burden under the MST is not uniform to various consumer goods, and to the domestically produced and imported goods because of variation in magnitude of wholesale and retail level margin. The variation is haphazard, if anything, the burden will be greater on the basic necessities, which tend to have low margins than on the most luxurious

goods on which the margins tend to be high. There is a particular danger of favoring imports, since advertising and other distributive activities with respect to these goods may be performed after the point of importation, whereas the costs of these activities will be reflected in the manufacturers' prices of domestically produced goods, if they are performed by manufacturers. VAT would put an equal burden on both imports and domestic products since the burden of this tax depends upon the final price irrespective of the proportion of the value added at different stages in the process of imports, production and distributions. It would improve the efficiency and competitiveness of domestic products in the international market by relieving exports from taxation.

Under MST, one serious defect, cascading becomes inevitable when goods and services are purchased from registered firms by non-registered firms and supplied again to registered firms. In practice, it is possible in many developing countries, where importers directly sell their imports to non-registered firms or persons, which may be raw materials for manufacturing industries. Even the purchase of raw materials from registered firms or primary producers are also taxed, which further extended the cascading effect and hence strikes a growing economic sector. Further, the refund system is not perfect in MST. In contrast, VAT does not suffer from cascading or pyramiding effects and it does not affect economic growth negatively.

Under a VAT, the taxable price always equals to the final sales price of the goods so that the net tax liability can not be reduced by altering the methods of doing business. So, there will not be incentive neither for vertical integration nor for disintegration. This makes the tax system neutral, which helps VAT to stand superior to the MST. However, VAT is difficult to administer than the MST. Basically, the difficulties arise due to the provisions like tax credit, refund, exemption, zero-rating, cross-checking etc and further, the taxpayers are in large number than the MST. However, the VAT can be made simple and effective by some measures, which are carried by the tax itself. They are; i) actual invoice based self-assessment mechanism, ii) VAT serves catch-up effects, which make tax evasion likely impossible; iii) VAT has a self policing features; iv) cross-checking of tax liability and credit is possible; v) net tax liability is distributed to all production and distribution stages rather than concentrating only in a single stage. Lastly, to conclude, more advantages of VAT over the MST can be attained when the tax is extended to the retail level.

2.6.3 VAT versus Wholesalers' Sales Tax

Wholesalers' sales tax, as such, is a tax on the sales value of the wholesalers, and hence it has a broader base than the MST since it covers the margins of the wholesalers into the tax base as well. Although, the significant difference between WST and MST depends on the extent to which wholesaler's sales tax is applied to the sales to retailers. Since the wholesaling is not carried on exclusively by separated enterprises and is done also by importers and manufactures, it is necessary to register all three kinds of enterprises (manufacturers, importers and wholesalers) and collect tax on their sales to unregistered buyers including retailers and consumers. It has been recommended for developing countries by some well-known experts but in practice has been only in Portugal and a few developed countries, including the United Territory, Australia, and New Zealand. An administrative advantage of the wholesalers' sales tax that is relevant for equal treatment is that manufacturers who sell direct to retailers do not need to be taxed on a hypothetical price that is less than the actual price, to be able to compete with manufacturers selling it independent wholesalers (Shoup, 1969; 242).

WST encourages manufacturers or importers to sell directly to the retailers or consumers so that product remains beyond the tax net. This results a loss in the revenue on the one hand, and on the other it discriminates against those products by means of competitive advantages, which bear the tax burden, favoring those firms and products which do not pay or bear the tax burden. In contrast, VAT does not create such discrimination since it is levied at every stage of production and distribution, and tax evasion is also more difficult. Thus, VAT is neutral among the process of production and distribution, and the consumer choices.

The problem of cascading remains coherent under WST because of imperfect poorly utilized tax credit method whereas VAT easily avoids the problem. Such cascading effect of WST creates less incentive for or competitive loss while it fails to provide proper amount of tax refunds on exports. Discrimination effects associated with WST hamper the output and economic growth. Instead of this, VAT being a neutral tax does not distort the economic growth.

2.6.4 VAT versus Retailers' Sales Tax

Retailers' sales tax is applied to the sales value of the retailers so retailers are required to register for sales tax purpose and tax is levied on their sales to consumers or non-registered firms or other persons. Among the all types of single stages taxes, RST is that one which has

the broadest base. A retail sales tax in its pure form is the equivalent of a comprehensive consumption type of tax on value added except that it does not offer an option between the destination principle and the origin principle. Like the IT and the MST, RST includes all the services into the tax base, which is not true in case of the MST and WST. Both the taxes RST and VAT with the similar rate and coverage would raise the same amount of revenue. However, the tax is levied only on single stage under RST and on multiple stages under VAT.

There is no incentive to alter distribution system, most import and domestic goods can be treated equally, pyramiding is avoided, and the desired pattern of the distribution can be attained. Thus, RST avoids virtually all the problems associated with the MST because of the imposition at the final sale to the consumer.

The actual amount of tax under RST is not affected by the number of stages through which a commodity passes but depends on the tax rate and the final price of the commodity. In the similar manner, under a VAT system the net tax liability remains unchanged regardless the choice of production and distribution system, since tax is levied only on the value added at each stage. In addition, some aspects like relieving producers' goods from taxation, free export from tax and broader tax adjustment are possible feasible in both the taxes VAT and RST, however, is a lesser degree in the latter. Thus, both taxes are neutral but RST is less than VAT. The problem of cascading does not appear in both VAT and RST because there is no possibility for tax being levied on tax, since inputs are relieved from taxation through the suspension technique under the RST while the same objective is achieved through the tax credit method. Both are similar while considering the treatment of imported and domestically produced goods. Further, similarity appears on the avoidance of the pyramiding problems since vendors need not be apply a mark up on the tax amount levied on earlier stages, under both the taxes. In this regard, RST may be considered a serious competitor of the VAT.

Beyond the various similarities between VAT and RST, there are also some basic differences between them. The collection of a retail sales tax places the entire impact of the sales tax upon retailers while much of VAT is collected at pre-retail levels. Under the RST, if the manufacturers or wholesalers or importers directly sell to the consumers, the whole tax amount from that community is lost, while under a VAT, it will reduce only a part of total tax liability that is amount of VAT liable at that stage. In developing countries, most of the retail traders are small entrepreneurs with relatively inadequate records and a high prosperity to evade tax. Thus, particularly in a developing country, the danger of complete evasion is far

less with VAT, since any sales can be collected more effectively from typical manufacturers and wholesalers than from retailers.

The only one advantage of RST over VAT is that the number of taxpayers is small; however, a significant problem is created because of the large number of small retailers having only limited records. If such very small retailers are kept beyond the tax net from the administrative difficulty, resulting decrease in the tax base is much larger under an RST than VAT. It is because RST loses entire amount of tax on the sale of exempted seller while such exemption causes a loss of tax only in a small amount. Taxation on services is difficult under RST than the VAT. In general, the services like telecommunication, transportation charges, construction etc are not taxed under the RST. Taxation on such services demands the separation of the services into i) sales to consumers and ii) sales to business firms, which complicates the tax system. If services are not taxed, discrimination will appear which makes sales incentive to use of goods than services. This distorts the economic choices of both consumers and producers, and unnecessarily accentuates the regressive impact of the tax, because the demand for services is generally more income elastic than the demand for goods (Cnossen, 1981; 220). Further, RST can not provide precise amount of tax refund because of the difficulty to identify producer's goods or consumer's goods.

2.6.5 Superiority of VAT

From the above comparison, VAT is definitely non distortionary and desirable than sales tax and other single-stage levies; however the RST is the nearest competitor. VAT is a perfectly neutral tax, which does not discriminate regarding the producers' and consumers' choice. Due to the broader coverage of VAT it is more productive, and does not carry any undesirable evils in the economy like others. The provision of VAT like exemptions, threshold, zero-rating, refund etc makes the tax system more equitable. It also induces investment and export trade by eliminating capital goods and exports from the tax base. Avoidance of pyramiding and cascading effects is the basic feature of VAT. Cross auditing and self-policing are other important features associated with VAT. In addition, VAT on the basis of origin serves a special benefit to the countries of Common Market Area since neither broader checking nor import or export verification of control is needed.

2.6.6 Some of the Major Sections of VAT Act

Extract of some of the major section of VAT Acts which is related to our study is as follows:

Section 5: Imposition of Value Added Tax

- 1) Except otherwise provided for this Act, a Value Added Tax Shall be imposed on the flowing transactions:
 - a) Goods or services supplied into the territory of Nepal.
 - b) Goods or service imported into the territory of Nepal.
 - c) Goods or services exported outside the territory of Nepal.
- 2) Tax shall be levied on the taxable value of every transaction.
- 3) Notwithstanding anything contained in subsection (1) no tax shall be levied on the transactions of goods or services set forth in Schedule 1, provided that any tax applied on such goods or services at the time of purchases shall not be offset pursuant to section 17 and shall not be refunded pursuant to section 24.

Section 10: Registration

- 1) When this Act commences every person engaged in any transactions shall apply within 90 days from the commencement of this Act to a tax officer in the prescribed form for registration.
- 2) Every person wishing to engage into a transaction after the commencement of this Act shall apply to a tax officer in the prescribed form for registration, before beginning to engage in such transactions.
- 3) Notwithstanding anything's contained in sub-section (1) and (2) a person who carries out the transactions of goods or services mentioned in the schedule 1, shall not be required to be registered.
- 4) The tax officer shall register each person who has duly submitted an application under sub-section (1) or (2) and shall issue to such person a unique registration number, in the prescribed form and time, together with a certification of registration.
- 5) The registered person shall display the registration certificate in a conspicuous place at his principal place of transactions. If there is more than one place of transaction, he shall display in a conspicuous place at each place, other than the principal one, a copy of the registration certificate attested by tax officer.

- 6) A registered person shall have to use his registration number for all transactions related to value added tax, excise and customs and to other transactions as prescribed as well.
- 7) Every registered person shall inform the tax officer within 15 days of any changes in the information pertaining to the application for registration as required under sub-section 1 and 2.

Section 11: Cancellation of Registration

- 1) The tax officer may cancel the registration of a registered person in any of the following cases:
 - a. In the case of an incorporated body, if the incorporated body is closed down, sold or transferred or if the incorporated body otherwise ceases to exist.
 - b. In the case of an individual ownership, if the owner dies.
 - c. In the case of a partnership firm, if it is dissolved; and
 - d. If a registered person ceases to be engaged in taxable transactions.
 - e. If a person is registered in error.
- 1a) Except under the condition laid out in sub-clause (1), under any other circumstances, those undertaking small business and are registered voluntarily within one year from the date of their registration. After completion of one year, however, those carrying out small business and wanting to cancel their registration can write an application in the prescribed format to the tax Officer to cancel their registration.
- 2) The cancellation procedure of a registration shall be as prescribed.
- 3) All the goods and services that remain available for use at the time of the cancellation of registration (capital goods as well) on which an offset had already been taken; tax shall be assessed and collected as prescribed.

Section 18: Returns to be Submitted

- 1) Every taxpayer shall self assess the amount of tax he is required to pay every month and shall submit. As prescribed a tax returns to a tax officer, within twenty five days after the close of that month. Such return has to be submitted whether or not a taxable transaction was carried out in that month.

- 2) Notwithstanding anything contained in subsection (1), a tax payer, an s prescribed may submit a return of a period that a longer or shorter than one month.

Section 21: Tax Collection:

1. If the tax due by a taxpayer is not paid within a specified period, the tax officer, with approval of Director General, may collect the tax by using any or all of the following methods:
 - a) By offsetting the amount. If any, to be refunded to the taxpayer.
 - b) By seizing movable and immovable property (Fixed Assets) of the taxpayer.
 - c) By selling through auctioning all or some parts of the taxpayer's assets at one time or on in a series of auctions as prescribed;
 - d) By causing to dedicate mounts from the taxpayer's bank account or other financial institutions;
 - e) By causing to deduct amounts due the taxpayer by G/N, or a corporate body owned by the G/N, or local bodies;
 - f) By deducting, with the pre-approval of the taxpayer, the amounts a third party owes to the taxpayers; and
 - g) By withholding imports, exports and other transactions of the taxpayer.
2. Notwithstanding anything contained in other places of this Act, tax under this Act, tax under this Act shall not be collected past six years from the date the tax was assessed.
3. When recovering or refunding tax, the amount that is less than rupees one will not be taken into consideration in the accounts.

2.7 Literature Review

Tax reforms to strengthen the country's fiscal system which becomes one of the seriously raised concerns in many developing countries in modern times. Most of the developing countries have undertaken many tax reform programs as an integral part of their development efforts in last three four decades. A distinguished and essential feature of tax in almost all developing countries around the world is the adoption of a VAT in their tax system.

2.7.1 In this connection, Dr Rup Bahadur Khadka (1989), an expert of Nepalese tax system, in his book, entitled "VAT in Asia and the Pacific Region" writes "VAT is the most recent innovation in the field of taxation. It is believed on the value added of goods and services. The Tax is broad 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 the nature, the various types and method of computation of VAT, reason for growing popularity of VAT etc. this apart, the report examine the structure and operation of VAT in the Asian Pacific Countries which also explores the possibility of introducing of VAT in Nepal. Probably he is the person of observer of VAT abroad and the firstly proposed VAT for Nepal with macro studied of Nepalese economy and tax system. In his proposed structure the coverage of VAT should be made as broad as possible covering all business transactions. Exemptions should not be granted unless there is a specific reason to do so, such as administration and equity, Zero rating should be limited to exports and tax rate should be single to avoid complications and inefficiencies in collection.

He lastly developed a VAT proposal for Nepal showing some successful VAT implemented Asian countries- China, Indonesia, Korea, New Zealand, Philippines, and Taiwan.

2.7.2 A study of VAT "in developing countries was undertaken by IMF staffs (1973) at the time when the introduction of VAT was gaining a pace in developed as well s in developing countries. The study examined the applicability of a VAT in seven developing countries have adopted the VAT considering the fact that many uncertainties arises in the introduction phase of new tax system because developing countries have limited experience. According to the study "the most important feature of VAT in developing countries is its conceptual basis such as taxable base exemptions, treatment of small traders etc. Implementing VAT in the developing countries is also a big issue in present time. In fact, the feasibility of VAT in developing countries depends largely upon the ability and willingness of these countries to administer it. The administrative efficiency is also influenced by the structure of VAT employed and the social and economic environment of the country."

Although the study shows that the VAT as a revenue raiser, the key problems should also be viewed from the angle of taxpayers compliance, as the cost of doing business

tend to increase with VAT because of the various compulsory compliance procedure such as billing system, maintaining books of accounting and other accounting treatment.

Finally, the study assures that VAT produces between 10 to 30 percent of Government revenues of the seven developing countries by the study and the VAT, revenue in these countries is expected at faster rate than the rate of the growth of the economy.

- 2.7.3 An IMF (1991) occasional paper, Washington DC entitled – " Value Added Tax: Administrative and policy issues" edited by Alan A. Tait brings out the beauty of the VAT and briefly reviews the reasons why the VAT is chosen as the main sales tax. The study concentrates on the policy concerns on the basic illustration of some theoretical as well as empirical proofs.

The study clearly depicts three main groups of reasons to adopt a VAT revenue, neutrality and efficiency.

VAT Revenue: VAT would generate more with less cost than taxes it replaces. "Traditional income and sales taxes have meeting public resistance and the VAT provides a new, buoyant revenue base, typically yielding more than initial estimates as the case of Indonesia, Korea, New Zealand, Portugal and Tunisia show". Because of broad coverage this tax offers much grater revenue potentiality as compares to other types of taxes. According to the study the VAT contributes from 12 percents to 30 percent of revenue in most countries

Neutrality: "the VAT is non distortionary provided there are few exemptions and little Zero- rating on investment should be fully credited and this frequently is an improvement over the taxes replaced that often taxed capital goods."

VAT is neutral with respect to the choice of methods of production and distribution. Since the tax is believed only on the value added at each stage in the system, tax liability remains the same regardless of the system of production and distribution. Total tax paid on a given commodity depends on the rate of the tax and on the total value added (i.e. the final price) of the commodity but not on the number of stages through which it has passed. So the tax is considered vertically neutral expect for the negligible element of discrimination. It also does not discriminate the production whether it is capital intensive or labor.

Efficiency: A significant characteristic of an ideal tax system is efficiency. An efficient tax system is one that does not cause any distortion in production and consumption in other words such a tax system does not bring any unintended and undesirable effect in the methods of production and distribution or in consumption. Rather it avoids probable distortions of the optimum allocation of resources.

In this connection Editor Alan A. Tait writes- "the VAT has often replaced inefficient, distortion and badly administered taxes"

The introduction of the VAT provides an opportunity to sweep away the cobwebs and revamp a substantial part of the tax administration.

2.7.4 Professor John F. Due and Ann f. Friedlander (1994) in their famous book "Government Finance" evaluates the VAT that in addition to avoiding the adverse consequences of turn over tax and greater revenue raise, a proper cross audit is possible. The possibility of cross checking is considered as a beauty of the VAT. In their view, tax reported as paid by one firm to its suppliers for which it takes credit against its own tax liability, should appear as tax paid to the Government by the suppliers. This cross check is not automatic but it can be made by auditors or ultimately by computers. So VAT is the most meritorious one, whose uses have extended rapidly.

Prof. Due & Friedlander also show the dismal aspect of the tax principle that the value added tax is somewhat more complex than the retail sales tax, particularly in concept. The number of taxpaying firms is somewhat larger, since not only retailers but all manufacturers and wholesale firms must be registered and must file return. According to them, the tax is somewhat less adaptable to exemptions than are other sales taxes, since the exemption must be handled throughout production and distribution channels. Farmers pose a serious problem; to register them all as tax paying firms would greatly add an administrative and compliance task if they are not registered, they would not receive credit for the tax paid on purchase for their firm use.

Researcher accepts that "the administrative complexity" is the main visualized problem of VAT in developing countries. However, they conclude that:"it is undoubtedly the ideal form of sales tax in many countries."

2.7.5 In a research under the title of "Tax Reform in Singapore" (Development Discussion paper No: 644) Glenn Jenkins and Dr. Rup Khadka (1998) have made an effort to assess the VAT in Singapore, which was in effect since 1993. This working paper carries the successful story of VAT's introduction and implementation in Singapore to be a good lesson for the non VAT countries and VAT Countries.

The research paper concluded that Singapore would be facing the problem of an adding population. In such a situation income a taxes will put a grater burden on a smaller group of younger, working Singaporeans, this might inhabit growth and enterprise. It is, therefore, necessary to introduce a broad- based tax like GST/VAT to distribute the burden of taxation among a larger section of the population, GST in a tax on consumption and has several features. It relieves investment and saving from the tax burden and rewards enterprise and strengthens economic resilience." GST relieves exports commodity taxes through the zero rating mechanism.

2.7.6 Gautam, (2002) submitted the thesis on "value added tax: problem and prospective".

The main objectives of his study were:

- To examine the possible effects of VAT in the Economy.
- To observe the potential revenue of VAT in Nepal.
- To analyze the existing challenges in VAT implementation.
- To examine the Nepalese tax structure.

Requires data and information's were collected from the secondary as well as primary source.

Gautam cited the following findings:

-) *There is a trend of persisting resource gap along with the huge amount of saving investment and import-export gaps in analyzing the revenue & expenditure structure of Nepal.*
-) *An efficient, strong & fair administration is the most crucial for proper implementation of VAT but VAT administration is weak.*
-) *There is a crisis of confidence between the private sector and the Government bodies i.e. VAT payers & self VAT collectors.*

- J *VAT being a self-assessed, involve based and account based tax the role of business community along with the general consumer is more important for its successful operation.*

2.7.7 Acharya (2003) submitted the thesis on “A comparative study of sales and VAT in Nepal”

The major objectives of the study were;

- J To compare and evaluate VAT and sales tax from the view point of theoretical and revenue generation prospective.
- J To access the feasibility of VAT as an alternative to sales tax in Nepal.
- J To examine the impact of VAT on different economic issues like investment, threshold, price level, punishment and administration.
- J To provide valuable suggestion and recommendation for the effective implementation of VAT in Nepal.

Acharya used secondary as well as primary source of the study purpose. Acharya pointed out the core findings which are as follows:

“In order to mobilize more tax revenue the tax system should be efficient, sales tax during mid 1990sThe main weaknesses of VAT administration were lack of sound physical environment, weak financial resources, lack simple and transparent. It was urgent to think the alternative of expert and lack of statistics. To study briefly about past 5 years VAT revenue collected at largest amount in fiscal year 2057/58.”

2.7.8 Bhatta (2005) submitted the thesis on " Value Added Tax System in Nepal"

The major objectives of the study were;

- To review background, trend of VAT collection and its contribution in Government revenue.
- To analyze the problem faced by the Governments to collect VAT.
- To study the efforts made by Government to collect VAT.
- To evaluate the performance of VAT & find out the status & prospects of VAT in Nepal.

Bhatta cited out the following findings:

-) *Administrative capability is grate importance for the effective implementation of VAT in Nepal.*
-) *There is a problem in billing system.*
-) *The VAT revenue collection is not satisfactory.*
-) *Various publicity programmes should be initiated.*
-) *Others.*

2.7.9 Kakshapati (2005) submitted the thesis on "Revenue collection from VAT with its problems prospects."

The major objectives of the study were;

- To revise about theoretical aspect of VAT.
- To examine the importance of VAT in revenue collection.
- To identify current problems & analyze future prospect of VAT.
- To recommend for making VAT effective & efficient in coming days.

Kakshapati demonstrated the following findings;

-) *Tax leakages have badly eroded Nepalese tax base.*
-) *Majority of the tax payers are not conscious about VAT system of Nepal.*
-) *Due to weak administration system, the smuggling business activities have increased.*
-) *Billing system is one of the major aspects of effective implementation of VAT.*

2.7.10 Nepal (2008) submitted the thesis on "Revenue generated from VAT in Nepal."

The major objectives of the study were;

- To analyse the status of VAT registrants
- To analyse the composition of VAT revenue
- To analyse the applicability of VAT
- To examine the helpfulness of VAT on economic growth

Nepal cited the following findings;

-) *Compulsory registrant is more than voluntary registrant in Nepal*
-) *VAT revenue form import dominates VAT revenue form Domestic VAT revenue.*
-) *Among the source of revenue VAT has dominant all other sources of revenue collection i.e. Income tax, excise duty, and other.*
-) *People show positive response towards applicability of VAT.*
-) *VAT increases inflation.*
-) *VAT helps in economic growth*
-) *VAT discourages illegal trade.*

2.7.11 Ghimire (2008) submitted the thesis on "Contribution of VAT to National Income."

The major objectives of the study were;

- To evaluate trend of VAT collection in IRO of Kathmandu and Nepal.
- To assess the contribution of VAT from IRO, Kathmandu to national revenue, total tax revenue, indirect tax revenue and total VAT revenue.
- To study about effectiveness and problems of implementation of VAT.
- To provide suggestions for effective implementation of VAT in Kathmandu.

Nepal cited the following findings;

-) *The trend of VAT registrants in IRO of Kathmandu is in increasing trend which shows that people are being quite aware regarding VAT system and its advantage.*
-) *Revenue is in increasing trend so it is expected to generate more VAT revenue in future and in the long run VAT will be an integral part of Nepalese tax structure but the revenue resources have not increased to meet in increasing Government expenditure as expected.*
-) *The share of tax revenue is greater than the share of non-tax revenue and the share of VAT is very low in national GDP as compared to other developed countries.*

-) *VAT system will help government to curb illegal activities.*
-) *Difficulties in business registration procedure, accounting keeping system and cost of record keeping are the major problems in business sectors.*

2.7.12 Shrestha (2008) submitted the thesis on "A study on VAT: implementation, problems & its effectiveness in the Nepalese economy."

The major objectives of the study were;

- To examine the implementation of the VAT in general
- To analyze the problems faced by the Governments to collect VAT.
- To conduct an empirical investigation regarding to effectiveness and problems of VAT in Nepal.
- To provide suggestions on the basis of the study to the concerned authorities.

Shrestha cited the following findings;

-) *Despite the best effort, large numbers of potential tax payers are outside the boundaries of VAT net due to which honest taxpayers have to face unfair competition.*
-) *There is no proper system of valuation of goods in custom and control mechanism is also not good. Beside this open boarder is one of the main problem for successful implementation of VAT.*
-) *Businesspersons are not happy with the present increased VAT rate although the present VAT Act is very good for implementation.*
-) *There is lack of education among customers and business sector.*
-) *Fine and penalty system is very strong rather than facilitative one.*
-) *There is need of modern tools regarding registration of tax payee, investigation system, tax audit and systemic database.*

Conclusion:

VAT has not been yet implemented effectively in the country. Besides this, the revenue performance of VAT is not properly studied. Only limited challenges for VAT

implementation are explained. In this study, the area of challenges for effective VAT implementation in Nepal is studied and the subject matter of the study is also important.

So, economic development and accelerating growth rate of the economy through expanding the tax net without any distributions, promoting the exports and making the tax system more transparent. However, VAT was the subject of a strict opposition from the business commodity in the period of introduction. Later these were some corrections in VAT rules and regulation and then slowly business community accepted the system and further demanded it to expand through the retail level so that all business forms will be treated equally.

There are lots of researches on VAT in abroad but very few of these are concerned about countries like Nepal. So, the study will mainly focus on the problems in VAT implementation in Nepal. Besides this, the study will be beneficial to the policy makers, revenue department, and students of tax, private sectors and researchers. It will provide the clear concept and ideas as well as knowledge to those persons who are interested and want to gain knowledge of VAT system. Similarly, it will be equally helpful to the researchers who carry out their research work. It will lead a step ahead about VAT by this research work. The focus of the research work is on the problems in VAT implementation in Nepalese perspectives.

CHAPTER III

RESEARCH METHODOLOGY

3.1 The Research Design

It is said that a research without a pre-drawn plan is like an ocean voyage without Mariner's compass. So, the use of a research design guides researcher in the right direction. The research work has followed historical as well as descriptive research design to analyze and to interpret the collected data & information. As the data and information are related to past, the historical research is used to explain those collected information during the study period.

3.2 The Population and Sample

The population in the study refers to aggregate figure of the economy. So, the population of the study represents Nepal because the data & information are in aggregate figures. Besides this, for an opinion survey 100 people are randomly selected to take their views related to problems in VAT implementation in Nepal. For this purpose, the sample population has been divided into four sub categories namely General Consumer Category, VAT Registered Business Category, Retail Shop & Other Business Group Category and Government Tax Authorities and Intellectual group to obtain their response towards the designed questionnaire.

3.3 The Data Gathering Procedure

The required data & information are collected from the secondary as well as primary sources.

3.3.1 Primary Data:

The questionnaire papers were prepared to collect the views of General Consumer, VAT Registered Business, Retail Shop & Other Business Group and Government Tax Authority Employee and Intellectuals. 100 questionnaire papers were distributed out of which 80 were collected. Besides these, subjective opinion and information are collected from the discussion and interaction with related persons, policy makers and intellectual persons.

3.3.2 Secondary Data:

Basic data are collected from the secondary sources. These sources are Inland Revenue Department, Central Bureau of Statistics, Ministry of Finance, Custom Department, and

Economic Survey, Budget speech of various years, various newspapers and other related materials.

3.3.3 The Statistical Procedure

The research work has used various statistical tools to analyze and to interpret the result of the collected data and information. The tools which are used in the research work are percentage bar-diagram, bar- graphs and mean. Besides these, to test the reliability of an opinion survey regarding to the problems in implementation of VAT, the Null Hypothesis i.e. large sample test (Z-test) is used.

3.4 The Data Analysis Procedure

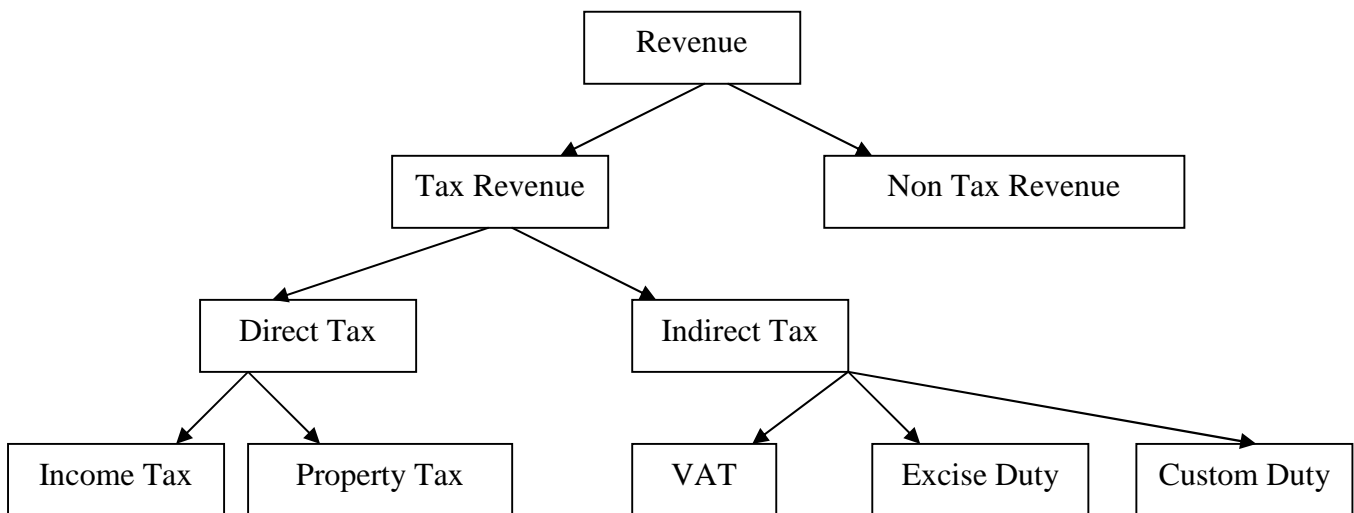
After data and information are collected, they are tabulated and presented in the tabular form. After this, different statistical tools are used to analyze those collected data & information to draw the result/conclusion of the research work. To test an opinion survey of people large sample test i.e. Z-test is used to interpret the opinion survey research work.

CHAPTER IV

PRESENTATION & ANALYSIS OF DATA

4.1 Total Revenue Structure

Figure 4.1



Source: RAJASWA (2062)

Every Government is responsible to perform many functions and works for the growth & development of the nation. Government needs a huge volume of revenue to provide social welfare, security, handle the administrative work perform the different development activities and so on. Therefore, the Government collects revenue from various sources. Basic source of revenue can be classified into two categories:-

Tax revenue and non-tax-revenue: These both source are subjected to non-repayment and their sum constitute the Government revenue. Besides, this source Government has other source which is subjected to repayment such as loans, grants. However, grants are not compulsory repaid.

4.2. Composition of total revenue (Rs. in crore)

Table 4.1

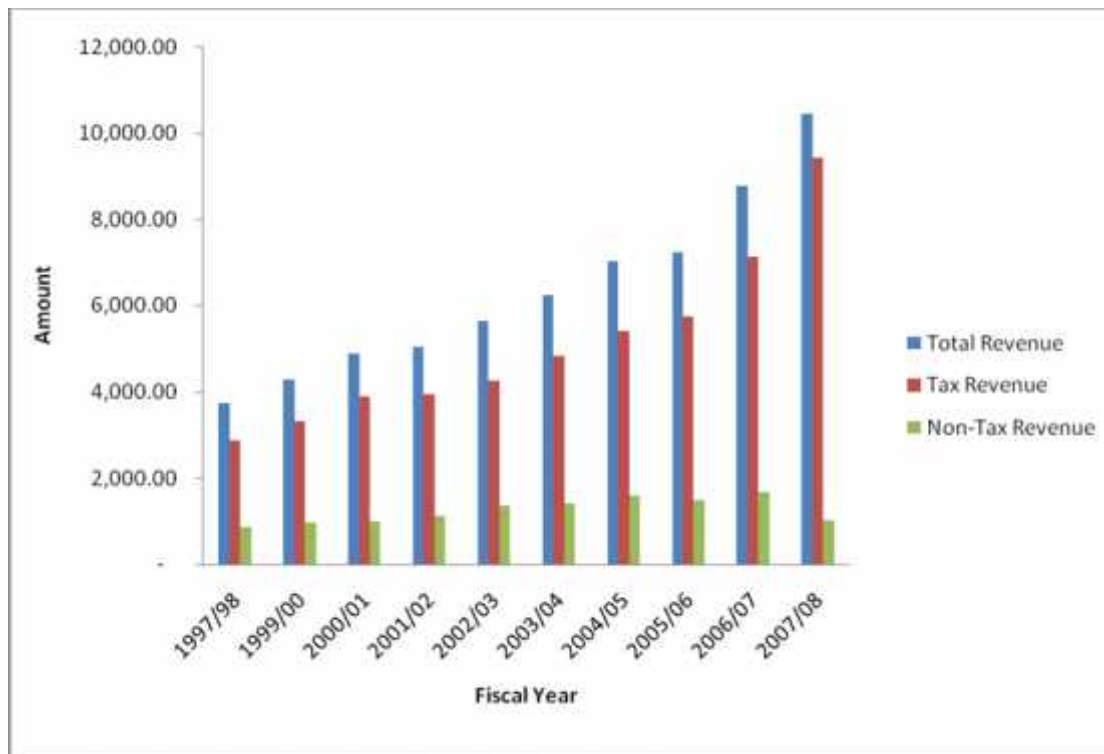
S.N.	FY	Total Revenue	Tax-revenue		Non-Tax-Revenue	
			Amount	As % on TR	Amount	As % on TR
1	1997/98	3,725.10	2,875.30	77.19	849.80	22.81
2	1999/00	4,289.40	3,315.20	77.29	974.20	22.71
3	2000/01	4,889.36	3,886.50	79.49	1,002.86	20.51
4	2001/02	5,044.55	3,933.06	77.97	1,111.49	22.03
5	2002/03	5,622.98	4,258.69	75.74	1,364.29	24.26
6	2003/04	6,233.10	4,817.30	77.29	1,415.80	22.71
7	2004/05	7,012.27	5,410.47	77.16	1,601.80	22.84
8	2005/06	7,228.20	5,743.04	79.45	1,485.16	20.55
9	2006/07	8,719.97	7,197.34	82.54	1,522.63	17.46
10	2007/08	10,493.93	8,515.55	81.15	1,978.38	18.85
	Average	6,325.89	4,995.25	78.97	1,330.64	21.03

Source: Economic Survey 1998 & 2008, Various Budget Speech Issues, MOF, Annual Report IRD, RAJASHOW, 2008, Sept/Oct, 2008

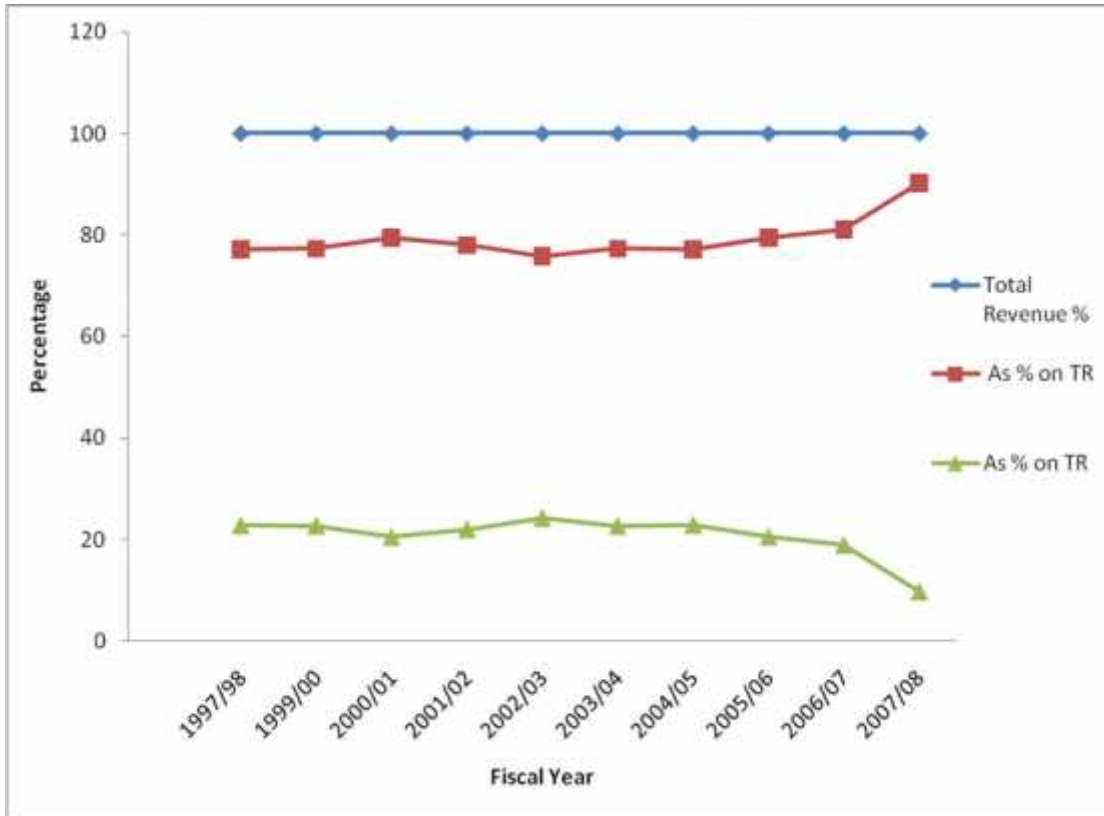
Nepalese economy is characterized by a low revenue performance in contrast to the growing public expenditure. The contribution of tax revenue total revenue is higher than non-tax-revenue. The above table shows the composition of tax revenue and non tax revenue and their share in total revenue.

In the fiscal year 1997/98, the share of tax revenue was 77.19 percent and the share of non-tax-revenue was 22.81 percent. Of the total revenue collection, in FY 2007/08, the share of tax –revenue was 81.15 percent where as the share of non-tax-revenue was 18.85 percent. In FY 2002/03, the share of tax revenue and non tax revenue were 75.74 and 24.26 percent respectively. On an overall the contribution of tax revenue to total revenue seems at increasing trend whereas non tax revenue seems as slightly decreasing trend from fiscal year 2001/02 to 2006/07. On an average the contribution of tax revenue was 78.97 percent and contribution of non tax revenue was 21.03 during the past 10 years starting from fiscal year 1997/98 to 2007/08.

Graph 4.2 Composition of total revenue (In crore Rs.)



Graph 4.3 Trend of tax revenue & non tax revenue as % on total revenue



4.3. Contribution of VAT revenue to tax revenue (Rs. in thousands)

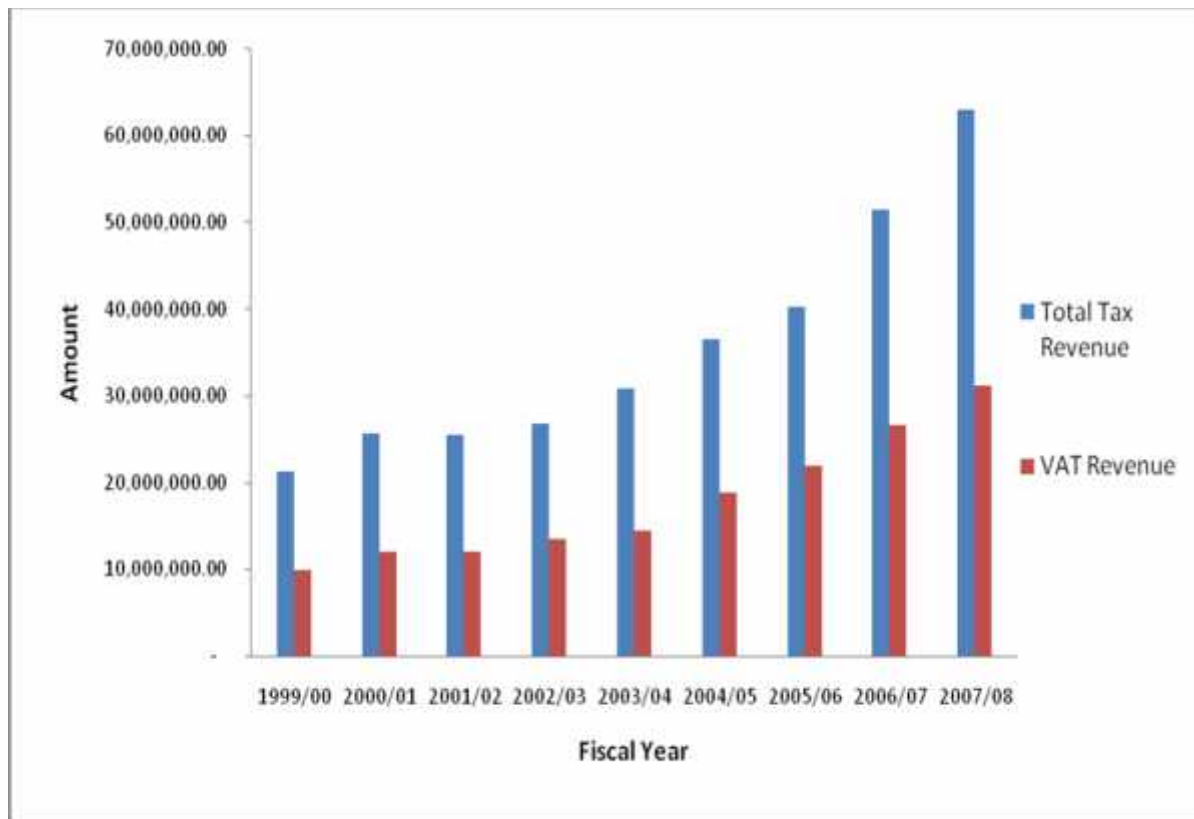
Table 4.2

S.N.	FY	Total Tax Revenue	VAT Revenue	VAT revenue as % TR	Increase/ (Decrease)
1	1999/00	21,210,000.00	9,860,000.00	46.49	
2	2000/01	25,690,000.00	12,050,000.00	46.91	0.42
3	2001/02	25,537,690.00	11,947,955.00	46.79	(0.12)
4	2002/03	26,853,422.00	13,449,123.00	50.08	3.30
5	2003/04	30,920,989.00	14,478,896.00	46.83	(3.26)
6	2004/05	36,552,762.00	18,894,627.00	51.69	4.87
7	2005/06	40,202,336.00	21,946,014.00	54.59	2.90
8	2006/07	51,541,450.00	26,704,180.00	51.81	(2.78)
9	2007/08	62,979,367.00	31,154,633.00	49.47	(2.34)

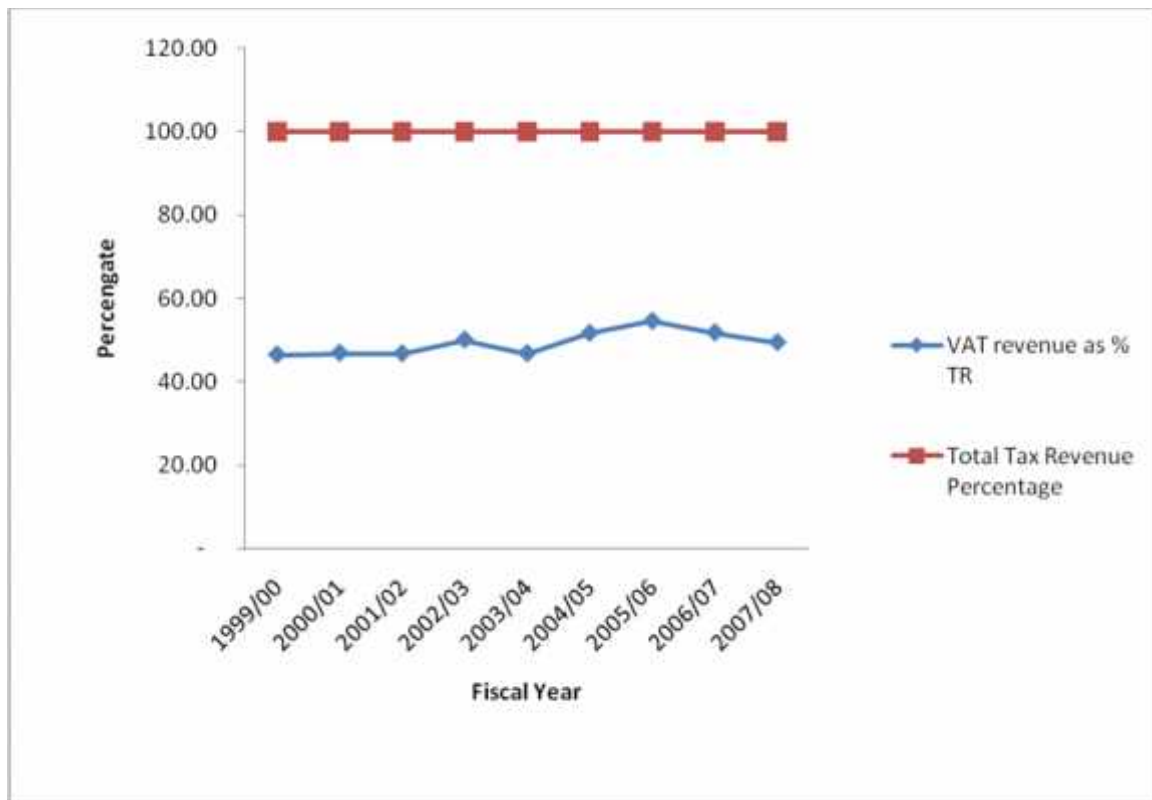
Source: Economic survey, MOF 2008, KTM

In the FY 1999/00, the tax revenue amount was Rs. 21,210,000.00 thousands out of which Rs. 9,860,000.00 thousands was VAT revenue. In F/Y 2000/01 the contribution of VAT revenue to total tax revenue was 46.91 percent and which was increased by 0.42 percent as compared to F/Y 1999/00. In 2000/01 the contribution of VAT revenue was decreased by .12 percent as compared to previous year but in year 2001/02 contribution of VAT revenue in total revenue was increased by 3.30 percent. Similarly the contribution of VAT revenue was 50.08 percent, 46.83 percent, 51.69 percent, 54.59 percent, 51.81 percent, and 49.47 percent respectively in F/Y 2002/03, 2003/04, 2004/05, 2005/06, 2006/07 and 2007/08. In an average about 49.92 percent contribution was provided by VAT revenue to total tax revenue during the last nine years.

Graph 4.4 Graph showing tax revenue & VAT revenue (in thousand Rs.)



Graph 4.5 Trend of tax revenue & VAT revenue as % on total revenue



4.4. Status of VAT Registration

Table 4.3

F/Y	VAT Registration (a)	No. of Statement submitted (b)	Percentage (b)/(a)	No. of tax payer not submitting return (c)	Percentage (c)/(a)	No. of cancelled Registration (d)	Percentage (d)/(a)	No. of closed business (e)	Percentage (e)/(a)
1999/00	17947	17271	96.23	676	3.77	-	-	-	-
2000/01	21093	19710	93.44	1,383	6.56	170	0.81	172	0.82
2001/02	25149	21473	85.38	3,676	14.62	80	0.32	360	1.43
2002/03	29872	23099	77.33	5,255	17.59	18	0.06	531	1.78
2003/04	34174	25049	73.30	7,322	21.43	30	0.09	570	1.67
2004/05	39776	28525	71.71	8,492	21.35	30	0.08	445	1.12
2005/06	46831	33633	71.82	13,198	28.18	36	0.08	647	1.38
2006/07	52965	36457	68.83	7,098	13.40	31	0.06	793	1.50
2007/08	59907	47880	79.92	9,050	15.11	150	0.25	863	1.44

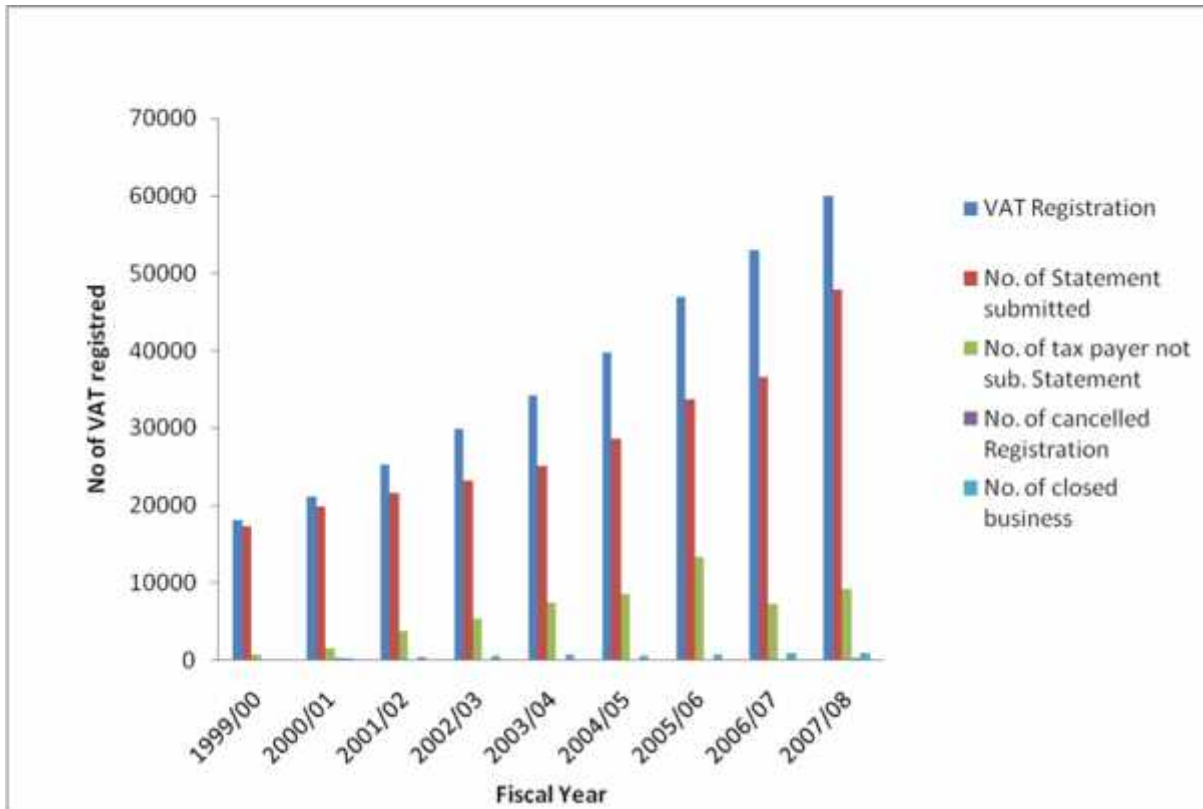
Source: Annual Report, Inland Revenue Department, 2008, Pn 43

The above table shows the no of VAT registered business divided into categories of statement submitted, statement not submitted, cancelled registration and closed business and their respective share during last 9 year starting form fiscal year 1999/00 to 2007/08. In the FY 1999/00, the total number of registered taxpayer was 17,947 out of which 17,271 had submitted the tax statement. It meant 96.23 percent tax payer had submitted the tax statement in the Inland Revenue Department. In the same FY, the number of taxpayers who had not submitted the tax statement was 676 which come to 3.77 percent of the total registers. There was no cancelled registration and closed business during the year. In fiscal year 2000/01, the total number of VAT registrants were 21,093 out of which 93.44 percent submitted the statement where as 6.57 percent did not submitted the return. Similarly, the number of tax payers who had cancelled their registration was 170 and the number of registrant who closed their business was 172 which come to 0.81 percent and 0.82 percent of the total no of VAT registrants.

From the above table we can conclude that the total no of VAT registered business and return filers has increased year by year in decreasing trend whereas no of registrants not submitting the return has increased up to fiscal year 2005/06 and slightly decreased in the fiscal year 2006/07 and again increased in 2006/07. Similarly no of closed business has been increased from the year 2000/01 in increasing trend up to 2003/04 and slightly decreased in fiscal year 2004/05 and again increased during the fiscal year 2005/06, 2006/07 and 2007/08 and which

come to 647, 793, 810 in number and 1.38, 1.50 and 1.35 respectively in percent out of total number of VAT registrant.

Graph 4.6 Graph showing tax restraints and return filing



4.5 Status of Return Filers

Table 4.4

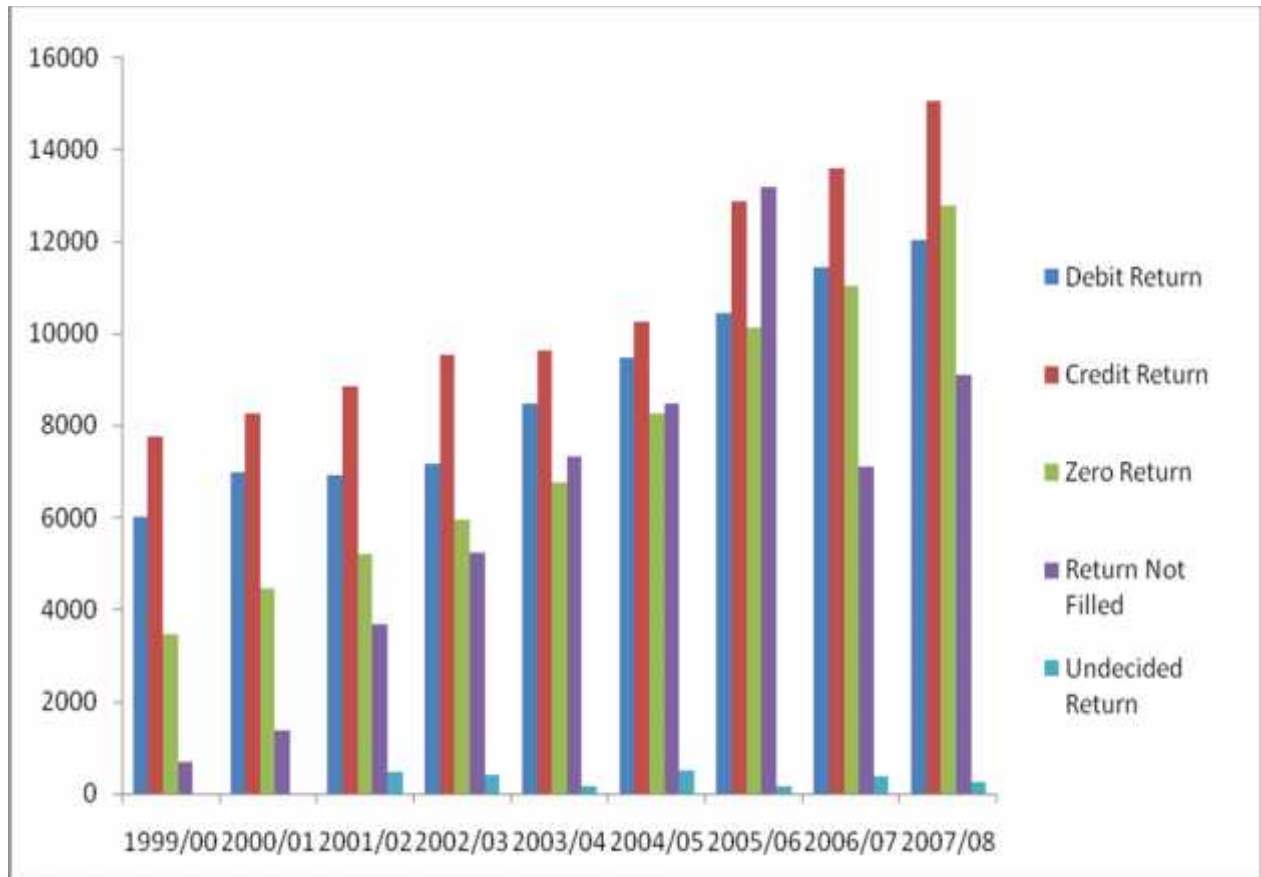
FY	Debit Return		Credit Return		Zero Return		Return Not Filled		Undecided Return		Total Return
	Total	%	Total	%	Total	%	Total	%	Total	%	
1999/00	6027	33.58	7766	43.27	3475	19.36	676	3.77	3	0.02	17947
2000/01	6975	33.07	8250	39.11	4471	21.20	1383	6.56	14	0.07	21093
2001/02	6936	27.58	8844	35.17	5207	20.70	3676	14.62	486	1.93	25149
2002/03	7178	25.32	9553	33.69	5972	21.06	5255	18.53	396	1.40	28354
2003/04	8483	26.21	9625	29.73	6783	20.95	7322	22.62	158	0.49	32371
2004/05	9478	25.60	10260	27.72	8271	22.34	8492	22.94	516	1.39	37017
2005/06	10449	22.31	12882	27.51	10139	21.65	13198	28.18	163	0.35	46831
2006/07	11457	26.30	13594	31.21	11044	25.36	7098	16.30	362	0.83	43555
2007/08	12052	24.48	15050	30.57	12779	25.96	9095	18.47	258	0.52	49234

Source: Annual Report, Inland Revenue Department, 2008, Pn 43

The above table shows that the total taxpayer divided into Debit Return Filers, Credit Return Filers, Zero Return Filers, Non Filers and Undecided Tax Returns during the last 9 years starting form 1999/00 to 2007/08. The number of Debit Return filers starting form 1999/00 to 2006/07 was 6027, 6975, 6936, 7178, 8483, 9478, 10449,11457 and 12052 which come to 33.58 ,33.07, 27.58, 25.32, 26.21, 25.60, 22.31, 26.30 and 24.48 percent respectively of the total registrants which is in increasing trend. The number of credit return filers during the same period was 7766, 8250, 8844, 9553, 962, 10260, 12882, 13594 and 15050, which come to 43.27, 39.11, 35.17, 33.69, 29.73, 27.72, 27.51, 31.21 and 30.57 percent respectively of the total registrants which is also increasing in decreasing trend. The number of Zero return filers had also increased during the same period which is 3475, 4471, 5207, 5972, 6783, 827, 10139, 11044 and 12779 which come to 19.36, 21.20, 20.70 , 21.06 20.95 22.34, 21.65, 25.36 and 25.96 percent respectively of the total registrants.

Likewise, the number of undecided return had also increased during the same period. The undecided return was 3, 14, 486, 396, 158, 516, 163, 362 and 258 which come to 0.02, 0.07, 1.93, 1.40, 0.49, 1.39, 0.35, 0.83 and 0.64 percent respectively of the total registrants during the reported period which seems oscillating in trend.

Graph 4.7 graph showing trend of return filing



4.6 Trend of VAT Registrants

The status of VAT registered business is depicted in the following table. On an average the no of VAT registered business has increased at the rate of 13% p.a.

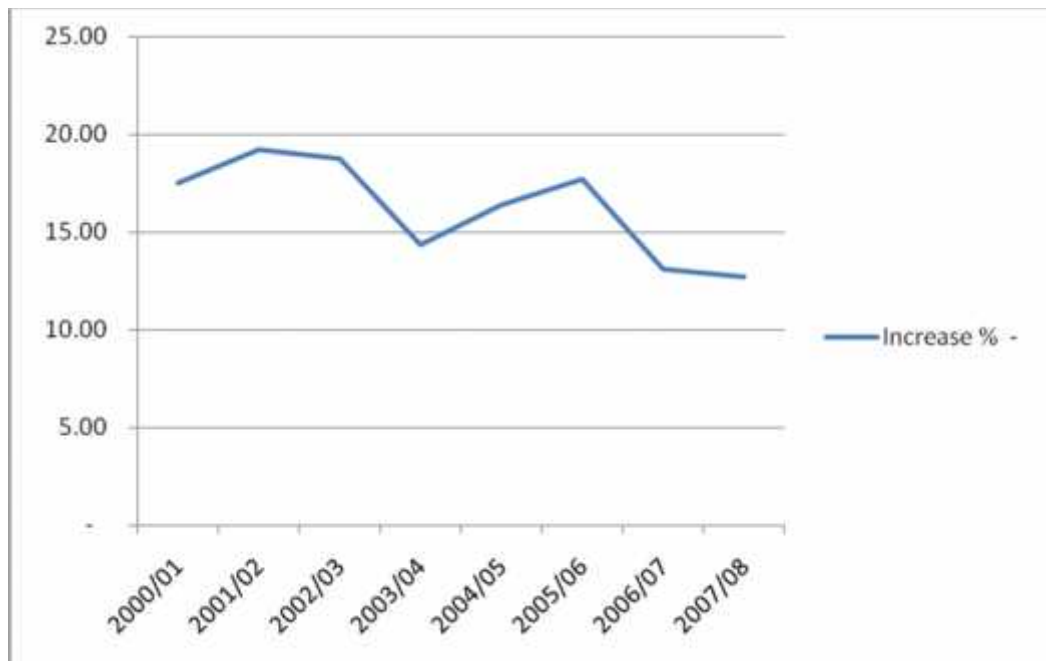
Table 4.5

S.N.	FY	VAT Registration	Increase %
1	1999/00	17,947	-
2	2000/01	21,093	17.53
3	2001/02	25,149	19.23
4	2002/03	29,872	18.78
5	2003/04	34,174	14.40
6	2004/05	39,776	16.39
7	2005/06	46,831	17.74
8	2006/07	52,965	13.10
9	2007/08	59,707	12.73

Source: Annual Report, Inland Revenue Department, 2008, Pn 43

In FY 1998/99, the number of VAT Registrants was 17947. During the fiscal Year 1999/00 the number of registrants has increased by 17.53 and reached to 21093. The average no of increase in VAT registrants during the fiscal year 1998/99 to 2006/07 is 49.72 percent. The number of VAT registrant was increased in increasing trend form 1998/99 to 2001/2002 and the number of VAT registrants increased in decreasing trend in fiscal year 2002/03. During the fiscal year 2003/04 and 2004/05 the no of VAT registrant was increased by 16.39 percent and 17.74 percent which come to 39776 and 46831 in number. During the fiscal year 2005/06 and 2006/07, the number of VAT registrant was increased in decreasing trend which was 52965 and 59850 in number and 13.10 and 13 respectively in percent.

Graph 4.8 Graph showing Trend of VAT Registrants



4.7 Trends of VAT Revenue (In thousands Rs.)

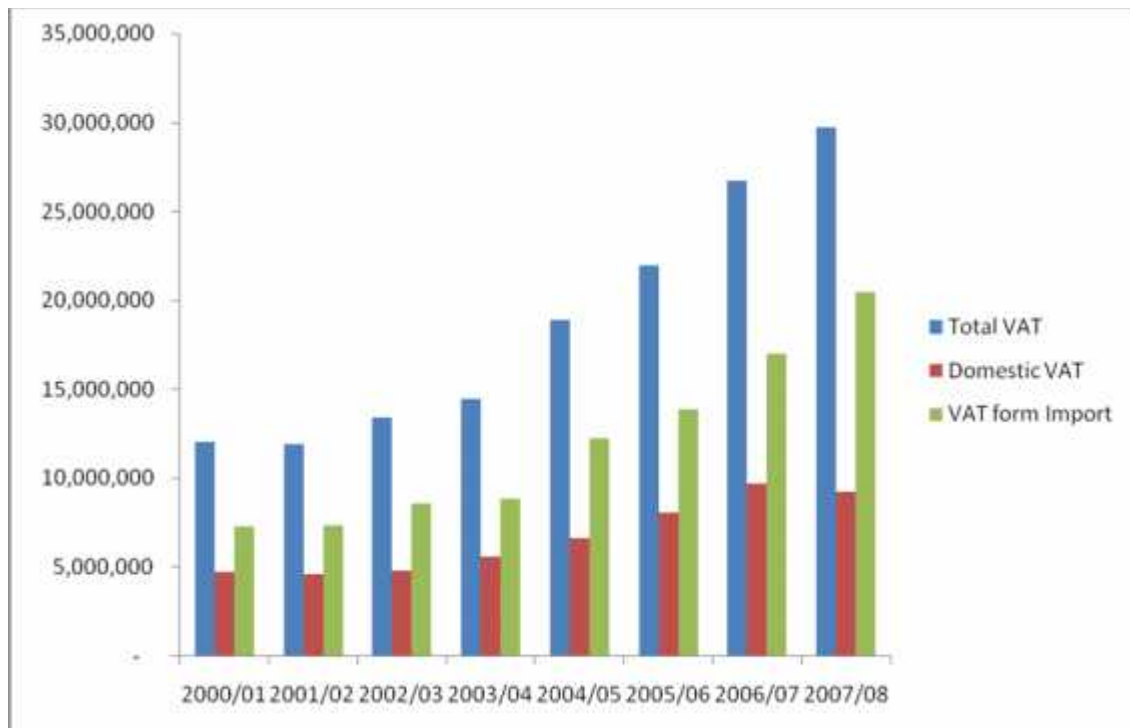
Table 4.6

S.N.	FY	Total VAT	Domestic VAT	Percentage	VAT form Import	Percentage
1	2000/01	12,050,000	4,744,720	39.38	7,305,280	60.62
2	2001/02	11,947,955	4,608,373	38.57	7,339,582	61.43
3	2002/03	13,449,123	4,819,610	35.84	8,629,513	64.16
4	2003/04	14,478,896	5,604,123	38.71	8,874,773	61.29
5	2004/05	18,894,627	6,624,333	35.06	12,270,294	64.94
6	2005/06	21,946,014	8,057,438	36.71	13,888,576	63.29
7	2006/07	26,704,180	9,689,979	36.29	17,014,201	63.71
8	2007/08	29,703,211	9,264,711	31.19	20,438,500	68.81

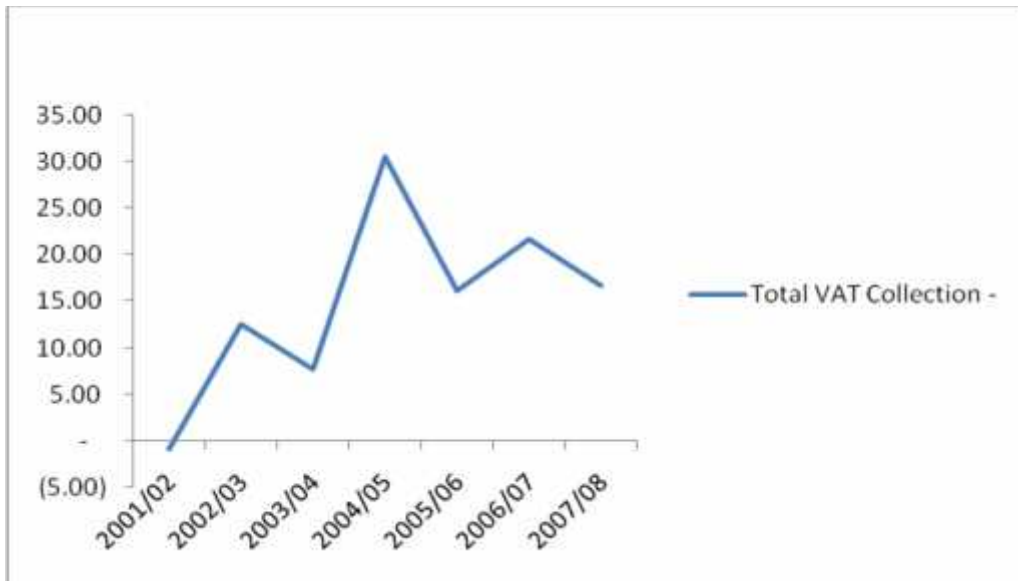
Source: Budget Speech 2008 & Annual Report 2064/065, IRD.

VAT Revenue was divided into two parts i.e. Import VAT and Domestic VAT. In the FY 2000/01 and 2001/02 VAT collection from import were Rs. 7,305,280.00 thousands & Rs. 7,339,582.00 thousands which was 60.62 and 61.43 percent of total VAT collection. During the 7 years started from 2000/01 to 2006/07 VAT collected from domestic transactions was higher in comparison to VAT collected from import transactions. VAT revenue collection was in increasing trends in each FY. Therefore, VAT revenue collection was also satisfactory as it was in terms of increasing trends.

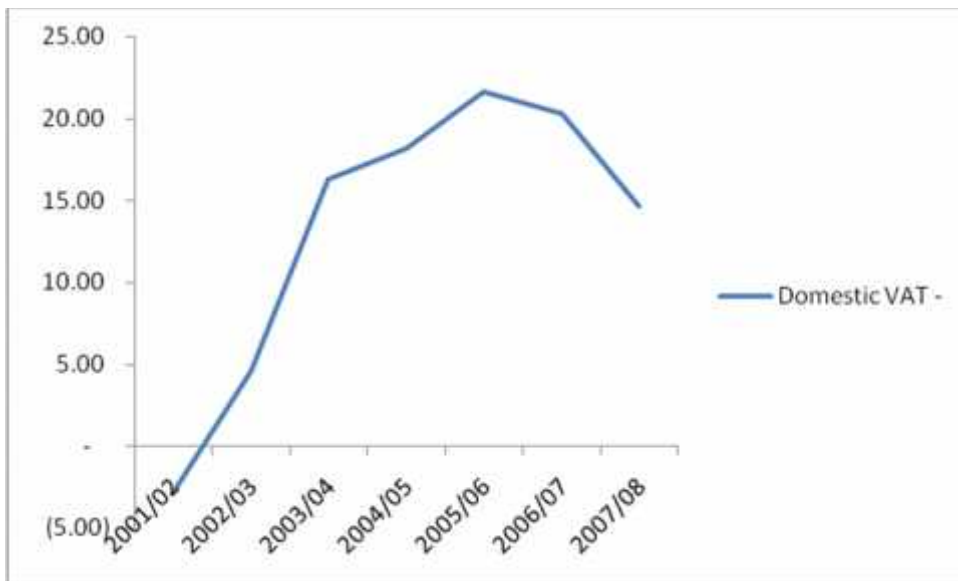
4.9 Graph showing the trends of VAT revenue



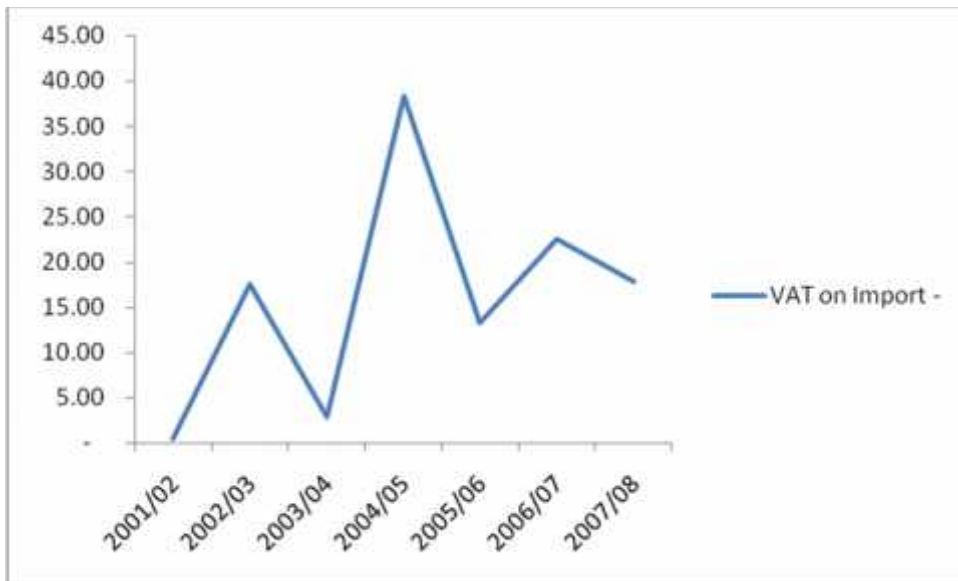
4.10 Trend showing the percentage increase of total VAT revenue



4.11 Trend showing the percentage increase of domestic VAT revenue



4.12 Trend showing the percentage increase of VAT revenue on import



4.8 Total Revenue and Gross Domestic Product Ratio (Rs. In million)

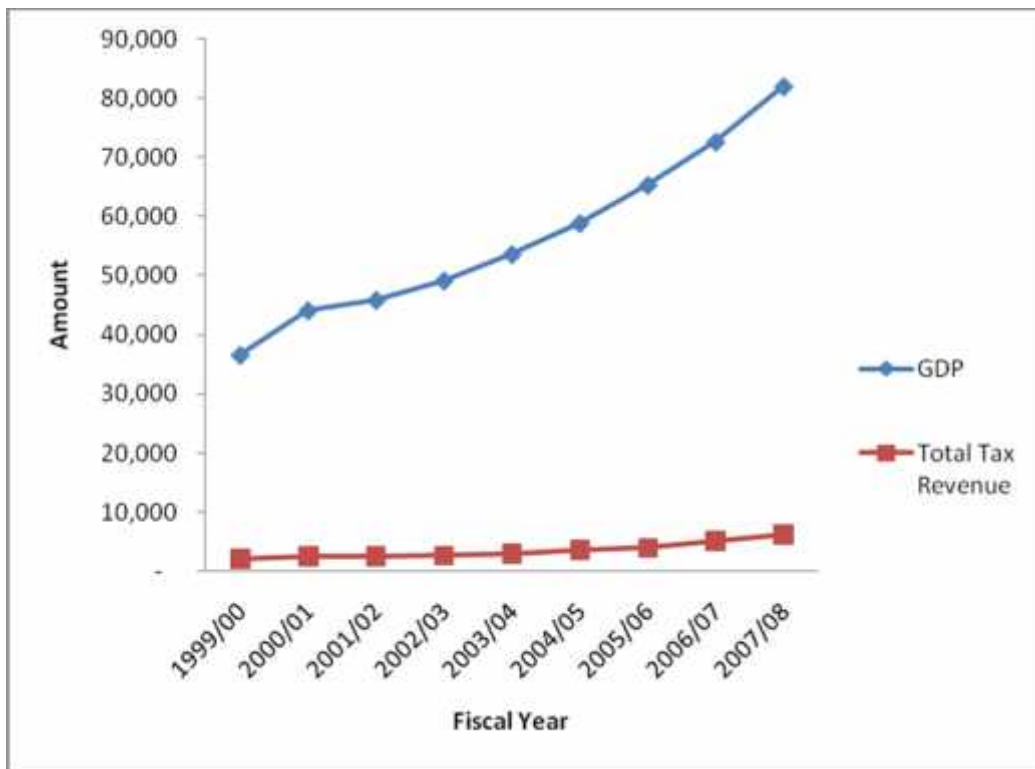
Table 4.7

S.N.	FY	GDP	Total Tax Revenue	Tax Revenue as % of GDP
1	1999/00	36,625	2,121.00	5.79
2	2000/01	44,152	2,569.00	5.82
3	2001/02	45,944	2,553.77	5.56
4	2002/03	49,223	2,685.34	5.46
5	2003/04	53,675	3,092.10	5.76
6	2004/05	58,941	3,655.28	6.20
7	2005/06	65,405	4,020.23	6.15
8	2006/07	72,709	5,154.15	7.09
9	2007/08	82,081	6,297.94	7.67

Source: Economic Survey, MOF 2008, KTM, Table No 1.7 Page no 7

The tax/GDP ratio is shown in the above table 4.6. The table shows that tax/GDP ratio is very low & it is marginally increasing during the study period." It is usually argued that LDCs should be expected to achieve a Tax /GDP ration of least 18%"(Musgrave & Musgrave, 1976:749).The Tax/GD ratio was highest in the FY 2007/08 i.e. 7.67% and lowest in the FY 2002/03 i.e. 5.46%. However, the tax/GDP ratio was in increasing trend from the FY 2002/03 to 2003/04. The contribution of Tax revenue to Gross Domestic Product is comparatively low i.e. not satisfactory. The growth rate in tax/GDP ratio is not continuous i.e. it fluctuates in each FY.

4.13 Graph showing the trend of GDP and total tax revenue



4.9 Comparison of VAT and Gross Domestic Product Ratio (Rs. In Crore)

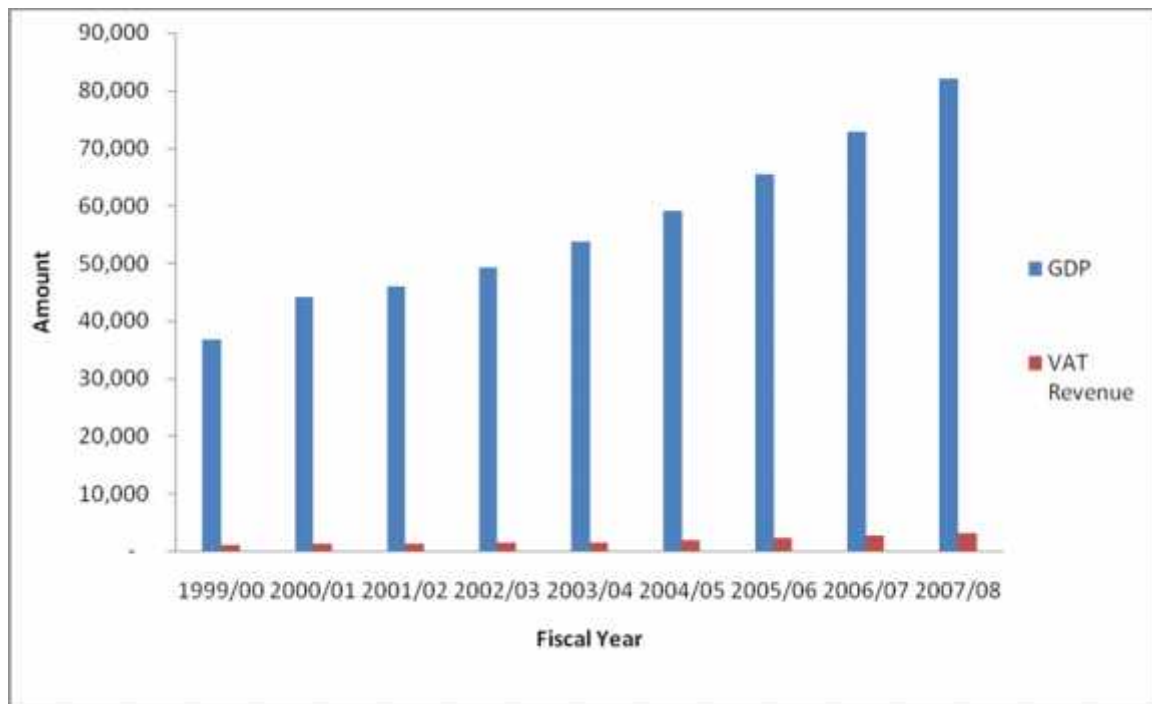
Table 4.8

S.N.	FY	GDP	VAT Revenue	VAT revenue as % of GDP
1	1999/00	36,625	986.00	2.69
2	2000/01	44,152	1,205.00	2.73
3	2001/02	45,944	1,194.80	2.60
4	2002/03	49,223	1,344.91	2.73
5	2003/04	53,675	1,447.89	2.70
6	2004/05	58,941	1,889.46	3.21
7	2005/06	65,405	2,194.60	3.36
8	2006/07	72,709	2,670.42	3.67
9	2007/08	82,081	3,115.46	3.80

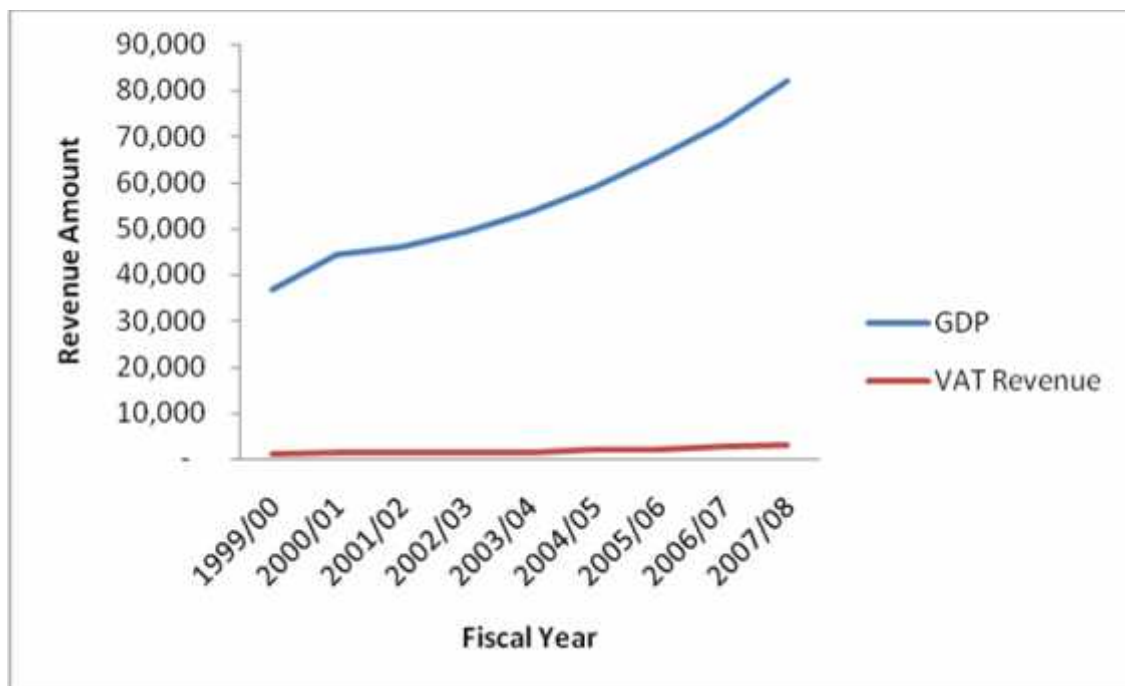
Source: Economic Survey, MOF, 2009 & RAJASHOW 2064 ASHOJ, Pn 6&7

The VAT revenue and GDP and percentage contribution of VAT on GDP has been shown in the above table. The contribution of VAT revenue on GDP has been fluctuated during the fiscal year 1999/00 to 2003/04. After fiscal year 2003/04 the contribution of VAT revenue has been increasing steadily.

4.14 Graph showing the contribution of VAT revenue on GDP.



4.15 Graph showing the trend of GDP and VAT revenue.



4.10 Contribution of VAT from Different Sectors (Rs. In Thousand)

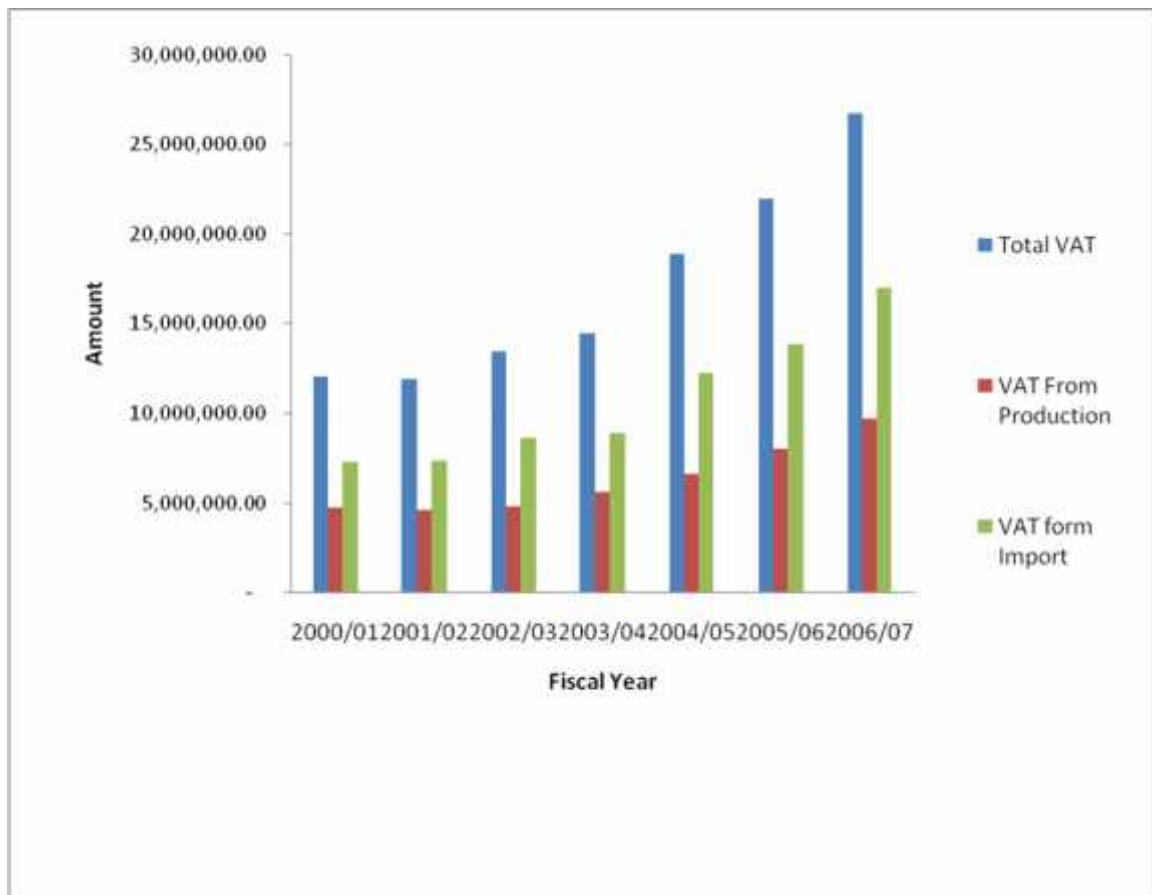
Table 4.9

S.N.	FY	Total VAT	VAT From Production	% Increase	VAT form Import	% Increase
1	2000/01	12,050,000.00	4,744,720.00	-	7,305,280.00	-
2	2001/02	11,947,955.00	4,608,373.00	(2.87)	7,339,582.00	0.47
3	2002/03	13,449,123.00	4,819,610.00	4.58	8,629,513.00	17.57
4	2003/04	14,478,896.00	5,604,123.00	16.28	8,874,773.00	2.84
5	2004/05	18,894,627.00	6,624,333.00	18.20	12,270,294.00	38.26
6	2005/06	21,946,014.00	8,057,438.00	21.63	13,888,576.00	13.19
7	2006/07	26,704,180.00	9,689,979.00	20.26	17,014,201.00	22.51

Source: Rajashow 2007 Sept/Oct, Pn 6.

The magnitude of Tax Revenue as the sum of Direct & Indirect Tax is presented in the above table. During the study period, the share of direct tax in Tax Revenue in FY 1998/99 to 1999/00 has increase from 26.14 percent to 27 percent as a result indirect tax has decrease from 73.86 percent to 73 percent. In FY 2003/04 and 2004/05, the share of indirect tax has increase i.e. there is greater contribution of indirect tax in tax revenue.

4.16 Graph showing total VAT, VAT from production and VAT from import.



4.11 Contribution of VAT Revenue to Indirect Tax Revenue (Rs. in Crore).

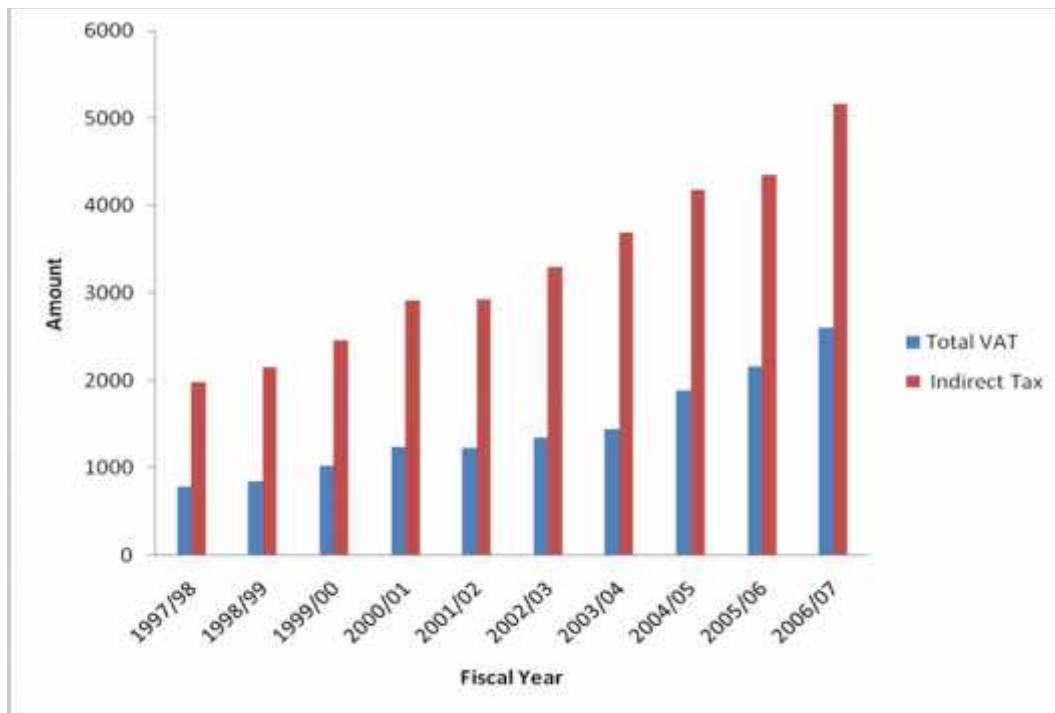
Table 4.10

S.N.	F/Y	Total VAT	Total Indirect Tax	% of VAT on Total Indirect Tax
1	1997/98	790	1,989	39.72
2	1998/99	851	2,146	39.66
3	1999/00	1,024	2,460	41.63
4	2000/01	1,238	2,914	42.48
5	2001/02	1,227	2,929	41.89
6	2002/03	1,346	3,304	40.74
7	2003/04	1,448	3,696	39.18
8	2004/05	1,889	4,183	45.16
9	2005/06	2,161	4,347	49.71
10	2006/07	2,610	5,165	50.53

Source: Economic Survey, MOF, 2008.

In FY 1997/98 to FY 2006/07, VAT Revenue as percent on indirect tax as increased from 39.72 percent to 50.53 percent i.e. in the first three fiscal year VAT Revenue has increased from Rs.790 crore to Rs.2,610 crore respectively. From FY 2001/02 to FY 2003/04, VAT revenue has decreased from 42.48 percent to 39.18 percent. In FY 2003/04 to FY 2006/07, VAT Revenue as percent on indirect tax revenue has increased from 39.18 percent to 53.53 percent which is a great contribution of VAT revenue in indirect tax revenue during the study period.

4.17 Graph showing the pattern of VAT revenue and Indirect tax



4.12 Resource Gap in Nepal

The economy is suffering from the persisting resource gap, revenue-expenditure, saving-investment and import-export. These gaps have affected the level of stability of the country in the macro level. Nepal's foreign trade is concentrated in a few selected commodities and countries. FY deficit is due to the continuously increasing expenditure of the Government instead of the low revenue performance in Nepal. Besides these, the country is also facing the increasing burden of foreign loan. Widening trends of the different resources gap is should be in the given table as follows:

Resource Gap in Nepal (In Million Rs.)

Table 4.11

FY	Total Exp. (A)	Total Rev. (B)	Resource Gap X (A-B)	Foreign Grant (C)	Resource Gap Y (A-B-C)	Foreign Loan (D)	Resource Gap Z (A-B-C-D)
1997/98	56,118.30	32,937.90	23,180.40	5,402.60	17,777.80	11,054.50	6,723.30
1998/99	59,579.00	37,251.00	22,328.00	4,336.60	17,991.40	11,852.20	6,139.20
2000/01	66,272.50	42,893.80	23,378.70	5,711.70	17,667.00	11,812.20	5,854.80
2001/02	79,835.10	48,893.60	30,941.50	6,753.40	24,188.10	12,044.00	12,144.10
2002/03	80,072.20	50,445.50	29,626.70	6,686.10	22,940.60	7,698.70	15,241.90
2003/04	84,006.10	56,229.80	27,776.30	11,339.10	16,437.20	4,546.40	11,890.80
2004/05	89,442.60	62,331.00	27,111.60	11,283.40	15,828.20	7,629.00	8,199.20
2005/06	102,560.40	70,122.70	32,437.70	14,391.20	18,046.50	9,266.10	8,780.40
2006/07	110,889.20	72,282.10	38,607.10	13,827.50	24,779.60	8,214.30	16,565.30
2007/08	133,604.60	87,712.10	45,892.50	15,800.80	30,091.70	10,053.50	20,038.20

Source: Economic Survey, Ministry of Finance, 2008

As shown in the table, the resource gap of Rs.23180.40 million in 1997/98 reached to a height of Rs.45, 892.50 million in FY 2007/08, the resource gap was decreased to Rs. 27,116.60 million in FY 2004/05. This shows that resource gap was fluctuated from FY 1997/98 to FY 200200/01/. After that resource gap was in increasing trend which is positive sign for the economy.

The ratios of total expenditure and revenue to GDP increased in FY 2006/07 compared to that in FY 2005/06. The ratio of revenue mobilization to GDP in FY 2006/07 increased by 1.0 percentage point and reached 12.1 percent compared to the ratio of 11.1 percent in FY 2005/06. The ratio of government expenditure to GDP increased to 18.4 percent in FY 2006/07 from 17.1 percent in FY 2005/06. Due to the increase in the ratios of revenue to GDP and total expenditure to GDP, the gap between revenue mobilization and total expenditure increased by 0.4 percentage points to 6.3 percent in FY 2006/07 from 5.9 percent in FY 2005/06.

However, all of these sources are economically undesirable in long term as they create the macroeconomic problems. Foreign loan can lead the economy into the debt trap, while printing of money is inflationary by nature. Domestic borrowing raises the domestic rate structure, which eventually may crowd out private sector investment. The excessive use of the foreign exchange reserve may create a balance of payment as well as exchange rate crisis. However, developing countries need to launch several development activities so increasing trends of the Government expenditure may be taken as general phenomenon. While undertaking fiscal adjustment reduces the fiscal deficit. Hence, the ultimate and the best measure to fill up the resource gap are to increase the public revenue through the effective tax system. Tax-effort ratio is extremely low in Nepal. Further more, Nepalese tax system is massively dominated by the custom duties.

Too many tax rates and tax slabs are the causes of bringing inefficiency and distortion in any tax system. Excessively high tax rates encourage tax evasion and act as a disincentive for further production. In addition, the country is demanding the drastic reduction in custom duties in the context of globalization. In this connection, the reform in Nepal's tax system was realized strictly.

In such circumstances, Nepal has already been adopted VAT since 1997 as a major step of reforming tax system for the purpose of strengthening internal resource mobilization, theoretically, VAT is considered as the best form of sales tax. However, success of a VAT in any developing country largely depends on the implementation aspect through the previous experience with multistage taxes or general sales taxes.

So it is a time to evaluate the Nepalese VAT by identifying its problem and prospects not only from evaluate the Nepalese VAT by identifying its problems and prospects not only

from theoretical aspect but also from the practical experience, which is the subject matter of the study.

4.13 Status and Trend of Tax Refund. (In crore Rs.)

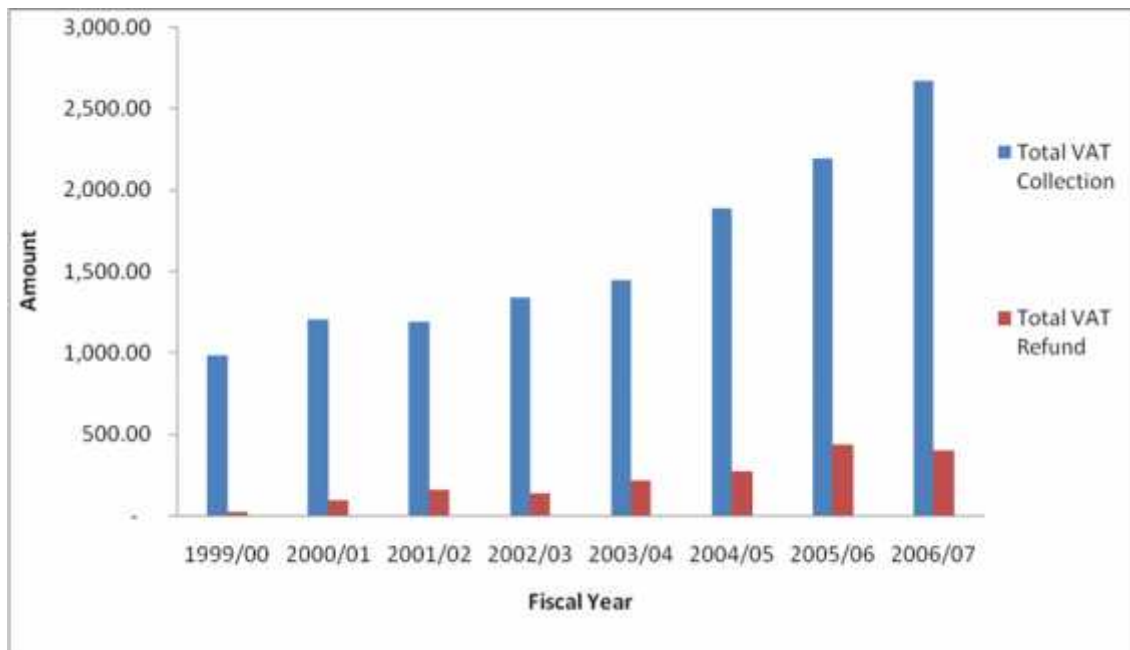
Table 4.12

F/Y	Foreign Diplomats		Export		Continuous Six Month		Total Refund		Increase%
	Amount	%	Amount	%	Amount	%	Amount	%	
1999/00	-	-	19.22	63.56	11.02	36.44	30.24	100	-
2000/01	2.98	3.04	82.91	84.59	12.12	12.37	98.01	100	224.1
2001/02	8.71	5.35	140.17	86.16	13.81	8.49	162.69	100	66.0
2002/03	13.64	9.62	122.40	86.34	5.72	4.03	141.76	100	(12.9)
2003/04	26.08	11.70	181.33	81.35	15.50	6.95	222.91	100	57.2
2004/05	14.57	4.82	263.85	87.28	23.90	7.91	302.32	100	35.6
2005/06	14.40	3.25	332.70	75.13	95.73	21.62	442.83	100	46.5
2006/07	20.25	5.03	290.00	72.03	92.34	22.94	402.59	100	(9.1)

Source: Annual Report 2007/08, Inland Revenue Department, Lazimpat.

In the FY 2000/01, the total refund claim amount was Rs.1269.6 million out of which Rs. 974.6 million was tax refund which was 76.76% of the total refund claim amount. In each Fiscal Year, refund claim amount was in increasing trend i.e. from FY 2000/01 to 2004/05. In FY 2004/05, the total claim amount was Rs.3212.5 million out of which Rs.2746.7 million was tax refund which was 85.50% of the total claim amount.

4.18 Graph showing tax refund (in million Rs.)



4.14 Problems in VAT Implementation

Nepalese tax system is circumscribed by serious structural constraints. The implementation of VAT is not devoid of challenges yet. To establish this tax at a completely successful level and make it a part of the daily life of the people requires much bigger and tremendous efforts. At present ineffective billing system, undervaluation of goods and service followed by ineffective implementation of threshold level, lack of proper transparency and simplicity, are the major obstacles facing by effective implementation of VAT. To overcome the major challenges faced in the implementation of VAT and make it more effective, the following measures should be adopted.

4.14.1 VAT Billing

It is the billing system on which the success or failure of VAT depends. But in Nepalese VAT, billing system is specially entangled in the knots of challenges. The condition to get invoice in the market is still not easy but invoices are the main basis not only for VAT but also for income tax and custom duty.

The implementation aspect of VAT seems weak owing to lack of proper practices of issuing and receiving invoices. Hence, the tax collection and other economic practice of issuing and receiving invoice. Hence, the tax collection and other economic benefits from this tax have not been achieved at the expected level. Despite the policy changes that were introduced to establish a proper billing system, the practice of issuing and receiving proper invoices could not be established and there is still a lack of this practice in the market. No matter how much we state that VAT is a tax based on invoice, there is only one fact that most often invoices are not available in the market and even if available the shopkeepers directly state that if you want to take an invoice on your purchase you have to pay 13% extra. The consumer of course looks at his/her benefit and there will hardly be any consumer who wishes to pay 13% extra and get a VAT invoice.

Similarly the problem of under invoicing at customs point has not been reduced. Billing has been seen as one of the toughest problems in implementation of VAT. Therefore, at this point, priority should be given to inculcating the habit of issuing and receiving invoices in this context, it appears advisable to adopt the following measures:

1. Ensure proper invoicing of imported goods, by developing and updating a database in the custom administration regarding prices in the international market of selected imported goods that are imported from the point of view of revenue collection.

2. Ask importer to give details information such as name, brand, number, price, etc. of their import at the time of opening of letter of credit.
3. Reduce the rate of import duties on custom sensitive item in order to make smuggling or under-invoicing less attractive. This would be particularly important in order to expand the formal sector by making informal sector less attractive or profitable.
4. Conduct monitoring and follow up the market to check whether or not invoice is being issued and whether they are being issued properly.
5. Expand audit and investigation activities.
6. Implement campaign to create public awareness regarding the importance of issuing and receiving invoice.

VAT should be the pride of nation- either of businessman, taxpayer, and tax authorities because VAT has enormous prospect of domestic resource mobilization effectively. Non-invoicing or under-invoicing is not only the problem associated with businesspersons but also with tax authorities. So strategies should be developed from all sides.

Once business persons understand the basics, they may find VAT reasonably straightforward. But there are some tricky areas where it is easy to make mistakes. These can give rise to stringent penalties, and ignorance is no defense. In this briefing, we try to concentrate on some of the common unexpected pitfalls that rest within VAT system.

4.14.2 Refund

Tax refund is very important aspect of VAT. So, it must be simple, easy and systematic. In connection to exports, tax refund is granted after verifying the export declaration forms, letter of credit or bills of entry and proof of payment to authenticate the export and the import declaration from or purpose invoices to authenticate the tax paid on inputs. The Inland Revenue Department has adopted an internal policy to provide refunds within 30 days of the receipt of the refund claim although the time limit fixed under the law is 60 days. However, on the other hand the taxpayers complain is that this system has not been put into proper practice and on other hand; the administrators complain is that there is delay owing to the fact that the taxpayers do not even comply with simple procedures and formalities.

Nevertheless, there are various problems regarding tax refund at the Inland Revenue Office, Inland Revenue Department and Taxpayers' levels. In order to avoid this problems, a new system should be introduced that does not require the taxpayer to submit a separate

application for refund but can apply in the tax return from itself, which would be able to resolve the problems of non-acceptance of refund claims. Whatever, it is necessary to make the tax refund system efficient and effective in practice.

4.14.3 Tax Credit System

Effective implementation of Tax credit facility helps to make VAT successful. If the tax administration is not capable or is less efficient or if the taxpayer misuses the provision for tax credit, it can result in large revenue leakage and create negative though among the taxpayer and people.

Similarly, if a taxpayer can not avail of the tax credit facilities because of minor error in issuing an invoice or in maintaining accounts, it works against the essence of VAT. VAT is a tax that is based on value addition and since this concept is translated in practice through the medium of TAX credit, the payer should entitle to entire tax paid in connection to his/her taxable transaction. If this is not allowed then it cease to be VAT and becomes just a turnover tax. If a taxpayer doesn't fulfill all required formalities, he/she should face the specified punishment but should be deprived of the right to deduct tax.

The existing number of credit returns and amount of accumulated credit is rather high. A part of the total credit may be real while some would be artificial as a result of misutilization by a taxpayer of the tax credit system. Here to identify and rectify such problem is the challenge of Nepalese VAT system.

To minimize and eventually remove these problems VAT administration should expand the tax-auditing programme. Since VAT is based on the principle of self-assessment, tax audit is absolutely necessary. The objective of tax audit is to evaluate whether the taxpayer have paid the due amount as per law. If a taxpayer is found to have paid less tax than the due amount he/she should be made to pay the difference amount. But if the taxpayer is found to have paid more what is due it should be seen that the excess amount is return.

Thus, tax audit has to be carried out on a systematic manner. To carryout tax credit, a time that is convenient to both the tax office and the taxpayer should be allocated and the taxpayer should be notified in advance to prepare the documentation that would be required. The taxpayer should also provide in time the necessary information and statistics requested by the tax official in relation to tax audit.

In relation to domestic trade, there is provision to carry forward the excess credit amount to be credited to the following month and only if a taxpayer remains in credit for six consecutive months will she/he be refunded. This provision was made right at the beginning so as to ensure that the taxpayer would not be able to misuse the tax credit system but it does not tally with the VAT principle of immediately refunding the tax amount that can not be adjusted. Therefore, once the environment to administer VAT effectively established, provision should be made to refund the excess credit immediately.

4.14.4 The Basis for VAT

Since those outside the VAT net do not have to be registered and neither have they to pay taxes. This results in inequality between registrants and non-registrants leading to unfair competition faced by the registrant which ultimately leads to low revenue potential. Similarly, the bulk source of GDP; agriculture is out of VAT net. In this context, it is important that VAT should be implemented equally in all sectors, reduce the threshold, and reduce the exemption of goods and services from VAT. But reduce the threshold, exemption list and bring the agricultural product into VAT net seems socially and even economically undesirable regarding equity, economy, administrative capacity etc. to increase the revenue mobilization it is necessary to broaden the tax base, which is possible by reducing threshold, exemption lists and include agriculture. Thus, in the context of Nepal, to bring all sectors and goods into VAT is most challenging.

Since the coverage of VAT has not been broaden at the expected level from both legal and administrative perspectives, it is important to keep on expanding this basis. To achieve this, on the one hand, it is necessary to bring all potential taxpayers into the VAT net and, on other hand; efforts should be made to bring the tax-exempt goods and service under the tax net.

VAT exemption is not beneficial to businesspersons too. According to the principle of VAT, in real terms those who come under the tax net are relieved from the tax burden and those who remain outside bear the burden of tax. On the other hand, tax exemptions result in problems such as narrow tax base, loss of revenue, distortion and degeneration so VAT system, practice of discretionary right in given exemptions and unnecessary complications in the tax-system.

To escape from this, VAT should be levied on as many goods and service as for as possible and at every level. This will help to develop a broad-based revenue source that is dependable and responsive. Under such circumstance, tax system will not have to change frequently, does

not create a situation of instability and confusion and decrease the lack of trust between the Government and the private sector. This will be helpful to mobilize domestic revenue.

4.14.5 The Bottleneck of Threshold

VAT is not applicable to all transactions. An annual threshold of Rs.2 million in transaction and business conducting within the specified area has been specified for this purpose. But still there is controversy regarding VAT registration threshold among policy makers also. Some consider that the existing threshold is too low and should be substantially increased while other consider that the registration threshold should be reduced to zero, and some other consider that the varying threshold should be established for varied goods. If a VAT threshold is not established, even small vendors will have to bring under VAT net. Those who recommend that there should be not threshold argued it provides scope for the sale of smuggled or undervalued goods through those carrying out transaction below threshold level and thus encourage smuggling. If this threshold is established, then all vendors will have to register for VAT. However, it will be next to impossible to control large number of taxpayers in a country where it is difficult to control less than a dozen large custom points. On the other hand, bringing very small vendors under the tax net cannot be justified from revenue, administration or equity points of view. In inequity between those who have to register and those don't base on the threshold level, there appears a tendency among businessmen to split their transactions. Thus, to remove this confusion regarding VAT threshold is a challenge of Nepalese VAT System.

If the threshold level is too high, a majority of the businessmen may not come under the VAT net and under such circumstances it will simply not be possible to implement VAT effectively. Therefore, it is common to keep the threshold as low as possible. The threshold level should be fixed based on the administrative capacity, the capacity to maintain accounts in the industry and commerce sector, the need for revenue etc.

In fact, threshold level does not trigger such problem. Because, it is not that there is absolutely no tax levied on the goods sold by those who are not registered under VAT.

The taxes into the point of purchase by such a person will have been paid and only the tax on his/her value added is not levied. On the other hand, those who are registered can collect VAT on their sales and hence have the advantage of cash flow up to the time that is deposited into treasury. In addition, other VAT registrants would buy from the registered person in order to take input tax credit. Besides, it has been made mandatory for all Government bodies

to purchase goods above Rs.25, 000.00 at one time only from those who have been registered in VAT. Thus, the potential buyers of those who are registered will be more. VAT registrants also can take an input tax credit.

Because of inflationary pressure, even if we keep the threshold level constant in absolute term, actually it is decreasing every year in real term. So whatsoever the debate regarding threshold, it should be constant at specific level.

4.14.6 Tax Rate

Two year after the implementation of VAT, talks to increase in the VAT rate had already begun. The average VAT rate in the Asian countries is 10.4 percent and it is 16 percent in the worldwide context. Although, the suggestion to increase the VAT rate does not appear irrational taking into consideration the tax rates adopted by other countries, when analyzing the current situation of VAT in our country the time does not seem ripe yet. This is because VAT implementation has not become fully effective as yet. Net potential taxpayers have been registered this is the big challenge to bring the all-potential taxpayers into VAT net. Even among those who have registered the practice to issue invoices with accurate price or not to issue invoice is still widespread.

Most imported goods are smuggled into the country or brought in through under- invoicing. Therefore, the current problem is not due to the low VAT rate but low compliance. In such situations increasing the VAT rate will worsen compliance, and as a result, revenue generation may decrease instead of increasing. In addition, this will only worsen the unhealthy atmosphere and competition that existed between those who are in the formal sector and are complying with VAT and others who have managed somehow to remain outside the tax purview. This could lead to drying up of the genuine economic activities of the nation's formal sector and expansion of illegal transaction, thereby creating a negative impact on the country's economic development. Besides, at present the country is going times and indications of economic sluggishness are emerging.

When considering all of these factors, it seems that the time to increase the VAT rate has not come yet. At this point in time, it appears more significant to adopt the policy of implementing the VAT law equally and effectively to increase revenue collection but also have a positive impact on customs and income revenue generation.

4.14.7 Timing for Tax Point

Timing is very crucial for VAT system. Every transaction must be shown in VAT return if the 'tax point' (the point at which VAT is accountable) falls within the VAT return period, whether or not payment has been received. The tax point is usually the date goods were supplied or services completed (the 'basic tax point'). There are some variations.

- If a VAT invoice is issued or payment is made before the basic tax point, the date of invoicing or payment becomes the tax point, whichever is the earlier.
- With continuous supplies, there is a tax point when a VAT invoice (eg when you are billed for electricity or telephone) is issued or payment is made — whichever is earlier.

4.14.8 Unreclaimable Tax

There is no specific provision in the VAT Act regarding treatment of VAT on bad debts. For bad debts one must write off debts in the books of accounts. As per accounting rule, bad debt should be written off in the books of account for income tax calculation. VAT paid on credit sales cannot be claimed in books of accounts if it is turned bad debt.

4.14.9 Paperwork Problem

4.14.9.1 Supplier must issue full VAT invoices when he/she supply to VAT-registered businesses. It is easy to get this wrong. A full VAT invoice should include a unique identifying number and name, address and VAT number and customer's name and address. It should also include the invoice date, the tax point, the date of issue (if this is different from the tax point), the type of supply (such as sale or rent), a description of the nature and amount of the goods or services, cash discount rate, the VAT rate, the total excluding VAT, the VAT amount and the total payable. VAT invoice numbers must be sequential, with no unexplained gaps. Duplicate invoices must be clearly marked. If one issue other documents (such as pro-forma invoices), which show the same details as a VAT invoice, they must be clearly marked 'Not a VAT invoice'.

4.14.9.2 If one makes retail sales and a customer asks for a VAT invoice, he/she may be able to use a simpler alternative. For retail sales under Rs 5,000 (including VAT), can be issued a 'less detailed' VAT invoice. This shows suppliers' name, address and VAT number, the date of supply, a description of the goods or services, the amount (including VAT) and the VAT rate charged.

4.14.9.3 One must keep VAT invoices for purchases, to reclaim the tax that has paid to suppliers. If one lose a VAT invoice, which must get a duplicate invoice from the supplier. If an invoice shows product codes rather than descriptions, one must also keep a copy of the supplier's product list.

4.14.9.4 If one settles an invoice on behalf of a third party, he/she will not be able to reclaim VAT. VAT can only be reclaimed by the recipient of the supply. Consider settling the net value only. It may be worthwhile for third parties on whose behalf one settle bills to pay the VAT and then reclaim it in their own right.

4.14.9.5 If one sells his/her business, the buyer can apply to retain the VAT registration number. One must retain the VAT records upon the sale of the business, unless the buyer is retaining the VAT number. In this case, one must provide information to the buyer so they can comply with their VAT duties.

4.14.9.6 A VAT registered person has to keep safe the records relating to VAT for up to 6 years from the closure of the fiscal year. Following are the records, documents, information and details are to be kept as per the VAT Act and VAT rule:

- a) Records relating to trade, accounts, cash receipts and payments.
- b) Tax invoices and abbreviated tax invoices issued by him.
- c) Tax invoices and abbreviated tax invoices received by him.
- d) All documents relating to his imports and exports,
- e) All debit and credit notes substantiating for the fluctuations in the values of goods purchased or sold by him and other documents pertaining there to.
- f) Books of purchases and sales.
- g) Other documents as prescribed by the department.

To record all these documents up to 6 years leads a registered person very problematic and costly.

4.14.10 Discounts and Part Exchange

4.14.10.1 Discounts can be problematic. The VAT one pays depends on how the discount is offered. If one give an unconditional discount (such as a sale or trade discount), VAT is based on the discounted value of the full sale. The same applies if one offers a discount for prompt payment — even if the customer does not pay promptly.

4.14.10.1.2 VAT is calculated on the full value of any part-exchange or barter transactions. Seller must calculate the VAT as if the transaction had been entirely for cash (i.e. purchases and sales at the full price). VAT invoices must be issued accordingly.

4.14.11 Irreclaimable VAT

4.14.11.1 A supplier cannot reclaim VAT on supplies for personal (non-business) use. If a VAT registrant buys goods or services for both business and non-business use, he/she may apportion the VAT between them. He/she can only recover VAT on the business element, subject to the normal rules.

4.14.11.2 A supplier can only reclaim VAT on some of the supplies that made to employees. One can reclaim VAT on the actual costs of employees' subsistence when travelling on business. One cannot generally reclaim VAT on free domestic accommodation that is provided.

4.14.11.3 There are particularly strict rules about supplies to sole traders, partners or directors. The rules are less generous than those which apply to ordinary employees. One cannot reclaim VAT on free meals at work. But one can for subsistence expenses while on business trips (but not for entertaining).

4.14.11.4 The treatment of entertainment varies, according to who is being entertained. One cannot reclaim VAT on business entertainment. One may be able to reclaim VAT related to staff entertainment. The entertainment must have a discernible business purpose, such as teambuilding. Where the entertainment is for both employees and outsiders, it may be possible to reclaim some VAT.

4.14.11.5 One cannot usually reclaim VAT on supplies purchased in order to make exempt sales.

4.14.12 Help and advice

If a business person wants to help for VAT related problems, he can contact of VAT office during the office hours but the VAT authorities will not be responsible for giving advice unless all the facts are disclosed. In the case of queries which cannot be answered with reference to a notice or leaflet, both the request for advice and the reply are given in writing.

4.14.13 Determination of Market Value

The market value of goods or services shall be determined as the consideration in money which the supply of these goods or services would generally be agreed on if the transaction were made under arm's length transaction at that date in Nepal taking into consideration the characteristics, quality, quantity, materials, and any other relevant factor, being a supply freely offered and made between persons who are unrelated. The market value is determined by studying the transactions and value of other vendors registered in regard to the transaction of the same nature.

Where the market value of goods or services could not be determined, it shall be determined in accordance with a process determined by Director General. So the process of determining the market value of goods which are not available in the market is very lengthy and complicated process.

4.14.14 VAT Account.

A taxpayer is required to issue invoices and maintain sales and purchase books and VAT accounts, accurately. There is also provision to maintain computerized accounts prior approval from the Inland Revenue office.

Once VAT becomes more effective, it would be desirable not to make mandatory maintain specific accounts for this purposes and information for VAT can be obtained for income tax or any other purposes.

4.14.15 The Period to File Tax Return

To reduce the cost of tax collection and compliance costs, increasing the existing tax period of one month to two months should be considered.

4.14.16 The Behavior of the Tax Collectors and the Tax Payers

For a success of any tax system, strong administrative capacity has significant role. Therefore, in a country such as ours it has been said that the "tax administration is tax policy". Owing to the fact the income tax administration and the VAT administration have been integrated. The tax administration has become even more challenging. Therefore, in order to increase revenue mobilization and to establish an efficient and fair tax system priority should be given to making the tax administration strong and effective.

To improve tax administration, coordination among tax administration is necessary. Through various training programs, seminars and regular monitoring efforts are necessary to solve the

existing problems and make the integrated administration operation smoothly and effectively. Positive attitude of the tax employees towards implementation of VAT and friendly behavior to the taxpayers are prerequisite for the success of VAT.

In the process of VAT implementation, it is equally necessary for the taxpayers to change their conduct as well. The administration has found instances where several taxpayers with the objective of evading tax has been maintaining two sets of accounts, issuing two types of invoices, collecting VAT from the buyers but not depositing them to the treasury and collecting VAT without being registered. These are the negative factors so many activities should be discouraged immediately.

4.14.17 Improving IT System

Even if the VAT system is based on the computerized system, the data arrangement is not so good. It is necessary to develop and expend the networking of data base and information system at all levels. Implementation of VAT will be successful only if there is perfect computerized system. Therefore, it is necessary to promote IT in tax system so that the exiting problems such as under-invoicing, non-issuance of bill, education of taxpayers, and enforcement of law would be automatically solved. Infrastructure development also required especially for the maintenance of IT. In addition, information campaign should be intensified through opening website, organizing seminars/ symposia and training programmes and advertisement on media.

4.14.18 Sufficient Skilled Human Resource

Human resource is the prime factor of suitable development of any faculty. But human resource that is needed in the tax system does not seem adequate in Nepalese context. This is the main problem for tax authorities. The Inland Revenue Department should give thrust for manpower development with reference to IT, subjective knowledge of tax, laws, auditing and accounts, training, seminars/workshop and observation/ study tours for the staffs. The department urgently requires support for manpower development especially through providing training and workshops both for senior and junior staff within and outside the country. A panel of tax expert can be prepared and they should get chances to improve their knowledge regarding tax system, audit, tax laws, and investigation technique. They should be trained in other countries where there is efficient tax system by arranging various interaction programmes, on the job training, organizing seminars, workshops etc. Continuous manpower development effort within the department is also necessary to support the enforcement

activities. Human resource development is also significant for sustainable quality services that could be possible through improving curricula by the Public Service Commission. A separate entrance examination is highly essential for those aspiring for revenue service before the final examination.

4.14.19 System Development through Improving Tax Administration

The tax administration can be improved through an appropriate organization structure compatible with the changing circumstances. The Department of Inland Revenue should give thrust to strengthen the physical facility of vehicles, photocopies, developing forms and manuals, simplifying procedures, and educating the taxpayers. The system can be improved through developing manuals and work procedures, and maintaining archives and micro films. Tax authorities should develop the long term tax policy.

4.14.20 Improving Tax Laws and Regulations

Lack of clarities in the tax law and regulations is the great issues within business and industrialists. They are arguing that the language used in tax laws and regulations are very complex and ambiguous. They lack clarity and often full of discrepancies and many interpretations can be made out of same law. There have been occasions when amendment have been made to different laws as soon as they are enacted, and on many instances different authority of Nepal Government interpret the law differently, keeping the taxpayer aside. There is lack on consistency in the interpretation of law among Government authorities. All this leads to loss of business confidences and shifts of investment from good infrastructure projects and value added to business requiring small investment. This further leads low productivity, low small production, low base for tax and low tax revenue.

Government is not devoting its efforts towards the promotion of industrial sector properly in the country. Because of revenue oriented nature of Government, business that do well are targeted for more revenue so the investment has been shifting on low productive areas where there is no tax, which ultimately contracting the base of tax.

To remove such ambiguity Government should take some steps immediately. The principle of no taxation without representation should be strictly observed. The change in the tax rates or base of valuation of commodities should be strictly based on the provisions of law and not on circular, ordinance or executive order. The VAT Act should adjust to the legal provisions made through the annual finance bills.

Simplify the language for clarity thereby reducing ambiguity in the tax law. The computation of taxable products and transactions should be done in accordance with the provisions of the VAT Act.

4.14.21 Improving the Institutional & Infrastructure Development

There is huge scope for Institutional and infrastructure reforms. The level of skills and knowledge of the staff at the revenue office should be enacted by continuous training programmes. Good governance practices should be followed from top to bottom in every Government office. Various training programme should be provided to every revenue staff to increase their efficiency. Experts from the outside can be hired to monitor and evaluate the existing system.

a) Improving the capacity of the Department of Revenue Investigation. The department of revenue investigation has been assigned a crucial role to fight unauthorized trade and control revenue leakages. This Department does not functioning in a well manner. There is speculation that this organization might go under the control of PM office or merge with the commission for the investigation of Abuse Authority. Thus there is urgent need to clarify the status of Department of Revenue Investigation.

b) Improving the status of Revenue training Center. The revenue Training Center is not working as the aspiration of its establishment. The main aim of this center was to organize various training programme related to tax issues. In recent years, the status of this center has been relegated to a dumping side for the personal at MOF (Dahal et al. 2002; 51). This kind of organization has greater significance for developing excellence of those in revenue services. Thus there is need to activate the institution in its fullest capacity.

Thus, to make the VAT as a nations pride needs as urgent effort toward improving VAT system and administration in Nepal through (a) changing the environment (b) changing the administration and (c) changing the tax law and regulations. (Dahal M.K., Economics Journal of Department Issues. Vol. 3; 49)

The Government can change the environment by providing education; information and knowledge to the tax payers that may help increase voluntary compliance. Computerization of tax administration, motivation for public servants and possibly "tax farming" may be instrumental in changing the tax administration. The best way to cope with administration problems, however, is to make a change in the tax law. The tax law and regulations should be

simple and concise. Too many tax shelters with series of tax exemptions and deduction must be eliminated that have not only distorted the tax structure but also led to massive corruption.

It is necessary to say that the Nepalese domestic revenue mobilization is very low in comparisons to the other not only developed but also developing countries. It is not enough by only saying this. It is the time to take actions immediately to improve the performance of domestic resource mobilization.

4.14.22 Geographical Condition

Geographical condition of our country has created an important issue about the application of VAT. Mainly three sets of problem have been arisen due to the geographical condition.

- i). In many districts of Nepal, there is no provision of transportation services to this area. The services are rendered by porters, animals and air transport. But the cost of manual or air transport is very high value added becomes very high due to maximum freight cost, which indicate that burden of VAT is higher in the remote areas than in other accessible areas, this is clearly inequitable and unjust able.
- ii). There are small scale business activities in the remote areas. The revenue collection in such areas would be negligible amount as compared to collection cost. Therefore, the collection cost does not permit VAT to be applicable in some of the district in Nepal.
- iii). Controlling VAT in far and remote areas is not easy due lack of transport, communication etc. It is difficult to control; the many functions of VAT like inspection, audit, tax refund, penalty, hearing appeal in the remote areas due to the lack of adequate tax office.

We do not have to ignore the remote areas. We have to search the appropriate option to treat the remote areas footing in case of VAT in Nepal. To identify the option of treating of the remote areas in equal footing in circle of VAT, some steps should be taken.

The district which is not connected by motor transport should be excluded from the VAT or subsidy is needed to provide transportation cost VAT or subsidy is needed to provide transportation cost.

4.14.23 Open Boarder

Open border is the major problem not only revenue collections point of view but also of many other reason in Nepal, in Southern part, Nepal share open border of almost 1000Km.

Similarly, in Northern part, it links 'Lhasa', great business center of China. Open border has an impact on the success of any tax in Nepal, because it creates unauthorized trade, corruption and bribery. There is the free movement of people between India and Nepal without passport and no need to pay 'Custom duty' for the goods brought for personal use. This gives two kinds of incentives: One is Nepalese consumers living near the Indian border go directly to Indian border to purchase cheaper goods and the second from India are brought for trading purposes through smuggling, which creates unauthorized trade, meanwhile, the same condition has been prevailing on Northern side too. There is no any measurement of unauthorized trade among Nepal, China and India. Many businessmen claim that only little amount of goods from India come through customs. To prevent such anomalies, the Government deployed Royal Nepal Army in the border side but News paper have been quoting that it has not been so effective.

Some options which help to minimize the thread of open border.

- i). Honest officials should be posted to the custom points, Border patrolling to control the illegal activities in the border areas should be increased and made effective.
- ii). Traffic should be reduced to discourage illegal import.
- iii). The tendency of Nepalese consumer going to Indian market should be discouraged.
- iv). Physical checking of warehouse and business inventories should be increased to detect smuggled goods. Physical checking of lorries carrying goods on the road would be highly effective for the preventing smuggling goods on the road would be about any tax fraud should be encourage.
- v). Strong management information system should be developed within the department for control purpose and to analyze past data and trends.

4.15 Field survey

In an opinion survey, 57 people out of 80 are found that the VAT is successful in revenue mobilization in Nepal. Does this opinion survey information support the conclusion that the VAT is successful in revenue mobilization in Nepal?

Solution:

Here,

Number of people taken as sample (n) = 80

No. of people who said that VAT is not successful in revenue mobilization in Nepal (x)
=23

Proportion of people who said VAT is not successful in revenue mobilization in Nepal implemented (P)

$$= \frac{x}{n} = \frac{23}{80} = 0.29$$

Null Hypothesis (H₀): P= 0.5

Alternative Hypothesis (A_H): P>0.5 (The majority of the people believe that VAT is successful in revenue mobilization.)

Under Null Hypothesis

$$\text{We have: } Z = \frac{p - P}{\sqrt{\frac{PQ}{n}}}$$

Where Z = large sample test, p = proportion of people who said VAT is not sufficient in revenue mobilization in Nepal. n = number of people. It is assumed that the VAT is successful in revenue mobilization (P) = 50% = 0.5

& VAT is not successful in revenue mobilization (Q) = (100 - P) % = (100-50) % = 50% = 0.5

$$Z = \frac{0.29 - 0.5}{\sqrt{\frac{0.5 \times 0.5}{100}}}$$

$$Z = \frac{-0.21}{\sqrt{0.0025}}$$

$$Z = \frac{-0.21}{0.05}$$

$$= -4.2$$

$$\therefore Z_{cal} = -4.2$$

$$Z_{tab 5\%} = 1.65$$

Decision:

Here $Z_{Cal} (-4.2) < A_{tab} (1.65)$ So Null Hypothesis (H_0) is rejected i.e. alternative Hypothesis is accepted. This concludes that the majority of the people said that the VAT is sufficient in revenue mobilization in Nepal.

4.16 Presentation and Analysis of Primary Data:

The main objective of this study is to examine the problems in VAT implementation in Nepal. For the purpose of this study, a survey questionnaire containing 19 different questions was prepared and distributed to different categories of persons. For the purpose of our study the population sample were divided into following four categories of respondents:

Category A: General Consumers

Category B: Tax Authority Employee and Intellectuals

Category C: VAT Registered Business

Category D: Retail Shops

Twenty five set of questionnaires were distributed to each category to obtain the opinion of the people. But, in actual only 20 response form each category could be collected. The responses received form various respondents for each question have been arranged, tabulated and analyzed systematically to come to a conclusion.

4.16.1 Causes of non-registration in VAT:

Table 4.13
Summary of response

Response		Category				Total	Percent
		A	B	C	D		
a	Business threshold limit	-	-	18	-	18	24
b	Types of good deal	-	-	1	-	1	1
c	Location area	-	-	-	-	-	-
d	Ceiling limit of telephone bill and rent	-	-	-	-	-	-
e	Voluntarily		-	1	-	1	1
f	Not applicable	20	20	-	20	60	73
g	Total	20	20	20	20	80	100

Source: Field Survey, 2009

This question is mainly related only to the VAT registered business i.e. related to category C. The summary of the responses is tabulated in the above table 4.13. Among the VAT

registered person, 18 are registered due to business threshold limit, 1 is due to type of the good he/she deal and 1 has registered voluntarily.

4.16.2 Type of your business:

Table 4.14
Summary of response

Response		Category				Total	Percent
		A	B	C	D		
a	Manufacturing	-	-	-	-	-	-
b	Export/Import	-	-	3	-	3	4
c	Service provider	-	-	5	1	6	8
d	Retail shop	-	-	1	19	20	25
e	VAT Registered	-	-	7	-	7	9
f	Farmer	-	-	-	-	-	-
g	Other (if any).....	20	20	4	-	44	55
Total		20	20	20	20	80	100

Source: Field Survey, 2009

The question is mainly prepared for the VAT registered persons and retail shops. The response received from the respondents have been summarized and tabulated in the above table 4.14. Among the 80 respondents, each category has equal number of respondents' i.e.20 persons. Among the VAT registered business, 3 are related to export/import business, 5 are related with service provider, and 1 is related to retail shop and 4 is related to VAT registered. The secondary category business - category D related to retail business.

4.16.3 Causes for selecting non-VAT registrants rather than registrants:

Table 4.15
Summary of response

Response		Category				Total	Percent
		A	B	C	D		
a	You get tax credit	1	-	16	10	27	34
b	You want to contribute to Government revenue	11	15	4	5	35	44
c	No it only increases cost of goods	7	-	-	5	12	15
d	Others.....	1	5	-	-	6	8
Total		20	20	20	20	80	100

Source: Field Survey, 2009

This question was mainly designed to know whether the buyer wants to purchase goods from the VAT registrant seller or non-registrant seller. The above table 4.15 summarizes the opinion of respondents regarding their choices of seller. From the above table, 44 percent responded that they want to contribute to government revenue and 34 percent of them responded that

they get tax refund. While 15 percent of them feel that VAT only increases the cost of goods. This shows that general consumers are much very much aware about VAT and feel that they want to contribute to Government revenue.

4.16.4 Practice of billing system at the time of purchase:

Table 4.16
Summary of response

Response		Category				Total	Percent
		A	B	C	D		
a	Yes	15	19	19	19	72	90
b	No	2	1	-	1	4	5
c	Shopkeeper does not want to provide	2	-	-	-	2	3
d	No idea	1	-	1	-	2	3
Total		20	20	20	20	80	100

Source: Field Survey, 2009

This question aims to know the opinion regarding the preference of in taking bills by respondents while purchasing goods. The above table 4.16 summarizes the views of respondents. The table shows that 90 percent of purchasers take bill on their purchase, 5 percent of them do not take the bill and 3 percent of them said that seller do not want to provide bill while they purchase the goods. Beside this 3 percent of the respondents were unaware about the billing system. The table shows that people are much aware about billing system and they take bills for the goods purchased.

4.16.5 First experience with Government VAT authorities:

Table 4.17
Summary of response

Response		Category				Total	Percent
		A	B	C	D		
a	Helpful	5	10	13	8	37	46
b	Satisfactory	9	-	4	9	22	28
c	Bad	1	-	3	2	5	6
d	Not experienced	5	10	-	1	16	20
Total		20	20	20	20	80	100

Source: Field Survey, 2009

This question has been designed with a view to know about the opinion of different persons regarding their experience with Government VAT authorities. It has been a burning issue that most of the person blames Government VAT authorities that they are not helpful. The

opinion is summarized in above table 4.17. From the above table 46 percent of the respondents who had experienced with Government VAT authorities finds that they are helpful, 28 percent of them feel that their experience was satisfactory and 6 percent of them find that their experience was bad. Beside this 20 percent of the total respondents had never experienced with the Government VAT authorities. It is clear from the above table that most of the respondents who experienced with Government VAT authorities find they are helpful and satisfactory with their behavior.

4.16.6 Causes for VAT registrants discouraged at most:

Table 4.18
Summary of response

Response		Category				Total	Percent
		A	B	C	D		
a	Frequent change in VAT law	8	18	12	5	43	54
b	Non cooperation from VAT authority	4	-	-	3	7	9
c	Complexity inherited within VAT law	4	1	4	4	13	16
d	Lack of education and training	4	1	4	8	17	21
Total		20	20	20	20	80	100

Source: Field Survey, 2009

The response received regarding this question has been summarized in above table 4.18. From the above table it is observed that 54 percent of the respondents are most discouraged by frequent changes in VAT Law, 21 percent of the person responded that they discouraged most by lack of education and training and 16 percent of person responded that they are discouraged most by complexity inherited within VAT Law. At last, 9 percent of the respondent said that they discouraged most by non cooperation from VAT authority. But this question was mainly designed for VAT registered business persons only. From the above table the extract of VAT registered business person has been summarized in the following table:

Response		Category	Percent
		C	
a	Frequent change in VAT law	12	60
b	Non cooperation from VAT authority	-	-
c	Complexity inherited within VAT law	4	20
d	Lack of education and training	4	20
Total		20	100

From the above table it is observed that 60 percent of the VAT registrant business persons are discouraged most by frequent changes in VAT Law. Beside this an equal number, 20 percent of registrant business persons are discouraged by complexity inherited within VAT law and lack of education and training.

4.16.7 Most difficult provision of VAT:

Table 4.19
Summary of response

Response	Category				Total	Percent
	A	B	C	D		
a Billing system	15	20	15	14	64	80
b Return filing system	3	-	2	4	9	11
c Getting tax credit	2	-	2	1	5	6
d Penalty system	-	-	1	1	2	3
Total	20	20	20	20	80	100

Source: Field Survey, 2009

This question has designed to know about the views of different person regarding the most difficult provision in VAT law. The summary of the response has been tabulated in above table no 4.19. Form the above response; it is observed that 80 percent of the respondents believe that billing system is the most difficult provision of the VAT. 11 percent of the respondents believe that return filing system is most difficult provision of VAT. Beside this 6 percent of them believe that getting tax credit is most difficult provision and rest 3 percent believe that penalty system is most difficult provision of VAT.

4.16.8 Demerits of present VAT system:

Table 4.20
Summary of response

Response	Category				Total	Percent
	A	B	C	D		
a Increase inflation	16	18	16	8	58	72
b Relatively complex	2	2	-	7	11	14
c Increase management cost	2	-	4	5	11	14
Total	20	20	20	20	80	100

Source: Field Survey, 2009

This question has designed to know the opinion of the respondents that what the demerits of present VAT system are. The response received form different person has been tabulated in

the above table 4.20. VAT is considered as an inflationary in nature in other words it increases the general price level raising the prices of goods and services. VAT has been implemented in place of sales tax so theoretically the effects of both the taxes are same. So it cannot be considered that VAT is more inflationary. But from the survey it is found that majority of respondent, 72 percent of them believe that VAT increases the inflation. After this an equal percent i.e. 14 percent of respondent believe that VAT is relatively complex and it increases management cost.

4.16.9 Causes that makes present VAT system inefficient among businessmen:

Table 4.21
Summary of response

Response	Category				Total	Percent
	A	B	C	D		
a Timing and paperwork problems.	18	20	18	20	76	95
b No reclaimable VAT.	-	-	-	-	-	-
c Exceptions for unusual supplies.	-	-	1	-	1	1
d Division of goods into VAT and non- VAT	2	-	1	-	3	4
e Where to get help and advice	-	-	-	-	-	-
Total	20	20	20	20	80	100

Source: Field Survey, 2009

This question is related with present VAT system and designed to know from respondents - what makes the present VAT system inefficient among businessmen. The response received from the respondents have been tabulated in the above table 4.21. From the above table it is observed that 95 percent respondent believe that timing and paperwork problems have made the present system inefficient among businessmen. Beside that 4 percent of the respondents believe that division of goods into VAT and non-VAT items and rest 1 percent believe that exceptions for unusual supplies have made the present VAT system inefficient among businessmen.

4.16.10 The most difficult compliance provision of current VAT law:

Table 4.22
Summary of response

Response		Category				Total	Percent
		A	B	C	D		
a	Record keeping	17	18	17	18	70	87
b	Billing system	1	2	1	2	6	8
c	Penal provision	1	-	-	-	1	1
d	Return filing	1	-	2	-	3	4
e	If other any specify.....	-	-	-	-	-	-
Total		20	20	20	20	80	100

Source: Field Survey, 2009

The responses from the various respondents regarding the most difficult compliance provision have been tabulated in the above table 4.22. From the above table; it is observed that 88 percent of the respondents believe that record keeping is the most difficult compliance provision of current law. After that 8 percent of them believe that billing system is most difficult provision and 4 percent believe return filing system is most difficult provision and rest 1 percent believe that penal provision is the most difficult part of compliance provision of current VAT system.

4.16. 11 Common problems associated with VAT system:

Table 4.23
Summary of response

Response		Category				Total	Percent
		A	B	C	D		
a	Complex law	12	20	15	13	60	56
b	Poor consumer awareness	10	1	5	5	21	19
c	Open Indo-Nepal Border	1	-	-	-	1	1
d	Difficult VAT registration procedure	2	-	1	1	4	4
e	Completing the VAT return	2	1	-	1	4	4
f	Keeping VAT records	2	1	1	3	7	6
g	VAT inspections	1	-	1	1	3	3
h	Lack of active VAT information for the consumer	4	1	-	1	6	6
i	Tax credit and tax Refund procedure	1	1	-	-	2	2
Total		35	25	23	25	108	100

Source: Field Survey, 2009

This question is related with the common problems associated with VAT system. The response received from the respondents have been tabulated in the above table 4.23. From the above table it is observed that highest, 56 percent of respondent believe that complex law is one of the common problem. After this, second highest, 19 percent believe that poor consumer awareness is common problem associated with VAT.

4.16. 12 Recommendation for Government for effective implementation of VAT in Nepal:

Table 4.24
Summary of response

Response		Category				Total	Percent
		A	B	C	D		
a	Tax policy should be made more liberal	9	15	12	13	49	64
b	Compliance procedures should be made easy	5	-	3	3	11	14
c	Facilities should be given to businessmen to encourage registering in VAT	1	-	1	2	4	5
d	Certain percent credit should be given to consumer who take VAT bill on their purchase	6	-	2	3	11	14
e	Tax authority should visit business house time to time and make suggestions	-	-	2	-	2	3
Total		21	15	20	21	77	100

Source: Field Survey, 2009

The question has designed with a view to get suggestion from respondent for effective implementation of VAT in Nepal. The response from the different persons has been summarized in the above table 4.24. From the response it is observed that 64 percent of respondent believes that tax policy should be more liberal, while an equal 14 percent of them believe that compliance procedures should be made easy and certain percent credit should be given to consumer who take VAT bill on their purchase. Beside this 5 percent of them believe that facilities should be given to businessmen to encourage registering in VAT and rest 3 percent believe that tax authority should visit business house time to time and make suggestions. From the above response it can be concluded that the tax policy is much complicated and should be made more liberal.

4.16.13 Views regarding sufficiency of 13% VAT rate to mobilize revenue:

Table 4.25
Summary of response

Response		Category				Total	Percent
		A	B	C	D		
a	Yes	15	19	10	10	54	68
b	It should be increased	-	-	-	2	2	2
c	It should be lowered down	5	1	10	8	24	30
Total		20	20	20	20	80	100

Source: Field Survey, 2009

VAT revenue mobilization mainly depends on the rate of VAT. The rate of VAT at the time of inception of VAT implementation was 10 percent and remained the same for upto fiscal year 2062/063. After f/y 2062/063 it has increased to 13%. The increased rate is expected to mobilize revenue effectively in the country. The question has designed to know the opinion of different respondents whether the rate is sufficient or not to mobilize the revenue. The different opinions have been tabulated in the above table 4.25. Form the table; it is observed that 68 percent of the respondents believe that the present VAT rate is sufficient mobilize revenue while 30 percent of them believe that it should be lowered down to be sufficient for revenue mobilization. Beside this 2 percent of them believe that the rate should be increased for effective revenue mobilization.

4.16.14 Views regarding successfulness of VAT for revenue mobilization in the country:

Table 4.26
Summary of response

Response		Category				Total	Percent
		A	B	C	D		
a	Yes	12	20	10	15	57	71
b	No	8	-	10	5	23	29
c	No idea	-	-	-	-	-	-
Total		20	20	20	20	80	100

Source: Field Survey, 2009

This question has been designed to know the opinion of the respondents that whether VAT is successful in revenue mobilization in the country. The responses received have been presented in the above table 4.26. From the above table it can be observed that 71 percent of the respondents felt that VAT is successful in revenue mobilization. Only 29 percent of the

respondents felt that VAT is not successful in revenue mobilization in the country. Form the above result it can be concluded that VAT is successful in revenue mobilization in the country.

4.16.15 Views on objectives that are attained through the implementation of VAT in the country:

Table 4.27
Summary of response

Response		Category				Total	Percent
		A	B	C	D		
A	It has made tax system more transparent, effective and efficient.	13	20	12	18	63	79
b	It has made increase the tax base	1	-	2	2	5	6
c	It has removed the cascading effect	-	-	-	-	-	-
d	It has increased revenue-mobilization capacity of the country	5	-	2	-	7	9
e	It has made chance of tax evasion less	1	-	-	-	1	1
f	It has made tax administration easy	-	-	-	-	-	-
g	No idea	-	-	4	-	4	5
Total		20	20	20	20	80	100

Source: Field Survey, 2009

The opinions regarding the objectives attained through the implementation of the VAT in the country have been presented in the above table 4.27. As per the survey result, 79 percent of the respondent believed that it has made tax system more transparent, effective and efficient, 9 percent of the respondent believe that it has increased revenue mobilization capacity of the country, 6 percent of them believe that it has increased the tax base and 1 percent of the respondent believe that it has made chance of tax evasion less. Beside this 5 percent of the respondents do not have any idea regarding the objectives attained through the implementation of VAT in the country. Form the above table majority of the respondent believe that it has made tax system more transparent, effective and efficient and we can conclude on the same.

4.16.16 Views regarding sufficiency of coverage of VAT:

Table 4.28
Summary of response

Response		Category				Total	Percent
		A	B	C	D		
a	No tax base should be increased.	6	20	9	6	41	51
b	Yes	14	-	9	13	36	45
c	No idea	-	-	2	1	3	4
Total		20	20	20	20	80	100

Source: Field Survey, 2009

This question is about the coverage of present VAT system which is one of the main issues among the policy maker and Government that whether it should be increased or not. The views obtained from the respondents have been tabulated in the above table 4.28. From the above table it is observed that 51 percent of the coverage of VAT should be increased, 45 percent of them responded that the coverage is sufficient. Beside that 4 percent of the respondents do not have idea about the coverage of VAT.

4.16.17 Views on whether the VAT is more efficient tax system:

Table 4.29
Summary of response

Response		Category				Total	Percent
		A	B	C	D		
a	Yes	19	20	17	18	74	93
b	No	1	-	3	2	6	8
c	No idea	-	-	-	-	-	-
Total		20	20	20	20	80	100

Source: Field Survey, 2009

The responses received regarding the whether VAT is more efficient tax system or not have been tabulated in the above table 4.29. From the table it is observed that 93 percent of the respondent replied – yes and rest 9 percent of them replied in negative i.e. no. From this we can conclude that most of the respondent believe that VAT is more efficient tax system.

4.16.18 Views on whether the VAT is effectively implemented in Nepal:

Table 4.30
Summary of response

Response		Category				Total	Percent
		A	B	C	D		
a	Yes	16	20	10	15	61	76
b	No	4	-	10	5	19	24
c	No idea	-	-	-	-	-	-
Total		20	20	20	20	80	100

Source: Field Survey, 2009

The main objective of this question is to know the opinion of respondents regarding whether the VAT is effectively implemented in Nepal or no. The response received from the respondents have been tabulated in the above table 4.30. From the above table it is observed that 76 percent of the respondent replied positive i.e. they believed that VAT is effectively implemented in Nepal. Rest 24 percent of them believed that VAT is not effectively implemented in Nepal.

4.16.19 Views on most liable authority for effective implementation of VAT:

Summary of response

Table 4.31

Response		Category				Total	Percent
		A	B	C	D		
a	Nepal Government	14	19	15	16	64	80
b	Civil servants of Tax authority	1	-	-	2	3	4
c	Businesspersons	-	-	2	1	3	4
d	Consumers	5	1	-	1	7	9
e	All of the above equally	-	-	3	-	3	4
f	No idea	-	-	-	-	-	-
Total		20	20	20	20	80	100

Source: Field Survey, 2009

The above table 4.31 summarizes the responses of respondents regarding the question, who is more liable for effective implementation of VAT. From the above table it is observed that 80 percent of the respondents believe that Nepal Government is more liable and 9 percent of them believe that consumers are more liable for effective implementation of VAT. An equal

4 percent of them believe that Nepal Government, Civil Servants of Tax authority, Business Persons and Consumers are equally liable for the effective implementation of VAT.

4.17 Major Findings of the Study

This research has been conducted primarily to review the resource gap, examine the revenue collection status and analyze the problems in implementation VAT in Nepal. On the basis of study of secondary data and primary data and their analysis, major findings have been divided into two categories:

- A. Findings form Secondary Data,
- B. Findings from Primary Data.

4.17.1 Major findings form Secondary Data,

-) Even though Tax/GDP Ratio is in increasing trend but it not satisfactory because contribution of tax revenue to gross domestic product is comparatively low. The growth rate in tax/GDP ratio is not continuous i.e. it fluctuates in each Fiscal Year, which is average 9.2 Percent.
-) There is greater share of tax revenue in total revenue than non tax revenue which is on average 80 percent contribution in total revenue. Similarly, VAT revenue has on average 31 percent contribution in tax revenue.
-) The contribution of VAT revenue to direct tax revenue was in increasing trend in each F/Y which is on average 41 percent of Indirect tax during the study period.
-) The number of VAT registrant business shows in increasing trend every year during the past nine years and reached a height of 59,850 during the fiscal year 2006/07. The number of cancelled registration and no of closed business shows oscillating trend.
-) The number of debit return, credit return filer and zero return filer all shows increasing trend. The number of debit return filers exceeds credit return filers in number.
-) The collection of VAT from import exceeds the domestic VAT collection and is in increasing trend in overall.
-) VAT is a great revenue raiser than all other alternatives because the share of indirect tax has increased during the study period and there is great contribution of VAT in Tax Revenue.

-) There is huge resource gap because the economy is suffering from the persisting resource gap, revenue-expenditure, saving-investment & import-export. Besides these, the country is also facing the increasing burden of foreign loan.

4.17.2 Major findings form Primary Data:

-) Most of the traders, businessmen and general public now have become much aware about VAT system than in past and they good idea regarding present VAT System. However they are still encountering many problems like pricing problem, accounting problem and more over billing problem.
-) Most of the buyers are also aware about the benefit of the VAT and they want to take VAT bill on their purchase. Very few people believe that VAT increases the cost of good.
-) Some of the sellers still do not want to provide VAT bill to customers.
-) Government VAT authorities are more helpful to businesspersons and most of the businessperson are satisfied with the behavior of VAT authorities and only few person replied that they are bad.
-) Frequent changes in VAT law and complexity inherited within the law discourages the most to the businesspersons. There is lack of education and training among the businessperson and general public.
-) General public and retail business faces the problem of non cooperation from VAT authorities.
-) Complexity inherited in billing system in VAT is the most difficult provision of VAT.
-) Return filing system in VAT is also one of the difficult aspects of VAT system.
-) Getting tax credit and penalty system are also difficult provision of VAT system.
-) Most of the people feel that VAT increases inflation. Beside this complexity within the law and increase in management cost are the demerits of present VAT system.
-) Timing and paperwork problem make the VAT inefficient among businesspersons.
-) Record keeping is one of the most difficult compliance provision found by most of the person.

-) Complex law, poor consumer awareness, keeping VAT records, difficulties in registration procedure, VAT return filing are the main common problems associated with VAT system. It is felt that there is lack of active VAT information for the consumer.
-) Most of the person feels that tax policy should be made more liberal for effective implementation of VAT in Nepal. Compliance procedures should be made easy and certain percent credit should be given to consumers who take VAT bill on their purchase to encourage consumers to take bill on their purchase. Some facilities should be given to businessmen to encourage registering in VAT.
-) The present rate of VAT is sufficient to mobilize revenue. Some believe that it should be lower down. There were very few who suggested increasing the rate of VAT.
-) Most of the respondents believe that VAT is successful in revenue mobilization in the country. There were only 29 percent who responded that VAT is not successful in revenue mobilization.
-) There is no doubt that VAT has made tax system more transparent, effective and efficient and less chance of tax evasion. It has increased tax base and increased revenue mobilization capacity of the country.
-) The tax base should be increased to mobilize revenue effectively in the country.
-) Most of the people know about the VAT and they think that VAT is more efficient tax system.
-) Most of the people believe that VAT is effectively implemented in Nepal. 19 percent of the respondents do not believe that VAT is not effectively implemented in Nepal.
-) Government is more liable for effective implementation of VAT in the country. Beside Government, civil servants of tax authority, business persons and consumers are equally liable for the effective implementation of VAT.
-) For effective implementation of VAT in Nepal, the following suggestions are obtained from the study which are as follows:

 - Proper training should be provided to businesspersons and awareness programs regarding VAT should be delivered to the customer form the concerned authority.

- There is a misconception among the consumer that VAT increases the cost of good therefore consumer awareness campaign should be launched to avoid such misconception. This will also help to avoid the problems that could arise from non billing by the seller.
- Government tax authority should change their attitude towards the businesspersons. They should act as a mediator and well-wisher rather than being ruler towards the people.
- The problems of complicated VAT law should be thoroughly analyzed forming a panel of experts and the businessperson and should be revised if it seems necessary.
- Study should be done to reduce the unnecessary paper work for VAT registered business.
- Paperwork for VAT registered business should be simplified and cost and benefit of maintaining books of account and records should be reviewed so that businesspersons do not feel it overburden.
- There should be some incentives or facilities for those who want to register in VAT. This will motivate businesspersons to register in VAT.
- Appropriate training should be provided to the businesspersons regarding the billing system, record keeping and compliance procedure of VAT.
- Billing system should be made simple and make sure that it is effectively implemented.
- Tax base should be increased to mobilize revenue.
- Trained & experienced staffs should be hired without any delay.
- Timely monitoring & supervision should be done.

CHAPTER V

SUMMARY, CONCLUSION AND RECOMMENDATION

Summary

VAT is a recent and an important innovation in the field of modern taxation system. After its origin in Germany it gained worldwide popularity at the academic as well as practical level, so in more than 125 countries VAT has already implemented.

VAT is a tax i.e. based on goods and services. The base of VAT is the value addition that takes place during process of production and distributions. Since this tax is based on consumption, the burden of this tax has to be borne by the consumer.

VAT is based on self assessment system. Under the self-assessment system, a taxpayer is required to keep a proper account of all business transactions. Therefore, the Tax returns filed by the taxpayers by assessing his/her tax liability have to be adopted by the tax administration not only in principle but also in practice. VAT has done away with administrative procedures such as taking approval of price for purpose of sales tax, submission of annual statement of accounts, tax assessment by the tax officers, stamping of invoices, submission of invoices at the tax office along with the tax returns etc.

VAT is transparent tax-system that is based on the taxpayer's transaction. VAT is not only transparent in itself but also demands transparency in other tax system as well. Unless such an environment is created VAT cannot implemented effectively. In order to implement this tax system effectively the system of creating an artificial price for the purpose of custom duty and assessing the income tax on the basis of negotiations schedule must be replace by the provision to levy custom duty on the actual transactions value and the acceptance of VAT accounts for the purpose of income Tax.

In order to make VAT effective, it is essential to create an environment in which invoices are issued properly, accounts are maintained accurately, Tax is based on transactions, there is acceptance of the tax payer's correct accounts, and a fair competition among industrialist and businessman is established with respect to tax. Until and unless such a situation is created, VAT implementation will not be easy and pressure will be created in some or another way.

While comparing VAT with other form of sales Tax, it is so far superior on many grounds such as economic efficiency, revenue productivity, and administrative simplicity. However

retail level sales tax is only the nearest competitor of VAT extended through the retail level and both will generate equal revenue with similar coverage and rates. If VAT can be implemented effectively along with its different provision like exemptions, threshold, Zero-rating, it will be more suitable. Avoidance of pyramiding and cascading effects and providing cross auditing, self-policing and catch-up effects are the most favorable features of VAT which makes it superior even than retail sales tax.

Although from the legal point of view, VAT has crossed its ninth years of implementation. In the first two years, since many compromises were made in the principle of VAT due to political instability and frequent change in Government, VAT could not be fully implemented. In our environment where the tax awareness is minimal, the practice to maintain tax account is negligible or improper, smuggling and under valuations is rampant, and tax leakage takes place with negotiations between the taxpayer's and the Tax administration, it was not easy to implement VAT and the political instability only aggravated the situation and made it more complex.

Like the other countries of the world, Nepalese VAT is of consumption type and method used for calculation is tax credit method. Further the VAT is subject to destination principle, currently threshold limit is 2 million and it is subject to flat rate of 13% with zero percent rates on exports. Some selected goods are completely out off VAT net base basically due to the administrative complexity and equity consideration.

Tax revenue is a major source of public revenue of nay country. The contribution of VAT revenue on tax revenue is about 49% and remained more or less constant during the study period in our country.

Naturally, to introduce new system replacing old one would face many complications and oppositions even if the new one is improved one. The same rule applies to the VAT. Beside these and several other reasons, before introduction of VAT system it would be better if it is implemented after adequate preparations. The implementation of VAT does not seem effective in Nepal till now as the gap between the potential and actual VAT is very large and widening every year. Poor consumer awareness, effective implementation of threshold, lack of coordination between custom and VAT offices, corrupt business practices, corruption in government offices, lack of transparency are the main other threat for effective implementation of VAT in Nepal.

Due to lack of experts, adequate manpower, lack of modern technologies like IT, MICS in VAT administration, the auditing system, major operation tools of VAT could not be utilized effectively in Nepal as expected. Beside this VAT refund system is not working as expected by business persons which are the main reason for feeling harassment and creating negative thought regarding VAT by the business world.

As the public conscious level is very low, businessmen are cheating consumers charging high price in the name of VAT. Businessmen also cheating the Government, as they are not issuing proper bills in their sales and hence do not pay real VAT amount.

It was expected that after implementation of VAT, problem of Tax evasion, undervaluation would be automatically abolished as it is transparent and all transactions would be recorded in computerized environment. But the exciting large amount of unauthorized trade to/from India has been posing a great threat due course of VAT implementation. The smuggling of good and services are creating loss of revenue. On the one hand, it is not coming through custom point and on the other hand it has discouraged the genuine traders and loss of revenue.

Whatever the present situation of VAT, the future seems very bright. There is eminent prospect of revenue mobilization if it is implemented effectively.

If provision of zero-rate is to be removed and all sectors including agriculture is to be brought under VAT net adequate revenue could be mobilized through VAT. VAT should be implemented for all economic as well as social welfare programme and then only Nepal could be independent for growing expenditure needed for development activities.

Conclusion

The ultimate objectives of any tax policy in developing countries like ours are:

- a) to increase the growth rate, in relatively short to the maximum possible extent.
- b) to have built in-flexibility into the tax structure and to provide maximum revenue productivity continuously and consistently with optimum growth rate.
- c) to act as instruments for combating inflationary pressure in the initial stage of economic development and
- d) to remove the inequality of income and wealth in society.

All economic indicators show that our economy is passing in low level of equilibrium trap. To escape from this trap it needs huge amount of investment in economic and social

overheads. Because of low income and low marginal propensity to save there is little scope for voluntary saving and investment. External source of financing would reduce the capital formation at the time of repayment of principle and payment of interests. Thus, in this context taxation have vital role to give the movement to the economy. But analyzing the revenue and expenditure of Nepal, there seems a trend of persisting recourse gap along with the huge amount of saving-investment and export-import gaps.

Regarding the current status of domestic revenue mobilization, it has only support fund for foreign aid and loans but also insufficient for meeting day to day expenditure of Government. So, that the Government has to depend on external source of financing and other inflationary financing, which are not desirable from welfare and other grounds.

This proves that the Government is getting bigger without better and which causing fiscal crisis in the economy.

In the process of tax reform, VAT has introduced in the year 1997 expecting to give speed for revenue mobilization, by creating good environment for tax payers and authorities. VAT was expected to have high revenue productivity due to its broader coverage and base. Elimination of economic distortion caused by tax system, elimination of cascading and pyramiding effects, creation of competitive business environment, strengthen the foreign trade etc were other spare of VAT that were expected to fulfill after implementation of VAT. VAT has crossed ninth years of its implementation. But could not get expected result, which are getting in other countries that are implementing VAT.

It was not wise to expect VAT have a revenue performance at least as much as the growth rate of GDP. In the context of Nepalese economy, performance of VAT revenue does not seem satisfactory. The contribution of VAT revenue as percent of GDP remained less than 3% after the implementation of VAT and the performance does not show improving. The revenue performance of tax which was replaced by VAT was even more than the replaced taxes with respect to GDP over the five years of VAT implementation. This indicates that there is still many challenges and needs more efforts to make the VAT success.

Considering the present economic conditions growing needs of Government expenditure, other source of domestic revenue, negative impact of external sources of revenue, present status of VAT, it seems most essential to rethink about VAT threshold rate, list of exempted goods and sectors etc.

VAT base can be increased significantly after designing the VAT structure properly when there will be fair and capable administration and it will be supported by the general public and the business community. But before modify any structure either it may VAT rate, base, threshold or any other it will be better to make this issue public issues. So, that it will be easy to get the support from either side. This will helps to make VAT broad based and revenue productive in future.

Theoretically VAT is a modern and in general, the best from sales tax, but all its negative and positive aspect mostly depends upon the implementation aspect. The administrative capacity of the Tax authorities, level of awareness of general public and taxpayer, honest and loyal tax collectors, nature and status of development etc are the perquisite to make the VAT effective. Without all these and other any prerequisites none can analyze and comments either the VAT sits in the economy or not because the economy can not experience all the aspects of VAT.

Thus the implementation aspect has vital role to play, which is dearth in most of the developing countries like Nepal.

Thus the study concludes that there is immense scope of VAT in Nepalese economy which can give right direction to the tax revenue and can be perennial source of domestic revenue, if the VAT is to be implementing effectively it will not so far to meet our objectives of taxation as well development which the study mention above. This can be claimed after looking the figure of potentiality of VAT revenue. But the present situation of VAT in not according to our expectation and the requirement of the economy. Inefficient tax authorities, low level of public and tax payers awareness, insufficient and inefficient manpower, lack of IT system, lack of research on about the weakness of existing VAT system low level of implementation of findings of scholars, lack of political commitment absent of proper mechanism for monitor and audit, etc are creating hurdles and obstacle on the path of VAT implementation. Because of these the economy is unable to experience positive impact of VAT.

Recommendation

In order to give motion for Nepalese Tax, Government decided to implement VAT in Nepal, as an improved and scientific tax and implementation of VAT has crossed its fifth years. In due course ups and down appeared. To make VAT as a perennial source of revenue many preparatory programmes were lunched in different levels and places. VAT Act, rules and

regulations have been setup in line of international standard and its preparation had been made comprehensive and much more extensive.

Since VAT is a modern tax, it demands modernization in all spares to give output as expected. If we implement a scientific tax like VAT but all our behaviors, attitudes and thinking remains pragmatic then it produces less output than a non scientific tax like turnover Tax. Therefore to achieve result according to our expectations from VAT it is essential to change our attitudes and behaviors towards VAT. Moreover the study indicates following recommendation that should be adopted to get result

- 1) As all of us know success demands labour, continuity, passion and commitment. By the same reasoning a strong commitment from the grass root to the top level prerequisite to make VAT success, which seems lack in Nepalese tax environment. Only the political parties and leaders of opposition in the parliament show their commitment but it seems intentionally nobody have strong commitment to make the system more effective and successful. Also there is lack of proper coordination among the Government and other political parties, and among the Government offices. Hence the Government should create an environment that could include all the communities and strong commitment for effective implementation of VAT.
- 2) One of the reasons of slow pace of development is the interventions of political parties on making policy and implementing them. Political parties and leaders give unnecessary pressure. Many political leaders who are reached into the cabinet seem not capable for the position. They are strongly motivated for their own benefits rather than the national problem, which are the primer cause for the failure of policies instead of implementation. Political leaders are giving their arguments without considering the actual facts, which is creating negative thought upon VAT. Hence, there should not be interventions from the political leaders to the policy makers and others in implementing policies and go to the public after full operation and implementing accordingly.
- 3) An efficient, strong and fair administration is the most crucial for the proper implementation of VAT. But VAT administration is still weak, traditional, corrupted and even physical infrastructures are not available properly. While comparing VAT with the sales tax, job requirements of the tax officials has been changed from physical control to audit base control system and they have to deal with the tax credit,

tax refund tax audit etc. instead of this there is lack of expertise, well trained and skill officers in the VAT administration. The informative programme such as seminars, training, discussion etc. should be organized to make the tax officers skilled and capable in their field of job and service minded attitude needs to be developed in the mind of tax officers making the provision of prize and punishment.

- 4) The tax administration can be improved through an appropriate organization structure compatible with the changing circumstances. The Department of Inland Revenue should give thrust to strengthen the physical facility inclusive of vehicles, photocopies, developing from and manuals, simplifying procedures, and educating the taxpayers. The system can be improved through developing manuals and work procedures, and maintaining archives and macro films. Tax authorities should develop the long term tax policy.
- 5) VAT is based on the self assessment by the taxes who are required to pay tax on the amount of total value added in their business transitions. Thus VAT is an invoice based and account based system implying a most significant role of business men as well as the general consumers for the effective implementation. But the public conscious level about VAT is very low in Nepal. Very large numbers of businessmen are still unknown about the procedure and accounting system of VAT. So, it is necessary to continue the programs to educate taxpayer as well as consumers and general public and make them known about the system and its significance. This can be done by publishing and providing tax related information through articles, journals, magazines, manuals, brochures, radios, television, discussion programmes etc.
- 6) Lack of clarities in the tax laws and regulations are the great issues within business and industrialists. They are arguing that the language used in tax laws and regulations are very complex and ambiguous. They lack clarity and often full of discrepancies and much interpretation can be made out of same law.

To remove such ambiguity Government should take some steps immediately. The principal of taxation without representation should be strictly observed. The change in tax rates or base of valuation of commodities should be strictly based on the provisions of law and not on circular, ordinance or executive order. The VAT Act should adjust to the legal provisions made the annual finance bills. Simplify the

language for clarity thereby reducing ambiguity in the tax law. The computation of taxable products and transactions should be done in accordance with the provisions of the VAT Act.

- 7) Human resource is the prime factor of sustainable development of any faculty. But human resource that is needed in the tax system does not seem adequate in Nepalese context. This is the main problem of tax authorities. The Inland Revenue Department should give thrust for manpower development with reference to IT, subjective knowledge of Tax, law, auditing and accounts and training and observation/study tours for the staffs. The department urgently requires support for the manpower development especially through providing training and workshop both for senior and junior staffs with in gain knowledge of tax system, audit, tax laws, investigation techniques practicing in other countries too, by providing training, interaction etc programmes. Manpower development is also necessary to support the enforcement activities. Human resource development is also significant for sustainable quality services that could be possible through improving curricula by the Public Service Commission. A separate entrance examination is highly essential for those aspiring for revenue service before the final examination.
- 8) There is crisis of confidence between the Government and private sectors i.e. VAT payer and controller. Without close cooperation between those two sectors, VAT can not implement effectively. There were made much agreement between the privet sectors and the Government but they are not seen in the practice. Person of each are blaming to the person of another. There is a loss of revenue due to the understated value by the taxpayers on the one hand and on the other taxable value is arbitrary fixed by the tax. Hence, it is necessary to incorporate the private sector with the Government through the civil society, FNCC and other different associations.
- 9) There is huge scope for Institutional and Infrastructure reforms. The level of skills and knowledge of the staff at the revenue office should be enacted by continuous training programmes. Good governance should flow from top to bottom. Existing excess, inefficient, and unproductive staffs in the various tax offices should replace by highly qualified, professional staff that have adequate training in the revenue system.
- 10) During the study period, the views are collected which showed monitoring system in the VAT is not so effective so that the taxpayers are encouraged for tax evading

practices. Many businessmen don't issue invoice and most of others issues improper invoices. This is not only contrasting the tax base and thus losses in the tax revenue but also results inequity since who issue proper invoice are discriminated against. So, this system should be checked through an effective monitoring system.

- 11) Some businessmen having tax able transactions are still beyond the tax net. So, the enforcement should be made more effective and voluntary compliance should be encouraged. The level of the voluntary compliance could be raised through a set of promontory and regularly measures including positive and services minded attitude of the tax personnel, rationalization of tax structure simplification of tax procedures and forms, strengthening tax administration, conducting audit ad investigation in an effective manner and penalizing those who break the rules. The procedures regarding registration, collection, interest, penalty, audit and appeal should be simplified and improved.
- 12) Tax system can be rationalized by lowering the level and number of tax rates. Thus it is necessary to lower the import duties on some selected items to discourage smuggling and under valuation by making it less profitable and more risky.
- 13) The existing long open border is the main cause of smuggling and undervaluation in the border sides. So open border should be systematized to greater extend.
- 14) Threshold and tax refund are two possible gates for tax evasion. An effective efficient tax auditing, investigation and monitoring system should be developed. Refund system should be made simple and effective and the period of such refund should be minimized.
- 15) Most of the taxpayers as well as publics are still unknown about VAT and its effects on various aspects. They have developed a kind of misconception regarding to VAT. They do not think that sellers already include VAT in their goods price rather they do think VAT as an extra charge. Thus, proper publicity regarding to VAT is the fundamental tools for the success of VAT.
- 16) The administration should be very watchful to prevent any kind of malpractice, fraud and tax evasion. Utmost are should be taken to prevent any kind of bringing and corruption. Tax officials should be effectively monitored.
- 17) Consumers should create awareness for taking invoice for every taxable purchase by comprehensive advertisement programmes.

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APPENDIX –I

List of VAT exempt goods and service

1. Basic Agricultural Products
 - a. Paddy, rice, wheat, maize, barley, millet, pulses, flour, and similar unprocessed food materials.
 - b. Green and fresh vegetable, fresh fruits, fresh eggs and similar products (except used in hotels, restaurants, bars, guest house, cafeteria and other similar organization.
 - c. Unprocessed cereals,(such as sugarcane, tea leaf, tobacco, cotton, cardamom, jute, oil, seeds, soyabean)
 - d. Herbs.
2. Goods of Basic Needs:
 - a. Unprocessed edible oil,
 - b. Piped water, including water supplied by tankers.
 - c. Fuel wood and coal.
 - d. Salt.
3. Live Animals and animal products:
 - a. He goat, sheep, yak, he buffalo, bore, pigs, rabbit, and similar other animals, their fresh milk and uncooked/ unprocessed varieties.
 - b. Cows, she buffalo, and she goat.
 - c. Ducks, hens, cocks, turkey and similar other birds and other fresh meat, eggs, and similar uncooked varieties.
 - d. Fresh or dried fish(other than packed)
4. Agriculture input
 - a. seeds of any plants listed in Group I
 - b. Manure, fertilizer and oil conditioners.
 - c. Agriculture hand implements.

- d. Pesticides made mainly for use of crops.
 - e. Agriculture equipment, including tractors.
 - f. Birds and animal feed.
5. Medicine, Medical and Similar Health service.
- a. Medical or surgical services provided by Government Institutions.
 - b. Human blood and products derived from human blood.
 - c. Human or animal organs or tissue for medical research.
 - d. The supply of services by persons on the register of veterinary surgeons and veterinary doctors.
 - e. The supply of goods made for, and suitable only for the use of disabled persons.
 - f. X-rays films and oxygen gas to be used for treatment.
 - g. Raw materials purchased or imported by the drug industries to the extent approved by the department of drugs management.
6. Education
- a. The provision of research in a school or university.
 - b. The provision, otherwise than for profit, of professional or vocational training or refresher training.
 - c. The provision of education in a school or university and supply of goods made in connection with such service.
7. Books, Newspaper etc
- a. Books, newspaper, newsletters and periodicals.
 - b. Newsprint.
8. Artistic and Cultural goods and services, carving services
- a. Paintings, handicraft, carving and related services.
 - b. Cultural program.
 - c. Admission to libraries, archaeology, museum, zoos and botanical gardens.

9. Personal or Professional services

Air transport, non-tourist passenger transportation (except cabal car) and goods carrier (except transportation related to supply)

10. Personal or Professional services

Personal services rendered by artists, sportsmen, authors, writers, designers, translators and interpreters instructionally or individually)

11. Other goods or services.

1) Postal Service(provided by Nepal Government only)

- a. The service conveyance of letter, money and packets by the post office.
- b. The supply by the post office of any service in connection with the conveyance of letter, money and postal packets.
- c. Postage stamps.

2) Financial and insurance services.

3) Bank notes and cheque books.

- a) The printing and issue of bank notes.
- b) The supply of bank notes from outside the territory of Nepal to the territory of Nepal.
- c) Cheque book.

4) Gold and silver.

- a) Gold, gold coins and gold ornaments.
- b) Silver and silver cons(other than ornaments and goods made or silver)

5) Electricity

6) Raw wool

7) Battery operated tempo, their chassis and battery,

8) Bio-gas, solar power and wind power operated power generation plant and their main parts on the recommendation of the alternative energy centre.

9) Aero plane, Helicopter, fire Bridge and Ambulance.

10) Jute goods.

11) Industrial machinery included in section 84 of custom tariff and subject to 5% TRAIFF.

12) Woolen carpet & woolen carpet weaving, dying, washing, knitting.

13) Aluminum, copper, scrape, circle, plate and utensils.

14) Cotton yarn.

15) Woolen yarn to be used in hand knitting sweater (except artificial & acrylic) domestically.

16) Donated goods received for calamities or Phil and tropic purpose approved by ministry of finance.

12. Land & Building:

Purchase and rent of land and building (accept the rental service provided by hotel, guest house or similar organization.)

13. Betting, Casinos, Lotteries

- a. The provision of any facilities for the placing of best of bets or the playing of games of chance.
- b. Lottery

APPENDIX -II

Zero Rates

Goods or service payable at zero rates

- 1) Export of goods.
 - a. Goods exported outside the territory of Nepal ;
 - b. Goods shipped for the use as stores on a aircraft to an eventual destination outside the territory of Nepal
 - c. Goods loaded for use stores on aircraft to a destination outside the territory of Nepal or as merchandise for the sale by retail or supplied to person in the course of such a flight.
- 2) Export of service
 - a. A supply of services by a person in the territory of Nepal to a person outside the territory of Nepal and having no business establishment, agent or legal representative acting on his behalf in the Territory of Nepal.
 - b. Where goods are supplied in hire or loan basis by a registered person resident in Nepal to a person outside the territory of Nepal.
- 3) Import of goods and service by accredited diplomats.

APPENDIX-III

RESEARCH QUESTIONNAIRE

Dear Sir/Madam:

I am conducting an opinion survey for a study on problems in VAT implementation in Nepal. So the following questionnaire is designed in order to collect data for the research as a partial fulfillment of Master of Business Studies (MBS) program Tribhuvan University. Therefore, I kindly request you to furnish the relevant information sought in this questionnaire so that your responses will contribute in finding out various solutions. I assure that all the information provided herein would be strictly confidential and be used only for my research purpose. I greatly appreciate your effort in expressing your views.

Section 1 — Questionnaire

1. You have registered in VAT because of:
 - Business threshold limit
 - Types of good deal
 - Location area
 - Ceiling limit of telephone bill and rent
 - Voluntarily
 - Not applicable
2. Type of your business:
 - Manufacturing
 - Export/Import
 - Service provider
 - Retail shop
 - VAT Registered
 - Farmer
 - Other (if any).....
3. You choose VAT registrants seller rather than non-registrants for your purchase, why?
 - You get tax credit
 - You want to contribute to Government revenue
 - No it only increases cost of goods

Others.....

4. Do you take bills while purchasing goods?

- Yes
- No
- Shopkeeper does not want to provide
- No idea

5. What was your first experience with Government VAT authorities?

- Helpful
- Satisfactory
- Bad
- Not experienced

6. When are VAT registrants discouraged the most?

- Frequent change in VAT law
- Non cooperation from VAT authority
- Complexity inherited within VAT law
- Lack of education and training

7. Which of the following is the most difficult provision with VAT?

- Billing system
- Return filing system
- Getting tax credit
- Penalty system

8. What are the demerits of present VAT system?

- Increase inflation
- Relatively complex
- Increase management cost

9. Which of the following points makes present VAT system inefficient among businessmen?

- Timing and paperwork problems.
- No reclaimable VAT.
- Exceptions for unusual supplies.
- Division of goods into VAT and non- VAT
- Where to get help and advice

10. Which is the most difficult compliance provision of current VAT law?

- Record keeping
- Billing system
- Penal provision
- Return filing
- If other any specify.....

11. What are the common problems associated with VAT system?

- Complex law
- Poor consumer awareness
- Open Indo-Nepal Border
- Difficult VAT registration procedure
- Completing the VAT return
- Keeping VAT records
- VAT inspections
- Lack of active VAT information for the consumer
- Tax credit and tax Refund procedure

12. What should be done by the Government for effective implementation of VAT in Nepal?

- Tax policy should be made more liberal
- Compliance procedures should be made easy
- Facilities should be given to businessmen to encourage registering in VAT
- Certain percent credit should be given to consumer who take VAT bill on their purchase
- Tax authority should visit business house time to time and make suggestions
- Other if any.....

13. Do you think 13% VAT rate is sufficient to mobilize revenue?

- Yes
- It should be increased
- It should be lowered down
- No idea

14. Do you think VAT is successful in revenue mobilization in the country?

- Yes
- No
- No idea

15. Which of the following objectives are attained through the implementation of VAT in the country?

- It has made tax system more transparent, effective and efficient.
- It has made increase the tax base
- It has removed the cascading effect
- It has increased revenue-mobilization capacity of the country
- It has made chance of tax evasion less
- It has made tax administration easy
- No idea

16. Do you think coverage of VAT is sufficient?

- No tax base should be increased.
- Yes
- No idea

17. Do you think VAT is more efficient tax system?

- Yes
- No
- No idea

18. Is VAT effectively implemented in Nepal?

- Yes
- No
- No idea

19. Who is more liable for effective implementation of VAT?

- Nepal Government
- Civil servants of Tax authority
- Businesspersons
- Consumers
- All of the above equally
- No idea

Section 2 — Personal Profiles

Name (Optional):

Mailing address:

Contact no:

E-mail ID:

Education:

Occupation:

Organization name:

Position: