A STUDY ON PRACTICES OF VALUE ADDED TAX IN CHITWAN DISTRICT

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A Thesis Submitted To:

Office of the Dean

Faculty of Management

Tribhuvan University

In the Partial Fulfillment of the Requirements for the Degree of

Master of *Business Studies (MBS)*

Putalisadak, Kathmandu

September, 2010

RECOMMENDATION

This is to certify that the thesis

Submitted By:
BIJAY RAJ SUBEDI

Entitled:
A STUDY ON
PRACTICES OF VALUE ADDED TAX IN CHITWAN DISTRICT

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

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VIVA- VOCE SHEET

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And Found the Thesis to be original work of the student and written according to the prescribed format. We recommend the thesis to be acceptance as Partial Fulfillment of the requirements for the degree of **Master of Business Studies (M.B.S.)**

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DECLARATION

I hereby declare that the thesis entitled "A Study on Practices of Value Added Tax in Chitwan District" submitted to the Office of the Dean, Faculty of Management, Tribhuvan University is my original work. It has been prepared for the partial fulfillment of the requirements for the Degree of Master of Business Studies (MBS) under the supervision of Prof. Dr. Kamal Deep Dhakal and Mr.Ghanendra Fago of Shanker Dev Campus.

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ACKNOWLEDGEMENT

The present research study “A Study on Practices of Value Added Tax in Chitwan District” has been prepared for the partial fulfillment of the requirement for the Degree of Master of Business Studies (MBS). Although VAT is no longer a new topic in the T.U curriculum, still I chose this topic mainly because of my curiosity to know why VAT is falling short of target in spite of its implementation. In fact, VAT promises a great change in the revenue structure of any country and is said to be more efficient and superior to sales tax in revenue generation. Moreover, many people are still ignorant and confused about the very name VAT.

I am immensely indebted to my thesis supervisor Prof. Dr. Kamal Dip Dhakal and Mr. Ghanendra Fago for guiding me in the completion of this thesis. I would also like to express my gratitude to Mr. Kapil dev Subedi (Saptagandaki Multiple Campus,Chitwan) for his valuable suggestions.

My thanks also go to all the respondents who gladly and unhesitatingly gave their valuable views and answers to all questions for my research purpose. I am also thankful to the personnel of Inland Revenue Department, Nepal Rastra Bank and Central Bureau of Statistics for their kind and indefatigable co-operation in providing me the necessary data and supportive materials. I would like to express my gratitude to officials of Tribhuvan University Central Library and Library of shankar dev Campus for their kind help and co-operation. Last but not the least; I would like to thank my family, colleagues and friends who directly or indirectly helped me to complete this thesis. Without their support & help, it would be difficult for me to prepare and complete this thesis in time.

BIJAY RAJ SUBEDI

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ABBREVIATION

ADB	=Asian Development bank
APC	=Average Propensity to consume
CBS	=Central bureau of statistics
DANIDA	=Danish International development Agency
DCs	=Developing Countries
e.g.	=For example
EU	=European Union
FNCCI	=Federation of Nepalese Chamber of Commerce and Industry
FY	=Fiscal year
GATT	=General Agreement on Tariff and Trade
GDI	=Gross Domestic Income
GDP	=Gross Domestic Product
GNP	=Gross National Product
GON	=Government of Nepal
HIID	=Harvard Institute for International Development
i.e.	= that is
IMF	=International Monetary Fund
IRD	=Internal Revenue Department
LDC	=Least development Country
MBS	=Master of Business Studies
MNC	=Multinational company
MOD VAT	=Modified Value Added Tax
MOF	=Ministry of Finance
MST	=Multi Stage Tax
NGO	=Non Government organization
NRB	=Nepal Rastra Bank
PAN	=Permanent Account Number
RLST	=Retail Level Sales Tax
R&D	=Research and Development
SAARC	=South Asian Association for Regional Cooperation
TPIN	=Tax Payer's Identification Number
TR	=Total Revenue

TXR	=Total Tax Revenue
UDCs	=Under Developing Countries
VAT	=Value Added Tax
viz.	=Videlicet
WDR	=World Development Report
WB	=World Bank
WLST	= Wholesale Level Sales Tax
WTO	=World Trade Organization

CHAPTER-I

INTRODUCTION

1.1 Background of the Study

The central economic problems of all societies include traditional questions such as what, where, how much and for whom goods and services should be produced (Todaro, 2001). The use of natural bounty in an optimal and a rational manner is the sole objective of society indulged in the twenty first century. The virtually patchy distribution of resources has execrated the difficulties of the rural poor and improvised city dwellers. Today's concern of the underdeveloped countries is for the achievement of the economic development, which suggests maximum welfare of the maximum people and the efficient allocation of resources. Economic development demands reduction inequality and poverty, decrease in unemployment, improvement of living standards and foreign trade account, reasonable degree of price level stability, acceptance rate of economic growth and modification in social and institutional environment over time. Economic development generally includes improvements in material welfare, especially for person with the lowest income: the eradication of the mass poverty with its correlate of illiteracy, diseases and early death; changes in the composition of inputs and outputs the generally include shifts in activities; the organization of the economy in such a way that employment is general among the working age population rather than the situation of privileged minority; and the correspondingly greater participation of broadly based group in making decision about the directions, economic and otherwise, in which they should move to improve their welfare (Charles and Bruce, 1997)

Europe, America and Japan are the three giant economic blocs of the world creating the huge amount of surplus that ultimately enhances the per capital income of the people. Rest of the economies strives for the access of these economic blocs. Most of the third world countries are characterized by rampant corruption, widespread poverty, increasing budget deficit, low rate of capital saving, ever widening resources gap, unemployment, lack of resources, agrarian economy, dependency on donors and so on. All the aforementioned features impede in the process of the economic development. Specially, the budget deficit creates the resource gap. The Governments are in dire need of apt fiscal policies for solving unabated problem of mass poverty. Governments do have some alternatives to overcome this problem. Government either cut down expenditure requires down sizing which faces obstacles in the process of its implementation. Procrastination of development projects due to the lack of the fund is no excuse from the economic point of view. Boost in revenue is the best alternative in meeting the development objective. Foreign loan can bridge resource gap but it is not a panacea of all difficulties. Debt financing entangles in the long-term debt payment schedule. Whether it is financed from the internal or external source, by non-inflationary or inflationary means, the accumulation of capital in any developing economy requires the mobilization of an economic surplus. (Gerald, 1995)

Accomplishment of millennium development goals formulated by the United Nation deserves the combined effort of all the nations-developed as well as developing world. Poverty is the ultimate concern of economics and economists. Alleviation of the mass poverty that still prevails in most countries has become a worldwide campaign in which virtually every nation rich or poor is involved (Higgins, 2001). Redistribution of public spending is an essential requirement for poverty reduction. Public finance is non-eligible instrument of the policy in the developing countries. Vicious circle in the developing countries can be broken through capital information for which fiscal policy can be adopted as a crucial tool for the promotion of the highest possible rate of capital information. Fiscal policy is the powerful instrument of stabilization (Jhingan, 2000). In the absence of well-organized and locally controlled money market, most developing countries have had to rely primarily on fiscal measures to mobilize domestic resources. Revenue mobilization is amplified through the application of the fiscal measures. The principal instruments of such public resources mobilization have been government's tax policies. Taxes levied are of direct and indirect nature. Direct taxes are levied on private individual, corporation and properties. For a long time taxes on income and wealth have been recognized, but these countries have sought to overcome the obstacle and have been relies on income taxes (Goode, 1983). Indirect taxes such as import and export duties as well as excise taxes comprise the measure huge amount of resource through indirect taxes. Just opposite of it in the developed countries the large part of the revenue comes from the direct sources.

There is a predominant role of the indirect taxes, especially import duty and the sales tax in the Nepalese tax structure. The primary purpose of taxation is to divert control of economic resources from taxpayers to the state for its own use of transfer to others (Goode, 1983). Taxed are very popular and there is much to be said for encouraging the people in underdeveloped areas to save a larger of their incomes voluntarily (Higgins, 2001). Traditionally, taxation in developing countries had two purposes. Tax concessions and similar fiscal incentives have been thought of as a means of stimulation private enterprise. The second purpose of taxation- the mobilization of resource to finance public enterprise is far important.

Political and social progress of any country largely depends on its governments ability to generate sufficient revenues for the expansion of the development programs based on health, education, transportation, communication and other components of the economic and the social infrastructures. In 1980s many least developed countries faced the problem of higher public expenditure in comparison of the public revenue-resulted from the ambitious development programs and unexpected negative external shocks. With rising debt burdens, falling commodity prices, growing trade imbalances and declining foreign private and public investment inflows, third world government with little choice but to undergo severe fiscal retrenchments, which means cutting government expenditure and raising revenues through increased or more efficient tax collections measures (Higgins, 2001). There gave been changes in taxation in the past years especially since early 1980s. The commodities in the tax system increased in among the countries, so the traditional tax system were characterized as too many and too high rates. Later the countries identified that tax holidays and incentives were the best ways to increase the investments in the desired geographical sectors and economical regions. High top marginal income tax rates could be taken as distributive justice. It was also believed that all tax should at a time look into revenue, equity and incentive objectives. There used to be dozen of taxes with little revenue, being collected from any of them making the tax system difficult to administer. Those taxes were also inefficient because of double taxation of the commodities. Taxes were levied at the manufacturing rather than the retail stage, which used to be added to the production cost. Too many tax incentives and tax holidays narrowed the tax base, which necessitate raising the tax rates, but high tax rates encouraged the tax avoidance and evasion that gave birth to the unaccounted economy. (Thapa, 2003)

Nepal's accession to the world trade organization (WTO has brought new challenges in Nepalese economy. It has ensured the free flow of foreign goods and services into the territorial boundary of Nepal. The provisions regarding the most favored Nation, National treatment, Non discrimination and predictability are the mandatory to its members. The compliance with the agreement is the most. Otherwise there is a tribunal body for dispute settlement. Under such circumstances Nepal no longer can rely on custom duty, which used to be the significant component of revenue generation. It is also the signatory of there bilateral trade agreement. In the first half of 1980s Nepal had to face the problem of deficit balance of payment due to high public expenditure. The budget deficit was balanced by printing paper notes. It increase inflation and imported and aggregated the problem of balance of payment. The size of import could be met with the size of export.

To solve this problem Nepal introduced the "Economic Stabilization Program" in 1985 by taking economic adjustment loan from International Monetary Fund (IMF). Under this program the government did the works like reducing aggregate demand by absorbing excessive liquidity of the economy, controlling the bank loans that goes to the private sectors and the government, encouraging export and discouraging import.Therefore the problem of balance of payment of 1980s to give continuity to the economic stabilization program of 1985 again taking economic stabilization facility from IMF (Joshi, 2008). Nepal had been generating bulk of its tax revenue from import duties. The restrictive economic policies of India benefited Nepal until the beginning of 1990s. Indian tourists were engrossed to buy goods by Nepal from third countries. These goods also used to be deflected to India by both the Nepali and Indian traders. The lure of this type of the trade however was diminishing by the advent of the liberal economic policy of India in early 1990s.

There was extreme reduction in the import tariff, quantitative restrictions and licensing system in India since 1991. As a result, the volume of import from the third countries in the Nepalese market for the Indian buyers shrieked. Further Nepal reduced its import tariff corresponding to the to the liberal economic policy adopted in 1992-93 and in line with the customs duties reform-taking place around the world generally. Consequently import duties proved to be less insignificant in the later years. The consequences were already evident as the relative position of the import duties decreased from 37% in 1990/91 to 34% in 1996/97. Further some, Nepal was not in the position to levy import duties on trade taking places within the South Asian Association for Regional Cooperation (SAARC). This reduced its dependence on its trade tax.

As the part of the tax reforms in Nepal, sales tax in Nepal was introduced in 2022 B.S. by Finance Act. At that time, it was imposed on retail level. In 2022 B.S., sales tax Act. And rules introduced. The sales tax collection point was shifted to wholesale level in Ashwin 2025 B.S. and import/production stage on Ashadh in 2031 B.S. In 2049/50 B.S. policy of imposing sales tax in two stages i.e. import level/production level and wholesale level was introduced but this system was again changed in fiscal year 2051/52 B.S. Due to unsuitability of sales tax in Nepal Value added Tax (VAT) has been implemented as the joint form of sales tax, hotel tax and contract tax (Puspa Raj Kandel, 2004) form 16 November 1997. Before the reform program was implemented in FY 1986/87, Nepal's Tax system was almost administratively unmanaged in terms of rates, incentives, deductions, tax holidays etc. without much revenue being collected in the national exchequer.

Revenue mobilization was stagnant to less than 10% of GDP. It was just 8.7% in FY 1985/86. Thus it was realized that tax system must be drastically reformed if some more revenue was to be mobilized. Therefore, the government took initiative first of all to reform the sales tax system. Until FY 1984/85 there were unto 17 rates of sales tax. Besides this, there was mark-up system to accommodate the distribution cost and the Value Added. Since the mark-up rates different for different products, the sales tax applicable to them also unavoidably different. Apart from this sales tax were different for imported and domestic products. Therefore sales tax was selected for reform in FY 1986/87 reducing the number of tax rates from 17 to 4. Simply the tax rates were 5%, 10%, 15% and 20%. Beside that mark-up system was also abolished in 1987/88. Uniform rates were made for both domestic and imported products. The design of tax in Nepal was so poor and defective as revenue rising instruments they always has disappointing performance.

The sales tax now been reformed to VAT. Value Added Tax has replaced the then sales tax, hotel tax, contract tax and entertainment tax. There is a single rate of 13%. In the process of reform Department of tax, department of customs and department of excise have been merged into a single department, which have been named as Internal Revenue Department. VAT is relatively a new tax. It was first introduced as the comprehensive national tax 40 years ago in France. William Von Siemen recommended it for the first time in Germany in 1919 in order to replace the multistage sales tax. In 1921 professor Thomas S. Adams recommended VAT in the U.K. (www.VAT.Com:)

Likewise, in 1949 the tax reform commission, headed by professor Carl S. soup, had proposed board structure of VAT for Japan with the aim of removing the problem regarding calculation of the prevailing tax systems. France launched it in 1954, which couldn't cross its boundary till 1959. But the introduction and the application of the VAT was with the greater place in the nineteen sixties. All European members' states were required to apply the agreed provisions of VAT.

Following the adoption of VAT by western European countries, many developing countries have been giving increased attention to this form as a means of rationalizing their sales and improving their revenues (Lent, 1973). With the alignment of the laws of potential candidates for membership, has ensured increasing consistency in the form of VAT operating in Europe. All the number states of the organization of Economic Cooperation and Development (OCED) apart from the United States of America have introduced the VAT in their tax regimes. Asian nations excluding Brunei and Malaysia have adopted VAT. India had introduced VAT as modified Value Added TAX. (MoDVAT). China also adopted partial VAT in 1984 and id full-fledged in 1994 (Dhungana, 2003).

1.2 Focus of the study

The study focuses on theory, practice and public awareness regarding VAT. Implementation of VAT is in its preliminary stage. It deeply focuses on finding the path for effective implementation and the root cause of avoidance, evasion and leakage points along with the role of different stakeholders for its effective implementation of VAT. The theory and practice of VAT is not free from misunderstanding and misinterpretation among its stakeholders. The business community levels as well as the consumers don't seem to be supportive in its implementation; there seems some information gap between the policy makers and its stakeholder. The study has focused on the background of VAT and its development, trend of VAT collection, its contribution in the national economy and the level of the public awareness towards VAT in Nepal.

1.3 Statement of the problem

Nepal is a underdeveloped country. her economy is vulnerable to minor changes due to its rugged topography, low productivity, and the lack of industrialization, dependence on India, landlockedness etc. So, she is in need of effective collection system for her treasure that will be mobilized for the welfare of her citizens ultimately results in the development of the country. For the purpose like other developed nations Nepal has brought different reforms in the tax collection system. Among them introduction and implementation of VAT in place of sales tax is one of them. Its implementation has not been successful till the date. For the development works of the country there is the need of the financial resource. Among the source of nation's treasury tax collection is one of them. Most of the people are uneducated as a result we can't aspect greater that they are aware towards the tax and tax collection system. This is the main cause why the government is always unsuccessful to collect its targeted tax revenue. Moreover VAT has been new term and educated groups too. Since its has some technical aspect consumers aren't aware of it as a result tax evaders are benefited while the nation has been adversely affected. So the main problem of the study is to find out the current level of public awareness towards VAT in Nepal. The major issues the present study attempts to resolve are as follows;

Whether the theoretical aspects of VAT is considered by Nepalese tax authorities consistently?

What is the contribution of VAT to total GDP and GNP of Nepal?

What are the major practices of VAT in Nepal?

Whether the tax payers are aware about the system of Vat applied by Govt.?

1.4 Objective of the study

a. To review the theoretical aspect of VAT.
b. To find out the contribution of VAT on total tax, GNP and GDP
c. To study the practices of VAT in Chitwan District.
d. To provide appropriate suggestions for the improvement of VAT system in Nepal.

1.5 Rational of study

In Nepal most of the plans regarding tax collection do not meet the target as a result the nation is unable to collect the targeted revenue. There are many other reasons behind it but among them the major problem is most of the people are uneducated moreover those who are educated they are also ignorant about tax and tax collection system. So this study will find out the level of public awareness towards VAT in Nepal, which is the major source of revenue. Beside that how can the awareness level be increased that finally result in public support to the VAT system from their heart? This will become the support to the tax office.

1.8 Limitation of study

The limitation of the study is as follows:

- The survey is done only in Chitwan that may not represent the whole population.
- The sample consists only 100 respondents which might be too small sample size for generalization of results.
- There may be greater personal prejudice as the direct personal interview is employed in the study.
- Mostly the sellers are irresponsive to answer the questions regarding the tax matter so they may have given made answers.
- Information regarding the contribution of VAT in the GDP is collected from the secondary source.

1.9 Organization of the study

Chapter I: Introduction

This chapter includes the brief background and definitions of the tax and VAT. This study is concerned with the historical development of VAT, contribution of VAT in GDP and the public awareness towards VAT in Nepal. This chapter includes the sub chapters like statement of the problem, objective of the study, rational of the study, limitation of the study and organization of the study.

Chapter II: Conceptual framework and Review of literature

This chapter includes the literature related to the findings of a few past researches in contribution of VAT in the national economy, historical background of VAT in the world as well as in Nepal, its implementations and success rate and the public awareness towards it.

Chapter III: Research methodology

In this study, the survey research is being adopted. Most of the information for the study is collected from the books, tax journals, tax newspapers, budget and websites related to tax and VAT.

Chapter IV: Presentation and analysis of data

The collected data are thoroughly checked complied and presented in appropriate table to facilitate analysis and interpretation. Tabulation is done to get answers for the specific objectives. Analysis is done descriptively as well as statically. For the statistical tools such as percentage, bar graphs, pie chart, line graph and trend analysis will be used.

Chapter V: Summary, conclusion and recommendation

This chapter will include the summary of the study, conclusions drawn and the recommendations made in this study.

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CHAPTER -II

CONCEPTUAL FRAMEWORK AND REVIEW OF LITERATURE

Value Added Tax (VAT) is the most recent innovation in the field of taxation. It is considered as the reformed from the sales tax. Sales tax is levied on the sales of goods and services, is commonly divided into three groups namely: turnover tax, single-stage tax and VAT. Turnover tax is levied at all the stages of production and the distribution process. The single tax many be levied at manufacturing level or at Wholesale Level Sales Tax (WLST) or at Retails Level Sales Tax (RLST) so the single tax is known as manufacturer's tax, wholesaler's tax and retailer's tax. On the other hand VAT is imposed on the value added each stage of production and distribution. VAT is the multiple stage tax, which grown as the hybrid from of the turnover tax in the sense that VAT is also charged on all stages of production and distribution process. VAT however differs from the sales turnover tax as the later is imposed on the total value at each stage while the former is imposed only on the value added at each stage. VAT is similar to the retails stage sales tax. Theoretically, VAT is broad - based as it covers the value added to each commodity by a firm during all stages of production and distribution process. There is presumption that VAT is shifted completely to the consumer.

VAT is an indirect tax on consumer's expenses. It is normally borne by the consumer in the price paid for goods and services. It is also charged on the business transaction. VAT paid is refundable. Under what condition it is refundable varies from country to country. The expenses, which are eligible for refund, vary from country to country but may include hotel, accommodation, car, rentals, meals, petrol, conference and trade show cost, profession fees, training courses, inter company expenditures. Canada allows a refund of expenses on hotel accommodation only. The following countries allow refund for non-resident companies to file for funds: Austria, Belgium, Canada, Denmark, Finland, Ireland, Italy, France, Korea, Liechtenstein, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and U.K. There are some norms for filing the refund. The applicant must submit an original invoice from the Foreign Service Provider, credit card statements, but carbon copies and duplicate is not accepted in Canada. Such requirements vary from country to country. European authorities return original Invoice on all paid claims when filing for claim.

It takes sis to eighteen months to receive a refund. The time for refund varies from country to country. Most of the countries impose one of two filing deadlines June 30^{th} or December 31^{st} . In Canada depending upon the location requires invoices to submit for refund within one year of the invoice is issued. (WWW.VAT.COM)

VAT is levied on the value added to goods and services. The value added for the firm is the gross receipt from the sales minus all expenditure on goods and services purchased from other firms. In the production and distribution process, a firm buys materials, auxiliary raw materials, chemical, electric capital goods, such as machinery, equipment, buildings, furniture, vehicle etc. The firm adds value to these purchased materials by processing or handling them with the help of its own factors of production, such as land, labor and capital etc. This increase in the value of the output over inputs is the value added by the firm. In order words, looked at from one angle, Value added a firm employs the sum total of the incomes paid out by the firm to the factors. This means that the value added by the firms is equivalent to its payment of wages, salaries, rent, interest and the profit of the firm. This value added is the base of the VAT calculation. For example, if a wholesaler purchases an article from the producer at Rs. 500 and sells it to a retailer at Rs. 650, then the value added at the wholesaler level is Rs. 150, Rs. 150 are the based for the VAT calculation. 13% Rs. 150 is Rs. 19.5, which is the VAT imposed at the wholesale level.

Let us suppose that a producer has imported raw materials at the rate of Rs. 50 to manufacture the goods. The producer then used the raw material to prepare the finished goods and sold it to the wholesaler at Rs. 100, the wholesaler then sold it to the retailer at Rs. 130 and finally the retailer sold it to the consumer at 150. AT this condition the value addition at different levels is Rs. 50, Rs. 50, Rs. 30 and Rs. 20 at import, production wholesale, and retails levels respectively. These amounts are the bases of the VAT calculation at different levels. VAT calculated at 13% at import level Rs. 6.5, at production level Rs. 6.5, at wholesale level Rs. 3.9 and at retail level Rs. 2.6. The total VAT amounts to Rs. 19.5.

2.1 Theoretical aspect of VAT

2.1.1 VAT Records

Value Added Tax (VAT) is tax based on the transaction of goods and services. The taxpayer has to maintain accounts of his/her transaction. This type of accounting is simple. For this purpose, the taxpayer has to maintain a purchase book, a Sale book and VAT accounts. Besides that has to issue tax invoice or abbreviated tax invoice while selling/supplying goods or services. A brief introduction to the accounting system related to these is described below.

2.1.1.1 Purchase Book

A registered taxpayer has to maintain a complete record of all the purchase and imports made of goods and service the tax amount paid should be stated. A sample of purchase book is as follows:

- 'Purchase of non taxable' implies purchase or import of the items listed in schedule 1 of the VAT Act. This list includes primarily goods and services related to basic needs, social welfare service, goods made for the use of disabled persons, educational and cultural goods and services etc.
- 'Purchase of taxable' implies the purchase of those goods and services within the country. Taxable imports imply the import of goods and services that is not in the 'tax exempted' list of goods and services.
- The purchase book does not have to be submitted at the VAT office, but has to be shown at the time of inspection or if and when the tax officer wishes to see it.
- The person has to get the purchase book certified by the tax officer either by taking it to the Inland Revenue Office or at the time when the tax officer comes on business inspection.
- The purchase book has to be maintained safely up to a period of six years after the transaction period is over.

(Pandit, 2000)

2.1.1.2 Sales Book

The sales book is similar to the purchase book. The sales of good and services throughout the tax period should be recorded in this. An example is given below.

- In the sales book, the date when the sale was made, the invoice number, and the name and registration number of the buyer has to be stated. Similarly, the total sales value, the sales value of non-taxable goods, the zero-rated sales value, the sales value of taxable goods and the amount of tax should be stated
- 'Sales of non-taxable' implies the sales of the items listed in schedule 1 of the VAT Act.
- Zero-rated sales imply the sale of those taxable items, listed in Schedule 2 of the VAT Ac within the country of their export outside the country.
- The person has to get the sales book certified either by taking it to the Inland Revenue Office or by the concerned tax officer at the time when he/she comes on an inspection of the transaction of the taxpayer.
- The purchase book does not have to be submitted at the IRD office, but has to be shown when the tax officer wishes to see it.
- The purchase book has to be maintained safely up to a period of six years after the transaction period is over.

(Pandit, 2000)

2.1.1.3 VAT Accounts

VAT accounts are an integrated, abbreviated version of the purchase book and sales book as described above. The VAT account shows the tax paid on purchases, the tax collected through sales and the self-assessed tax amount that has to be paid to the Government by the taxpayer.

The taxpayer has to maintain this account each month and keep it with oneself. This does not have to be submitted at the Inland Revenue Office along with the VAT statement but has to be shown to the Tax Officer when he/she wishes to see it.

2.1.1.4 Tax Invoice

There are two types of tax invoice:

Tax Invoice

A registered taxpayer has to issue a tax invoice while selling goods or services. But 'Tax Invoice' has to be stated as 'title' only in the first copy of the bill and not in the other two, out of a total of three copies. The first original copy has to given to the recipient, the second copy has to maintained in a separate record to be submitted at the tax office if and when asked for and the third copy should be maintained as record for the purpose of one's transaction.

An-Example of Tax Invoice

Invoice number Transaction date:

Seller's taxpayer identification number:

Date of issue of invoice:

Seller's name:

Address:

Buyer's name:

It is not necessary that all sellers have to issue the invoice in the pattern given above. Based on one's transaction, the invoice pattern can be changed with the permission of the tax officer, but all information contained in the sample pattern above has to be entered.

- 'Tax Invoice' should be stated as title only in the first original copy of the invoice.
- Issuing and receiving invoice is one of the prime duties of a VAT registrant.
- If a tax invoice is not issued, the VAT registrant has to face penalty and will also fore go the facility of tax deduction.

(www.ird.gov.np)

Abbreviated Tax Invoice

In the sale of up to NRs. 5,000 including tax, and abbreviated tax invoice can be issued. An example of an abbreviated tax invoice is given below. To issue an abbreviated tax invoice the taxpayer has to take the permission of the tax officer.

An Example of and abbreviated Tax Invoice

Date: ....

Invoice Number:

Seller's Name:

Address:

Taxpayer Identification Number:

Tax Rate (%):

- In case where most sales comprise of small items and low costs, the invoice can be issued by combining the items as 'some goods' under particulars.
- If the buyer demands a tax invoice instead of an abbreviated one then a tax invoice has to be issued.
- When calculating the tax amount to prepare the tax statement to be presented, the total amount in the tax invoice has to be multiplied by the tax fraction. (www.ird.gov.np)

2.1.1.5 Credit or debit note

- If there is a difference in value after the commodity or service has been supplied based on the tax invoice, then a debit or credit note has to be issued.
- When issuing such a note it has to be stated whether it is a credit note or debit note.
- The relevant tax invoice number also has to be stated.
- If the goods have been returned the reason for doing so has to be stated.
- The item returned along with its cost has to be stated.
- The difference arising in the tax amount after the debit or credit not has been issued also has to be clearly stated.

(Pandit, 2000)

2.1.1.6 When an Item Purchased is to be returned

The quantity, quality and the nature of the item is the same:

- If an item purchased is damaged, torn or stained and exchanged with the same or similar item, the same tax amount stated in the tax invoice has to be maintained. Or, since the tax invoice has already been issued, preparing a credit not and issuing a new invoice can exchanged the item.
- If an item purchased is damaged torn or stained and is exchanged with the same or similar item, the same tax amount stated in the tax invoice has to be maintained. Or since the tax invoice has already been issued, preparing a credit note and issuing a new invoice can exchange the item. If the item is similar but cost is different.
- Let us assume that the cost of the item purchased was NRs. 100. But at the time of exchange, if for some reason the cost has come down to NRs. 75, then a credit note has to be issued.

- If for some reasons the cost of the above item purchased at NRs. 100 has reached NRs. 150 at the time of exchange, then the tax amount on the additional NRs. 50 have to be charged and a reference to the tax invoice number has to be made. **(**www.ird.gov.np)

2.1.1.7 Others

Once the purchase book, sales book and the VAT account have been prepared, it will be easy for the taxpayer to calculate the tax amount that he/she has to pay while preparing the VAT return. To estimate how much tax has to be submitted to the Government within a stipulated time period, the tax incurred has to be deducted from the tax collected within that period. If the tax collected is more than the tax paid, then the person has to submit that extra tax amount received from sales to the Government. But, it the tax paid in purchase is more than the tax collected from sales then the person can adjust the extra amount in the tax due in the following month. If this process continues for six consecutive months and the amount is still not adjusted then the taxpayer can write an application to the concerned Inland Revenue Office to get a refund of the amount that has not been adjusted. Once such an application is received, the tax officer has to refund this amount within 60 days from the date that the application has been received. If the amount due is not refunded within 60 days, it has to be paid back along with interest.

2.1.2 Types of VAT

There are three types of VAT according to their modes of treatment of capital goods. The various types of VAT are:

Consumption type

If all the goods (investments) bought from other firms are excluded from the tax base (Value Added in the year of purchase but depreciation is included in the tax base, it is known as consumption type VAT. It can be clarified by the following question.

Value added Tax base = wages + interests+ rents+depreciation+profit-capital Purchased from outside (in the year of purchase)

Or

Value added Tax base = sales-purchase (including purchase of capital goods from outside in the year of purchase) (www.ird.gov.np)

The above equation clearly shows that the tax base is consumption because investments (Capital goods purchase from outside the business use) are free from taxation. Under this type of VAT investment is encouraged because it is excluded from tax base. Similarly, imports are taxed whereas exports are relieved from tax.
Thus, tax base from the nation under this type is equal to domestic consumption of the country. Nepal has adopted it with tax credit mechanism from very beginning.

The Income Type

Under this type of VAT, capital goods purchased from outside suppliers are also included in the tax base in year of purchase but the depreciation is excluded from the tax base. The following equation makes clear idea about the tax base under it.

Value Added Tax base = wages+interest+rents+profits+capital goods purchased from outside (in the year of purchase)

Or

Value Added Tax base = sales-purchase excluding purchase of capital goods from outside (in the year of purchase)- depreciation. (www.ird.com.np)

The above equation clearly shows that the value added is equal to the consumption plus net investment. It means the tax base for the nation is net national income that comprises the consumption and net investment of all firms within the country.

The gross national type

The production type of VAT includes capital good purchased from other firms in the tax base in the year of purchased and also includes depreciation in the tax base. It can be clearly shown by the following equation:

Value Added Tax base = wages+interest+rents+depreciation+profit+ goods+purchased from outside (In the year of purchase)

Or

Value Added Tax base = Sales - Purchase excluding purchase of capital goods from outside (in the year of purchase)

The aforementioned equation obviously shows that tax is imposed both on consumption and gross investment. This means that Value Added by all firms within the country constitutes the Gross Nationa Product (G.N.P). That is why the tax base of this type of VAT is conceptually equal to the GNP, Thus, this type of VAT is also termed as "Gross National Type of VAT" (www.ird.com.np)

Methods of calculation of VAT

VAT is levied on the sum total of value added by a firm in due course of production and distribution. There are three methods of calculation of VAT.

2.1.3.1 Additive method

This method is also known as the direct value added computation method Under this method the tax base so obtained by adding the incomes produced by the firm, In order words, the tax base is computed by adding the payments made by the firm to the factors of production employed in turning out the product such as wages, interest, rent, royalties and profit. This method is appropriate for the income types of VAT that included in its base the rewards to all factors. (www.ird.com.np)

2.1.3.2 Subtraction Method

Under this method, value added is determined as net turnover, which is obtained by subtracting the cost of materials from sales proceeds. Thus, VAT is levied on the amount, which is derived by subtracting purchase from sales. This method is appropriate for the consumption Variant VAT. (www.ird.com.np)

2.1.3.3 Tax credit method

This method is known as the invoiced method. Under the method, tax is levied on the total sales and taxpayers are permitted to deduct from their gross tax liability the tax they have already paid by their suppliers and passed on to them. Thus, in contrast to the subtraction method, which deducts purchase from sales and levies taxes on the difference, tax on purchase in subtracted from the tax on sales under the tax credit method. (www.ird.com.np)

2.1.4 Principles of VAT

2.1.4.1 Territorial Scope

Because the VAT is an indirect tax focusing on the transaction or activity rather than on the economic operator, the primary determination of the territorial scope of the territorial scope of the charge to VAT is by reference to the location of a transaction if the transaction occurs within the state, then it is within the charge of VAT. Attention must also be paid to the person to be charged to VAT on the transaction, to ensure that the amount of VAT due can be enforced and collected. It is therefore necessary to provide rules to determine the identity of the person responsible for payment of the VAT when some element of the transaction being taxed takes place outside the jurisdiction of the state.

There are conflicting principles on which the territorial scope of VAT can be based: The origin principle and the destination principle. As these names suggest, the origin principle charges a transaction, only part of which occurs within the jurisdiction, if the transaction originates or is created within the state and the destination principle charges the transaction if it is destined for consumption in the state. Potential problems of double taxation; states that impose a VAT on imports remove exports from the charge to tax. This will also remove double taxation if both states have the same system. There is no international agreement either determining that states should follow one of these principles rather than the other of seeking to reach common rules to avoid double taxation. In practice, however, and with limited exception states have adopted the destination basis as the primary basis.

The main exception is that of Russia and states within the commonwealth of independent states, adopting an origin basis. The European commission had formally proposed that the European Union Change from the present destination basis to a form of origin basis, originally for 1997 for transaction within the EU, although that date now been deferred.

Internal Charge to VAT

The common pattern of Invoice based VAT is that a charge to VAT is imposed on all transaction within the state and within the scope of the VAT. Each taxable person is allowed a deduction against the total VAT charged by the person to take account of any VAT paid by the person on inputs related to transaction within the scope of VAT.
A transaction within the scope of VAT and on which VAT is imposed is commonly called an output and the VAT collected on it is called output tax. A transaction made to the person making the output is known as an input, and the VAT paid by that person when obtaining the input is an input tax. The internal charge to tax is charge amounting to the output tax received by a person less the input tax paid by the person.

The normal approach is to impose output tax on transaction and person if

- The transaction are "supplies of good and services"

- Those supplies are "taxable and exempt from VAT"
- Those taxable supplies are made by a "taxable person" that is a person within the scope of the charge to VAT and
- The taxable person makes those supplies as part of the person's business activities and not as part of a hobby of non-commercial activity.

(www.ird.com.np)

2.1.4.2 Approach of VAT on imports

States have normally adopted the practice of treating imports of good separately from imports of service. Imports of goods are identified by the physical entry of the goods. Services can not be identified in this way. Instead stated have chosen to adopt rules that treat a supply of a service as occurring within a state if the supply meets certain criteria. An import of service is taxable only if the supplier is a taxable person. Since there is usually a registration threshold for VAT, a foreign supplier that supplies only services with a low annual value may not be a taxable person.

2.1.4.3 Principle of Non discrimination

The existence of separate charge on locally supplies goods and imported goods gives rise to the possibility of discrimination between the two classes of supplies.

Most states are obliged by international agreement no to discriminate against supplies by way of import. The primary source of this obligation is Article III of GATT. A growing number of states are also under other obligations include the terms of customs unions and free trade area agreements, double tax agreements and bilateral trading and investment agreements.

2.1.5 Taxable persons

2.1.5.1 Taxable person within the scope of Law

A person within the scope of VAT is usually as a taxable person. A VAT law should include all legal person created under the law of the state that engage in economic activities of any kinds, as well as all physical persons. A VAT law may regard an association or partnership, although the association does not for general legal purpose, have separate personally. Government bodies at the national, regional and local levels are to be included as taxable persons.

2.1.5.3 Excluding person with low levels of Business Activity

Most states require only some of the many persons active in business within the state to be taxable persons. Setting a minimum level or threshold of business activity and requiring only those persons with levels of activity above the minimum to be taxable person normally achieves this. Those with levels of activity below that level are not required to be taxable persons, although they are often given the right to voluntarily choose to be taxable person. The usual measure of business activity is the total turnover of taxable goods and services supplied by the person over a set period.

2.1.6 VAT Register

To administrator the VAT, it is standard practice to establish a formal state register of those who are registered person. There must be a requirement that any person who is, or should be a taxable person take the necessary action to seek to be registered for the VAT.

2.1.6.1 Voluntary Registration

States often allow those who are not required to be registered to register voluntarily. This may be appropriate for many organizations that intend to have a large turnover, but have not yet reached it, incur large expenditure in one year, expecting the income in the next year, or are carrying out business with this information to be known by the customers. Voluntary registration also allows those operating just below the threshold level to avoid any competitive disadvantages compared with other operators who are required to register.

2.1.6.2 Exporters and Person engaged in international activities

In most of the states VAT is not levied to the exporters. To avoid the exporters from paying VAT provisions is made for them to claim back any input tax they have paid in making the exports. Therefore, exporters and those in a similar position must be registered. If they have not registered then they are not entitled to claim back the input tax.

2.1.6.3 Effect of not registered

A person who is to register for the VAT is taxable person who is subject to collect VAT on all supplied whether or not the person is registered.

2.1.6.4 Cancellation of Registration

There are main three conditions for the cancellation of VAT registration. The first case is where a person has been registered for VAT property or not, the person registered for VAT but if this current level of business is below the threshold then his registration for VAT is cancelled. The second case is when the person is not allowed to carry any business activity by the law. The third case is when the person has registered for VAT by mistakenly or by misrepresentation on the part of the person.

2.1.6.5 Continuing registration despite a charge in the taxable person

Situations will arise where a person ceases carrying on a business unavoidably. For example, the death, insolvency, winding up of a company may mean that the person registered as running a business is no longer running it. The business will usually continue at least for a time to be run by some other person.

2.1.7 Supplies of goods and services

2.1.7.1 Transaction within the scope of Law

A board-based VAT brings its charge every kind of economic transactions, subject to limited exemptions. Transactions are usually stated to be within the scope of VAT if they are supplies of goods and services. The aim is to bring within the charge of all economic activity. The terms cover transaction dealing with land or other immovable property and with intellectual property rights.

2.1.7.2 Supplies of goods

Supply of goods is a transfer of right to dispose of tangible movable property or of immovable property other than land. A supply of goods is not constituted merely by transfer of possession, which is a transfer of the use of goods, not of the goods themselves.

2.1.7.3 Supplies of services

A supply of services is often defined as any supply within the scope of VAT that is not a supply of goods or a supply of land. A supply will occur whenever there is some transaction or event involving a taxable person whereby the taxable person receives payment for the effect of that transaction or event.

2.1.7.4 Supplies by employees

The service undertaken by an employment for the employer that employee does not form a supply made by that employee. An employee can never be taxable person by providing that a person is taxable person is respect only of supplies made by that person immediately.

2.1.7.5 Supplies by agent

When a supplier supplies goods or services through an agent to another person, the supply is made not by the agent but the supplier. An employee is the employer's agent. The employee's service, if supplied directly or indirectly to a third person, is a supply by the employer.

2.1.7.6 Mixed supplies and multiple supplies

On board practical rule is to treat any supply incidental to a main supply as part of that main supply.

2.1.7.6.1 When a supply of goods takes place

Generally a supply of goods takes place when a VAT invoice issued for the supply goods are delivered, goods are made available, the goods are removed or transported to the customer, or the goods are paid fully partially.

2.1.7.6.2 When a supply of service takes place

Services are not delivered or appropriated in the same way as goods. Instead it is usual to determined the time of supply by reference to when the services have been rendered.

2.1.7.6.3 Where a supply of goods takes place

The VAT usually based on the destination principle that is with goods being subject to VAT where they are either received or consumed. For this reason, the goods crossing frontier are subject to a regime similar to custom duties on arrival. Therefore it is necessary to clarify where goods are received. In the case of imported goods, the adoption of customs law will help deal with this problem.

2.1.7.6.4 Where a supply of services takes place

Determining the location of a supply of services ca be a matter of considerable difficulty, especially for international services. Custom rules can not be used because they do not apply to services. There is no clear and universally accepted answer to the question of how to treat international services. The primary rule in the European Union is that the service is supplied where the supplier has established his business or has a fixed establishment or his permanent address or where he usually resides.

2.1.8 Treatment of imports

The destination principle requires a charge to VAT to be placed on all imports. This is usually done.

2.1.8.1 Taxable supplies

A taxable supply is the supply or transaction on which VAT is imposed. When taxable supply is made and then a taxable person must be imposed and collect VAT and account for it to the tax authorities. Even if the person does not do this, the tax authorities are still entitled to collect VAT from the taxable person on the assumption that the VAT has been imposed. VAT is a tax on supplies made in the course or furtherance of economic activity or put another way as part of a business. So it is confined to activities of this nature and is not imposed on other activities such as the personal hobbies of individual gifts made for personal reasons or charitable activities with any business or commercial content.

2.1.8.2 Payment for a supply

A supply is made for payment, consideration or compensations if the taxable person making the supply receives or is entitled to receive, payment for the supply. For this purpose, it does not matter in what from the payment is made. An exchange of goods is a supply for payment or consideration by both parties to the bargain as is a supply of goods in exchange for the provisions of services by the person receiving the goods. In addition, it does not matter, who makes the payment.

It will usually come from the person receiving the supply, but the source is irrelevant. Therefore some laws make it clear that all forms of payment are to be included as payment of consideration for the supply even if this includes grants made by public authorities or other third parties.

The concept that a supply is within the scope of VAT only if there is payment or consideration for it allows from the fundamental nature of the tax as one imposed on the value added by a transaction. If a supply does not result in gain for the supplier, the same reasoning argues that the consideration should include all forms of payment received by the supplier, in cash or in kind, whenever and however paid and regardless of who pays them.

2.1.8.3 Transaction where no payment is payable

In principle, if there is nothing paid or payable for a supply, then it is not a taxable supply. Safeguards are needed to prevent the operation of this principle from allowing transaction to escape a charge to VAT in appropriative situations.

2.1.8.4 Supplies where payment is not full

Together with transaction for which no payment is made, but where it is deemed to be made, mention must be made of supplies where the payment made is than the full payment or consideration that should or might be paid in the open market. If some payment is made, then the supply is within the scope of Vat.

2.1.8.5 Exempt supplies

Exempt supplies are not taxable supplies. The standard way of dealing with this is to exempt certain form of supply that are otherwise with the scope of VAT from liability to VAT. By contrast, some states have adopted the practice of listing those supplies that subject to VAT.

It is open assumed that exemption results in the reduction of the VAT burden on the supply. This is true if the person supplies is a consumer and is not receiving the supply. It is not true if the person supplied is taxable person. Exemption of a supply to a business results in an increase in the burden of VAT on the supply.

The reason for this is that the person running the business can offset the VAT against the VAT charged by the business, so claiming a full rebate for any VAT. The person making the exempt supply will probably have had to pay VAT on some part of the supplies made to it and will therefore have to pass some VAT on the business as a part of its price.

It is this VAT that can be recovered if the supply is subject to tax, but that can not be recovered if it is exempt. To avoid the distortions cased by this failure to recover, it is good policy not to exempt the types of supply that are typically made to business.

New Zealand has maintained special exemptions on land and buildings supplies by nonprofit organizations and individuals and financial services. The tax exempt supplies can be put in to alternative taxes. States generally have accepted treaty obligations to exempt certain supplies or imports as a part of the recognition of diplomatic and consular immunities and of similar immunities for international organizations. There involve immunity from taxation for the embassies and consulates and for the recognized diplomats.

International practice recognizes agreed categories of goods that are exempted from customs duty on import. Practice on this is well established and ranges from the import of a limited quantity of goods bought duty free in other states to exemption of gifts to charities or similar organizations.

2.1.8.6 Taxable Value Supplies

2.1.8.6.1 Charge to VAT

VAT is designed as a tax levied as a proportion of the value added on any taxable supply. It is therefore necessary to attribute a value to all taxable supplies to ensure that this objective is achieved. To be consistent with the fundamental principles of the tax the value to be taxed must reflect the value added by the supply.

2.18.6.2 Value of International supplies

The general rule for valuing a supply for VAT purpose is to value it at the total of all payments, or consideration, that the supplier receives or is entitled to receive as a result of the supply. In other words, the value is taken as the actual realized value.

2.1.8.6.3 Tax inclusive Vs. Exclusive Base

The Value of a supply should be taken as including all other taxes paid on that supply. VAT is not an alternative from the excise tax or custom duty, but is a separate tax. Both custom duties and excise taxes reflect the stat's separate decisions to increase the price of the dutiable and excisable products by the amount of the duty or tax. That represents the value of final consumption of the goods for the VAT purpose and is therefore the basis of the Value for VAT.

It is felt that the combined effect of excise duty and VAT on a product is too high, the answer lies in adjusting the level of excise duty not of the VAT.

2.1.8.6.4 Fair market value of supply

The open market price or some other objectively determined price will need to be determined in any case where a supply is treated as made for consideration although no consideration is actually paid or payable.

2.1.9 Adjustments and Rebates

The Value added is always the discounted price. This is both consistent with the principles of the tax and the most practical answer. Complication arises where the effect of a discount or an arrangement on purchase result in later adjustment. In this case no amount should be taken of the charge in connection with the first transaction.

2.1.9.1 Value of imports

In the special case of imports of goods it is standard practice to use the customs value of goods as the amount for VAT calculation, subject to specific adjustments. The customs value generally represents an international agreed upon approach to the valuation of goods subject to customs duty and therefore minimizes the scope for difficulty or dispute in levying VAT on import.

2.1.9.2 Payment of VAT

There are two elements to establish how much VAT the taxable person must pay to the tax authorities. The fist is the rate of VAT to be paid on the value of the supply. The second effect is the offset of input tax against output tax to identify the net VAT payable.

2.1.9.3 Rates of VAT

It is generally accepted that the VAT should not be used as a vehicle for imposing luxury rate of indirect tax. VAT will have a main or basic rate and one or more lower rates. Arguments for lower rates therefore concentrate on socially important goods such as food and socially important services that are not exempted or outside the scope of VAT.

2.1.9.4 Zero Rates

A zero rate means that, while no VAT is due on the supply, the supplier remains entitled to claim any tax incurred in making that supply and is therefore entitled to a refund of that input tax if there is no output tax against which to offset the input tax. From one point of view a tax rate of 0% is nonsense. It is not a rate of tax, and no tax is collected. A zero rate is therefore an exemption of the supply from output tax.

2.1.9.5 Zero Rating exports and international supplies

The main use of zero rating is to deal with exports of goods and exported supplies of international services. The destination principle calls not only for removing a direct charge to VAT from exports and international services but also for removing any VAT indirectly impose on those supplies in the from of the input tax paid by supplier. Few states zero rate some internal supplies. This is widely viewed as inappropriate because it amounts to subsidy of the activity or transaction treated in this way. It would be better to identify the policy reason for the subsidy and address it through a direct subsidy.

2.1.9.6 Paying VAT to tax authorities

A taxable person is liable to pay VAT to the state authorities at regular intervals after deduction of any allowable input tax.

2.1.9.7 Entitlement to Credit for input Tax

Any VAT incurred by taxable person as input tax should be repaid to that person in some way. The usual method of repayment is allowing the input tax to be set off as a deduction of credit against output tax collection during the same period. A duty is imposed on the taxable person to pay only the net amount to the tax authorities.

2.1.9.8 Partial Exemption

The principles are that input tax incurred only for the purpose of making taxable supplies is allowed, but input tax incurred only some other purpose or purpose should not be allowed. Input tax incurred partially for the purpose of making taxable supplies and partly for other purpose should be apportioned so that only the part devoted for making taxable supplies is available for credit.

2.1.9.9 Disallowed Input Tax

It is increasingly common practice for states to deny input tax credit for certain kinds of supply. The main group may be described as supplies of or for luxuries, amusement or entertainment.

2.1.9.10 Capital Goods

For revenue protection reasons, some states have rules that input tax on capital goods or certain kinds of capital goods to be set off over a period of years in much the same way as the deduction of capital expenditure is controlled by capital allowances or depreciation for income tax purpose.

2.1.10 Procedures and Administration

2.1.10.1 Need for specific VAT Rules

Legislative approaches to dealing with administrative and procedural provision of tax law vary from state to state. In general, there are distinct advantages combining as far as possible the procedure and administration of VAT with that of other taxes.

2.1.10.2 Combining VAT and Customs administration on Imports

The case of combining the collection of VAT on imports with the collection of customs duties if particularly strong. This approach ensures that powerful provisions exist to handle VAT on Imports with minimum of legal difficulty, administrative provision and taxpayer's confusion.

2.1.10.3 Handling VAT on Internal Supplies

There is also strong argument for combining the administration of the direct taxes. In particular, many taxpayers with business income will also be taxable persons for VAT purpose.

2.1.10.4 Regulations, Instructions and Guidance

The tax an invasive tax and potentially applies to every aspect of the economy.

2.1.10.5 VAT Invoices

A VAT invoice, chit, bill roll print or other document that is issued by a taxable person who makes a taxable supply and that records the supply and the amount of VAT payable on it. In an invoice-based VAT system the issue of invoices in the proper form is an essential part of the procedure for imposing and enforcing the VAT. The requirement that a special invoice be issued is a feature unique to VAT.

2.1.10.6 VAT Returns

There should be a standard from return, so that taxable persons know precisely what is required of them and can comply more easily with the formalities of making a return and so that the tax administration can process return effectively.

2.1.10.7 Payment of VAT

All taxable persons must pay to the tax authorities at specified time the net amount of VAT due for the VAT period on a self-assessment basis.

2.1.10.8 Assessment of VAT

Where a taxable person has not made a return a period for, which a return should have been made the tax authorities should be given reserve powers to impose and obligation on the taxable person to pay VAT to tax authorities.

2.1.10.9 VAT periods

The standard period is calendar month; often taxable persons with small levels of taxable turnover are allowed to use longer periods of three months or a year.

2.1.10.10 Payment of Excess VAT Credit

Where the input tax credit for any VAT period exceeds the output tax collected there is excess of VAT credit or of deductible input tax. As a direct result the taxable person will pay no VAT to the tax authorities for that period. In such case the tax authorities use that excess to offset future obligations.

2.1.11 Historical Background

The concept of VAT is originated from Germany in 1919. At the mean time Dr. Wilhem Von Siemen developed the philosophy and principle of VAT by recommending it for Germany to replace turnover tax (multistage sales tax) to avoid the problems of cascading effect. Professor Thomas S. Adams recommended VAT for the U.S.A. in 1921. A detailed structure of Value Added Tax was designed for Japan in 1949 to replace enterprise and turnover taxes. Due to the new concept and fear of its complicated nature, these countries couldn't introduce immediately. France introduced

VAT for the first time in 1954. Ivory Coast introduced VAT in 1960, while Senegal adopted it in 1961. Denmark and Brazil implemented it in 1967.

Among the SAARC countries, India introduced MoDVAT (Modified Value Added Tax) in 1986 for manufacturing products in order to correct excise duty. Pakistan, Bangladesh and Srilanka adopted VAT in 1990, 1991 and 1998 respectively. Now a day more than 115 countries have implemented VAT as an indirect taxation in the world.

The concept of introducing VAT was developed along with the eight plan (1992-1997) when the government indicated its intention to convert the import/manufacturing level sales tax into VAT in that document of the plan. Preparation of VAT was initiated in September 1993 when VAT task force was created in the sales tax and excise department in order to make the necessary preparation for the interlocution of VAT. A VAT steering committee was also formed to evaluate and monitor VAT preparatory activities. After the depth study on various aspects relating to the structure and operation of VAT, the task force prepared the draft of VAT law in 1994.(pandit,2000)

It was discussed in depth at several stages within taskforce with concerned parties. After reviewed by the steering committee, the draft was sent to various business groups for their comments. Although the business community did not provide any written comments on the draft of VAT law, the private sector opposed to the implementation of VAT.

Due to the disagreement of private sector and political instability in those days, the government did not indicate its commitment to introduce VAT. They expressed the arguments that the infrastructures and preparation were insufficient to implements the VAT effectively. In September 1995, along with the formation of coalition government, it committed to introduce VAT in the same fiscal year 1995/96. The VAT bill was presented to the parliament on December 1995. As per the parliamentary process, it was referred to the Finance Committee (a parliamentary committee) and the committee returned the bill to the parliament on the same month together with its report for amendments to few provisions. The lower house of the parliament passed the VAT bill on the same month while upper house of the parliament passed it on January 1996. (pandit,2000)

The Royal Seal was provided to "Value Added Tax Act. 1995 (2052)" on 21st march 1996. For the effective implementation and administration of VAT, the government established one VAT department in center and 17 VAT offices in different districts by changing the name of sales tax and excise department and its offices as VAT Department and VAT offices respectively.) 16th July 1996 (1st Shrawan, 2053). The Government has issued VAT rules 1997 (2053) in 24th March 1997. (www.ird.gov.np)

Since the strong opposition from the business community and from the opposition political parties, the government could not enact VAT laws immediately and had made a provision section 1.2 of Act and section 1.2 of the rules that VAT laws shall come into force on such date as HMG may specify by notification published in the Nepal Gazette. In this way the implementation of the VAT has postponed for some time although the Act. was already provided the Royal seal. The Act finally had come to force as government specified the date of implementation of VAT by publishing in the Nepal Gazette on 16th November 1997 (1st Mangshir 2054). However, it could not be implemented VAT in full phase since 17th July 1998 (1st Shrawan 2055). (www.ird.gov.np)

It has been introduced as an improved indirect tax for the replacement of the sales tax. It has replaced hotel tax, entertainment tax, and contract tax and has been supposed to collect the same revenue as the four taxes it has replaced. Now VAT is administered through Inland Revenue Department and Inland Revenue Office as Department of VAT and department of Taxation are merged as Inland Revenue Department since July 2001 (2058/04/01).

Nepal has adopted board based consumption type VAT with credit method. This means the tax base is domestic consumption only. Some social or political grounds including exports of goods and services are zero-rated. Some goods and services like goods and services of basic needs. Agricultural products, social welfare services, educational goods and services and cultural goods and services are tax exempted. Otherwise tax levied at 13%, which previously was 10%.

2.1.11.1 International experience of VAT

After three and half decades of proposition of concept of VAT by Dr. Wilhelm Von Siemen in Germany, France took the courage to put VAT into practice in 1954. In the 1960s, then European community adopted VAT as its standard tax system. Adoption of turned to be precondition to get its membership. Later VAT took global momentum during 1970s. Now, around 125 countries have incorporated VAT into their tax system and several new countries are sincerely contemplating the introduction of VAT.

while the VAT system of New Zealand stands as an example in the world, the implementation of VAT in Ghana for the first time was not a good experience. New Zealand, in 1977, was the first state to adopt a from of VAT with minimal exemptions. The New Zealand exemption are financial service, certain supplies by mosses profit bodies, certain supplies of accommodation and land; supplies of gold and fine metals. The threshold of NewZealnd, NZ $ 2500 was suggested to increase and later on it was raised to NZ $ 40,000.

The New Zealand example has been followed in Singapore. VAT was implemented successfully in Singapore. In the process of implementing VAT in Singapore, there was active involvement of various institutions. The high level of preparation and participation made it a success story. But the situation was just the reverse in Ghana. Low level of commitment at the political level impeded the implementation of VAT in the country. VAT was abolished after three months of its introduction in 1995 and was reintroduced again in 1998. Introduction of various exemptions distorted the basic norms of the system. VAT was introduced in 1995 and was abolished after a charge in the Government in 1997 and it was reintroduced in 1999 in Malta. (en.wikipedia.org/wiki/Value_added_tax)

China implemented VAT on Experimental basis in selected provinces and on selected goods only. In 1982, VAT implemented throughout China but only one selected goods.

The process of including more goods was extended from 1984 and VAT was implemented fully in 1994. Initially, this tax was limited to only the production stage of selected goods, both subtraction and tax credit methods of tax calculation were adopted, only a partial tax credit system was adopted, and several rates were applied. In addition, since this tax was levied on the basis of goods such as production tax, business tax, sales tax, etc. it became rather complex and China could not benefit much from this tax system. The experience of China indicates that in order for VAT to be effective it should be implemented fully no partially. India implemented M0D-VAT in 1986 on certain goods and this was gradually expanded. Owing to reason such as Indians federal system and the constitutional provisions that grant the rights to governments at different level to implement tax, it is not possible to replace the tax being imposed on goods and services at the central, state and local levels by VAT at the central level. The states of Maharastra, Andhara Pradesh, Kerala, West Bengal, Rajsthan and Uttar Pradesh made effort to convert their sales tax system into the VAT system. (en.wikipedia.org/wiki/Value_added_tax)

However owing to factors such as Maharastra establishing a very high threshold, some states trying to only partially implement VAT and the fact that the neighboring states had not satisfactory, the experience illustrated the fact that the implementation of VAT can not be successful if applied only to limited areas or on limited goods by establishing a very high or low threshold. VAT was introduced in Bangladesh in 1991. It has a uniform tax rate of 15 percent. It has exempted VAT experts, which has helped to boost its export trade.(en.wikipedia.org/wiki/Value_added_tax)

2.1.11.2 Introduction of VAT in Nepal

Measures for economic reform were introduced in Nepal after the restoration of the multi-party democratic system. Tax reform was a part of this economic reform and value added tax emerged as the main feature of the tax reform program. To bring about sustainability in internal resource mobilization, His Majesty's Government of Nepal adopted the policy to integrate the prevailing commodity taxes under VAT within the period of the eight five year development plan (1992/93-1996/7). In the budget speech of the fiscal year 1993/94 and the speeches thereafter the intention to introduce VAT declared. It was necessary to introduce this tax system owing to the following reasons:

- To increase revenue mobilization by broadening the tax base,
- To make the tax system neutral and efficient and
- To establish a fair and transparent tax system

The preparation for the introduction of VAT was commenced in September 1993. For this purpose a steering committee and a task force were formed. The financial assistance for preparatory work to introduce VAT was provided by the United State's

Agency for International Development (USAID) and the technical assistance by the Harvard Institute for International Development (HIID) of the Harvard University, USA. However, the announcement in 129094 to hold mid-term election brought about slackness in the preparation activities for VAT.

The new minority government dissolved the task force and the USAID activities were suspended. New coalition government decided to introduce VAT at the earliest date. As a consequence, the USAID/HIID technical assistance resumed and continued until the end of September 1997.

The VAT bill was presented to the parliament on 3 December 1995. It was referred to the finance Committee of the parliament, which held discussions over it on 24, 25 and 26 December 1995. The Finance Committee sent the bill to the parliament on 27 December 1995 together with its report for amendments to a few provisions. The lower House of parliament passed the VAT Bill on 30 December 1995 and the Upper House of parliament on January 1996. The VAT regulations were initially drafted in July 1996. Like the VAT Act. Regulations were discussed at different stages and finally approved by the cabinet on 27 January 1997.

As VAT was a new concept in Nepal, a comprehensive taxpayer education program was launched to import knowledge regarding the various aspects of VAT to parliamentarians, industrialists, businessmen, journalists, consumers as well as various sections of the society. Seminars and interaction programs were organized as the part of the taxpayer educational program. Interaction programs were also held with various specific associations and professional organizations. To educate the potential taxpayers and various sectors of the society on various aspects of VAT, brochures were prepared and distributed in large scale.
Through the budget speech of the fiscal year 1996/97, His Majesty's government of Nepal declared that all taxpayers should register within 90 days from April 16, 1997 and that VAT collection would commence from the beginning of the fiscal year 1997/1998. But after the change in the government in April 1997, the new government decided to postpone the date for VAT implementation and published a gazette notification declaring that VAT would commence on 16 November 1997.However after the implementation of this Act there stood strong opposition from the business community.

Nepal has adopted, as all VAT levying countries, the consumption type VAT with tax credit method. But within this provisions based n our specific context have been made regarding the following aspects: goods and services to be exempted, the threshold level, the structure of the tax rate, provisions of tax refund and tax credit etc. Therefore, mistakes have been observed in the VAT structure and operations process. VAT also puts pressure on the reform of customs duty and income tax. For example, to ease the implementation of VAT, the government had adopted the policy of accepting the transaction price for the purpose of customs duties and made provisions for the income tax to be assessed on the basis of VAT accounts. The practice of VAT in Nepal includes the following aspects:

2.1.12 Basic Features of VAT in Nepal

Type	Consumption type of VAT
Method of calculation	Tax credit method
Principle of levy VAT	Destination principle
Level Threshold	Rs. 2 million
Rate	13%
Provisions of exemptions	As per Schedule 1
Provisions of Zero rating	As per Schedule 2
Facility of tax refund	To exporters, diplomats, non exporters and Zero rated and exempt

Source: www.ird.gov.np

2.1.12.1 Taxable Supply

VAT levied on taxable supply, which is defined as the process of selling exchanging or delivering goods or services; or the grant of permission thereto or a contract thereof for a consideration. To be taxable supply the consideration can be in money of money's work.

2.1.12.2 Place of supply

Under the Nepalese VAT system the place of supply is defined as follows

Goods/Service	Place of supply
Movable goods	Point of sale or transfer
Immovable goods	Location
Imported Goods	First entrance point of customs
Goods supplied by the vendor	Vendor's Residence
Service	Point of service receipt

Source: www.ird.gov.np

2.1.12.3 Time of supply of VAT

General Rule	Earlier of the time of the supply or the issue or receipt of the payment
Special Provisions	Time of the issue of invoice for continuously provides services and date of first payment for partial payment

Source: www.ird.gov.np

2.1.12.4 Taxable Value of VAT

Expenditures to be included	All other related expenditure incurred by the supplies and taxes except VAT
Lower transaction Value	Prevelling market value is approved

Source: www.ird.gov.np

Tax Credit

It is necessary to meet the following conditions for entitlement of an input tax credit

In case of taxable supply	Inputs should be used only for taxable sales, should have valid invoice and should claim within one year
In case of mixed supply	Tax credit for taxable sales and no tax credit for exempt sales
In case of personal use	Partial tax credit for mixed use and no tax credit for only personal use

Source: www.ird.gov.np

2.1.12.6 Tax Refund in VAT

Refund to exporters	more than 50% sales as export
Refund to non-exporters	Excess tax credit constantly for half year
Refund to diplomats	zero rated imports and refund for domestic products.
Refund to others	Refund of VAT collected by mistake

Source: www.ird.gov.np

2.1.12.7 VAT Administration

2.1.12.7.1 Registration

Compulsory registration	Volume of transaction exceed the level of threshold
Voluntary registration	vendors falling below the threshold level for registration

Source: www.ird.gov.np

Deregistration

The taxpayer is deregistration in the following conditions:

In case of incorporated body	Closed, sold, and transerred
In case of partnership firm	partnership is dissolved
In case of sole trading	death of owner
In case of registered person	cases to be engaged in taxable transaction or registered in error

Source: www.ird.gov.np

Taxpayer identification number

TPIN is issued by the VAT administration. TPIN once issued for a particular taxpayer is not issued to others even the taxpayer is deregistered. The TPIN should be mentioned in the following documents:

- Tax invoice or abbreviated invoice
- Purchase and sales books;
- Correspondence to the VAT office;
- Documents relating to the income tax;
- Documents relating to the customs duties;

- Documents relating to the exports/imports; and
- Documents relating to obtaining loan from the banks or the financial institutions exceeding Rs. 1,00,000

  (www.ird.gov.np)

2.1.12.8 Invoicing

2.1.12.8.1 Tax Invoice

A VAT registrant is required to issue a tax invoice in the prescribed from whenever a transaction takes place. A minimum of three copies of each invoice must be prepared. The first copy must be given to the buyer and the vendor must retain the rest copies.

2.1.12.8.2 Abbreviated Invoice

VAT registrant may prepare abbreviated invoice under the following conditions:

- The recipient of goods or service for which an abbreviated invoice is issued shall not be entitled to put tax credit in that purchase.
- The abbreviated invoice shall not be issued for transaction exceeding Rs. 5000 inclusive of VAT.
- The registered person must keep the daily record of sales.
- Any cash rolls used by the retailer must be totaled daily and retained for inspection at any reasonable time.

  (Source: www.ird.gov.np)

2.1.12.9 VAT Accounting

Purchase Book	Account of the purchase for VAT use
Sales Book	Account of the sales for VAT purpose
VAT	Monthly summary of taxable purchase, sales and VAT paid on purchase; and VAT charged on sales.
Others	With prior approval of VAT authority

Source: www.ird.gov.np

2.1.12.9.1 Submission of return

A VAT registered must submit a VAT return to the concerned VAT office within 25 days of the month following the end of the accounting period. In case of compulsory registrants, it is necessary to submit VAT return every month but the voluntary registrants have to submit the returns on a trimester basis. Otherwise, the registrant will be subject to a penalty of 0.5% of payable tax per day or Rs. 500, whichever is higher.

2.1.12.9.3 Payment of Tax

If a registrant's output tax liability is greater than his input tax credit, the registrant is to remit the difference to the government with 25 days from the close of the month in which the tax liability occurred. If the input tax liability is greater than the output tax liability, the balance of credit is to be carried forward for the next month.

2.1.12.10 Tax Assessment

2.1.12.10.1 General

VAT is self assessed tax. Taxpayers determine their tax liability themselves and pay tax. But sometimes the taxpayers fail to remit tax on time sue to fraudulent reason as well as others. At this time tax authority may carry out tax assessment under the following situations:

- Tax return is not field
- Tax return is late
- Tax return contains incomplete information and
- The tax administration has the reason to believe that the tax is otherwise is declared.

  (www.ird.gov.np)

2.1.12.12.2 Computer Assessment

Computer prints out the list of non filers after 45 days of the expiry or the tax period. Then the computer assessment is carried out in the following ways:

- Find out highest amount declared by the tax payer in his tax returns during the previous 12 months from the VAT payable.

- If the tax payer has not field any return, find the turnover figure stated on the registration application. Divided by the number of filling periods in a year and then multiply by the VAT rate.
- Pick the highest figures in 1 or 2 above.

To increase the number found in 3 by 30% to get the assessment amount. Then the different sections exchange information for the accuracy of the calculation carried out by the computer and finally assessment orders are issued and distributed to the concerned parties.
(www.ird.gov.np)

2.1.12.12.3 Management Assessment

The tax officers do management assessment when a taxpayer receives updated information after submitting his returns and informs it to the tax officer or in the case of those taxpayers where tax officers find errors during the tax audit.
The management assessment process is given below.

- Tax officer assesses tax and determines interest and penalties;
- Tax officer creates management assessment on trimester basis in case of others;
- Management assessment must be batched and submitted to the computer section.
- VAT assessment will only normally extend back four years from the time the taxpayers is given the notice of assessment.

(www.ird.gov.np)

2.1.12.13 Collection

VAT administration collects tax through the following methods:

- Tax officers are empowered to recover tax dues from the credit in VAT debtors' accounts.
- Tax officers also can issue to third party who is indebted to the VAT debtor a demand for the payment of the money owed by the third party to the VAT debtor.
- Tax officers are also authorized to suspend the transaction of a VAT debtor.
- Tax officer also can withhold export/import of VAT debtor.

- Tax dues also can be realized by seizing and selling the property of the VAT debtor.
- Tax officers can collect tax arrears within six years of such arrears becoming due.

(www.ird.gov.np)

2.1.12.14 Penal Provisions

Type of non-compliance	Penalty provisions
Failure to register before the commencement of the business	Liable tax plus Rs. 10,000 or 10% of the payable tax whichever is higher
Non-issuance of invoice	Rs. 500 each time
Failure to maintain required account	Rs. 10,000 each time
Fraudulent or tax evading activity	Not exceeding 100 of the tax amount or 6 months jail or both

Source: www.ird.gov.np

2.1.12.13 Appeals

A taxpayer may file an appeal to the Revenue Tribunal within 35 days against a tax assessment or penalty order by a tax officer of an order by the Director General relating to the suspension of his place of transaction. Before filing an appeal, the tax payer must deposit the disputed amount of the tax assessed tax due; the rest amount of the tax due surplus the whole amount of the fine shall have to be deposited or a bank guarantee of the same has to be provided.

2.2.12.14 Tax law designing and drafting

It is International monetary fund publication. It deals with the drafting and designing of different tax laws. VAT is also discussed here. VAT has been dealt by David Williams. The article confers standard practices on VAT in the international context. It begins with the general introduction of the VAT. The present status of VAT, its terminologies, economic implication, territorial scope, charges to VAT and its principle of non-discrimination are covered in the introduction section.

2.2.12.15 Sales tax vs. VAT again

According to Nil Einne VAT, (as well as any other tax) distorts what would have happened without it. Because the price for someone rises, not all the goods that would have been traded were there no tax are traded. Correspondingly, some people are worse of than the government is made better off by tax income. In other words, a deadweight loss is created. The income lost by those being taxed is greater than the government's income; the tax inefficient.

There is a important additional function of VAT as a suppressant - cash flow. All inputs must be paid (cash outflow) inclusive of VAT. This money must come from somewhere. In many cases this is debt, with interest cost. If not debt then at the very least there is an opportunity cost (the money cannot be invested elsewhere) Sure there is VAT included in the sale price (cash inflow), but this is only received a while later. Therefore not only are intermediate companies administering and collection VAT on behalf of governments, they are also financing it. Furthermore, if a customer is late paying, the intermediate company must still pay the VAT over to the government even if they have not themselves been paid yet, which can be a further huge drain on cash flow. This alone has put many companies out of business and is a fundamental reason why VAT is major contributor to the far; far lower GDP per capita of EU when compared to USA.
(http//en/wikipedia.org/wiki)

2.2.12.16 VAT and Inflation

According to an article by Alan S.Tait based on his survey global voice in concerned countries introducing value-added tax is that the introduction of the tax would set in motion a spiral in which tax, prices and wages would feed on each other that is, VAT would be inflationary was heard. There are a number of variables influencing price change, and therefore, it is difficult to empirically assess the effort of VAT on prices. The impact of VAT on prices, therefore, cannot be strictly segregated from the general trend in inflation.

First, the taxes that have been replaced are also relevant. They could be a wholesale sales tax of the cascading type, a simpler VAT, a multistage ring system, a cascade production tax and so on.

Second, the design to yield equal or higher revenue also makes a difference. Third, other concurrent changes such as rise in oil or steel prices in international and internal market, increase in utility rates, changes in wage level, administrative changes such as tighter monetary policy, price control, monitoring of prices and so on, make due impact on the price rise. It is seen that the net price effect of VAT would be nil if the VAT is equal-yield tax. There would not be any effect on the overall price change although there may be changes in relative price. The tax being revenue neutral, the aggregate demand is unchanged and so there would be no impact on the aggregate price level. The economists all over the world have viewed that VAT not inflationary.

Thus, this brings us to conclude that the potentially inflationary effect can be constrained by government policies to inform the public and traders about the expected effect of VAT on prices, the use of price control, monitoring of prices, offsetting adjustment in other taxes and generous provisions to ensure to full credit for previously paid taxes on inputs. Moreover a mechanized form of Government can give it better shape through administration. (www.economywatch.com)

2.3 Review of Related Studies

This chapter is developed to the review of various contemporary literature of tax reform on VAT. In this section it is tried to review the existing empirical literature briefly on the subject in various developing countries including Nepal.

Carl S, Shoup(1969) explains values added tax as the latest and probably the final stage in the historical development of general sales taxation at the national level which is levied on the value added, the difference between the sales proceed and the cost of the materials, etc, that has purchased from other firms. VAT has eliminated the uneven impact of the turnover tax and the manufacturers and wholesaler sales taxes. A comprehensive consumption type of VAT is equivalent to a retail sales tax in its pure form except that the later does not after an option between the destination principle and the origin principle shoup has explain VAT differently in closed and open economy as follows.

Value Added Tax in Closed Economy

i. Gross Product Value Added Tax: Under this type of VAT, purchases from other firms that are deductible from sales exclude purchase of capital goods which includes any asset that will not be used up entirely within the tax year of purchase. Further depreciation in successive years is not allowed to deduct from the tax base. Thus this tax creates an incentive to the firms to use that method of production, which do not require capital assets and do not involve frequency year to year fluctuation in physical volume of inventories. Therefore, tax base = GNP = C+I=W+P+D

Where, C= Consumption, I = Gross Investment, W = Wages, P = Net profit after depreciation, D = Depreciation.

ii. Income type of Value added Tax: In this types of VAT, tax base excludes depreciation although purchase of capital goods are not permitted to deduct. Thus, Aggregate base NNI = C+I-D=W+P

iii. Capital exemption types of Value Added Tax: There are types of VAT which exempt purchase of capital goods from the tax base in either way a) Wages types of value added Tax: In a two-sector economy, the base for this type of VAT ID NNI after deduction from the firm's capital for that year. Therefore tax base = Yp=Y-p=C+I-D=W Where, Yp=NNP and Y=NNI. b) Consumption type of Value Added Tax: this type of VAT requires the deduction of full value of the capital goods purchased from the other firms in the same tax year but depreciation are not allowed to deduct in subsequent year. Therefore, tax bas = C=W+P+D-I

Value Added Tax in Open Economy

In an open economy, considering relative unimportant of the gross – product type of VAT from practical point of view, more focus is given to capital – exemption types of VAT.

i) Wage type of VAT: Under this type of VAT, in an open economy, the destination principle is less suitable as it would require each import be broken down into the same two elements, so that a tax rebate can be given for the value Added Tax paid domestically at earlier stges on the wage element. These complications are entailed under origin principle; moreover, no tax refunds on account of the exemption of profits will be required.

ii) Consumption type of VAT: Considering a two country world, this type of VAT under destination principle would exempt one country's firm's export sale and would impose a tax on the import purchase of another country's firm. This type would be much simple for both tax payer and tax administration under destination principle. The tax bases under two different principles are given by:

Under destination principle,
Tax base = C = W+P+D-X+M:

Under origin Principle,
Tax base = C+I = W+P+D-X+M:
I = capital goods purchased.

In conclusion, consumption type of VAT is regarded superior however, wage type of VAT is simpler than consumption type under the origin principle, While analyzing the computing method of VAT the author favors the tax credit method, however, the origin principle and the tax credit method are somewhat in compatible though perhaps not so much. So a country moving to the origin principle need give up the use of the tax credit method. Lastly, VAT a more productive and neutral tax is also complex and regressive in nature.

A study of VAT in developing countries undertaken by the IMF staffs (1973) states that many developing countries have been giving increased attention to VAT as a means of rationalizing their sales taxes and improving their revenue following the adoption of this form of tax by Western European Countries Comparative analytical methodology is being used to analyze the VAT structure of seven developing countries and its covers several issues such as revenue productively administrative difficulties and comparison of VAT with other sales taxes. The study considers that VAT can be mode neutral only. With a comprehensive a uniform coverage. More elastic and revenue productive by a lower rate ease in cross-checking, less incentive for tax evasion, and superior even than the retailer's sales tax on the ground of neutrally are the good features of VAT and achievement of these features largely depends on the implementation aspect. Experience shows that developing countries are adopt to limit the range of the VAT by excluding the most troublesome sectors because they pose different problems. In general, VAT will have faster speed than the GDP trend; Fundamental difficulties in developing countries arise from the problem of dealing with small taxpayers. VAT is suggested to extend retail level only after getting experience from other sales taxes. Lastly, study considers VAT as a major step in the process of Tax reform in the world, however, it may be and additional burden when administrative structure is poorly designed.

John F. Due (1976) analyzed the different aspect of VAT. Especially, in the context of developing countries through a paper entitled “Value Added Taxation in Developing Economic”. The first part of the study deals theoretical aspect including nature and history of VAT and the next part analyses the implementation aspect in developing countries and makes useful recommendation for its successful implementation.

Theoretical Aspect:

Considering the types of VAT, he states that there are several bases for classifying Value Added Taxes. VAT serves distinctive features of ‘Fractional’ impact without ‘cascade’ features and it applies only to the valued added, but at more than one stage in production and distribution. The evaluation criterion of the tax in the developing countries must be based on the goals of the country, and hence the criterions for taxation are:

I) Maximum net contribution to economic development, II) Minimum adverse effect on efficiency in the utilization of resources and encouragement of grater efficiency, if possible. III) Case of administration of the taxes. IV) Maximum contribution to the attainment.

Richard A. Musgrave and Peggy B. Musgrave (1976) state that a sales tax may be imposed in either single or multiple stages. A properly implemented Value Added Tax is equivalent to corresponding single stage tax, from the economists’ point of view. VAT has come to be the basic instrument of tax coordination among common market countries, where it has replaced widespread use of turnover taxes. Bases of a consumption types of VAT is same as that of retail, sales tax, notwithstanding, the difference in techniques; only the method of collection differs. Hence Choice between the two must be made in terms of administrative convenience. Only the value-added approach is feasible if a sales tax is to be imposed on net product.

Among the three types of VAT: GNP types, income type and consumption type, the last one is most important from the practical point of view and it also involves both efficiency and equity criterion. Among the three types of computing base for VAT, the addition method is readily applicable to the income type but clumsy for the consumption type of VAT. By making the tax credit for each firm contingent on presentation of the tax receipt made out to the proceeding supplier. The invoice method includes a self-enforcing element because each will demand copy of such a receipt. This method, further, constitutes and advantage of the value added approach, especially in those countries where tax compliance is otherwise poor.

Richard Goode (1984) in a book “Government Finance in Developing Countries” state that the Value Added Tax is the most important tax innovation of the second half of the twentieth century and it applies to the value added at successive stages of production and distribution. VAT, a sales tax on consumption is fairer than an income tax because the later result in double taxation of saving is unconvincing but the former lacks the progressiveness which is served by the later. The following merits of VAT are explained by him: i) It is board-based and relatively natural ii) It avoids both simple cascading and cumulative taxation of goods of producer that are not physically incorporated in the product. Iii) spreading the tax over the several stages of production and distribution is often considered an administrative advantage compared with collection it all at one stage because enterprises have less incentive to evade tax. Iv) it generates the possibility of using information as a crosscheck on compliance with other taxes, particularly income taxes. Besides these, suitability of VAT is questionable for countries where small enterprise are important, accounting is unreliable and administration is we is weak.

Alan A. Tait (1991) in a paper entitled “VAT policy, Issues: Structure Regressively, Inflation and Exports” mainly deals on the policy issues of VAT by illustrating some theoretical as well as empirical proofs. He was made the following conclusions. VAT provides a new buoyant revenue base and improves tax system in terms of neutrality and efficiency. Experience broadly shows that VAT contributes from 12 percent to 30 percent of revenue in most countries, representing about 5 to 10 percent of gross national production. However, VAT is more complicated than other sales taxes from administrative point of view as substantial refunds can be involved. Further, Collecting VAT and paying refunds make it inefficient.

Lastly at least if VAT can not promote exports would make the system easier. A VAT admonition is affected by the decisions regarding: Where all retail state are included, should services be taxed, choice of proper rates, and the treatment of capital goods, financial service, foods, small traders.

Kwang Choi (1993) analyses and evaluates the vat experience in Korea through this paper " Value Added Tax in the public of Korea" The study captures all the aspects from its introduction to effects on the economy. VAT in the republic of Korea was introduced in 1977 as a major step of tax reform with the objectives of simplifying tax structure and its administration, promoting exports and capital formation, besides these, introduction of VAT was also supported by the expectation of higher revenue productively and maintaining neutrality in the existing indirect tax system. A single rate of 10 percent was used since the introduction of VAT and general characteristics remained same as the VAT adopted by the European countries. Korea, VAT was of the consumption type covering all the stage of production and distribution and the tax credit method was used for computation. Experience showed good symptoms for the prospects of VAT, as the effect of VAT on the economy were lesser than expectation made by either VAT supporter or opponents. VAT showed a good impact on investment and encouraged exporters as compared to the previous tax system, and there were no major impacts on price increase, as well.

However VAT being a member of indirect taxation, could not remain exception from theViewpoint of regressively. To some extent, there was regressive impact of VAT with respect to income. The experience showed that practice is not as simple as theory. It creates a host of problems that gave rise to voluminous paper work, more or less arbitrary distortions in trade and consumption, and inequalities in the distribution of tax burden. From the policy point of view, VAT revolved around three issues: (i) coverage of the VAT, (ii) the level and structure of the tax rate and (iii) the treatment of small taxpayers. The study, by analyzing positive and negative results of VAT, concludes that Korean VAT has worked relatively well and in some cases much better than its designers and taxpayers had anticipated. As compared to previous taxes, VAT has broadened the tax base, reduced evasion, increased revenue and eliminated many problems that were in existence. Further, Korean experience provided proper lesion for other countries to tackle with the problems and issues relating to VAT implementation including coverage, rate structure, administration, special taxpayers, coordination with direct taxation etc.

Dr. Govinda Bahadur Thapa made on effort on “Value Added Tax in Nepalese Context” by means of an article in (1994), published in Mirmire, the conclusion derived was considering the present condition of Nepal facing government expenditure, low revenue effort, high dependency on foreign loan, need of more economic growth of the economy, and because of low revenue potentiality from direct taxes there is prompt need to improve the sales tax of Nepal. But there is less chance to mobilize more revenue through existing from of sales tax. In this context there is no any other alternate except introducing VAT in Nepal.

Rup Bahadur Khadk (2000) Identifying the major area to be reformed, he states that since the implementation of VAT is great jump from the traditional tax system to a modern one, several things still need to be done for the successful implementation of VAT in Nepal.

He points out a few key ones:

i) The tax administration should be reoriented in the light of this modern tax.

ii) The tax investigation and audit should be made effective.

iii) Adequate measure must be taken so that both tax performing their new responsibilities under VAT system.

iv) The tax investigation and audit should be made effective.

v) Adequate measure must be taken so that both tax performing their new responsibilities under VAT system.

vi) VAT administration should be computerized for its effective implementation.

vii) There should be the provision of tax payer education programme.

viii) The existing exemption list in rather long. So the exemption list must be shortened gradually.

Raju Chaudhari (2001), in his dissertation, VAT in Nepal: An Analysis of its problems and prospects, having the objective to review historical background of VAT, to examine the structure of VAT in Nepal, to observe the contribution of VAT to resource mobilization and to analyze the existing problems of VAT in Nepal through the primary and secondary data and information, has concluded that the main problems for business houses are account keeping and billing and the weakness of VAT administration are lack of motivation and service minded attitude among tax officials lack of honesty in VAT officers. Though from the theoretical point of view it is sure that VAT system is the best and advanced fiscal tool, its effect in the context of Nepal is not as expected because of the lack of strong and honest tax administer, lack of motivation and service minded attitude among the tax officials, lack of the cooperation of business community, lack of strong coordination between tax collectors and tax payers, lack of strong political commitment and weak public consciousness. He has further recommended some suggestion for better solution of these problems. Tax related information should be published regularly. Interview programs with professor, researchers, tax experts, and economists should be conducted and published through advertising media. Often escape away from actual custom duty, as under valuation of the goods has been a tradition. Thus to overcome these problems, the government either has to collect the custom duty of the actual price of the goods or it has to fix the actual price of the goods in the market. Enforcement should be effective through more audits, investigation and collection visits and integrated approach to total tax system should be introduced for successful implementation of VAT.

Bhattarai & Koirala (2007) in a book "Taxation in Nepal with Tax Planning and VAT" state that VAT is a general consumption tax assessed on the value added to goods and services. It is a general tax that applies, in principle, to all commercial activities involving the production and distribution of goods and the provision of services. It is a consumption tax because it is borne ultimately by the final consumer. It is not a charge on companies. It is charged as a percentage of price, which means that the actual tax burden is visible at each stage in the production and distribution chain. It 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). As VAT is intended as a tax on consumption, exports (which are, by definition, consumed abroad) are usually not subject to VAT or VAT is refunded.

Bhattarai & Koirala also analyzed the basic characterícts of VAT are stated as follows.

- It is a form of indirect taxation.
- It is a broad-based tax as it covers the value added can be obtained either by adding payments to factors of production (i.e., wages+rent+interest+profit) or deducting cost of inputs from sales value.
- It is a substitute for sales tax, hotel tax, contract tax and entertainment tax.

- It is based on self-assessment system and provides the facility of tax credit and tax refund.
- It avoids cascading effect existed in
- Sales tax and contain catch-up effect.

CHAPTER-III

RESEARCH METHODOLOGY

Research methodology is a research method used to meet the specified objectives. It is a systematic way to find out the probable solution. It refers to the various sequential steps (along with rational of each steps) to be adopted by a researcher in studying the problem with certain objectives in view. Thus the research method designed to achieve the objectives of this thesis contains research design, population and sample, data collection procedure, tools for analysis and methods of analysis and presentations.

3.5 Research Design

The research design is a plan, structure and strategy of investigation conceived so as to obtain answers to research questions and to control variance. The plan is the overall scheme or program of the research. It includes an outline of what the investigator will do from writing the hypothesis and their operational implications to the final analysis of the data. The purpose of the research design is to provide a maximum amount of information relevant to the problem under investigation at a minimum cost.

This research study is concerned with past phenomena both numerical as well as opinions. This study is both descriptive and analytical.

3.6 Population and Sample

The population for this study was comprised of the entire person belonging to or associated with Value Added Tax in Nepal. They were Tax administrators, Auditors, Experts, Business persons and Customers. In order to fulfill the objectives of the study, 100 samples from the population in the Chitwan district were carefully selected by consultation with lecturers and best judgment of the researcher. The respondents could be divided into three groups. The following Table shows the groups of respondents and the size of samples.

Table No. 3.1

Group of Respondents and Sample size

S. No.	Group of Respondents	Sample Size	Percentage
1.	Tax Authorities/Policy Makers	10	10
2.	Experts/Economists	25	25
3.	Auditors	5	5
4.	Businessmen	30	30
5.	Consumers	30	30
	Total	100	100

3.7 Nature and Sources of Data

Both primary as well as secondary data were collected in order to achieve the real and factual result out of this research. Since the nature of these primary and secondary data is different, collection procedure also tend to vary. A set of questionnaires was designed and distributed to the selected respondents well-learned in and at least familiar to VAT and its implications. Information and data were also collected from respondent through field visit by the researcher. The secondary data were collected through annual reports, different books and publications. The sources and data collection procedure is explained below.

2.3.1 Primary Sources

The primary data were collected through following techniques:

a. Interview

b. Questionnaire

c. Telephone queries

d. Discussion with resource persons

e. Field Survey

2.3.2 Secondary Sources

The secondary data of this research were collected from the following sources:

a. Published and unpublished reports, articles and dissertations on the concerned subject.

b. Published documents of National Planning Commission

c. Publication and annual report of Inland Revenue Department (IRD)

d. Different publication of Central Bureau of Statistics.

e. Publications of Nepal Rastra Bank

f. Various books written by tax officers and scholars

g. Publications, Budget Speeches and Economic Survey of various fiscal year of Ministry

of Finance, the Government of Nepal.

h. Newspapers, such as, Gorkhapatra, The Rising Nepal, Kantipur Daily, and so on

i. Publications of various VAT Department.

j. Websites

The collected data through secondary sources have been tabulated in different ways according to the requirements of the study.

3.8 Procedure of Presentation and Analysis of Data

In the process of presentation and analysis of the data, various statistical tools were used in order to get the meaningful result. Collected data from primary and secondary sources were first processed for tabulation and analysis. For the purpose of analysis, following simple statistical tools were used:

a. Simple Average,

b. Simple Percentage,

c. Graphs, Charts and Diagrams,

d. Trend analysis

e. Correlation

f. Hypothesis testing (Student's t-test)

CHAPTER-IV

PRESENTATION AND ANALYSIS OF DATA

4.1 Presentation of Data

4.1.1 Revenue Structure of Nepal

The total revenue of government of Nepal is collected from tax and non-tax sectors. The tax revenue, which is compulsory sacrifice of the peoples, can divide into two components i.e. direct tax and indirect tax. Those revenues collected as income tax, land tax, property tax, etc are direct tax and those revenues collected as sales tax, value added tax (VAT), customs and contract tax etc are an indirect tax. Another sides, the government has received other kinds of revenues, e.g. postal service charge, fees fines and forfeiture etc are non-tax revenues. Non-tax revenue are not imposed specially views of revenue collection. In Nepalese economy amount of tax revenue is generally higher than that of non-tax revenue. In Nepal, the contribution of tax revenue used to be almost 80% and non-tax revenue almost 20%. The structure can see in the Table no.

Table no. 4.1

Revenue Trend in Nepal

Rs.in million

Fiscal Year (FS)	Total Revenue (TR)	Tax Revenue (TXR)	Tax Revenue as % of TR	Non-Tax Revenue (NXTR)	Non-tax Revenue as % of TR
1991/1992	13512.60	9875.60	73.08	3637.10	26.92
1992/1993	15148.40	11662.50	76.99	3485.90	23.01
1993/1994	19580.80	15371.50	78.50	4209.40	21.50
1994/1995	24605.10	19660.00	79.90	4945.10	20.10
1995/1996	27893.10	21668.00	77.68	6225.10	22.32
1996/1997	42893.80	24424.30	80.41	5949.20	19.59
1997/1998*	30373.50	25939.80	78.75	6998.10	21.25
1998/1999	32937.90	28752.90	77.43	8380.90	22.57
1999/2000	37133.80	33152.10	77.29	9741.60	22.71

2000/2001	48893.60	38865.10	79.49	10028.8	20.51
2001/2002	50445.50	39330.60	77.97	11115.0	22.03
2002/2003	56229.80	42586.90	75.74	13642.7	24.26
2003/2004	62331.00	48173.00	77.29	14158.0	22.71
2004/2005	70122.70	54104.70	77.16	16018.0	22.84
2005/2006	72282.10	57430.40	79.45	14851.7	20.55
2006/2007	87712.08	71126.73	81.09	16585.35	18.91
2007/2008	107622.49	85155.54	79.12	22466.95	20.88

Source: Annual Report 2007/2008, Inland Revenue Department

Economic Survey 2007/2008, Ministry of Finance

*Note: VAT Implementation Year

The above table demonstrates the structures of total revenue of the government before and after implementation of VAT. The contribution of tax revenue on total revenue in the year 1991/92 is 73.08%. This slightly increased up to the year 1996/97 except in the year 1995/96. In the year 1996/97 it reached to 80.41%. On the other hand, the contribution of non-tax revenue on total revenue is 26.92% in 1991/92, which kept decreasing until it reached to 19.59% in the year 1996/97. It proves that tax revenue was in increasing order and non-tax revenue is in decreasing order before and after the implementation of VAT respectively. But after the implementation of VAT in the year 1997/98 the contribution of tax revenue come down to 78.75% and does not cross 80% in any year afterwards. This proves that tax revenue increased in amount where it does not lead to the proportionate increasing scenario. On the other hand, the contribution of non tax revenue increased to 21.25% in the year 1997/98. But in the fiscal year 2006/07 tax revenue exceed 80%, which must be considered a good sign in the tax revenue collection following the implementation of VAT. But overall all judging figures presented in the table, no significant changes have occurred so far after the implementation of VAT.

4.1.2 Structure of Tax Revenue

Tax is the compulsory levy made to government treasury by public. Tax is levied either directly on income of indirectly on consumption of goods and services. Indirect tax is collected mainly from customs and the consumption of goods and services. Supremacy of tax user of indirect tax is one of the important features of the developing economies. The propensity to consumption is higher in developing countries due to their marginal income. The insignificant level of saving, marginal results in to the poor level of the collection of direct tax. The heavy reliance on indirect taxation in Nepal is justified on the administrative ground. Nepal is not in a condition to generate adequate revenue from direct taxation. Agriculture is the main occupation of the Nepalese people. The industrial development is very primitive in Nepal. It contributes only about 10% in the GDP. The per capita income of Nepalese people is extremely low. In Nepalese economy the contribution of direct tax ix very low, it is almost 20% of total tax and contribution of indirect tax is remarkably higher than direct tax it is almost 80% of total tax revenue. The table below shows the structure of total tax revenue.

Table no. 4.2

Structure of Total Tax Revenue

Rs. in million

Fiscal Year (FS)	Total Tax Revenue (TXR)	Direct Tax		Indirect Tax	
		Amount	% of Total Revenue	Amount	% of Total Revenue
1991/1992	9875.60	1595.20	16.15	8280.40	83.85
1992/1993	11662.50	2036.20	17.46	9626.30	82.54
1993/1994	15371.50	2855.30	18.58	12516.20	81.42
1994/1995	19660.00	3849.30	19.58	15810.70	80.42
1995/1996	21668.00	4655.90	21.49	17012.10	78.51
1996/1997	24424.30	5340.00	21.86	19084.30	78.14
1997/1998*	25939.80	6187.90	23.85	19751.90	76.15
1998/1999	28752.90	7516.10	26.14	21236.80	73.86
1999/2000	33152.10	8951.50	27.00	24200.60	73.00
2000/2001	38865.10	10159.40	26.14	28705.70	73.86
2001/2002	39330.60	10597.50	26.94	28733.10	73.06
2002/2003	42586.90	10105.70	23.73	32481.20	76.27
2003/2004	48173.00	11912.6	24.73	36260.4	75.27
2004/2005	54104.70	13071.8	24.16	41032.9	75.84
2005/2006	57430.40	13968.1	24.32	43462.3	75.68
2006/2007	71126.73	18980.29	26.69	52146.44	73.31
2007/2008	85155.54	22804.65	26.78	62350.89	73.22

Source: Annual Report 2007/2008, Inland Revenue Department

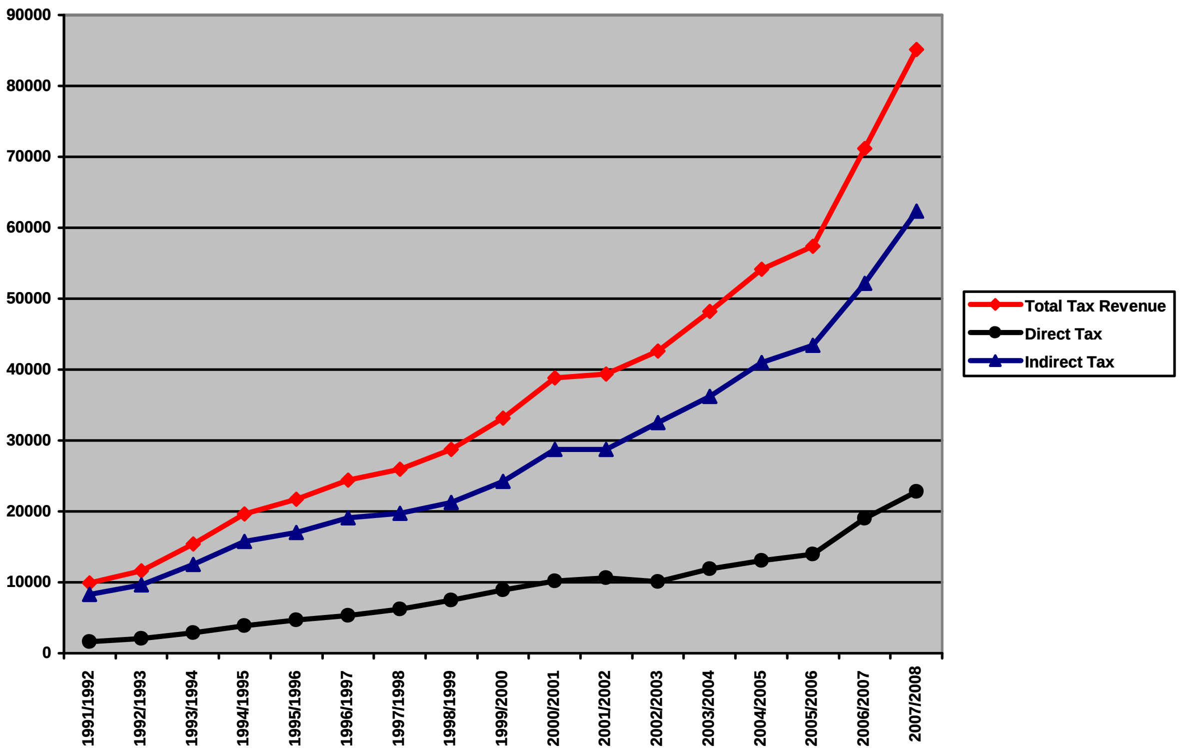
Economic Survey 2007/2008, MOF

*Note: VAT Implementation Year

According to above data, the contribution of the direct tax is very low. Contribution of direct tax revenue in the year 1991/92 is 16.2% and there after gradually increased and reached to 27% in the year 1999/2000 and thereafter slightly decreased. On the other hand contribution of indirect tax revenue is also in decreasing order. Although, value added tax belongs to the indirect tax category, introduction of this tax does not increase the share of indirect tax on total revenue. The tax experts always say that implementation of VAT helps to collect more revenue. It also helps to collect more income tax and other direct taxes due to its transparency characteristics. This claim of tax experts might come true in the case of successful implementation. But hopefully, in spite of the decreasing trend of the direct taxes, in the fiscal year 2006/2007, it suddenly had started picking up once again but in an insignificant percentage of only 26.29 with reverse impact on the indirect tax revenue standing at 73.21, about 2% falling below the previous figure.

Figure No.1

Structure of Total Tax Revenue



4.1.3 Registration

Registration is a preliminary step in the whole process of VAT system. The threshold limit of VAT registration used to be Rs. 2 million previously. But now, it has changed to Rs. 1 million only. All tax payers whose taxable transaction stands above Rs. 1 million are compulsorily required to register for VAT. But those firms whose turnover is apparently below the prescribed threshold limit also can go for registration if they so desire. The firms having more than Rs. 2 million who were not previously registered under sales tax required to register for VAT within 90 days from 16 November, 1997, or the date of issue of VAT Act. It was however not necessary to register if they only dealt with tax exempt goods and services. Similarly, the Nepalese VAT Act does not allow branch or division registration system.

Table no.4.3

Year-wise number of VAT Registrants

Fiscal Year	No. of VAT registrant	Cumulative Total	Rate of Increase (%)
1997/1998	5237	5237	-
1998/1999	4405	9642	84.11
1999/2000	8305	17947	86.13
2000/2001	3146	21093	17.53
2001/2002	4056	25149	19.23
2002/2003	4723	29872	18.78
2003/2004	4302	34174	14.40
2004/2005	5602	39776	16.39
2005/2006	7055	46831	17.74
2006/2007	6134	52965	13.10
2007/2008	4031	56996	7.61

Source: Annual Report 2007/2008, Inland Revenue Department

The number of sales tax registrant was 2045 at the time of the introduction of VAT in 1997. Among them those with an annual transaction above the VAT registration threshold were converted into VAT registrants from 16 Nov. 1994 while between those having transaction below the threshold level some registered voluntarily and other remained under the VAT net. Other potential tax payers that were outside the sales tax net registered for VAT over the year. The member of VAT registrants increased gradually. In one side some tax payers registered under the revenue department and in the other side some registrant tax payers cancelled their registration under VAT department. This is proved by the above table and chart which shows in the year 1997/98, 5237 tax payers registered for VAT. In the year 1998/99 new tax payers registered were 4405 and the total tax payers increased to 9642 by 84.11%. The growth rate of VAT registration remained at a high level in the fiscal year 1999/2000 at about 86.13%. Both voluntarily and compulsorily, the business communities came under VAT flag because there is a legal provision in the VAT law that the government bodies are required to buy only from the VAT registrants in case of their purchases exceeding certain amount. This seems to have compelled them to register for VAT. However, the figure above shows the trend is in the steady line with sporadic rise, but that is negligible.

Figure No.2

Year-wise number of VAT Registrants

The percentage is on the decrease finally ending up at 13.10% in the fiscal year 2006/2007. This show the businessmen are getting disinterested in registration for VAT.

4.1.4 Non-Filers

There is a legal provision in the VAT law that all the registrants are required to submit their tax return after 25 days of completion of the tax period. It does not matter whether any transaction takes place within that period or not. It is necessary to submit the tax return within the specified time. Registrants who fail to submit their tax return is known as non-filers. The table and chart below illustrate the no. of non-filers in each fiscal year from 2000/2001 to 2007/2008.

Table No.4.4

Year-wise number of Non filers (2000-2008)

Fiscal Year	Total Registrants	Non-filers	Percentage
2000/2001	21093	1383	6.72
2001/2002	25149	3676	15.18
2002/2003	29872	5255	17.59
2003/2004	34174	7322	21.43
2004/2005	39776	8492	22.96
2005/2006	46831	13198	21.63
2006/2007	52965	7098	14.58
2007/2008	56996	9536	16.79

Source: Annual Report 2007/2008, Inland Revenue Department

The Table show that the status of Non-filers were in increasing trend from the fiscal years 2000/2001 to 2005/2006. In the fiscal year 2000/2001, only 4 percent failed to submit the tax return. But this trend was on the increase in each subsequent year until the fiscal year 2005/2006. But in 2006/2007, the trend once again declined showing a significant check on taxpayers' habit of not submitting the tax return. On the other hand, it foretells a good sign for the future trend as well because it is said that the morning shows the day.

4.1.5 Tax Returns

Tax Return means a return furnished by a Taxpayer in regard to the tax payable for transactions carried out during the Tax Period. Studies on the status of Tax Return facilitate the forecasting of the amount of potential tax collection. In general, the tax return includes debit, credit and nil tax return. Debit return implies the return which the tax payer furnishes declaring to pay tax. Debit return in a favorable position shows the output tax exceeding input tax credit. Credit return is just opposite of debit return. If input tax is greater than output tax, the possibility of credit return is realized. As the credit return increases the liability to refund also increases. So, debit return is favorable for the government. If there is no transaction during the particular tax period, then it is nil or zero return. The status of tax return is depicted in Table.

Table no. 4.5

Status of Tax Returns (2000-2008)

Fiscal Year	Debit		Credit		Nil		Undecided		Total
	No.	%	No.	%	No.	%	No.	%	
2000/2001	6975	35.39	8250	41.86	4471	22.68	14	0.07	19710
2001/2002	6936	32.30	8844	41.19	5207	24.25	486	2.26	21473
2002/2003	7178	31.06	9553	41.36	5972	25.85	396	1.72	23099
2003/2004	8483	33.87	9625	38.42	6783	27.08	158	0.63	25059
2004/2005	9478	32.20	10260	36	8271	29	516	1.8	28525
2005/2006	10449	31.06	12882	38.17	10139	30.14	163	0.4	33633
2006/2007	11457	31.43	13594	37.29	11044	30.29	362	0.99	36457
2007/2008	12065	31.53	14376	37.57	11563	30.22	260	0.68	38264

Source: Annual Report 2007/2008, Inland Revenue Department

The table reveals that the credit return is higher than the debit return. This is considered something not so good for the VAT system. In the fiscal year 2001/2001, the ratio of debit return to the total return is 35.39% whereas the credit return stood at 41.86%. From then onwards, the figure just seemed to rise consistently. The nil return in that particular period was 22.68% and the undecided percentage is 0.02. Understandably, at the initial periods, the credit refund might rise due to the provision to carry forward credit from the sales tax and the provision also of getting credit facility of old stock. But the continuous increase of the credit refund is definitely not a good sign for the government who needs to think about this in time. It is a duty of Inland Revenue Department to seriously come up with measures to make sure this doesn’t happen in future. Unless the government is proactive enough to figure out the actual cause behind the increasing trend of credit return, nil return and undecided return which in the above table is not high though, the government's intention to mobilize VAT as resource may be just a daydream. So complete tax audit and investigation on these issues must be a top priority of the government.

4.1.6 Revenue Collection from VAT

VAT is considered as modern and scientific tax system in sales tax family. Nepal has adopted VAT since fiscal year 1997/98. Since then the actual collection of VAT from the fiscal year 2000/2001 to 2007/2008 has been shown below.

Table no. 4.6

Revenue collection from VAT

(Rs. in million)

Fiscal Year	Targeted	Achieved	% Change
2000/2001	13500.00	12050.00	-11
2001/2002	14750.00	11947.95	-19
2002/2003	13730.05	13449.12	-2
2003/2004	15503.50	14448.89	-7
2004/2005	16950.00	18894.63	11
2005/2006	23650.00	21946.01	-7
2006/2007	26463.00	26704.18	1
2007/2008	29554.00	30439.12	3

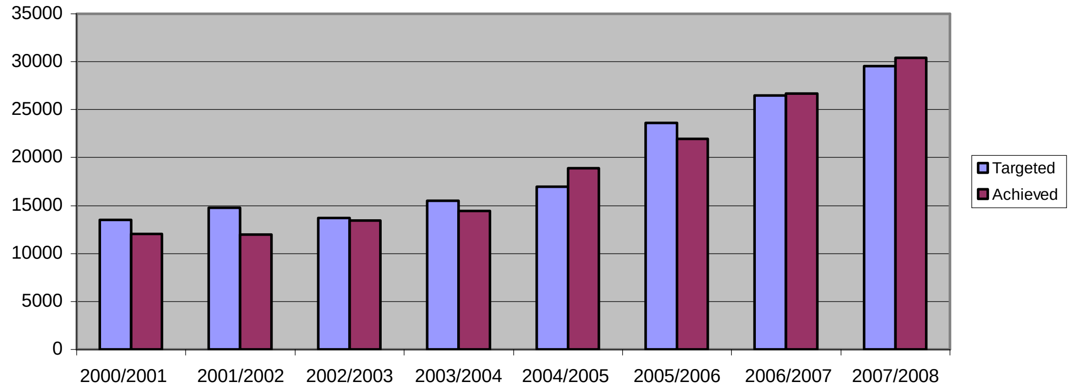
Source: Annual Report 2007/2008, Inland Revenue Department

VAT was introduced in order to meet the revenue gap that government had been facing for a long time. In the fiscal year 1999/00 total Rs. 9860.00 million was collected where as expected or targeted was Rs. 10460.00 million in the same year which is less by 6% than targeted. The figure is not shown in the table though because the data shown range from the fiscal year 2000/2001 to 2006/07 only. Similarly, in the fiscal year 2001/02 achieved VAT was Rs. 11947.95 million whereas targeted was Rs. 14750.00 million which is 38% less than targeted. However, by small margin of 2% only differ between targeted and achieved in the fiscal year 2002/03. In the fiscal year 2004/05, the revenue actually collected even exceeded the targeted one. In figure, the targeted revenue for that period was Rs. 16950 million where as the collected revenue amounted to Rs. 18894.63, i.e. 11% more than the targeted one. But the boom period in revenue collection was to soon be followed by the depression when the 11%

increase went far down to -7 in the fiscal year 2005/06 with the targeted revenue Rs. 23650 million and the actual collection

Figure No.3

Revenue collection from VAT



only amounting to Rs. 21996 million. This trend seems to be improved again in the following fiscal year 2006/07 when the actual revenue marginally exceeded the targeted one by 1 percent. The change in the revenue collection was triggered partially by the major change in the Nepalese political scenario that took place in the aftermath of the people's movement part 2 on April 2005. Now as can be seen in the figure above, after for the last few years, comparatively the trend of revenue collection is good one although it is still in a fluctuating nature.

4.1.7 Composition of VAT Revenue

VAT is levied on both domestically produced goods and services and imported goods and services. Nepalese economy is agricultural based. Mare than 60% people are farmer and the farming is unorganized. Agriculture production through unorganized sector is exempted from VAT. Most of the products and services are imported from neighboring countries and third countries. Thus import generates more VAT revenue than domestically produced goods and services. The composition of VAT revenue collection from imports and exports are shown in a table.

Table No. 4.7

Composition of VAT Revenue

(Rs. in million)

Fiscal Year	Total VAT Revenue	Domestic Product		Imports	
		Amount	%	Amount	%
2000/2001	12050.00	4744.72	39.38	7303.04	60.61
2001/2002	11947.95	4608.37	38.57	7339.58	61.43
2002/2003	13449.12	4819.61	35.84	8629.51	64.16
2003/2004	14448.89	5604.12	38.79	8874.77	61.42
2004/2005	18894.63	6624.33	35.06	12270.29	64.94
2005/2006	21946.01	8057.43	36.71	13888.58	63.29
2006/2007	26704.18	9689.98	36.29	17014.20	63.71
2007/2008	30439.12	10994.61	36.12	19444.51	63.88

Source: Annual Report 2007/2008, Inland Revenue Department

In fiscal year 2000/01, share of domestic and imported VAT revenue in total revenue was 39.38% and 60.61% respectively while in the fiscal year 2002/03 is 35.83% to 64.16%. In the fiscal year 2006/07, domestic products contributed 36.29% whereas imported goods contributed 63.71% in the total VAT revenue. In Nepalese VAT structure, collection from imports share about two-third and collection from domestic source occupies one-third only.

4.1.10 Share of VAT Revenue to Gross Domestic Product (GDP)

Gross Domestic Product is the total final output of goods and services produced by the country's territory by residents and non-residents, regardless of its collection between domestic and foreign claims. The VAT/GDP ratio measures the consistency of the growth of VAT revenue with the corresponding growth in gross National Product. This is an indicator of the utilization of taxable capacity. Normally, the growth of VAT revenue mobilization in line with the growth in GDP is desirable for the rapid economic development of a country. The collection of VAT revenue is more reliable than the direct tax revenue, Non tax revenue which facilitates the process of economic planning and development in the country. VAT has been introduced in Nepal to increase the contribution towards revenue generation. The contribution of VAT revenue in GDP is shown below.

Table No.4.8

VAT Revenue as percentage of GDP

(Rs. in million)

Fiscal Year	GDP*	VAT Revenue	% of GDP
2000/2001	413428.70	12050.00	2.91
2001/2002	430396.60	11947.95	2.78
2002/2003	460325.30	13449.12	2.92
2003/2004	500699.10	14448.89	2.89
2004/2005	548484.70	18894.63	3.44
2005/2006	611088.50	21946.01	3.64
2006/2007	675484.00	26704.18	3.98
2007/2008	713040.91	29020.76	4.07
Average	542579.57	18557.69	3.33

Source: Economic Surveys 2007/2008, MOF.

Macroeconomic Indicators of Nepal 2008,

Economic Reports 2008, NRB, Kathmandu

*Gross Domestic Product at current price

Above table reveals that share of VAT revenue in GDP is 3.01% in an average through the analysis period. The contribution made through VAT in GDP is very low. In fiscal year 2000/2001, total amount Rs. 12050 million was collected as VAT which was only 2.73% of GDP. However, though insignificantly, the percentage shows the increasing trend, but very low percentage of GDP throughout all the years of analysis. The highest percentage i.e. 3.71% was recorded in the fiscal year 2006/2007 with VAT revenue amounting to 26704.18.So it can be said that the trend does show an increasing trend although in a snail pace which can be better seen in the graph. So in conclusion, the contribution made through VAT in GDP is very low.

4.1.11 Share of VAT Revenue in Total Revenue

Total Revenue includes Tax revenue and non-tax revenue. The contribution of VAT revenue to the total revenue has been shown in the Table

Table No.4.9

VAT Revenue as percentage of Total Revenue

(Rs. in million)

Fiscal Year	Total Revenue	VAT Revenue	% of Total Revenue
2000/2001	48893.9	12050.00	24.65
2001/2002	50445.6	11947.95	23.68
2002/2003	56229.7	13449.12	23.92
2003/2004	62331.0	14448.89	23.18
2004/2005	70122.7	18894.63	26.95
2005/2006	72282.1	21946.01	30.36
2006/2007	87712.08	26704.18	31.00
2007/2008	107622.49	30439.12	29.01
Average	69454.94	18734.98	26.59

Source:, Economic Survey 2007/2008, MOF.

Budget Speech 2007/2008, MOF.

Above table reveals that an average contribution of VAT to the total revenue is 26.75.In the fiscal year 2000/2001, its contribution was 24.65, it kept increasing in the following years ending up with 31.00%, the highest one in the fiscal year 2006/2007.

4.1.10 Share of VAT Revenue in Total Tax Revenue

The contribution of VAT revenue to the total tax revenue has been shown in the following table.

Table No. 4.10

VAT Revenue as % of Total Tax Revenue

(Rs. in million)

Fiscal Year	Total Tax Revenue	VAT Revenue	% of Total Tax Revenue
2000/2001	38865.10	12050.00	31.00
2001/2002	39330.60	11947.95	30.38
2002/2003	42586.90	13449.12	31.58
2003/2004	48173.00	14448.89	29.99
2004/2005	54104.70	18894.63	34.92
2005/2006	57430.40	21946.01	38.21
2006/2007	71126.73	26704.18	37.54
2007/2008	85155.54	30439.12	35.75
Average	54596.62	18734.98	34.19

Source: Annual Report 2007/2008, Inland Revenue Department

The above table shows that there is high share of VAT in total revenue in Nepal. In the fiscal year 2000/01, the percentage of VAT in total tax revenue is 31% similarly in the fiscal year 2006/07 it was increased to 37.54% less by 0.67% from the previous fiscal year. The average contribution of VAT to the total revenue is 34.19% which is a fraction above the half of the total tax revenue. This proves that Nepalese tax revenue without the inclusion of VAT is unthinkable.

4.2 Analysis of the Data with Various Statistical Tools

4.2.1 Time Series Analysis

A time series is an arrangement of statistical data in a chronological order, i.e., in accordance with its time of occurrence. It reflects the dynamic pace of movements of a phenomenon over a period of time. Most of the series relating to Economics, Business and Commerce, e.g., the series relating to prices, production, and consumption of various commodities; agricultural and industrial production, national income and foreign exchange reserves; investments, sales and profits of business houses; bank deposits and bank clearings, prices and dividends of shares in a stock exchange market, etc., are all times series spread over a long period of time. One of the most commonly used method is the Least Square Method which is employed here to measure the trend for further prediction of the GDP and VAT revenue for the next five years from the fiscal years 2007-2008 to 2012-2113 to estimate whether there may be increase in the VAT/GDP ratio from the current average of 3.22%, given the same trend. Future amount of GDP and VAT are predicted on the basis of the data of the last fiscal years.

The parameter of time series analysis for the further prediction of GDP and VAT revenue, a and b, where a is the Y interception or the computed trend figure of y variable when X = 0 and b represent the slop of the trend line or the amount of change in Y variable that is associated with a changeable of one unit in x variable. The x variable in time series represents time and Y represents GDP and VAT revenue. For predicting the amount of GDP, the parameter of the analysis, computed in the Appendix III are as follows:

a = 519986.70

b = 44132.47

Thus the trend line of dependent variable GDP and independent variable time (i.e. year) is:

GDP (Yc) = 519986.70 + 44132.47 x

Similarly, for predicting the VAT revenue, the parameters of the analysis, computed in the Appendix III are as follows:

a = 17062.97

b = 2478.72

Where the trend line of dependent variable VAT revenue and independent variable time (i.e. year) is:

VAT Revenue (Yc) = 17062.97 + 2478.72 x

Predicted amount of GDP and VAT revenue, computed in the appendix III for the period 2008-2009 to 2011-2012 is presented in the table.

Table no. 4.11

Predicted GDP and VAT Revenue

(Rs. in million)

Fiscal Year	2008-2009	2009-2010	2010-2011	2011-2012
GDP	740649.04	784781.51	828913.98	873046.44
VAT	29456.57	31935.29	34414.01	36892.73
VAT/GDP (%)	3.98%	4.07%	4.15%	4.23%

The table shows that given the same trend, the ratio of VAT on GDP will grow in a nominal rate in the coming future. These ratios are presented in the figure 12 as well. In the figure 12, X-axis denotes years and y-axis denotes ratio of VAT on GDP. The figure depicts that the percentage of VAT of VAT on GDP will increase over 4% over the next five years. The remarkable point is that, if VAT revenue and amount of GDP follow the same trend lines in the coming years, the target of government to increase the percentage of VAT on GDP at or beyond 4% will be achieved. But this is only nominal growth. For the phenomenal increase like up to 5 or 6% at least, there must be several things that need to be taken into considerations by the government like the good administration, VAT education etc which were already described above.

4.2.3 Correlation Analysis

Correlation is defined as the association of two or more random variables or is the degree of relationship between variables, which seeks to determine how well a linear or other equation describes or explains the relationship between variables. The significance of correlation coefficient can be tested through t-test with certain level of significance at certain number of degree of freedom. One very convenient and useful way of interpreting the value of coefficient of correlation between two variables is to use square of coefficient of correlation, which is called coefficient of determination.

4.2.3.1 Gross Domestic Product with Value Added Tax Revenue

The relationship of VAT revenue and GDP is examined with the help of seven year data from the fiscal year 2000/2001 to 2007/2008. Further, the relation of VAT with GDP, coefficient of determination and value of t-test are presented below:

Statistical Tools of Analysis

Correlation Coefficient (r) 0.989

Coefficient of determination (r2) 0.977

Value of t-test 14.64

Table value of t0.05,5 2.571

The association of VAT revenue with GDP is very high or in other words, the VAT revenue is perfectly correlated with GDP (i.e. r = 0.989). The significance of correlation efficient is high which is over 5 times greater than the value of t0.05,5 (i.e. 14.64 > 2.571).The coefficient of determination (r2) is 0.977 which means 97.7% of total variation in VAT revenue is explained by gross domestic product.

4.2.2.2 Total Revenue with Value Added Tax Revenue

The effect of VAT revenue to total revenue is identified with the help of six years VAT revenue from the fiscal year 2000-2001 to 2007-2008. The association of VAT and sales tax revenue with total revenue, coefficient of determination and value of t-test, computed Appendix V, and average ratio of VAT and sales tax with total revenue over the reviewed period are presented below:

Statistical Tools of Analysis

Correlation Coefficient (r) 0.978

Coefficient of determination (r2) 0.956

Value of t-test 10.42

Average % in total revenue 26.25

The relationship of total revenue with VAT revenue is very high. Or, there is almost linear relationship between total revenue and VAT revenue, where the calculated value of r is 0.978. The significance of correlation coefficient is also very high which is almost 4 times greater than the tabulated value of t0.005,5 (i.e., 10.42 >2.571). For testing the significance of correlation coefficient, 5% level of significance has been fixed. The coefficient of determination (r2) is 0.956 which means 95.6% of total variation in total revenue is explained by VAT revenue. The percentage of VAT revenue in total revenue over the reviewed period in an average is 26.25. This means 25.25% in total revenue is contributed by VAT revenue.

4.2.2.3 Total Tax Revenue with Value Added Tax Revenue

The effect of VAT on the total tax revenue is found out with the help of six years data from 2000-2001 to 2007-2008 on which the study has been confined. The correlation of total tax revenue with VAT and sales tax revenue, coefficient of determination and value of t-test and average ratio of VAT in total tax revenue are presented below:

Statistical Tools of Analysis

Correlation Coefficient (r) 0.992

Coefficient of determination (r2) 0.984

Value of t-test 17.82

Average % in total tax revenue 49.78

The relationship of total tax revenue and VAT revenue is positive and very high or to put it another way, these are perfectly correlated where value or r is 0.991. The significance of correlation coefficient is also high which is more than 6 times greater than table value of t0.05,5 (i.e., 17.48>2.571). For testing the significance of correlation coefficient 5% level of significance has been fixed and degree of freedom was 5. The coefficient of determination (r2) is 0.984 which means 98.4% of total variation in total tax revenue is explained by the VAT revenue. The average percentage of VAT in total tax over the reviewed period is 49.78. This means 49.78% in total tax revenue is contributed by VAT revenue.

4.2.2.4 Total Indirect Tax Revenue with Value Added Tax Revenue

The contribution of VAT in Total indirect tax revenue and association of total indirect tax with VAT is found out by analyzing the six years data from the fiscal year 2000-2001 to 2007-2008 on which the study has been confined. The relationship of Indirect tax with VAT, coefficient of determination and value of t-test and average of percentage of VAT on indirect tax over the studied period are summarized below:

Statistical tools for analysis

Correlation Coefficient (r) 0.986

Coefficient of determination (r2) 0.971

Value of t-test 13.04

Average % in total Indirect tax revenue 44.65

The association of total indirect tax and VAT is 0.986, which is very high. It can be said that it is perfectly correlated with each other. This result shows that the total indirect tax is largely affected by VAT. The significance of correlation coefficient between VAT and indirect tax revenue is also higher which is more than 5 times greater than table value of t0.05,5 (i.e., 13.04>2.571). For the purpose of testing the significance of the relation, 5% coefficient of determination (r2) is 0.971, which means 97.1% of total variation in indirect tax revenue is explained by the VAT revenue. The contribution of VAT in indirect revenue in an average over the reviewed period has been 44.65%. The result shows that the correlation coefficient, coefficient of determination and contribution of VAT are all higher and increased proportionately over the succeeding fiscal years although with slight hiccups in the beginning of course.

4.2.3 Hypothesis testing (Student's t-distribution)

Hypothesis testing begins with an assumption, called a hypothesis that we make about a population parameter. Then we collect sample data, produce sample statistics, and use this information to decide how likely it is that our hypothesized population parameter is correct. Let us suppose that we assume a certain value for a population mean. To test the validity of our assumption, we gather sample data and determine the difference between the hypothesized value and the actual value of the sample mean. Then we judge whether the difference is significant. The smaller the difference, the greater the likelihood that our hypothesized value for mean is correct. The larger the difference, the smaller the likelihood (Levin & Rubin, 1996).

Test of VAT/GDP and VAT/TR (Total Revenue) ratio

The Hypothesis testing tool is used here to test whether there is significant difference between the mean ratios of VAT/GDP and VAT/TR. For that the following hypothesis is established

Null hypothesis (H0) : $\mu 1 = \mu 2$

i.e., there is no significant difference between mean ratios of VAT/GDP and VAT/TR.

Alternative hypothesis (H1) : $\mu 1 \neq \mu 2$ (two tailed test)

i.e., there is no significant difference between mean ratios of VAT/GDP and VAT/TR.

For the purpose of testing the hypothesis, $\mu 1$ denotes the mean of VAT/GDP ratio and $\mu 2$ denotes the mean of VAT/TR ratio for the period of 2000-2001 to 2006-2007. Likewise, X1 denotes VAT/GDP ratio and X2 denotes VAT/TR ratio whereas n1 and n2 denote no. of years.

For the purpose of getting conclusion, (generally used) 5% level of significance is fixed (t0.05) and degree of freedom (n1+n2-2) is 12. The test is two tail test (viz., two tailed) because the study is directed to examine whether or not there is a significant difference between those two mean ratios $\mu 1$ and $\mu 2$. Thus table value of t for 5% level of significance at 12 degree of freedom (y) is 1.782 (i.e., t0.05,12 = 1.782).

which is greater than table value (i.e., 18.42 > 1.782). Alternative hypothesis is accepted and it can be concluded that there is significant difference between mean ratios of VAT & GDP and VAT & TR. In other words, VAT contributes lesser portion to GDP than the Total revenue.

4.3.3.1 Test of VAT/TR (Total Revenue) and VAT/TXR (Total Tax Revenue) ratio

The Hypothesis testing tool is used here to test whether there is significant difference between the mean ratios of VAT/TR and VAT/TXR. For that the following hypothesis is established

Null hypothesis (H0): $\mu 1 = \mu 2$

i.e., there is no significant difference between mean ratios of VAT/TR and VAT/TXR.

Alternative hypothesis (H1): $\mu 1 \neq \mu 2$ (two tailed test)
i.e., there is no significant difference between mean ratios of VAT/TR and VAT/TXR.
For the purpose of testing the hypothesis, $\mu 1$ denotes the mean of VAT/TR ratio and $\mu 2$ denotes the mean of VAT/TXR ratio for the period of 2000-2001 to 2006-2007. Likewise, X1 denotes VAT/TR ratio and X2 denotes VAT/TXR ratio whereas n1 and n2 denote no. of years.

For the purpose of getting conclusion, (generally used) 5% level of significance is fixed (t0.05) and degree of freedom (n1+n2-2) is 12. The test is two tail test (viz., two tailed) because the study is directed to examine whether or not there is a significant difference between those two mean ratios $\mu 1$ and $\mu 2$. Thus table value of t for 5% level of significance at 12 degree of freedom (y) is 1.782 (i.e., t0.05,12 = 1.782). Computed value of t is 3.95, which is greater than table value (i.e., 3.95 > 1.782).

Alternative hypothesis is accepted and it can be concluded that there is significant difference between mean ratios of VAT & TR and VAT & TXR. In other words, VAT contributes more portions to Total Tax Revenue (TXR) than the Total revenue.

4.4 Survey Result

In the earlier period of implementation, there was lack of skilled and trained manpower and officers; administrative structure was not set up properly. But currently VAT and Tax offices are amalgamated into Inland Revenue offices in district as well as national level. Different informative programmed, seminars and meeting were held to make the businessmen consumers as well as tax officers known to the VAT. Currently business community is also in favor of VAT and further demanding to identify all the traders having taxable capacity and include into the tax net. In such situation, an empirical study is done to know the views of person of different field on different aspects of VAT. For the purpose of survey, a questionnaire was prepared and it was asked to fill up to the persons of different field as given in the table below.

Table No. 4.12

Sample size of the field survey

Respondents	Sample Size	Percentage
Tax Authorities/Policy Makers	10	10
Experts/Economists	25	25
Auditors	5	5
Businessmen	30	30
Consumers	30	30
Total	100	100

Purposive sampling method is used in this field survey retailer, wholesalers and the members of different associations are included in the category of businessmen, students of the related field members are included in Economists. Members are included in other general consumers are included in consumers.

4.3.5 The most challenging problem

From the experience of the other under developed countries. It is found that the future success of VAT basically depends on its implementation aspect. In the context of Nepalese economy there are many problems associated with the implementation of VAT Respondents were asked to identify the most challenging problem among under invoicing and unbillings, lack of proper accounts and weak tax administration survey result is summarizes in the table below.

Table No 4.13

View on most challenging problem

Respondents	Under invoicing and smugglings		Lack of proper billings		Lack of proper accounts		Weak Tax administration		I don't know		Total nos.
	No	%	No	%	No	%	No	%	No	%	
TA/PM	-	-	6	60	-	-	4	40	-	-	10
Experts/Economists	6	24	10	40	-	-	9	36	-	-	25
Auditors	1	20	1	20	2	40	1	20	-	-	5
Businessmen	13	43.3	-	-	-	-	17	56.7	-	-	30
Consumers	9	30	9	30	-	-	12	40	-	-	30
Total	29	29	26	26	2	2	43	43	-	-	100

Source: Field Survey

From the Field Survey it is found that 40% tax authorities/policy makers, 36% experts/economists, 20% auditors, 56.7% businessmen and 40% consumers argue that weak tax administration is the most challenging problem associated with VAT implementation. Consumers argue that weak tax administration is the cause so that businessmen are encouraged for under invoicing and smuggling. Lack of proper billings is identified as the most challenging problem by 60% tax authorities/policy makers, 40% experts/economists, 20% auditors and 30% consumers. Similarly, 24 experts/economists, 20% auditors, 43.3% businessmen and 30% consumers identified smuggling and under valuation as major problem, 40% auditors identified lack of proper accounts as the most challenging problem. Thus 43%, 29% and 2% of the respondents identified weak tax administration, under invoicing and smugglings, lack of proper billing and lack of proper accounts respectively as the major problem. Thus weak tax administration along with under invoicing and smugglings are the most challenging problems associated with VAT implementation.

4.3.6 Making VAT effectively successful

VAT is already implemented in Nepalese economy, however many problems are still existing in the practices in real field. To identify the problems of practices, solve them successively to make the VAT successful in future so that it will have positive effects on the different sectors of the economy. Hence the requirement is to choose the best alternative way to make VAT successful. The option given to make VAT effectively successful were (a) strengthen and improve the capacity of VAT administration, (b) educate tax payers about the significance of VAT, (c) mobilize cooperation of private sector through FNCCI, (d) Improve VAT laws and regulations. Respondent view on this question is summarized in the table below.

Table No. 4.14

View on making VAT effectively successful

Respondents	Strengthen and improve the capacity of vat administration		Educate taxpayers about the significance of VAT		Mobilize cooperation of private sector through FNCCI		Improve VAT laws & regulations		I don't know		Total no.
	No	%	No	%	No	%	No	%	No	%	
TA/PM	5	50	3	30	2	20	-	-	-	-	10
Experts/Economists	9	36	8	32	5	20	3	12	-	-	25
Auditors	2	40	1	20	1	20	1	20	-	-	5
Businessmen	8	26.7	4	13.3	18	60	17	56.7	-	-	30
Consumers	13	43.3	8	26.7	2	6.7	7	23.3	-	-	30
Total	37	37	24	24	28	28	11	11	-	-	100

Source: Field Survey

Out of the five samples of tax authorities/policy makers 50%, 30% and 20% are on the support of (a), (b) and (c) respectively. Remaining all the respondents of different category are basically concentrated on the first option that strengthen and improve the capacity of VAT administration. Thus 37%, 28%, 24% and 11% of the total respondents provided their view on the options (a), (b) (c) and (d) respectively to make the vat effectively successful. This means that efficient and capable tax administration is still lacking for the successful operation of VAT.

4.3.7 Tax structure of VAT

Tax structure which covers basically base, rate, coverage exemption etc. is one of the most important aspects for the successful operation of VAT in any economy. The tax structure of VAT in Nepal is designed on the VAT act 1996 and different laws and regulations are prepared in successive years. The field survey has been conducted to find out whether existing tax structure is appropriate or any comment. The summarized finding of the survey result is presented in the following table.

Table No. 4.15

View on Tax structure of VAT

Respondents	It is ok		It has to be improved		It is not compatible with existing rules & regulations		It has very insignificant contribution w.r.t. GDP		I don't know		Total nos.
	No	%	No	%	No	%	No	%	No	%	
TA/PM	3	30	6	60	1	10	-	-	-	-	10
Experts/Economists	7	28	11	44	3	12	4	16	-	-	25
Auditors	-	-	3	60	1	20	1	20	-	-	5
Businessmen	12	40	9	30	2	6.7	7	23.3	-	-	30
Consumers	11	36.7	12	40	3	10	2	6.7	2	6.7	30
Total	33	33	41	41	10	10	14	14	2	2	100

Source: Field Survey

Out of the ten samples of the tax authority policy makers, 60% comment has to be improved. Similarly, 44% of experts/economists, 60% auditors, 30% businessmen and 40% consumers are the support of VAT improved. The respondents from other field i.e. Tax authorities/policy makers experts/economists, businessmen and consumers generally agreed with the existing structure 40% of the total respondents agreed with the improved VAT structure following by 33% agree with the existing structure. Thus tax structure is not important rather it should be properly implemented in practice.

4.3.8 Expanding the base of VAT

Expanding the base of VAT One of the most favorable aspect of VAT is its broader base so that a high potential revenue can be obtained by a relatively low rate of VAT The options given for expanding the tax base are reduce threshold of VAT, include all of the services incorporate agriculture sector and all of the above. Respondents view and findings are presented in table below.

Table No. 4.16

View on expanding the Base of VAT

Respondents	Reduce threshold of VAT		Include all the services		In corporate agriculture sector		All		I don't know		Total nos.
	No	%	No	%	No	%	No	%	No	%	
TA/PM	2	20	4	40	1	10	3	30	-	-	10
Experts/Economists	6	24	9	36	4	16	6	24	-	-	25
Auditors	-	-	3	60	1	20	1	20	-	-	5
Businessmen	11	36.7	6	20	9	30	4	13.3	-	-	30
Consumers	4	13.3	8	26.7	6	20	8	26.7	4	13.3	30
Total	23	23	30	30	21	21	22	22	4	4	100

Source: Field Survey

Field Survey shows that 20% tax authorities/policy makers, 24% experts/economists, 36.7% businessmen and 13.3% consumers favor to reduce the existing threshold of VAT to expand the VAT base while 40%, 36%, 60%, 20% and 26.7% of respondent from the respective categories favor for including all the respondents desire to include all services, following by 23% to reduce the threshold, 22% agree to apply all the options i.e. reduce threshold, include all the services and incorporate agriculture sector to expand the VAT base and remaining 21% favor to incorporate agriculture sector.

4.3.5 Rate structure of VAT

Currently existing VAT is subject to 13 percent rate. Due to the broader base and coverage of VAT it was expected to have a greater revenue yield even with the 13 percent rate. However this expectation is not achieved in practice basically due to its weak implementation aspect. In such situation field survey was also conducted about the rate structure of VAT. Following table shows the survey result on the rate structure of VAT.

Table No. 4.17

View on Rate Structure of VAT

Respondents	It is ok		Raise to 15%		Reduce to 10%		Establish two rates such as 13% & 15%		I don't know		Total nos
	No	%	No	%	No	%	No	%	No	%	
TA/PM	4	40	2	20	-	-	4	40	-	-	10
Experts/Economists	12	48	2	8	-	-	11	44	-	-	25
Auditors	4	80	-	-	-	-	1	20	-	-	5
Businessmen	7	23.3	5	16.7	11	36.7	7	23.3	-	-	30
Consumers	8	26.7	-	-	12	40	6	20	4	13.3	30
Total	35	35	9	9	23	23	29	29	4	4	100

Source: Field Survey

Survey result shows that most of the respondents agrees with the existing rate of 13%. However 40% tax authorities/policy makers, 44% experts/economists, 20% auditors, 23.3% businessmen and 20% consumers suggest implementing VAT by establishing two rates such as 13 percent and 15 percent. All the respondent from categories, tax authorities/policy makers, experts/economists, auditors, businessmen and consumers gave their view by supporting the existing VAT rate 23% and 4% of the respondents provided their view to reduce VAT rate by 10% and unknown regarding tax structure respectively many respondents agree that rate structure is not a instrument to raise the revenue from taxation until the tax system is not implemented well. Once the implementation will be effective, it will be better to change the rate structure to some extent according as the requirement.

4.3.8 Existing Exemption

VAT as a member of indirect tax is regressive by nature so exemptions on selected goods and services are must require. Exemptions is needed theoretically as well as practically not only to cut down the burden of indirect tax on poor but also due to the objective of simplifying administrative complications summarized finding of the survey on exemptions is presented in the survey on exemptions is presented in the table below.

Table No. 4.18

View on Exemptions

Respondents	It is ok		It should be reduced		It should be increased		I don't know		Total nos.
	No	%	No	%	No	%	No	%	
TA/PM	7	70	3	30	-	-	-	-	10
Experts/Economists	13	52	9	36	3	12	-	-	25
Auditors	4	80	1	20	-	-	-	-	5
Businessmen	11	36.7	11	36.7	7	23.3	1	3.3	30
Consumers	12	40	8	26.7	4	13.3	6	20	30
Total	47	47	32	32	14	14	7	7	100

Source: Field Survey

From the field survey it is found that the existing exemptions is wide since basic concentration of the respondents is found to reduce the existing exemptions wide range exemptions provides an opportunity for tax evasion and may bring distortions in the economy. The finding shows that 70% tax authorities/policy makers, 52% experts/ economists, 80% auditors, 36.7% businessmen and 40% consumers provided their view by supporting the existing coverage of exemptions. Similarly 30% tax authorities/policy makers, 36%, experts/economists, 20% auditors, 36.7% businessmen and 26.7% consumers provide their view to reduce the existing exemptions. 47% and 32% of the total respondents provide their view to existing exemptions is appropriate and to reduce the existing exemptions.

4.3.9 Price rise due to VAT system

During the earlier period of VAT implementation there was a strong opposition from the business community and basic argument behind it was that VAT will raise the price. This argument is true when the VAT will be subject to the same rate of when the VAT will be subject to the same rate of sales tax since VAT collected at each stages of production and distribution. But VAT rate is 13 percent (10 percent in initial stage) while sales tax was levied at the rate of 15 percent After implementation of VAT there was a voice of price rise from some person of different groups. In such circumstances, field survey was also done to get the view that vat has increased price or not. The following table presents the respondents view on this aspect.

Table No. 4.19

View on price Rise Due to VAT system

Respondents	Yes		No		I don't know		Total nos.
	No	%	No	%	No	%	
TA/PM	5	50	5	50	-	-	10
Experts/Economists	9	36	16	64	-	-	25
Auditors	3	60	2	40	-	-	5
Businessmen	17	56.7	13	43.3	-	-	30
Consumers	14	46.7	10	33.3	6	20	30
Total	48	48	46	46	6	6	100

Source: Field Survey

There were 50% tax authorities/policy makers, 36% experts/economists, 60% auditors, 56.7% businessmen and 46.7%, consumers who considered VAT has increased price. Among the total respondents providing the view on price rise due to VAT, there are 2 tax authorities/policy makers, 4 experts/economists, 6 businessmen and 3 consumers who argue that there is rise in price to some extent such as compliance cost high profit or non awareness of consumers. Respondent views are presented in the table below.

Table No. 4.20

Primary reason for price rise

Respondents	Compliance cost		High profit		Non awareness of consumers		Total nos.
	No	%	No	%	No	%	
TA/PM	1	50	1	50	-	-	2
Experts/Economists	1	25	-	-	3	75	4
Businessmen	3	50	-	-	3	50	6
Consumers	-	-	1	33.3	2	66.7	3
Total	5	33.3	2	13.3	8	53.3	15

Source: Field Survey

Survey result shows that 75% experts/economists, 50% businessmen and 66.7% consumers identified non awareness of consumers as the primary reason attributing to price rise similarly 50% tax authorities/policymakers, 25% experts/economists and 50% businessmen considered compliance cost as the primary reason attributing for price rise. Out of total 53.3%, 33.3% and 13.3% of the respondents provided their view respectively on no awareness of consumers, compliance cost and high profit respectively. All of the respondents argued that consumers are responsible for price rise. They said the non awareness of the consumers is the primary reason attributing to price rise, implying low level of public consciousness.

4.3.8 Effect on VAT on Revenue Mobilization

The government is not capable to operate the development activities in the country due to the lack of sufficient revenue besides to this large amount of foreign debt is forcing the economy towards the debt gap. In such circumstances, VAT was expected to have the greater revenue yield due to its broader base and other features such as catch up effect self enforcing nature, transparency etc. Survey result shows the concentration on the positive effect of VAT on revenue mobilization as compared to the replaced taxes but it depends on its effective implementation. The outcome of the survey in this aspect is shown in the table below.

Table No. 4.21

View on effect of VAT on Revenue Mobilization

Respondents	Positive		Negative		No effect		I don't know		Total nos.
	No	%	No	%	No	%	No	%	
TA/PM	2	20	1	10	7	70	-	-	10
Experts/Economists	11	44	7	28	7	28	-	-	25
Auditors	3	60	-	-	2	40	-	-	5
Businessmen	13	43.3	11	36.7	6	20	-	-	30
Consumers	13	43.3	9	30	6	20	2	6.7	30
Total	42	42	28	28	28	28	2	2	100

Source: Field Survey

Survey shows that 20% tax authorities/policymakers, 44% experts/economists, 60% auditors, 43.3% businessman and 43.3% consumers said that VAT will have positive effect on revenue mobilization as compared to the replaced taxes. In aggregate 42%, 28% and 28% of the respondents provided their view on positive, negative and no effect respectively.

4.3.9 Effect on VAT on Economic Growth

The ultimate aim of the government is to achieve the economic development and accelerate the rate of economic growth. Economic Growth of country depends on the various aspects the choice the importance of the tax system differs significantly in different countries based on socio economic background, political environment, geographical structure, government policy and plans etc. The effect of VAT on economic growth is the aggregate effect of VAT on different sectors. Such as investment, revenue mobilization, foreign trade etc. Whether the effect of VAT on economic growth will be positive, negative or no effect is found out from the field survey as follows.

Table No. 4.22

View on effect on VAT on Economic Growth

Respondents	Positive		Negative		No effect		I don't know		Total nos.
	No	%	No	%	No	%	No	%	
TA/PM	7	70	-	-	3	30	-	-	10
Experts/Economists	13	52	-	-	11	-	1	-	25
Auditors	4	80	-	-	1	20	-	-	5
Businessmen	13	43.3	2	6.7	12	40	3	10	30
Consumers	11	36.7	6	20	9	30	4	13.3	30
Total	48	48	8	8	36	36	8	8	100

Source: Field Survey

Survey shows that 70% tax authorities/policy makers, 52% experts/economists, 80% auditors, 43.3% Businessmen and 36.7% consumers have expected to have positive effect of VAT on economic growth, Similarly 30% tax authorities/policy makers, 20% auditors, 40% businessmen and 30% consumers provided their view on no effect on

VAT on economic growth. Thus 48%, 36%, and 8% of the total respondents provided their view respectively on positive, no effect and negative of VAT on economic growth while the remaining 8% were unknown about the matter.

4.3.11 The Most Responsible Group for tax Evasion

Any tax system can not provide the expected revenue yield whenever the tax evading loopholes exist. Evasion of tax not only losses the revenue but also creates economic distortion, market imperfection etc. However tax evading practice is a general phenomenon in any country and it can not be solved perfectly but it must be minimized as far as possible. Generally business enterprises may be taken responsible for tax evasion but it is not true in all the cases and time. There are other groups such as consumers, tax administration who may be supporting, helping or encouraging business enterprises for tax evasion, for their direct or indirect benefit and thus may be more responsible for tax evasion. Field survey was conducted to provide the view on most responsible group for tax evasions among business enterprise, consumers, tax administration or all the finding is presented below.

Table No. 4.23

View on most responsible Group for Tax Evasion.

Respondents	Business Enterprises		Consumers		Tax Administration		All		Total
	No	%	No	%			No	%	
TA/PM	3	30	1	10	2	20	4	40	10
Experts/Economists	9	36	-	-	5	20	11	44	25
Auditors	2	40	1	20	1	20	1	20	5
Businessmen	3	10	9	30	9	30	9	30	30
Consumers	16	53.3	6	20	3	10	5	16.7	30
Total	33	33	17	17	20	20	30	30	100

Source: Field Survey

According as the field survey 30% tax authorities/policy makers, 36% experts/economists, 40% auditors, 10% businessmen and 53.3% consumers said that business enterprises are most responsible for tax evasion under VAT system. Similarly

20% tax authorities/policy makers, 20% experts/economists, 20% auditors, 30% businessmen and 10% consumers said that tax administration is most responsible for tax evasion. But 10% tax authorities/policy makers, 20% auditors, 30% businessmen and 20% consumers said that consumers are most responsible and it is due to the low level of awareness. Remaining 40% tax authorities/policy makers, 44% economists/experts, 20% auditors, 30% business men and 16.7% consumers identified all the groups equally responsible for tax evasion. This out the total sample 33% respondents identified business enterprises responsible for tax evasion while other 30% and 20% to identify all the groups and tax administration.

4.4 Major Findings of the study

On the basis of preceding chapters and data presentation and analysis, some important findings of the research are presented in summary as follows:

- The VAT system that has been implemented in Nepal has completed 12 years of its operation and enters into 13 year. But the data presented in this research is only of the 10th year i.e., 1997-98 to 2006-07 due to several constraints. Due to various complexities and problems this tax system has not been able to achieve the expected level of success.
- Theoretically VAT is superior to Sales tax in many of its form. As it was abolished already, there is no possibility to compare it with VAT now. So only theoretical superiority is established.
- A large amount of government revenue comes from taxation. More than 75% of government revenue comes from taxation whereas the contribution of non-tax revenue is less than 25% in Nepalese tax structure. The contribution of tax revenue was expected to increase after the implementation of VAT. But implementation of VAT did not increase the contribution of tax revenue on total revenue significantly.
- Though VAT has been implemented in Nepal in order to generate more revenue, but the efficiency of the Nepalese VAT administration is not satisfactory and not up to the expectation of the general people.

- More revenue can be generated through VAT by widening its coverage. The small traders which fall on the threshold limit could not have been brought into VAT net yet. They should be registered. The revenue can increase by discouraging tax evasion. There is wide range of practice of evading tax.

- Only few numbers of consumers have habit of taking bills on their purchases. Customers have no habit to take bill on their purchase. This implies that there is very low public awareness and consciousness level towards VAT. On the other hand, businessmen do not want to issue bills. The businessmen have the intension of 'malpractice' on VAT. So they don't provide bills to customers. This indicates the very need of supervision and rational auditing. The percentage of customers demanding bills on their purchase is very low. This might be the cause of ignorance and no habit of taking bills. Taxpayers are not satisfied with the VAT administration. Only few administrators show helpful behavior towards them. Most of the VAT administrators complete their works very slowly and in steady manner. This type of behavior has created great tension and frustration among taxpayers. Professionalism has not been developed yet in VAT in Nepal. Lack of trained manpower and expertise affects the fluency of VAT administration. Physical infrastructure is also lacking. Unless and until administration is made transparent, capable and trained, the government's intention to collect comparatively more revenue through VAT is just a daydream. There is little knowledge about VAT to taxpayers and low public consciousness level in Nepal. To educate taxpayers and all the concerned bodies, educational programmed has to be launched in an effective way. But whatever programmed has been underway is not sufficient to create its impact on people. Most of the respondents suggest that Radio/TV might be best media to educate taxpayers and consumers. Newspaper might be another good alternative. The expected amount of VAT collection is not possible due to lack of maintenance of proper accounts which is very serious problems. Billing is also a very serious problem regarding VAT collection. Customers do not have the habit of keeping bills on their every purchase and business does not feel liable to provide bills on their every sale to customers. The only motive not to provide bills is for tax evasion. It has been noticed that traditional Nepalese businessmen do not have the habit of maintaining their account. Tax evasion is very difficult if account is properly maintained. Some are illiterate and some desire to evade tax. Administrative incapability, under invoicing/unbilling and lack of public awareness towards VAT are main problem in the process of VAT implementation in Nepal.

- Number of taxpayer registrants under VAT has been increasing year after year. The ratio of registrants just kept fluctuating, decreasing sharply in the fiscal year 2006/2007, to just 13.10%. This is certainly not a good sign which will have a long term bearing on revenue collection. Number of taxpayers cancelling their registration under VAT is also generally in the increasing trend, though this has reduced to 31 in the fiscal year 2006-2007.

- The status of Non-filers is not also satisfactory. In the fiscal year 2005/2006, it had increased up to 21.63%, although it had decreased to 14.58% in the fiscal year 2006/2007. But the trend seems to be fluctuating. There is never a constant proportionate increase.

- Credit returns status in on the increasing trend from every fiscal year. Nil tax return and undecided tax return are also increasing year after year. This is not a good sign for Nepalese revenue. Unless the government is active to find out the increasing trend of credit return, nil return and undecided return, VAT cannot be the effective tool for revenue generation.

- Up to the fiscal years 2005/2006, the government failed to meet the targeted revenue. It was only in the fiscal year 2006/2007 that it had just touched the target in the fairly low margin. Even after the implementation of VAT 10 years ago, the government could never get rid of this dire situation.

- In Nepal, collection of VAT has been classified as imports and domestic sources, out of which collection from imports has significant; share i.e. Rs. 17014.20 million in the fiscal year 2006/2007 as compared to domestic contribution amounting to just Rs. 9689.98 or just 36.29% of the total VAT revenue in the same fiscal year. This surely indicates that there is a heavy dependence on imports rather than domestic products.

- The contribution of VAT to GDP is just 3.22 in an average of 7 years. The contribution of VAT to GDP reached 3.98% in the fiscal year 2006/2007. So the VAT/GDP ratio is very low as indicated by the statistical tools like hypothesis testing also.

- The contribution of VAT in total revenue is not up to the satisfactory level either. In an average, it could contribute just about 26.75% to the total revenue which is way above the VAT/GDP ratio as indicated by hypothesis testing.

- Hopefully, an average share of VAT revenue in total tax revenue is pretty good, i.e just about 50% which simply indicates that VAT though implementation wise, faring very poorly, is still emerging as the important source of revenue generation.

- So far as the price to the consumer is concerned, as with the sales tax, the consumer pays the same amount to the retailer. There is no difference in consumer price which paid for the product or service.

- The Time Series shows that given the same trend, the VAT/GDP ratio is expected to rise to 4%. But this is just the estimated figure for the next 5 years. The last trend shows that the actual VAT revenue has kept falling short of its target.

- The correlation coefficient of VAT with GDP is 0.989 and coefficient of determination is 0.977. These results show that flexibility of VAT is greater than the sales tax whose correlation coefficient and coefficient determination are 0.983 and 0.966 respectively. Likewise, the association of total revenue with VAT revenue and coefficient of determination are 0.978 and 0.956 respectively and the relationship of tax revenue with VAT revenue is 0.991 and coefficient of determination is 0.984 with its average percentage in total tax revenue being 49.78. The correlation coefficient of indirect tax with VAT and coefficient determination is 0.986 and 0.971 respectively. The contribution of VAT in indirect tax revenue is 44.65. So these result show that VAT revenue is growing quite proportionately or head to head with GDP, Total Revenue, Total tax revenue and Total Indirect Tax Revenue.

- Most significantly, the hypothesis that the VAT/GDP ratio is different from the VAT/Total Revenue also proved correct when it was tested using the student's test. All these result show that there is only nominal share of VAT revenue in GDP as contrasted with its big share with Total Revenue and Total Tax revenue.

4.5 Major Findings of the primary Data

Consumers argue that weak tax administration is the cause so that businessmen are encouraged for under invoicing and smuggling. Thus weak tax administration along with under invoicing and smugglings are the most challenging problems associated with VAT implementation.

- To identify the problems of practices, solve them successively to make the VAT successful in future so that it will have positive effects on the different sectors of the economy. This means that efficient and capable tax administration is still lacking for the successful operation of VAT.

- The field survey concluded existing tax structure is not appropriate. 41% of the respondents provide their view on tax structure is not important rather it should be properly implemented in practice.

- 30% of respondent from the respective categories favor for including all the respondents desire to include all services, following by 23% to reduce the threshold, 22% agree to apply all the options i.e. reduce threshold, include all the services and incorporate agriculture sector to expand the VAT base and remaining 21% favor to incorporate agriculture sector.

- Many respondents agree that rate structure is not a instrument to raise the revenue from taxation until the tax system is not implemented well. Once the implementation will be effective, it will be better to change the rate structure to some extent according as the requirement.

- From the field survey it is found that the existing exemptions is wide since basic concentration of the respondents is found to reduce the existing exemptions wide range exemptions provides an opportunity for tax evasion and may bring distortions in the economy.

- There were 48% respondents who considered VAT has increased price. They argue that there is rise in price to some extent such as compliance cost high profit or non awareness of consumers.

- Survey result shows 42% respondents from different categories provide their view on the positive effect of VAT on revenue mobilization as compared to the replaced taxes but they depends on its effective implementation.

- From field survey,48% of the total respondents favor for on positive, 36%, and 8% of the total respondents provided their view on no effect and negative effect of VAT on economic growth.

- Out the total sample 33% a respondent identified business enterprises responsible for tax evasion but there is other groups such as consumers, tax administration who may be supporting, helping or encouraging business enterprises for tax evasion, for their direct or indirect benefit and thus may be more responsible for tax evasion.

CHAPTER-V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This chapter is the final chapter of the research which briefly deals with the summary of the study. It also tries to draw the final conclusion of the study while attempting to offer various recommendations to make the various aspects of VAT better in future.

5.1 Summary

This research work entitled, “Value Added Tax Practices In Chitwan has been carried out to ponder into the theoretical knowledge of VAT and to examine the administration system of VAT especially in the Chitwan, to assess the post-implementation period of VAT as compared to the period before the implementation in connection with generating revenue, to examine whether VAT is superior to Sales tax. To achieve those objectives, correlation analysis, time series analysis, t-test analysis empirical analysis have been done with the help of 8 years data (i.e. from the fiscal year 2000/2001 to 2007/2008) and questionnaire developed by the researcher.

The study has been divided into five broad chapters. The contents of those chapters are as follows:

Chapter I : Introduction
Chapter II : Theoretical framework and Review of Literature
Chapter III : Research Methodology
Chapter IV : Presentation and Analysis of Data
Chapter V : Summary, Conclusion and Recommendations

The first chapter begins with the brief background of the study, i.e., the introduction to Taxation itself, its types and all relevant information about Taxation which is essential for having some understanding about VAT, the main topic. The chapter also goes on to discuss the main focus of the study, research questions, objective of the study, significance , limitations and organization of the study. Therefore this chapter presents the outline of the study highlighting its main aims and the reasons for carrying out the research.

In the second chapter, theoretical framework of VAT has been discussed. This chapter includes introduction to VAT, types of VAT, methods of computation of VAT, Origin vs. destination principle as dual principles of VAT, historical development of VAT around the globe and in Nepal, Coverage of VAT in Nepal and Tax administration also. Likewise in the resume of earlier studies, related materials like books, dissertations and journals have been reviewed.

The third chapter briefly explained the research design, nature and sources of data and the statistical procedure and tools which have been used to conduct the research.

The fourth chapter is the main body of the research work which has two main sections viz. presentation and analysis of data, and major findings of the study. This chapter begins with the need for reforms on the present tax system in Nepal, the reform in Tax being the VAT. Its importance was also studied. . It also tries to show the superiority of VAT to different forms of Sales tax. The study then moves on to examine the trend preceding and following the implementation of VAT in Nepal. The sample survey of 100 concerned people consisting of tax officials, policy makers' experts, Auditors, Businessmen and consumers was conducted to throw light on the administration system of Nepal. About 10 questions were asked them about the various issues relating to administration of VAT in Nepal. The study also discusses the trend of registration, cancellation of registration, Non-filers. Tax return, revenue collection from VAT, composition of VAT revenue, share of VAT revenue to GDP, to Total Revenue and to Total Tax revenue. The chapter then studies the future trend of GDP/VAT ratio. This was done with the statistical tool of Time Series. This will set a benchmark for the future action plan to ensure the growth of the ratio. For studying these various issues, data from the 8 fiscal years, i.e. from 2000/2001 to 2007/2008 has been used. To analyze the relationship of VAT with GDP, Total Revenue, Total Tax Revenue, and Total Indirect Tax Revenue, different statistical tools like correlation coefficient, coefficient of determination and student's t-test method for hypothesis testing were also used. After all these studies were made, the study came up with major findings which were also included in this chapter.

The fifth and final chapter contains the summary of the four earlier chapters. This chapter also has conclusion of the research and attempted to offer various suggestions and recommendations for the enhancement and betterment of VAT in Nepal.

5.2 Conclusion

The ultimate goal of the underdeveloped countries like Nepal is to achieve the economic development and ensure the rapid rate of economic growth. It calls for a huge amount of investment in economic overheads and other development activities for which taxation is undoubtedly a primary source of Inland Revenue for the government. Taxation may be considered as a basic tool in the path of economic development for the underdeveloped countries. Recently, developing as well as developed countries in the world have increasingly focused their attention towards reforming the tax system by standardizing and improving the poorly designed tax structure in order to mobilize high volume of resources for the development purposes and make the economy healthy, efficient and self sufficient to a larger extent. In this regard, VAT has become a point of attraction for about 130 countries in the world including Nepal. Existed sales tax along with contract tax, entertainment tax and hotel tax were replaced by VAT since 1997 in Nepal. VAT was initially expected to have a high revenue yield due to its broader coverage and basis. Elimination economic distortions caused by tax system, elimination of cascading and pyramiding effects, creation of the competitive business environment, strengthening foreign trade etc, as it were, are other features of VAT theoretically, expected to be fulfilled in the real practice. It was not easy for the Nepalese government to implement VAT easily as there were many objections and complaints from the business community. But after some dialogue and negotiations, the government was able to implement it to the satisfaction of all. However, there are several issues in the applicability of VAT in Nepal. One of the key issues is administrative capability and situation which definitely are of great importance for the effective implementation of VAT in Nepal. Actually VAT was introduced in Nepal in an ambitious hope to increase the revenue and particularly stop the leakage made through other forms of taxes. But history has shown that the government has already tried many reforms in the field of taxation but no alternative have effectively materialized because it lacked proper planning and in other words leading to administrative failure. Indeed, this is true in the case of VAT also, Nepalese businessmen are generally found to avoid the frequent contacts with the tax officials because they are widely known for unofficial benefits. Even in the administrative area, there is a widespread corruption. From the survey, it is clear that it is difficult for the customers to get the job done by officials without sufficiently bribing them. There is also a red tapism everywhere. So, for the government, administrative capability and transparency are the serious concerns. In order to make VAT applicable, following things should be considered

i. Administrative power and credibility
ii. Tax payer identification
iii. Registration and educational program
iv. Incentives for small traders
v. Co-ordination with private sector
vi. Feasibility of refund system
vii. Electronic media

Currently DANIDA and GTZ have jointly established a VAT project in order to assist the implementation of VAT in Nepal. While the numbers of registrants are increasing but the tax collection has not been satisfactory when compared to the number of registrants. Public awareness is very low. The salesmen are not used to issuing bills and the consumers to receiving them. Undervaluation and smuggling of goods are mostly found. The problem seems to be aggravated by the government's increasing the VAT rate to 13% which immensely discourages the customer in demanding bills on their purchases. Truly, recent increment in VAT rate has a fairly negative influence on general people. Their viewpoint is to broaden the tax base instead of increasing the tax rate. Tax rate has been increased time and again for nothing, but this does not get reflected in real revenue mobilizations. Rates should be continued for a long time for transparency and must be incorporated in VAT Act itself. So, the government has to pay serious heed in increasing the tax base instead of increasing the tax rates. International experience tells us that the gradual lowering of duties or tax rate is an effective tool in achieving the desired goals rather than increasing it. Periodical policy has also been obstacles for its speedy enforcement, and a major hurdle that has hurt revenue generation. Excise duty is an important source for VAT, but it has not been effectively administered. Custom officials are more worried on customs duty than VAT collection. Widespread leakages are normal practices due to lack of professionalism, integrity, technically competent, and international orientation. Tax auditors have been auditing without basic knowledge and academic background. As it's weakly enforced, many sectors are out of tax net. Taxpayers complain that the procedures are complicated and time consuming during the decision-making process. The current modality of the raffle tickets has been designed so as to seize the original bills from eighty percent of taxpayers, who pay only twenty percent of revenue. The system is not new; many countries have already tried with the lottery system, and failed gaining from it. It means, we have no valid mechanism to bring potential payers into net, and no valid mechanism has been developed on bringing them into the tax net. The April 2005 movement (also known as the second janandolan) is a harbinger of new hope in Nepal. It was intended to overthrow the old feudal regime replacing it with the new sovereign and people-ruled system. Nepalese people are beginning to dream of a different New Nepal following the constituent assembly. Under such situation, the old status quo in the administrative field also must change. Surely, this is a real challenge to the administrators and the policy makers of Nepal. In other words, this is not happening at the moment. If that status quo could not be broken, no matter whatever big changes take place, they would have no influence at all. This is a real paradox. However, if the nation is to march fast enough to keep pace with the momentum of development and political change, it must come out with a new inventory of concepts and strategies as opposed to the old stereotyped ones. It is a well known fact that the industrialization of Japan, Hong Kong and South Korea was possible because of their tax policies. So under the changed system in the country, a tax system definitely could play a crucial role in course of nation-building. Sweeping and radical reforms on VAT system with a comprehensive incentive package based on VAT concept would help the economy boom. A bold vision, evolutionary leadership, efficient bureaucrats, honest taxpayers plus collectors and graft-free society are the invisible infrastructures required. So all must think from a long-term perspective rather than weighing up immediate pros and cons. The Inland Revenue Department must come up with a forward-moving process, concrete action plan and policies to cope with the global challenges in order to accelerate the reform process.

5.3 Recommendations

On the basis of research, the following corrective measures are recommended for the better administration and implementation of VAT system in Nepal.

- A proper co-ordination between IRD and MOF should be established. Unpractical Acts, Rules and Regulations should be amended. VAT laws needs to review on the basis of experience gained so far VAT laws should be effectively implemented.

- Unproductive, corrupted, inefficient staff lacking practical and specialized training is a serious problem. So, providing training to such staff is highly essential.

- The tax administration should be very watchful to prevent any kind of malpractice, fraud and tax evasion. Utmost care should be taken to prevent any kind of bribing and corruption. Tax officials should effectively be monitored.

- Taxpayers, customers are clearly ignoring the VAT system and taking it for granted. They have lack of proper knowledge about computation of tax liability, taking invoice or bill on their purchases. So, emphasis should be given in educating the tax payers. The issuance of proper bill for every taxable sells must be made mandatory.

- The success of VAT system is not only the success of the IRD, but also the success of nation as a whole. The role of general media, radio, TV, newspaper plays an important one. Emphasis should be given on mass media. Awareness towards VAT system should be created among general public, nongovernmental and government organization.

- Computer system and networking program through online service must be developed and linked so as to make the work simple and easy. Computer links between tax officer and custom offices should be maintained.

- Government has been providing tax refund facility to business organization and foreign diplomacy and foreign aided project. Tax refund is one of the sources of tax leakage. Therefore, tax authority should manage tax refund facility properly.

- Research and investigation should be conducted on various issues, such as the effect of VAT on price, economic growth, investment and measures for solving VAT problems should be recommended by the expert group. VAT law needs to be reviewed on the basis of experience gained so far.

- The accounting system should be transparent. Taxpayers should be encouraged to register their business voluntarily. Instead of forcefully coercing tax payers, providing various facilities to them can increase VAT compliance. The tax administration can select genuine business persons and reward them.

- Border should be effectively controlled to prevent the illegal trade. Warehouse and highways checking should be done effectively to prevent any kind of illegal trade

- VAT collection on import is remarkably higher than domestic production. Government should take effective steps to encourage domestic production.

- Lots of efforts should be made to reestablish a functionally well-organized organization where the tasks are carried out in a modern, effective, efficient, transparent and service-minded manner.

- Most of the national economic activities are dependent upon agriculture and large portion of GDP coming from agricultural sector remains out of the tax net. Thus VAT should also be levied on agriculture sector with sufficient exception for generating more tax revenue. This will increase VAT/GDP ratio.

- Most of the taxpayers are not satisfied with VAT administrators. They always have complaints against the administrators who do their jobs rather slowly, harassing the customers unnecessarily. The work that is to be finished today is postponed for the next day. This is their habit. Therefore it is suggested that tax administrators should be consumer-focused and result oriented.

- Lastly, the periodic information about VAT is now available on the website as well. For the researcher this is a great privilege. But the websites are not updated and doesn't have the older reports. So The website must be updated from time to time and must be kept up-to-date. And all backup copies of the old (old fiscal years') annual reports and Economic surveys must also be available on the website. This facilitates the researchers greatly and other concerned bodies, even the consumers, because for minor information, they would not have to frequent the Inland Revenue Department and Ministry of Finance.

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APPENDIX- I

QUESTIONNAIRE

Name:

Address:

Occupation:

Please, you are requested to provide your view on VAT in Nepalese context.

1. Which is the most challenging problem associated with VAT implementation?

   i) Under invoicing and smugglings ii) Lack of proper billings

   iii) Lack of proper accounts iv) Weak tax administration v) I don't know.

2. What is your opinion to make VAT effectively successful?

   i) Strengthen and improve the capacity of VAT administration ii) Educate taxpayers

   About the significance of VAT iii) Mobilize cooperation of private sector

   Through FNCCI iv) Improve VAT laws and regulations v) I don't know

3. What is your comment on tax structure of VAT?

   i) It is ok ii) It has to be improved iii) It is not compatible with the existing rules

   And regulations iv) It has very insignificant contribution with respect to GDP

   v) I don't know

4. How could the base of VAT be expanded?

   i) Reduce threshold of VAT ii) include all the services iii) In corporate agriculture

   Sector iv) All v) I don't know.

5. What is your suggestion on the rate structure of VAT?

   i) It is ok ii) Raise to 15% iii) Reduce to 10% iv) Establish two rates such as

   13% and 15% v) I don't know.

6. What is your comment on exemption?

i) It is ok ii) It should be reduced iii) It should be increased iv) I don't know.

7. Do you consider that VAT has increased price?

i) Yes ii) No

If yes, what is the primary reason attributing to price rise?

i) compliance cost ii) high profit iii) Non-awareness of consumers

iv) I don't know.

8. What will be the effect on resource mobilization by VAT as compare to the taxes replaced by it?

i) Positive ii) Negative iii) No effect iv) I don't know

9. What will be the effect of VAT on economic growth?

i) Positive ii) Negative iii) No effect iv) I don't know

10. Who are most responsible for tax evasion?

i) Business enterprises ii) Consumers iii) Tax administration

iv) All v) I don't know.

Any suggestion………………………………………..

APPENDIX -II

VAT Rate Structure in Countries

Country	Rate	
	standard	Reduced
Argentina	21%	10.5% or 0%
Australia	10%	0%
Bosnia and Herzegovina	17%	
Canada	6% or 14%	4.5%
Chili	19%	
People’s Republic of China	17%	6% or 3%
Croatia	22%	0%
Dominican Republic	6%	12% or 0%
Ecuador	12%	
El Salvador	13%	
Guyana	16%	0%
Iceland	24.5%	14%
India	12.5%	4%,1% or 0%
Israel	15.5%	
Japan	5%	
Kazakhstan	15%	
Lebanon	10%	
Moldova	20%	5%
Republic of Macedonia	18%	5%
Malaysia	5%	
Mexico	15%	0%
New Zealand	12.5%	
Norway	25%	13% or 8%
Paraguay	10%	5%
Peru	19%	
Philippines	12%	
Russia	18%	10% or 0%

Serbia	18%	8% or 0%
Singapore	5%	
South Africa	14%	0%
Republic of Korea	10%	
Sri Lanka	15%	
Switzerland	7.6%	3.6% or 2.4%
Thailand	7%	
Turkey	18%	8% or 1%
Ukraine	20%	0%
Venezuela	16%	8%

APPENDIX- III

Implementation of VAT in different countries

Year	**Countries that have started adopting VAT**
1954	France
1960	Ivory Coast
1961	Senegal
1967	Brazil, Denmark
1968	Germany, Uruguay
1969	Netherlands, Sweden
1970	Ecuador, Luxemburg, Norway
1971	Belgium
1972	Ireland
1973	Austria, Bolivia, Italy, United Kingdom, Vietnam
1974	Argentina, Chile, Colombia, Costa Rica, Nicaragua
1976	Honduras, Israel, Peru
1977	South Korea, Panama
1980	Mexico
1982	Haiti
1983	Dominican Republic, Guatemala
1984	People Republic of China
1985	Indonesia, Turkey
1986	Morocco, New Zealand, Nigeria, Portugal, Spain, Taiwan
1987	Grenada, Greece
1988	Hungary, The Philippines, Tunisia
1989	Japan, Malawi
1990	Iceland, Kenya, Pakistan, Trinidad and Tobago
1991	Bangladesh, Benin, Canada, Jamaica, Mali, Algeria, South Africa, Armenia, Azerbaijan, Cyprus, EL Salvador, Estonia, Fiji, Kazakhstan
1992	Tajikistan, Belorussia, Kyrgyzstan, Russia, Thailand, Turkmenistan, Ukraine, Uzbekistan, Moldova

1993	Burkina Faso, Czech Republic, Paraguay, Poland, Romania, Georgia, Slovak Republic, Venezuela
1994	Bulgaria, Finland, Lithuania, Singapore, Western Samoa, Madagascar, Niger
1995	Gabon, Ghana, Switzerland, Zambia, Malta, Latvia, Liechtenstein, Mauritania
1996	Albania, Belize, Guinea, Uganda
1997	Barbados, Congo, Nepal
1998	Croatia, Mongolia, Sri Lanka, Tanzania, Vanuatu, Surinam, French Polynesia
1999	Cambodia, Cameron, Mozambique, Netherlands, Papua New Guinea, Slovenia, New Jersey
2000	Australia, Chad, Macedonia, Namibia, Sudan
2001	Botswana, Rwanda
2002	Lebanon
2005	India*

Source: The VAT Project Office (Revenue Administration Support), IRD, IRD/DANIDA, 2001: 3-4)

*India has implemented Modified VAT since 1986. This system is not exactly a VAT system.The system was introduced to refund excise