

CHAPTER - I

INTRODUCTION

1.1 General Background of the Study

Taxation is the backbone of a country's economic development. VAT is the latest innovation in the field of indirect tax system. It is an improved and modified form of sales tax. It is levied on value added of goods and services at each stage in the process of production and distribution chain. It is not a genuinely new form of taxation but merely a sales tax administered to different form. Although it is eventually borne by the final consumer VAT, it is the recent innovation in the field of taxation. It was developed by Dr. Wilhelm Von Siemens of Germany in 1919 A.D. Then it was developed further in 1949 by a tax mission to Japan headed by Prof. Carl S. Shoup. It was remained as only topic of academic interest until 1953. However the credit of rising VAT at first goes to France. This country introduces VAT in 1954. By the end 1960s, only eight countries included VAT. It has been introduced by at least one country each year and by now it has been adopted by more than 120 countries. However, the concept of this tax in Nepal was introduced in early of 1990's after a long discussion, interaction, preparation and debate. Nepal finally implemented VAT from 16 November 1997. Nepal has decided to adopt VAT by the VAT act 1996 instead of sales tax and service based taxes i.e. hotel.

From the Economist Points of View

According to Musgrare and Musgrave, "A properly implemented VAT is equivalent of corresponding single tax unlike the expenditure tax, the VAT is not a genuinely new from the taxation but merely a sales tax administered in different from."

According to Indian Taxation Inquire Committee, “VAT is a broad based tax on the business designed to measure net value generated in a country. It is a tax system that aims to minimize tax evasion and increase resource mobilization.

‘Value added for a firm is nothing but its gross receipts from sales minus all expenditures on goods and services purchase from other firms. The firm adds value to these purchased materials by processing them with the help of its own factors of production such as labor, land, capital etc. This increase in the value of outputs is the value added by a firm.’ (Khadka, 1997:1-2)

“Value added is the value that a producer adds to his raw materials or purchases before selling the new or improved product or service. A tax based on this base is called VAT. Theoretically, value added can be defined in terms of earning of factors of production i.e. land labor, capital and entrepreneur. Each factor receives rent wage, interest and profit respectively,” (Silwal, 2001)

In conclusion , VAT has been the most essential choice for the most developing countries as an ingredient of their tax reforms because it is the most improved form of sales tax, which leads to revenue the enhancement and economic efficiency. It is an important instrument for the mobilization of internal resources.

After the restoration of multiparty democratic system, Government of Nepal has introduced the comprehensive tax reform programs. The implementation of value added tax has been taken as an important part of tax will become wider thereby increase tax collection, make the system economically efficient and increase transparency in entire tax system of the nations. In order to create a conducive policy environment to implement value added tax more effectively, Government of Nepal made several changes in the customs and income tax system.

The sources of Government revenue can be broadly classified into two categories of tax revenue. The Government receives tax revenue as a compulsory payment whereas non-tax revenue is conditional one. In general, tax can be grouped in two groups, direct tax and indirect tax. If person bearing and paying tax is same, it is called a direct tax. In the word of Dalton, a direct tax is really paid by the same person on whom it is legally imposed. Direct tax includes: Income tax, Property tax, Vehicle tax, Gift tax and Interest tax which is different. Again in the word of Dalton, an indirect tax includes: Value Added Tax (VAT), Sales tax, Entertainment tax and Hotel tax, Excise Duty, Import and Export Duties etc. The indirect tax is a commodity tax, which partly or fully passed on by forward and backward shifting process (Tiwari, 2052).

It is unanimous that all government needs resource mobilization from internal resource or external resource to fulfill their declared policies and programs. When the country depends upon foreign grant and loan assistance because of lacking in internal resource of revenue, the country has to increase its capability of resource mobilization for sustainable development and reduces dependency over foreigners. Considering this fact, Government of Nepal has introduced VAT Act, 2054 to obtain the objectives for increasing revenue mobilization by making effective the process of collecting revenues required for the economic development of the country. It is expedient to impose a value added tax on all transactions including the sales, distribution and delivery, importation of goods or services and to collect revenues effectively by regulating the process of collection.

VAT is a part of indirect tax and it is considered as one from the sales tax. It is a tax imposed on value added by business firms on goods and services at the successive stage of production of goods and distribution of goods and services. The value Added Tax is a tax imposed upon the value that the activity of a business firm adds to the goods and services. It purchases from other firms that is

upon the excess of sales during a period over the amounts paid for goods and the services acquired from other business firms during that period (Ojha, 2053).

VAT is levied on all goods and services excluding those that have been exempted by the law and it lived on each level of sales from the production and import to the distribution of all goods and services except ones.

1.2 Significance of the Study

In addition to consumers, person involved in commercial activities is affected by VAT. A person means an individual, firm, company, association, cooperative, institution, joint business, partnership, trust, government body or religious organization.

There are categories of persons and organizations which are neither required to collect VAT nor allowed to claim a refund of the VAT. They have paid in producing their goods and services for sale. These would include unregistered small suppliers, that is, persons with annual sales of taxable goods and services of Rs. 2 million or less. But even such people can voluntarily register for VAT purpose.

Besides the persons who are affected by VAT for the production and consumption of goods and services, this research is very useful for those persons like students, researchers, scholars, professors, journalists, legislators, planners and the person who are interested in VAT system of Nepal.

1.3 Statements of the Problems

Major sources of public financing are revenue mobilization, foreign grants and loans, internal loan and change in cash balance. Nepal is an underdeveloped country where most of the people live under the poverty line. Population growth

rate of the nation is greater than GDP. The growth rate is increasing rapidly. In comparison, government revenue is nominal than government expenditure. The government expenditure is increasing but government revenue is not growing equivalently as per the expenditure. There are many reasons for increasing expenditure. The main reasons are unstable political situation, unstable economic growth etc. Due to such reasons, the government revenue is not satisfactory, as it has been expected. So the government face deficit financing year by year. The deficit financing increases share of external as well as internal loan and foreign aids. For the payment of external as well internal loan and financing the government expenditures, internal revenue is the main source. Tax revenue is one of the most important sources of government revenue. VAT is a strong complement of tax revenue. But lack of proper implementation of tax policies, lack of knowledge, lack of public awareness and lack of efficient tax management are creating obstacles on revenue collection (Mainali,2061).

At this critical situation, the government introduces the VAT system as a scientific and modern tax system. Introducing of VAT is a positive process on revenue collection, which helps to increase the government revenue. For easily operation of VAT, its implementation part must be strong. But we don't feel that situation. Before the implementation of VAT, our existing tax system faces unskilled manpower, weak administration, inefficient management and other problems.

Availability of information about VAT is very essential to make people conscious about VAT. So, the researcher selects this topic (An Analysis of VAT is Nepal) for providing a lost of information about VAT to the businessman, consumers, researchers and other interested parties who like to collect information about it and to provide suggestions and give recommendations to the concerned authority with the view to improve existing taxation system.

1.4 Objectives of the Study

Value added tax is now an innovation of a modern tax. It has been implemented from 16 November 1997 in Nepal. But there are many difficulties and problems to make it effective. The general objectives of the study are to examine the various issues relating to VAT and to find out the reality and to provide useful view as well as suggestion. The specific objectives of the study are as follows:

- a. To explore the prevalent constraints of applying VAT system.
- b. To identify the major issues involved in the process of its implementation.
- c. To analyze the trends of registration, refund and collection of VAT.
- d. To measure contribution of VAT to government revenue.
- e. To identify effective measures that government should introduce for effective return from VAT.
- f. To recommend a package for effective implementation of VAT.

1.5 Limitations of the Study

Each and every study has its own limitations and boundaries. This study also has various limitations. Some of which are given below:

- a. Major sources of data are secondary sources thus the error consisted in those sources may perceive in this research.
- b. Lack of availability of plenty secondary sources.
- c. The person selected for interview may not be sufficient to represent the universe.
- d. Lack of Nepalese study in VAT.
- e. Due to time and resource limit, data and information which researchers collected are might not be sufficient for the study.
- f. Being a research in nature, not all the factors of VAT explore in detail.

Although the findings of this study will be helpful to all concerned offices and persons throughout the country, the conclusions, however should be applied with care, as it is the study only of particular place i.e. Kathmandu Valley.

1.6 Plan of the Study

This study is divided into five major chapters, which are as follows.

Chapter - I: This is the introduction chapter. This chapter includes background, statement of problem, objective of the study, significant of the study and limitation of the study.

Chapter - II: This is the literature review chapter. This chapter includes conceptual framework of income tax and review of related available studies.

Chapter - III: This is the research methodology chapter. This chapter includes research design, population and sample source of data, data collection procedure etc.

Chapter - IV: In this chapter data are presented, analyzed and interpreted by using statistical tools, mathematical tools and other accounting and financing tools etc.

Chapter - V: The final or last chapter contains the summary of the whole study. The conclusions of the study have been presented and at last suitable points are suggested in the form of recommendation. Bibliography and appendixes will incorporate in the end of the study.

CHAPTER - II

REVIEW OF LITERATURE

2.1 Theoretical Background

2.1.1 Value Added Tax

VAT is the latest innovation in the field of indirect tax system. VAT is the youngest member of sales tax family. It was the buzzword some years back. It is more scientific, modern and progressive as compared to sales 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 contains catch up effect. It is based on value added principle value added can be obtained either by adding payments to factor of production.

Value added = wages + rent + interest + profit

Or deducting cost of inputs from sales value

Value added = sales value – cost of input

VAT is an important and essential taxation tool to provide the right direction to Nepal's economy and the government's revenue policies. VAT is based on goods and services. It is also considered to be a tax that is based on consumption. The burden of this tax has to borne by the consumers. This tax is levied on the value addition at each stage from the time of production to consumption of all goods and services. The burden of VAT depends upon the final price irrespective to the proportion of value added at different stages in the process of import / production and distribution, it paces an equal burden on both imports and domestic products or on the items which have a high value added at the import / manufacturing level or in the distribution.

VAT differs from turnover tax as the turnover tax is imposed on total value at each stage, while VAT is imposed only on value added at that stage. In the production and distribution process a firm buys materials from other firms. These materials may include principal raw materials, auxiliary raw materials, chemical, electricity and capital goods such as machinery, equipment, buildings, furniture, vehicles etc. The firm adds value to these purchased materials by processing or handling them with the help of its own factors of production such as labor, land, capital etc. This increase in the value of outputs over inputs is the value added by a firm. Value added by a firm is equivalent to its payment of wages, salaries, rent and interest plus its profit and this value added is the base of VAT (Daiha, 1998).

We know that a production process has many stages, right from the manufacturer to the retailer before the goods finally reach the consumer. In this respect, VAT is imposed on each stage of transaction such as production, import and distribution stages of goods and services. It affects only the added portion of price i.e. the value of goods and services added in the various stages of transaction. VAT is levied in accordance with the price rise at different levels from the production of goods and services to their distribution.

2.1.2 Evolution of VAT

During the First World War, the German Government introduced Umsatzsteuer a multiple stage sales tax as a temporary measure to mobilize the much needed resources. The German Government debated a lot on this and held many discussions but since this was a totally new concept and had not been implemented anywhere in the world. Wilhelm Van Siemens is often credited as the first to propose this tax for Germany in 1919 A.D. Then it was developed further in 1949 A.D. by a tax mission to Japan headed by Prof. Carl Shoup. It remained as only a topic of academic interest until 1953. After three and a half decades of the evolution of the concept of VAT, France took the courage to put VAT into

practice. However the credit of rising VAT at first to France. This country introduced VAT in 1954 A.D. In the 1960s in the process of establishing the European Union (EU), the policy to adopt a standard tax system among the members of the community was also adopted. Since it became a precondition to adopt VAT to become the member of the EU, the member countries started to introduce VAT into their tax systems and gradually it became the standard tax system of European country. VAT started to spread worldwide. In 1960, this tax was adopted by Ivory Coast, in 1961 Senegal followed suit and in 1967 Brazil and Denmark adopted this tax system. There after many countries started adopting this tax.

VAT was implemented fully in 1968. In Ghana, VAT was abolished, after three months of introduction in 1995 and was reintroduced again in 1998. In Malta, VAT was introduced in 1995 and was abolished after a change in the Government in 1997 and it was reintroduced in 1999 (Panta, 2060).

Between Our Two Neighboring Countries

Along with various measures taken by China for economic reforms in the late 1970's, it has also implemented VAT in various forms and scales. It was only partially implemented VAT till 1993. Hence, it could not take the complete benefit from VAT. Therefore China adopted VAT in its full form on 1st Jan 1994.

To make the commodity based tax system of India. Simple and more efficient and transparent, the various tax reform comities, economists and intellectual have been recommending the introduction of one VAT system instead of several commodity taxes. Some states trying to only partially implement VAT and the fact that the neighboring sates had not introduced VAT, the experience regarding VAT in these states (Maha Rastra, Andhar Pradesh, Kerala, West Bengal, Rajasthan and Uttar Pradesh) was not satisfactory. This experience illustrated the fact that the

implementation of VAT cannot be successful. If applied only to limited areas or on limited goods by establishing a very high or low threshold. At present various states of India are making preparation to convert their sales tax into VAT by April 2003.

Among the 24 members of the organization of Economic co-operation and development countries: VAT has been adopted by all except Australia and the United States. VAT has been considered in great depth even in these two federal countries, there are many supporters of this tax.

VAT has been spreading in the Asian region as well. South Korea introduced VAT in 1977, China in 1984, Japan in 1989 and Thailand in 1992 while Singapore has been implementing this tax since 1st Jan 1994.

In SAARC region, VAT has been considered in great depth in India. This country introduced VAT in a different way under the name of MODVAT in 1986. Among the other members of the SAARC countries, Pakistan and Bangladesh adopted VAT in 1990 and 1991 respectively while Nepal has implemented it on 1997. (Sharma and Luitel, 2009)

2.1.3 VAT in Nepal

Tax reform which was a part of economic reform and VAT emerged as the main feature of the tax reform program prior to the introduction of value added tax in 1997. Nepal used to levy several independent domestic trade taxes on goods and services i.e. sales tax excise duties, hotel tax, contract tax, entertainment tax, air travel tax. To bring sustainability in internal resource mobilization, His Majesty Government of Nepal (HMG / N) adapted the policy to integrate the prevailing commodity taxes under VAT within the period of the Eighth Five Year

Development Plan (1992/93-1996/97). For regular operation, collection and proper management, VAT act 2052, VAT regulation 2053 has been implemented.

Although the act has passed 2052 its implementation was delayed due to political instability and strong opposition from the business community. VAT has been fully implemented with effect from 16 Nov 1997 (1 Mangsir 2054). It has replaced sales tax hotel tax, contract tax and entertainment tax. It has been designed to collect same revenue as the four taxes. It was replaced since the collection of both custom duties and income tax depended to a great extent upon the effectiveness of VAT.

2.1.4 Need to Introduce VAT

There are several reasons to introduce VAT in Nepal. They are: (Thapa 2002)

1. To introduce VAT in order to broaden the base of domestic trade taxes.
2. To make tax system Neutral and efficient.
3. To increase revenue mobilization by broadening the tax base.
4. To minimize the cost of taxation.
5. To establish a transaction based transparent tax system.
6. For economic development.

2.1.5 Preparation Made for the Introduction VAT

The ideas of introducing a VAT in Nepal was originated in the early 1990s and the government adopted a policy to introduce VAT in place of several domestic trade taxes within the period of the 8th 5 year plan. To this end, in September 1993, a VAT tasks force was constituted to make necessary preparations for the introduction of VAT. A VAT steering committee was also set up to evaluate and monitor assistance was provided by various development agencies i.e. United States Agency for International Development (USAID) Harvard Institute for International Development (HIID) (DANIDA).

Legal Basis

The VAT law was drafted in 1994 and after wide deliberations, was passed by the Parliament and provided with the royal assent on 20 March 1996.

The VAT regulations were drafted in July 1996. They were discussed at different stages and were approved by the cabinet on 27 January 1997. The VAT operational manual was initially drafted in 1996 nine volumes and was finalized in the fall of 1997. The Government approved it on 21 September 1997.

Administrative System

A new organizational structure and personnel system was adopted to administer VAT. Under the new structure, several sections and subsections were created on the basis of the function of VAT administration. A large taxpayer section was created to deal with the large taxpayers and an internal monitoring section was created to monitor various sections of the VAT Department and VAT offices.

An officer oriented personnel structure was created to administer VAT. Under the new system, higher-level positions were increased while lower level positions were decreased and additional personnel were recruited. Numerous training programmes were also organized for tax officials on various aspects of VAT. A comprehensive computer system was developed to run VAT. Several assessments, collections, audits etc. were developed, tested and implanted. A number of computer user manuals were prepared and tax officials were provided with the appropriate training. All activities regarding VAT are now operated using a computerized system.

Tax Education

As VAT was new to Nepal, a comprehensive VAT educational programme was launched to educate the public on the various aspects of VAT. In the context,

seminars, public speeches and interaction programmers were organized in different parts of the country. VAT presentations were also made during programmers arranged by various local and international bodies and organizations, such as the Chambers of Commerce, Bar Association etc. Other VAT awareness methods utilized include the use of explanatory brochures, media advertisements, visits by tax officers etc.

Adjustments in Other Taxes

Some adjustments were made in other taxes in order to create a congenial environment for the implementation of VAT. For example, as stated earlier, excise duties were reduced on a number of revenue unproductive items. The number and level of sales tax rates was lowered and brought down to a uniform rate of 10%. The rates of customs duties and income tax were also reduced. Similarly, a system of levying import duties on transaction value, in place of administratively fixed value, was introduced in the field of customs duties and a practice of accepting books maintained by taxpayers in place of the negotiated assessment system in respect of income tax was adopted to ease the VAT implementation.

2.1.6 Types of VAT

Value added tax could be classified into three groups:

- a. Consumption type VAT
- b. Income type VAT
- c. GNP type VAT

a. Consumption type VAT

Under the consumption type VAT; all capital goods purchased from other forms are excluded from the tax base in the year of purchase, while depreciation is not deducted from the tax base in subsequent years. Similarly, discrimination is done with respect to capital or consumable goods. Whatever is purchased for the use of

business is treated at par. This implies that full credit of inputs is provided. Since the investment is relieved from taxation under this variant, the base of tax is consumption.

2. Income Type VAT

The income type VAT does not exclude capital goods purchased from other firms from the tax base in the year of purchase. This variant however excludes depreciation from the tax base in subsequent years. The tax falls both on consumption and net investment and the conceptual tax base of this variant is the net national income. This type of VAT has the difficulty of calculating income for a particular period. As a result only few countries practice this type of VAT.

3. The Gross National Product Type VAT

Under this variant, capital goods purchased by firms are not deductible from the tax base in the year of purchases. Similarly, this variant does not allow the deduction of depreciation from the tax base in subsequent years. Thus, the tax is levied both on consumption and gross investment and the conceptual tax base of this variant is gross domestic product (Agrawal, 1998).

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

- a. This variant does not affect decisions regarding investment and growth since it relieves investment from any tax burden.
- b. Likewise, the consumption variant is attractive from the point of view of tax administration as there is no need to distinguish between the purchase of intermediate goods and goods under this variant which is necessary under this variant. Unlike the consumption variant, the other two variants stimulate firms to classify their purchases of capital goods as intermediate goods leading to complication for the administration.

- c. Furthermore, the consumption variant is more attractive than the income variant form the consideration of foreign trade because the consumption variant is compatible with the destination principle of taxation, which has been used by many countries.

2.1.7 Method of Computing VAT

There are three methods of computing VAT:

- a. Addition Method
- b. Tax Credit Method
- c. Subtraction Method

a. Addition Method

Under this method, tax base is obtained by adding the payments made by the firm to the factors of production employed in the production process such as wages, rent, interest and profit. This method is suitable for income type VAT.

Table 2.1
Addition Method

Item	Raw Material Producer	Manufacturer	Whole Seller	Retailer	Cumulative
Purchased input-a	-	100	500	800	1400
Value Added					
Wages	60	275	200	100	635
Rent	10	25	40	50	125
Interest	10	50	25	25	110
Profit	20	50	35	25	130
Total Value –b	100	400	300	200	1000
Added VAT @ 13%	13	52	39	26	130
Sales Output a+b	100	500	800	1000	2400

Note :- Value added can be estimated in two ways.

- a. Deducing purchases from sales of output (Rs. 2400 – Rs. 1400 = Rs. 1000)
or
- b. Adding input by the firm itself (excluding inputs supplied by others i.e. wages + rent + interest + profit).

2. Tax Credit Method

Under this method, tax is imposed on total value of sales and tax payers are allowed to deduct from their gross tax liability the taxes already paid by their supplier and pass on to them. As compared to subtraction method, which deducts purchases from sales and levies tax on the difference tax on purchases is subtracted from the tax on sales under this method. This method is also known as invoice method.

Table 2.2

Tax Credit Method

Item	Raw Material Producers	Manufacture	Whole Seller	Retailer
Sales of output	100	500	800	1000
Less-purchase	-	100	500	800
Value added	100	400	300	200
Tax on total sale	13	65	104	130
Less – credit				
On purchase	-	13	65	104
Tax liability	13	52	39	26

Note: Assume 13 % VAT on a consumption basis.

3. Subtraction Method

Under this method, value added is determined as Net turnover. The net turnover is obtained by subtracting the cost of materials from sale precedes. This method is suitable consumption type VAT.

Table 2.3

Subtraction Method

Item	Raw Material Producers	Manufacture	Whole Seller	Retailer
Sales	100	500	800	1000
Cost of material	-	100	500	800
Value added	100	400	300	200
Value @ 13%	13	52	29	26

Out of three methods of computing VAT, tax credit method is widely used in the countries of the EC and elsewhere. The reason behind this is that this method possesses several advantages over addition and subtraction methods.

Since businesses are required to state the tax on invoices under the tax credit method, it facilitates border tax adjustments. This implies that the amount of tax that levied on exports can be returned to exporters. Similarly, this method is effective under the destination principle where exports are zero-rated and the tax credit chain is not broken. It also provides the facility of cross checking.

2.1.8 Reasons for VATS Growing Attraction in the World

- a. VAT is based on the most modern theories.
- b. It is more informative.
- c. It raises considerable revenue and sustains it.
- d. Increment of tax payers are also advanced in it.
- e. It is less tedious.
- f. It is free from cascading effect due to the input tax credit.
- g. It is effective to control price raise and reduce tax evasion due to its catch up effect.

2.1.9 Principle of VAT

There are two principles for levying VAT.

a. Origin Principle

Under the origin principle, goods or services produced in a country are taxed at the place where they are produced. This implies that all exports are taxable and all imports are Non-taxable. Where there is a border and cross-country trade, this principle gets importance to import goods or services over domestic production. Countries with international boundaries do not prefer to have this principle. But in EC where there is common border this principle of taxation is essential. The main reason of not following this principle is of revenue loss. It also discourages the exports either directly or indirectly.

b. Destination Principle

Under the destination principle goods or services are taxed not at the place where they are produced but the place where they are consumed. VAT is levied on domestic consumption, meaning that VAT is levied on all imports while exports are relieved from VAT by means of zero rating. (I.e. the tax payer gets refund of VAT earlier paid in purchasing raw materials and interrelated goods but he should not pay tax on added value.) This method is largely adopted by many countries. The main advantage of this principle is non-discrimination between import and internal production. This principle is favorable for promoting export. Many countries follow this principle because they are eager to boast export.

Nepal's VAT system is also characterized by the principle of destination.

2.1.10 Tax Credit Mechanism

Tax credit is the main feature of VAT. It is due to this reason that VAT is also taken to be an improvised version of sales tax. For the sake of simplicity tax credit

mechanism was selected. Under this system, a tax collector is required to levy VAT at the rate of 13% on his selling price. He/she has to add collected VAT on sales and paid VAT on purchase for each tax period and set off the latter from the former and pays the balance to the Government. It is called tax credit mechanism. If tax credit is not implemented effectively the complete benefits from VAT cannot be availed of. If tax administration is not capable or is inefficient or if the tax payers misuse the provision for tax credit, it can result in large revenue leakages.

A partial credit is granted for goods such as cars and computers that can be used for both business and personal purpose. An input tax credit is not granted for some items such as liquor, soft drinks, light petroleum fuel and vehicles and entertainment expenses, since it is very difficult to ascertain whether these items have been used for business or personal purpose.

2.1.11 Tax Refund

Tax refund is a very important aspect of VAT. It must be made simple, easy and systematic. In connection to exports tax refund is granted after verifying the export declaration forms, letter of credit or bills of entry and proof of payment to authenticate the export and the import declaration forms or purchase invoices to authenticate the tax paid on inputs. The inland Revenue Department has adopted an internal policy to provide refunds within 30 days of the receipt of the refund claim although the time limit fixed under the law is 60 days. In the case of Non-exporter, there is a possibility of a future adjustment to the excess input tax credit. The carry forward system is not needed for taxpayers to prepare refund claims and tax administration does not have to process refund claim.

1.2.12 VAT Threshold

Nepal's VAT regime seeks to keep small vendors outside the tax net, who are defined using a 'Turnover' threshold as the criteria. The threshold is currently set at Rs. 2 million. The VAT registration threshold has been unnecessarily controversial. If the threshold level is too high a majority of the businessmen may not come under the VAT net and such circumstances it will simply not be possible to implement VAT effectively. Therefore, it is common to keep the threshold level as low as possible. The threshold is fixed based on the administrative capacity, the capability to maintain accounts in the industry and commerce sector the need for revenue etc.

2.1.13 Zero-Rate

In addition to the positive rate of 13%, a zero-rate was also prescribed under the Nepalese VAT. The zero rates were recommended for exports in order to maintain the competitiveness of Nepalese products in the international market. This is because VAT would not apply to the exports but exporters would receive input tax credit, meaning that exports would be completely free from VAT. The list of zero-rated goods and services is given in Annex-2.

2.2 Resume of Earlier Studies

The history of value added tax is not so long even in global context. Several studies and experiments have been undertaken on VAT, which has been major instrument of tax reform since last four decades. Most of the economists have studied on VAT in the world. Their findings are found in various books, research papers, seminar papers, reports of international institutions and issues of journals and articles.

IMF staffs undertook a study of seven developing countries that had adopted VAT in their respective countries. From the empirical study of seven developing countries, it was found that the effectiveness of the VAT largely depends upon the

administrative capacity. The study shows that VAT helps to increase the government revenue by 10 to 30 percentages.

Due and Fried in their book “Government Finance” reached in the conclusion that the main visualized problem of VAT in developing country is the administrative complexity.

Tiwari (2052) in an article stated that VAT is considered as the mostly growing trend in the field of taxation. The authors focuses the problems of Nepalese sales taxes such as administrative inefficiencies very large number of small tax payers’ with no record keeping and issuing the invoices and sales tax concentrated only on import / manufacturing level.

Silwal (1988), stated that most of the developing countries are now engaged in the study of VAT very seriously and most of the economists of all countries have realized that the VAT only is the source of tax revenue, which has very high tax potential yield among the existing tax systems. VAT is said to be consumption tax by when the taxable goods and services are consumed will ultimately pay the tax. If any goods become spited before consumption, it is not liable to tax. The features of VAT are as follows.

- a. Input tax credit
- b. Neutrality
- c. Compulsory invoice system
- d. Wide tax converge

Similarly possibility of tax evasion and cheating are also minimized pointing out the problems of VAT in Nepal, the researcher writes “When retail level sales tax was introduced firstly in 1965 there appeared several absurdities such as very low monitoring and supervision skill of the tax administration, very informal retailing system, lack of compulsory invoice system and lack of skilled and experienced

administrators. The researcher recommended that before introducing VAT. Some necessary conditions should be fulfilled. They are given below.

- a. Change in the origination of the tax administration.
- b. Development in personal and staff.
- a. c. Sufficient information system about VAT should be developed and introduced.

Binguag Hsiung (1991) had conducted a study to evaluate the VAT in Taiwan, which was in effect since 1986. The study showed the good result of VAT after some years of experiences. The impact of VAT showed the business tax revenue increased considerably due to cross checking procedure of VAT. Adoption of VAT did not cause price fluctuation.

John F. Due and Francis Greony (1991), wrote successful stories of VAT in Trinidad and Tobago. A VAT of general type went into effect in Trinidad and Tobago in 1990. Development of VAT was carefully planned and it went through the several phases from 1986 to 1989. The tax performance committee was established in 1987. The first task of the committee was to review the current tax system and develop a preliminary recommendation in direction of reform. The studies showed that the existing tax system was an urgent need of revision for several respects. The value added tax was put forward as an alternative. Further the issues such as choice of rate structure exemptions tax administration etc. were resolved for the final adaptation of VAT. The structure of VAT was drafted in the final report after the careful examination of several issues including revenue and equity with the development of analytical models. After so many detailed works, it was finally drafted and passed by the registration in 1989.

The VAT was well received and also welcomed by the business community. One year experiment showed that the operation was reasonably satisfactory. It yielded

the previously expected and forecasted result. For its success, there were several reasons such as careful planning of tax structure and administration, a close co-operation between the government and business sector, the extensive publishing program, the co-ordination reform in purchased tax and income tax and selection of competent persons in the key positions. There were several things that can be taken as suggestion from Trinidad and Tobago for the introducing and operation of VAT in other developing countries as well.

Khadka (1997), in his book entitled “VAT in Nepal” has described the theoretical background and the development of VAT in Nepal. Being a researcher and a VAT advisor, he has spent a lot of time in preparatory work of VAT and has played a significant role in formulation of tax policy.

Different aspects of VAT have also been analyzed in his book entitled “The Nepalese Tax System”. In his own words “Tax compliance is very poor in Nepal and different taxes are not being fully paid as per the law. There is a lack of transparency. Both the tax payers and tax collectors take undue advantage of the situation. There is lack of co-ordinate approach and long-term strategy. Several tax measures were introduced in 1997/98 without any consideration and their possible effects.

Nepal Chamber of Commerce also made a study to analyze the possible effects of VAT in Nepalese economy in 1997. Dr. Puspa Raj Karnikar heading the team. The main finding of the study report was as follows:

- a. VAT effects adversely in price level.
- b. It increases the price of imported goods. Ultimately increases the cost of production there by reduces the export business.
- a. Requirement of book-keeping is complicated.

- b. It will finally affect the small traders.
- c. It is untimely to implement.
- d. It would be unjustifiable on social ground.
- e. Present administration is incapable for handling VAT.
- f. Computerization system is not sufficient and it is new concept for the tax administrator.

The study report suggested for a partial VAT on some commodities. It was in favor of phase wise implementation of VAT. The study analyses negative impact of VAT neglecting its positive impact.

Ghimire (1998), in his dissertation explains that administrative capacity, organizational structure, audit and inspection system, reward and punishment, political intervention, selection of skilled and experienced manpower are needed to improve for effective implementation of VAT. Among which the first one is most challenging. There are large numbers of small trader. So more revenue can be generated only in VAT is extended through retail level. To make the retail stage VAT more effective and efficient, the major suggestions of this research are to improve the following aspects.

- a. Administrative power and creditability
- b. Tax payers' identification system
- c. Registration and educational programme
- d. Some incentive for small trader

The existing major problem of VAT implementation in Nepal are existence of small traders in large proportion, lack of accounting records, illiteracy and high compliance cost, open boarder with Indian market etc. which create a question for the successful implementation of VAT. The essential pre-requisites for the successful implementations of VAT in Nepal are strong administration,

educational programme, technical data base system, combination of various revenue offices, high level VAT implementation team, co-ordination of VAT department and closed co-operation between government and the private sector.

Khanal (2000), in his dissertation examined the issues and options in Nepal. In his study he opined that VAT would be an improvement over the sales tax system. Adoption of VAT in the place of Sales tax would insure certain 'gain' though the gain may be at least amount. That is why a move towards VAT would be 'better' but not an 'ideal' step. It is because the allegedly overemphasized theoretical advantages of VAT would crash down on earth when it comes to reality due to the absence of a 'good' environment for the applicability of the tax. Thus one biggest problem for implementing a VAT in Nepal is its applicability. The applicability issues assume greater importance and demand a very careful examination as well as solution for the implementation of VAT in Nepal.

He found that the major hurdles for the applicability of VAT in Nepal are the existence of large proportion of small traders in trading activities, unfavorable business structure and practices, weak administration, existence of open boarder and large amount of unauthorized trade from India to Nepal, under valuation of imports, tax evasion and low tax consciousness of the people.

Dhakal (2000), in his dissertation analyzed the Nepalese tax structure and potential revenue of VAT in Nepal. He has provided the following conclusions. Theoretically VAT is the attractive alternative of sales tax on the ground of revenue productivity equity norms, supporting economic growth without economic distortions; export promoting, price stability and neutrality on production and distribution etc. Further, the hypothesis of self polishing or 'Cross-checking' channels without cascading and pyramiding effect has made VAT 'mile stone' in the history of reforming of the indirect tax. Empirically, he has found that

VAT has high revenue potential power. Even the broad coverage of VAT would generate more revenue without addressing the equity norms. But, it would be noted that, achieving both efficiency and equity objectives simultaneously is a difficult task under the consumption levy. Practically, he has found that the VAT is going to become 'hot milk in mouth' due to inefficient tax administrators.

He has expressed that VAT is suitable both theoretically and empirically but the practical aspect is extremely weak. Thus only the introduction of VAT is not really acceptable as tax reform. The system of VAT itself has great need of reforming for the Nepalese context.

Laudari (2001), in his dissertation found that before the introduction of VAT the revenue contribution from the areas replaced by VAT was generally increasing whereas after the introduction of VAT, contribution was gradually decreasing. This study shows that there will be improvement in revenue mobilization due to VAT. The reason behind this claim is that theoretically VAT system is transparent; it broadens that tax base and discourages the tax evasion. The study shows that the main problem for business houses are account keeping billing and the weakness of VAT administration are lack of motivation and service minded attitude among the tax officials, lack of honesty in VAT officers.

The study concludes that because of the problems such as lack of strong land honest tax administration, lack of motivation and service minded attitude among tax officials, lack of co-operation from business community, lack of strong co-ordination between tax collectors and the tax payers, lack of strong political commitment and weak public consciousness are putting the obstacles in front of the revenue generation process of VAT. That's why VAT is running little behind its expectation from the revenue generation point of view.

For the betterment of the VAT system the study recommends following suggestions:

- a. Tax education programmes must be provided to give the right view about VAT to the different people.
- b. Close co-operation is necessary between the private sector and government in the VAT implementation process.
- c. The government should pay its attention to design strong administration.

Laudari (2001), in his dissertation “Analyses the problems and prospects of VAT in Nepal” concludes that VAT will have effect on economic growth major problems associated with the VAT system business houses are account keeping and billing. Weakness of VAT administration are lack of motivation service minded attitude and dishonesty in VAT officers. VAT system the best and advanced fiscal tool in theoretical sense could not yielding the expected returns in Nepal because of the lack of strong and honest tax administration lack of co-ordination between tax collectors and tax payers’ lack of strong political commitment.

Jyoti in articles “Analysis and suggestion of VAT” (2001) concludes that under the VAT system a self-enforcing environment is created where a one-tax payer ensures compliance by the previous taxpayer. Honest taxpayers are able to conduct their business in a simple and proper manner. This is one of the biggest positive aspects of VAT. But many are experiencing problems in the implementation of VAT in the trading sector. This is not because of any weakness or defect in the legal aspects of VAT but due to the lack of effective implementation of VAT in the right manner.

In his opinion, there are two main issues that are obstructing the proper implementation of the VAT.

-) Lack of invoicing or invoicing with the correct value.
-) Lack of effective implementation of VAT threshold.

Lene Bendix (Chief Technical advisor at the VAT project 2001), an article. “4 years of value added tax’ concludes that there were a lost of constraints and difficulties in introducing and implementing VAT in Nepal. The first two years of VAT were very turbulent. Despite this, VAT was introduced and survived because of the efforts of a small group extremely dedicated, motivated and hard working people. Since its establishment in 1997, the VAT administration had been improving gradually until the early summer of 2001. The merger between the former VAT Department and the former Department of Taxation into the Inland Revenue Department took place in April 2001. This made it very difficult to keep focus on various important activities and decision that needed to be carried out and to continue the VAT implementation process by the new Inland Revenue Department (IRD). Some difficulties were expected after the merger and some of the problems have already been solved still lots of challenges are left to be resolved.

In future the IRD with support from the VAT project will have to focus on the overall mission of any modern tax administration i.e. to collect revenue in the most efficient, effective and transparent manner and to increase the level of voluntary compliance. Lot of effort will have to 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.

At last, she emphasized that committed, dedicated, motivated and hardworking persons to carry out this difficult job are there.

J.B.R. (Member of Parliament of Lower House).2001, In his views published on “4 Years Implementation of VAT” conclude that, revenue plays an important role in the country’s development and tax is the primary source of revenue mobilization. Finding new source of revenue as a VAT was a timely action. This tax reduces the possibility of leakage by maintaining two accounts and also creates an environment of fair competition amongst the industrialists and businessmen such types of weakness must be corrected in order to make VAT effective. To support the economic development and to make this tax effective it is necessary to solicit the co-operation of industrialists and businessmen. Similarly to make VAT successful it is necessary to raise the level of awareness of the consumers.

Silwal (2001), an article “VAT its Past, Present and Future” on VAT 4 years of implementation books concludes that VAT could no broaden the tax base as desired. The crux of the problem was lackluster invoicing. The success of VAT system hinges on how the billing habit will be improved in future. The post of VAT was full of turmoil but even then it had been glorious. Its present is less than immaculate but its future will be glorious again. Today, there is an overall economic down turn through which the VAT is flourishing. It is going to remain the mainstay of revenue forever.

Dawadi (2001), an article “Let us support VAT” on book 4 years implementation of VAT concludes that each individual can become rich only if the country becomes rich. Therefore, let us all tax payers, tax administrations and the general public commit ourselves to sacrifice for the welfare of the nation and take conscious measures to make VAT success.

Phuyal (2001), an article on VAT concludes that VAT can help to raise the level of economic development of a country. The economic development of any nation depends on the resources and the resource in which the development is based on is revenue. The source of revenue is income tax, custom duties and VAT. The only tax system that is popular worldwide scientific and transparent is VAT. Therefore, we should consider it seriously. He emphasizes that all industrialists and traders should register under VAT to increase the revenue source of the country to build out nation ourselves. Why should we always depend on foreign aid and spread our hands and ask for donation ad alms? It is drop by drop that a jar gets filled and hence let us all get together and do what we can do to make our nation self dependent. Businessmen can make a major contribution by issuing invoice keeping accurate and proper accounts. VAT office should provide help by maintaining a supportive attitude. The consumer should be more alert and demanding in terms of asking for and taking invoice.

Ghana Shyam Gautam (2002), in his dissertation “Problem and Prospects of VAT in Nepal” concludes that successful operation of VAT is extremely challenging for a burgeoning economy like Nepal.

Where is a long boarder a large segment of the economy is yet to be magnetized, business system is still running in a traditional way, geographical structure is rugged, non adherence of standard norms and codes is wide spread, public consciousness level is very low, existing practice of smuggling and under valuation in the border areas is supporting for the under invoicing the successive stages of production and distribution. Further all the rules and regulations are not seen in real practice. Corruption and bribing is wide spread in the tax administration and all other sector of economy. These are the facts, which encourage businessmen for the tax evading practices and make them less responsible to the system.

Upadhaya (2002), in his study paper finds that although some achievements have been realized in the field of registration and refund and in reducing the number of non filers the result are still far from satisfaction. He also finds that the implementation part of Value Added Tax is not working properly. He has found the following problems in the VAT implementation.

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

Prasai (2002), in his study concludes that VAT puts greater significance in revenue mobilization in Nepal. Adoption of VAT in Nepal is both a compulsion and a necessity. It cannot curtail its development projects for which more revenue is required. Due to the numerous reasons the revenue collection from other source of taxation such as income tax, customs duties and excise duty are drastically decreasing or remaining unchanged. So to get the pace to revenue generation, VAT is an appropriate path or element. The implementation of VAT will help to reduce the burden of foreign debt and will provide a great relief to our future generation.

Despite its significance it has been facing numerous problems, which minimize its merits and effectiveness. He finds that the good implementation of VAT depends on the behavior of people relating to the VAT. If tax administrators, businessmen

and consumers take VAT as serious matters and behaved as per their full potential and implementation factor will not be concerning factor. He also concludes that despite having a good VAT system the revenue collection is not increasing as it was expected. To get the great amount of revenue generation the responsibility and accountability in every section of the economy is its basic requirement as well as honesty and confidence between the business community and administration.

Thapa (2003), on his dissertation “Resource mobilization through VAT in Nepal” stated that the main objectives of introducing VAT are listed below.

- a. Collecting the revenue at low rate.
- b. Export promotion.
- c. Evolving clear and transparent accounting system.
- d. Reduce the economic inefficiency.
- e. Removing of unfairness of sales tax expanding the tax net.
- f. Accelerating the development by abolishing / reducing cascading / paramedic effect of sales tax.

For the Nepalese context, VAT is suitable both theoretically and empirically but the practical aspect is extremely weak. Thus, only the introduction of the VAT is not acceptable as a tax reform. The system of VAT itself has a great need of reforming for the Nepalese context and the percentage of export of goods materials and equipment. The average percentage of import before the introduction of VAT was 75% whereas the average percentage of exports was 25% only. Similarly, the average percentage of import was 70.2% and the average percentage of export was the introduction of VAT in Nepal. It shows the introduction of VAT in Nepal improves the inclination of export to some extent of 4.8%.

Khadka (2004) an article as “Overview of VAT in Nepal” concludes that VAT in Nepal was introduced as a major part of the overall tax reform programme initiated in the early 1990s. A detailed preparation was made for the implementation encountered various obstacles due to mainly the political instability and the opposition from the business community. Despite this, the number of VAT registrants and the VAT revenue collection has been increasing gradually. The tax refund system is also becoming institutionalized. The tax has been accepted by the business community and others and is well established. The implementation of VAT will broaden the tax base and develop a stable and reliable source for future revenue generation.

Kandel (2004), in his dissertation finds that Value Added Tax puts greater significance in revenue mobilization in Nepal. The reason behind this is that VAT system is transparent, broaden tax base and discourage tax evasion. VAT is the most scientific, innovative and powerful tax with built-in quality of universal application for both developed and developing economies. The biggest virtue of VAT is revenue buoyant and highly instrumental for resource mobilization especially in an economy with acute shortage of resource. Although, VAT was introduced as part of the national tax reform program but VAT system in Nepal from its inception has been facing innumerable problems, which curtails its merits and effectiveness. Theoretically, Nepalese VAT system has no weak provisions. It is one of the best models in the world. In practice, however the system is not effective due to the problems concerning the operation of VAT. The government needs to take necessary steps to sort out emerging problems in implementation of VAT. The government need full co-operation from the tax administration, the tax payers and businessmen as well as consumers in its effort to generate more revenue. VAT must be made successful and this largely depends upon honesty faith and morality of tax officials and business people. He suggests that in the absence of growth of economic activities, revenue generation cannot be increased.

Thus it is time of action and improvements for effective and successful operation of VAT in Nepal for further perspective as well as present needs of economic development.

CHAPTER - III

RESEARCH METHODOLOGY

3.1 Introduction

This study was undertaken to evaluate the effectiveness of VAT in Nepal. Actually, this is a review of VAT implementation since its conception, decisions, preparation, implementation and results achieved till now. The value added tax, contribution to various tax heads. Its registration, collection, refund were incorporated in this study.

Research methodology refers to the various sequential steps to be adopted by a researcher in a studying a problem, with certain objective in view. It describes the methods and process applied in the entire aspects of the study.

3.2 Research Design

Research design is the plan, structure and strategy of investigation conceived so as to obtain answer to research question and to control variance (Karlinger, 1986). Thus it is not possible for the researcher to conduct a research work without research design. Most of the data and information of the study were concerned with past phenomena of the performance either they are numerical or opinions. For studying the stated objectives exploratory and diagnosis research design has been applied. After the collection of past data and experiences, this study analyzed and described its own procedure. Thus this study also followed an analytical as well as descriptive research design.

3.3 Data and Information Gathering Technique

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

qualitative and quantitative information. Data collection is the most essential aspect of any research because the whole result of research depends on the adequacy and relevancy of the data / information; however, this study is based upon the primary and secondary data.

I. Primary Data

An interview schedule is prepared to collect the views of tax experts, tax administration, businessman, consumer etc. subjective; opinion and information are collected from discussion and interaction with related person, policy makers and other intellectual persons.

II. Secondary Data

Further data needed for the study is collected from the secondary sources. These sources consist the followings.

- a. Published and unpublished reports, articles and dissertations on the concerned subject.
- b. Publications and economic survey of various Fiscal Years of Ministry of Finance (MOF) HMG / Nepal.
- c. Publications and annual reports of Internal Revenue Department (IRD).
- d. Various books written by tax officers and scholars.
- e. Related articles and journals.

3.4 Method of Data and Information Analysis

With reference to the research methodology, different tools and techniques are used by the researcher to present and analyze the effectiveness of VAT in Nepal. Basically the tools and techniques used to analyze and present are as follows.

- a. Ratio Analysis
- b. Trend Analysis
- c. Percentage
- d. Bar-Diagram

3.5 Organization of Report

This study will be divided into five chapters.

- a. Introduction
- b. Review of Literature
- c. Research Methodology
- d. Presentation, Analysis and Interpretation
- e. Summary, Conclusion and Recommendation

The first chapter focuses the whole study, which includes the background of the study, statement of problems, objectives of the study, limitations of the study and introduction of tax. The second chapter presents the review of literature and conceptual aspect of VAT. The third chapter is research methodology. The fourth chapter deals with the presentation analysis and interpretation of data. The fifth or last chapter provides the summary, major findings and recommendation.

3.6 Sample Size

Sixty samples from Kathmandu Valley have been taken to fulfill the objectives of the study. The respondents have been divided into three groups. The following table shows the group respondents and size of sample.

Table 3.1

Sample Size

S.No.	Group of respondents	Distribution	Collected
1	VAT policy maker/expert	25	15
2	Tax officer/administration	35	20
3	VAT payers/Consumer	40	25
	Total	100	60

CHAPTER - IV

DATA PRESENTATION AND ANALYSIS

Revenue collection has been one of the challenging jobs for the developing nations. Negligence in maintaining the book of account by the vendor, lack of government commitment to enforces them to maintain account of their business, late introduce of arise technology in the country, narrow tax base and low level of tax consciousness among the Nepal ease citizen are the prominent challenge in Revenue collection.

Taxation is one of the key internal sources of total Government revenue. It is also the pillar of the fiscal policy. It contributes more then 70% to total internal resources of revenue. In this situation the tax structure stands as a mirror of the fiscal policy. For the purpose of this study Tax structure from F/Y 1996/1997 to 2006/2007 and VAT,F/Y 1998/1999 to 2006/2007 data has been used . Nepali fiscal years starts from Shrawan 1st to Ashad end (June 15to July 15).

4.1 Registration of vendors in VAT

Registration is the entry point of the tax system. Participants of tax payers to the tax system can be assessed by the trends of registration. All vendors whose taxable transaction is above the threshold are required to register for VAT.VAT registration began on 16th November 1997 when all sales tax registered manufactures were required to convert in to VAT registrations if they had an annual turnover of more than Rs 2 million. In mid Nov. 1997, 2045 manufacturers were registered under the imports / manufacturing level sales tax. There is no provision of registration threshold under this tax. According to tax office other vendors, who were not registered under the sales tax were required to register for VAT with in 90 days from 16th Nov. 1997. This rule is not applicable to them who

deal with exempted goods and services only. Similarly, small vendors falling below the threshold limit are exempted from VAT registration. VAT registrants are issued a registration certificate as well as tax payer identification number (TIN). In the mean time it has made compulsion to all concern to state the TIN on all specified documents including the tax invoice. The trend of vat registration is shown in Table 4.1.

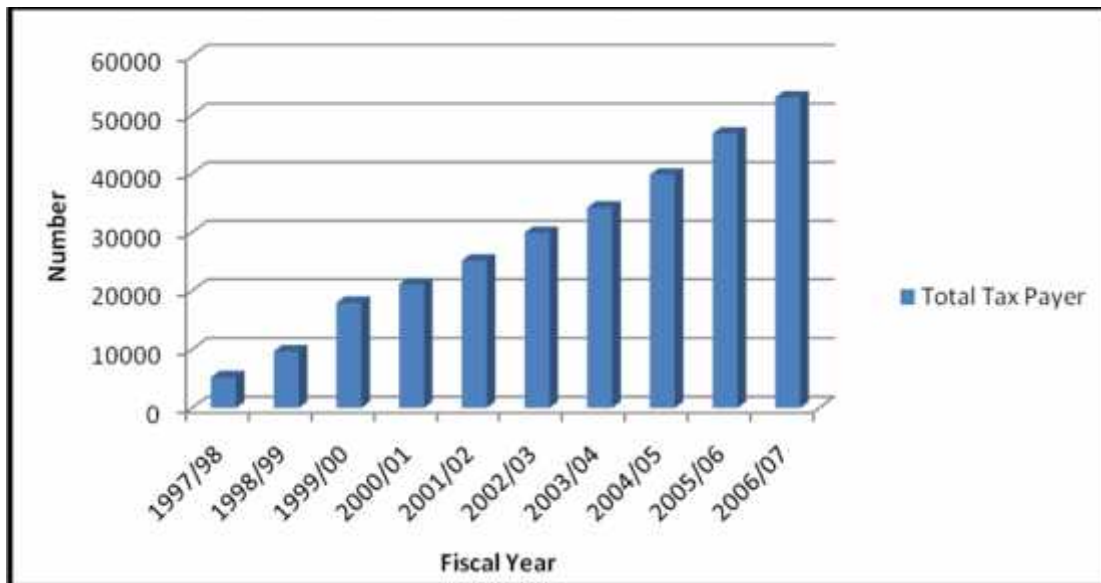
Table 4.1
Trend of VAT Registration

Year	Number of Registered Tax Payers			
	Compulsory Number	Voluntary Number	Total tax Payer	Tax payer's growth %
1997/98	4522	715	5237	0
1998/99	6577	3065	9642	84.11
1999/00	12137	5810	17947	86.13
2000/01	14775	6318	21093	17.53
2001/02	16877	8272	25149	19.23
2002/03	19449	10423	29872	18.78
2003/04	23407	10765	34174	14.75
2004/05	29071	10705	39776	16.39
2005/06	33302	13529	46831	17.74
2006/07	38578	14387	52965	13.09

Sources: Annual report 2063/2064 (2007/08) Inland Revenue Department, Ktm.

In the table 4.1 showed that the number of registered in VAT has an increasing trend. It is only 5237nos in 1997/98, which is reached to 52965 nos. in 2006/2007. The growth rate of registrants is satisfactory. Compromise made by government with registrants has also helped to increased VAT registrants' number gradually. There may be potential tax payer still outside from the tax net. According to businessman, the registration process and service provide by tax office is not satisfactory.

Figure 4.1
Trend of VAT Registration



4.2 Tax Return

The tax return of each tax period must be filed at the relevant tax office within 25 days of the expiry of the period. The tax period is monthly compulsory for registrants and once every four months for voluntary registrants. Tax payers from the tourism industry have the option to file bi-monthly returns.

These returns can be debit, credit, or zero returns. When the tax collected by a tax payer on sales is more than the tax paid on purchases, the excess amount should be submitted to the government, and such returns are known as debit returns. But if the tax paid on purchases is higher than the excess amount from the government, such a tax return is called a credit return. Sometimes, even if there are no sales or purchases in a transaction, the tax payer still has to file tax returns at the concerned tax office. Such a tax return is known as a zero return. The trend of tax return is shown in table 4.2.

Table 4.2
Tax Return

Year	Debit		Credit		Zero-rated		Total
	No.	%	No.	%	No.	%	No.
1998/99	4510	48.88	2950	31.97	1767	19.15	9227
1999/00	6027	34.90	7766	44.97	3475	20.12	17268
2000/01	6975	35.41	8250	41.89	4471	22.70	19696
2001/02	6936	33.05	8844	42.14	5207	24.81	20987
2002/03	7178	31.62	9553	42.08	5972	26.30	22703
2003/04	8483	34.08	9625	38.67	6783	27.25	24891
2004/05	9478	33.88	10260	36.63	8271	29.53	28009
2005/06	10449	31.22	12882	38.39	10139	30.14	33470
2006/07	11457	31.43	13594	37.29	11044	30.29	36095

Sources: - Annual report IRD 2063/2064 (2006/07)

Note: - in above table, among the total number of tax payer the number of Non-filer, suspended and cancelled have not been included.

In table 4.2 showed that the ratio of debit return to total return is in decreasing trend. It was 48.88% at fiscal year 1998/1999, which is declined to 31.43% in fiscal year 2006/2007.

The ratio of credit return to total return is in increasing trend. It was 31.97% at fiscal year 1998/1999, which is reached at 37.29% at fiscal year 2006/2007.

The ratio of zero rated return to total return is in increasing trend. It was 19.15% at fiscal year 1998/1999, which is reached at 30.29% at fiscal year 2005/2006.

The status of tax return is not satisfactory. In general most tax returns should be debit returns. Since business and professions are undertaken to earn profit as a

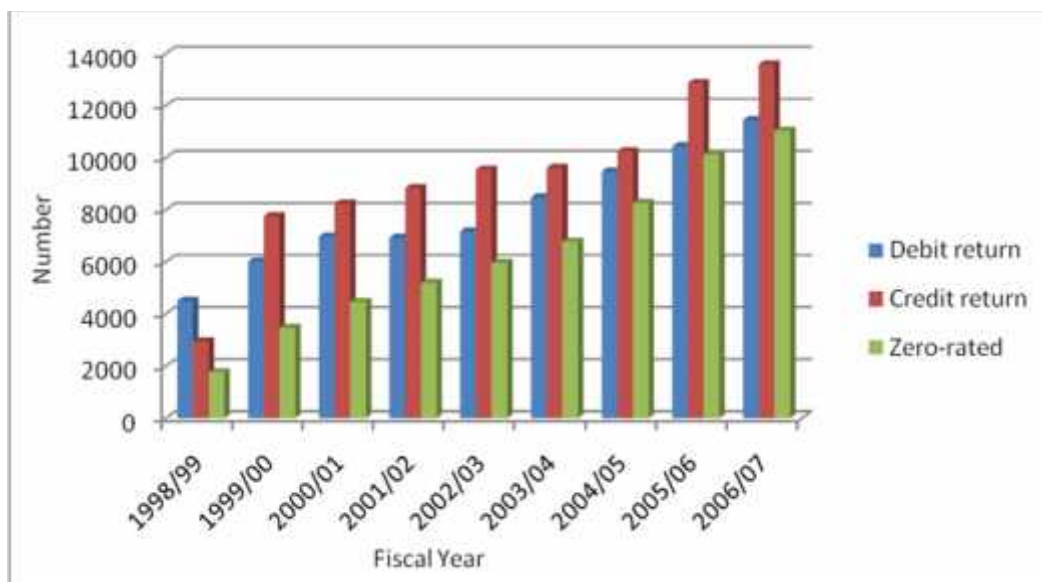
general rule. But it is not necessary that businesses or professions are always run on a profit.

The credit return replaced the number of debit return that changed in studied period (1998/99 to 2006/2007). At the initial stage there might be possible of credit return due to the provision to carry forward credit from the sales tax and the provision of getting credit facility of old stock. Under this provision, tax payers were allowed to declare their stock at the market value without any documentary evidence. They are then required to pay 25% of the declared value as VAT at the time of the declaration of stock and make a claim later on 10% of the same value as and input tax credit. There might be possible of showing artificial stock only to enjoy credit facility. It must be checked through tax audit and investigation. The trend of credited and debited is higher the global general standard due to above mentioned reason.

The interview with the businessman revealed that the refunding and paying facilities that businessman hope they will get tax office is being delayed.

The interview with tax office revealed that IRD have not been able to carry out timely verification of necessary documents in case of exporters and under take audit in the case of other tax payer.

Figure 4.2
Status of Tax Return



4.3 Non filer, Suspended and Cancelled

There is legal provision in VAT law that all the registrants are required to submit their tax return after 25 days of completion of tax period. It does not matter whether transaction is done or not in any tax period. Registrant who became fail to submit their tax return is known as non-filer. Some tax payers do not submit tax return on time owing to various reasons. This happens in many countries around the world and is not specific to Nepal. If the return filed by the tax payer has not been posted in the tax payer's account due to incorrect figures; such a tax return is known as suspended return. If the taxpayer wants to close their business or they would not like to be VAT registrants due to threshold, they can cancel their VAT registration. The trends of non filer, suspended and cancelled are shown in table 4.3

Table 4.3
Status of Non filer, and Suspended and Cancelled

Year	Total registrant	Non filer		Suspended		Cancelled	
		No	%	No	%	No	%
1998/99	9642	415	4.30	0	0	36	0.37
1999/00	17947	676	3.77	3	0.02	123	0.69
2000/01	20193	1383	6.56	14	0.07	501	2.38
2001/02	25149	3676	14.62	486	1.93	914	3.63
2002/03	29872	5255	17.59	396	1.33	1518	5.08
2003/04	34174	7322	21.43	158	0.05	1754	5.13
2004/05	39776	8492	21.35	516	1.30	1896	4.77
2005/06	46831	13198	28.18	163	0.04	2135	4.56
2006/07	52965	7098	13.40	362	0.68	2226	4.20

Source: - Annual report of IRD 2063/64 (2006/2007)

In above table 4.3 and figure 4.3 indicate that, the percentage of Non filers are increasing trend. In fiscal year 1998/99, there was 4.30% non filer, which is reached at 13.40% in fiscal year 2006/07. In fiscal year 1998/99, there was not any registrant file was suspended. The trend of suspended is increasing and decreasing slightly. It was 0.02 in fiscal year 1999/00 however it was reached at 1.93% in fiscal year 2001/02 and decreasing at 0.68% in fiscal year 2006/07. In fiscal year 1998/99, 0.37% tax payer cancelled their registration. It was 4.20% in fiscal year 2006/07. the number of canceling its registrant has been increasing.

This is due to small contactors have registered under VAT so as to participate in contracts tendered by Government office some of these contractors were very small and may not have received any contracts and did not executed any transactions with in some tax period. Among those who do not file tax returns may be the majority of such contractors.

The suspended file is greater than before. This may be due keeping artificial record to submit at Revenue Department by taxpayers.

The cancellation trend of registration has been also increasing than before. It may cause due to economic regression in the country.

Figure 4.3

Non Filer

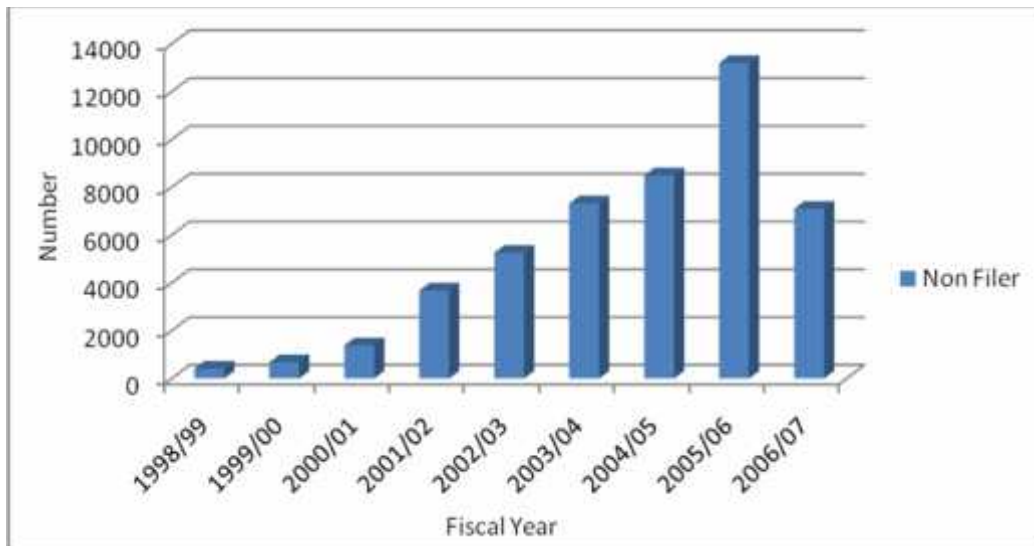


Figure 4.4

Suspended

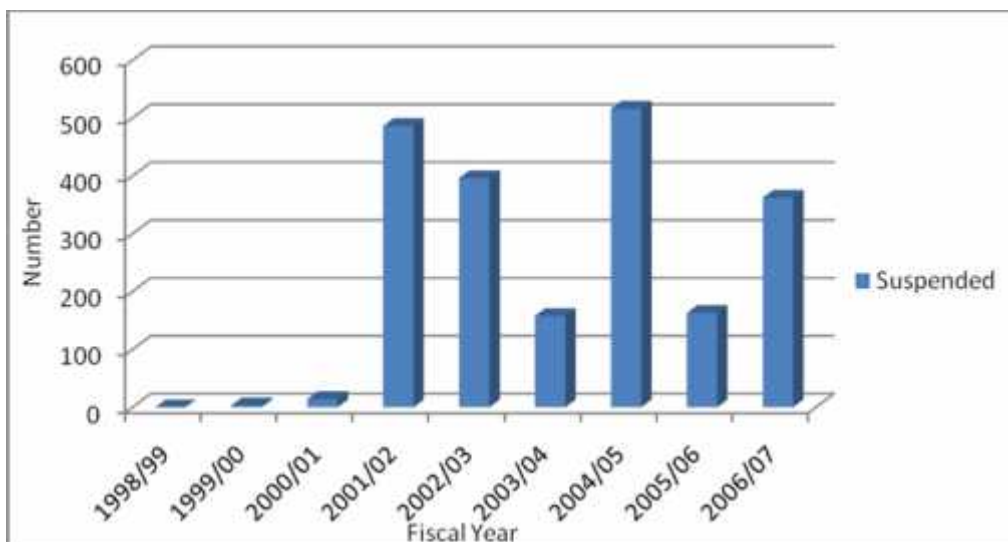
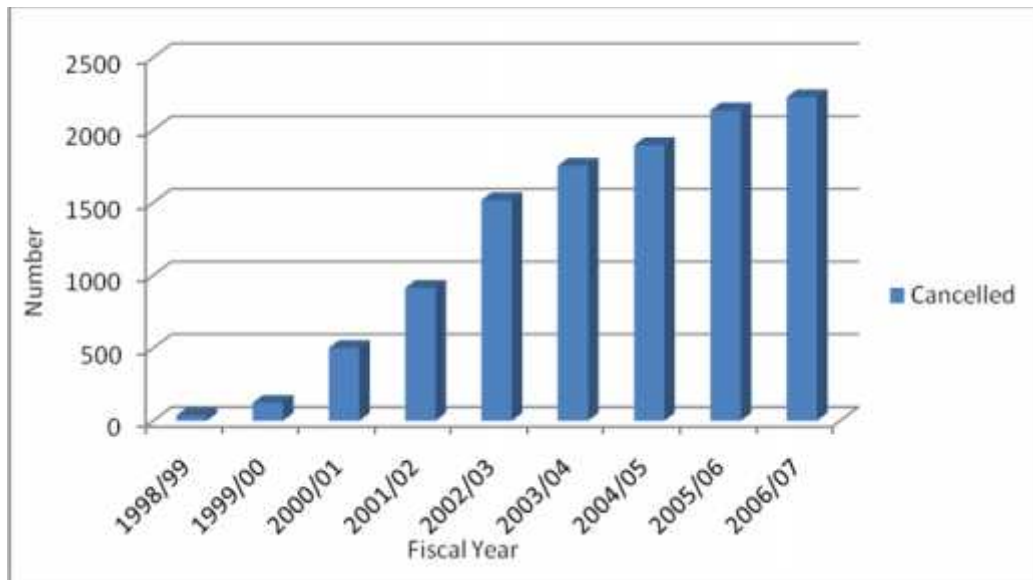


Figure 4.5
Cancelled



4.4 VAT Collection

After implementation of VAT, the revenue collected figure is divided in to domestic and import component. The revenue collected figure is shown in table 4.4

Table 4.4
Status of VAT Collection

(Rs in million)

Year	VAT collection	Ratio	Domestic	Import
1998/99	8162.9	36:64	2938.6	5224.3
1999/00	8765.9	38:62	3331	5434.9
2000/01	10259.9	39:61	4001.4	6258.5
2001/02	12267.3	39:61	4784.2	7483.1
2002/03	13459.7	36:64	4845.5	8614.2
2003/04	14478.9	39:61	5646.8	8832.1
2004/05	18885.4	35:65	6610	12275.4
2005/06	21610.7	37:63	7996	13614.7
2006/07	26704.2	63:37	9689	17015.2

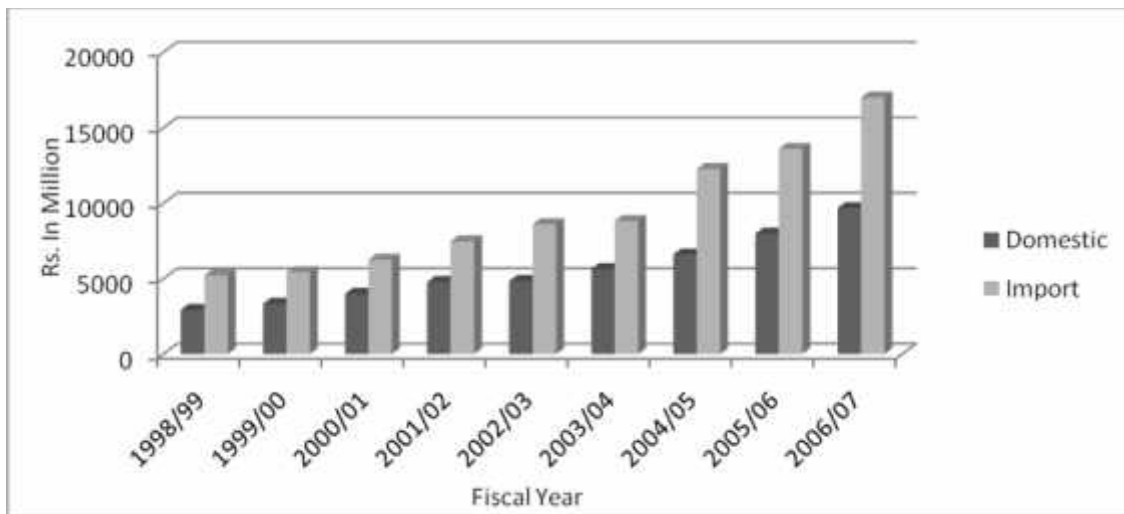
Source: - Annual report of IRD 2063/64(2006/07)

In above table 4.4 shows that 2/3rd of VAT revenue is generated from imports. And the rest is from domestic products. The share of domestic and imports VAT revenue in the total VAT collection was 36% and 64% respectively in fiscal year 1998/99. The contribution % is same in fiscal year 2002/03. The collection of VAT revenue is in increasing trend. It is only Rs8162.9 million in fiscal year 1998/1999 which is reached to Rs 26704.2 million in fiscal year 2006/07. The collection trend is satisfactory. Domestic VAT is divided in to three parts: Production, Distribution and Services. Under distribution, the tax collected at the dealer, wholesale and retail level is included. The relative contribution from distribution and service has been increasing. The VAT revenue is in increasing trend. It may be due to increasing trend of registration in to VAT.

The interview businessman revealed that the cause of not collection VAT as expected are economic slowdown, lengthy accounting system and lack of social recognition to businessman (Tax payer).

The interview with tax expert revealed that the VAT revenue can not collect smoothly due to lack of will power of Government and tax payers nation building.

Figure 4.6
Status of VAT Collection



4.5 The different between Estimated and Actual VAT Revenue

The Government has estimated its VAT revenue in each fiscal year budget and evaluates its actual collection after completion of each fiscal year. The difference between estimated and actual VAT revenue figure is shown in table4.5.

Table 4.5
Estimated and Actual VAT Revenue Collection

(Rs in million)

Year	Estimated VAT	Actual VAT	Difference	Actual collection % of estimated VAT
1998/99	9420	8765.9	654.1	93.06
1999/00	10460	10259.7	200.3	98.08
2000/01	13256	12382.4	837.6	93.41
2001/02	13500	12267.3	1232.7	90.87
2002/03	13668.3	13459.7	208.6	98.47
2003/04	15678.5	14478.9	1199.6	92.35
2004/05	19875.2	18885.4	989.8	92.02
2005/06	21946	21610.7	335.3	98.47
2006/07	26423	26095.5	327.5	98.76

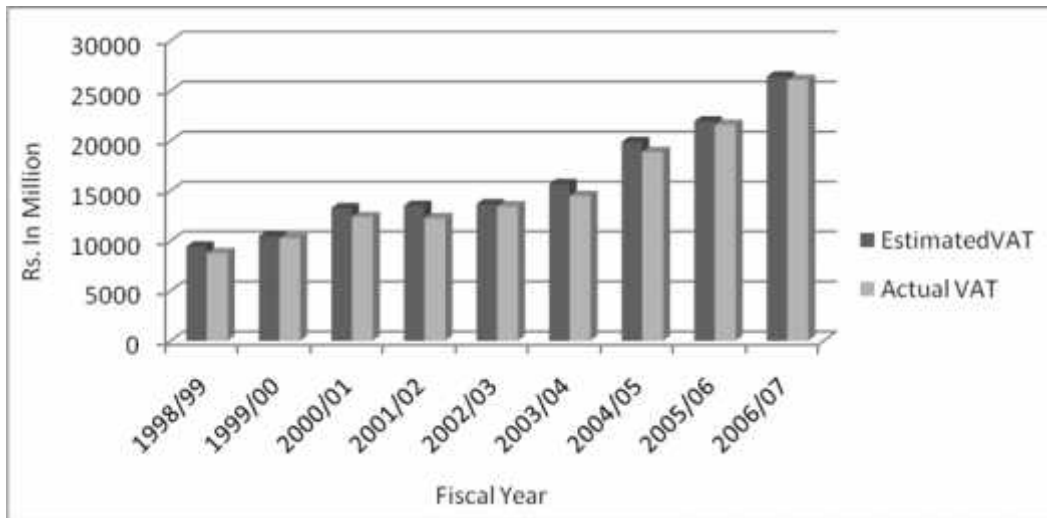
Source: - Annual report of IRD 2063/64 (2006/07)

Table 4.5 shows that the Nepal government is able to collect more than 90% of estimated VAT collection. Government of Nepal became able to collect VAT of 93.06% of estimated VAT revenue in fiscal year 1998/99, which is increased at 99.95% in fiscal year 2004/05. the full implementation of VAT till the retailer level has reached its ninth year, but VAT revenue could not be collected as estimated amount. There may be many reasons behind collecting less amount of VAT than estimated. An undervaluation of stock at the custom may be the cause of not achieving targeted VAT revenue.

The interview with tax administration that lack of billing system and less involvement of and cooperation of business community are cause of not collecting targeted revenue.

Experience of expert revealed that it is new system for Nepal. Economic slowdown, political instability and low level of consumer’s awareness are the main cause of VAT.

Figure 4.7
Difference between estimated and Actual VAT



4.6 Tax Refund

VAT law has provided a facility of refund. Excess of input tax over output tax in any tax period can be adjusted by carry forwarding for next tax period or can claim for refund. The trend of refund after adoption of VAT is shown in table 4.6.

Table 4.6
Trend of VAT Refund

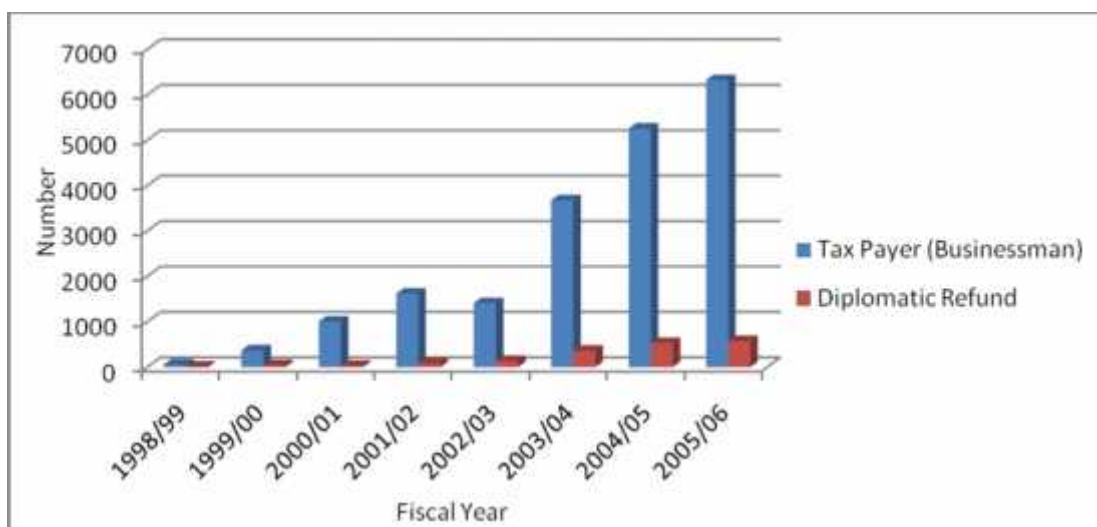
(In number)

Fiscal year	Tax payer (Businessman)	Diplomatic Refund	Total
1998/99	58	8	66
1999/00	366	46	412
2000/01	1007	32	1039
2001/02	1618	88	1706
2002/03	1410	136	1546
2003/04	3676	360	4036
2004/05	5255	531	5786
2005/06	6322	570	6892

Source: - Annual report of IRD 2062/63 (2005/06)

According to the VAT law accredited diplomat and foreign aided projects are required to pay VAT on their purchase and later they are allowed to claim refund. Table no 4.6 shows that the tax refund of tax payer and diplomatic has increase in each year. The 58 tax payer and 8 diplomats VAT were refund in fiscal year 1998/99, which is reached at 6322 and 570 in fiscal year 2005/06. The refund also is in increasing trend.

Figure 4.8
Trend of VAT Refund



4.7 Lottery Program

Recently Nepal government, Inland Revenue Department has introduced a lottery program to enhance the billing system to collect VAT revenue through the program has shown its effectiveness. It has not met the targeted VAT revenue for first nine months of the fiscal year 2005/06. Government has expected to collected Rs 21,94,60,00,000 revenue from VAT. Actual collection is Rs 21,61,07,00,000 only.

Government has introduced lottery program from Chaitra 2062 with in Katmandu Valley. It has planned and distributed Rs572 lakhs cash prize to consumer each month. The program enhanced the billing habit. The result of lottery program is shown in table 4.7

Table 4.7
VAT expected and collected by Lottery Program

(Rs in million)

Month	Expected VAT (Rs)	No of coupon issued	Actual VAT collected (Rs)	% of expected collection
Magh	437	40258	416	95.19
Falgun	715	69214	708	99.02

Chaitra	546	56946	527	96.52
Baishakh	392	37148	373	95.15
Jestha	1003	89556	980	97.71
Ashad	1168	113921	1135	97.17

Source: - Annual report of IRD 2062/63 (2005/06)

Table shows the number of coupon issued, expected VAT revenue and after introducing the lottery program. The issued number of coupon on Ashad is three times greater than Magh i.e. 113921. The expected figure in Magh, Falgun, Chaitra, Baishakh and Jestha were 437, 715, 564, 392, 1003 and 1168 million respectively. But actual collection has been 416, 708, 527, 373, 980 and 1135 million on respectively months. This program became popular among consumers in Kathmandu. Thus the Government decided to conduct such program from 2061 to Pokhara, Biratnagar and Birjung. The program can not meet the expected VAT revenue collection target.

4.8 Resource Gap

4.8.1 Recent Trend of Resource Gap in Nepal

Table 4.8
Recent Trend of Resource Gap in Nepal

Rs in million

Fiscal Year	Govt. expenditure	Total revenue	Resource gap (A)	Foreign grant	Resource gap (B)	Foreign loan	Resource gap (C)
1997/98	56118.3	32937.9	23180.4	5402	17778.4	11054.5	6723.9
1998/99	59579	37251	22328	4336.6	17991.4	11852.4	6139
1999/00	66272.5	42893.8	23378.7	5711.7	17667	11812.2	5854.8
2000/01	79835.1	48893.6	30941.5	6753.4	24188.1	12044	12144.1
2001/02	80072.2	50445.5	29626.8	6686.1	22940.7	7698.7	15242

2002/03	84006.1	56229.8	27776.3	11339.1	16437.2	4546.4	11890.8
2003/04	89442.6	62331	27111.6	11283.4	15828.2	7629	8199.2
2004/05	102560.4	70122.7	32437.7	14391.2	18046.5	9266.1	8780.4
2005/06	110889.2	72282.1	38607.1	13827.5	24779.6	8214.3	16565.3
2006/07	133604.6	87712.1	45893.2	15800.8	30091.7	10053.	20038.2
Average	86238	56109.9	30128.1	9553.18	20574.8	9417.01	11157.77

Source: Economic survey fiscal year 2007/2008

In an average the Governments total expenditures were Rs 86238 which was converts by Rs 56109.9 from total revenue, Rs 9553.18 from foreign grants and Rs 9417.01 from foreign loan, rest Rs 11157.77 was converted by international loan. The experience of developing countries showed that there were negative results from increasing international aid and loan to finance the public development activities, continuous use of borrowing to raise the necessary public funds is not good as it reduces the liquidity position of the Government and Increase the inflation. Government has to impose higher taxes to repay the interest and the borrowed sum too. Moreover, the scare resources of Government are used to pay back the external loan and interest.

4.8.2 Recent Trend of Resources Gap in Nepal

Table 4.9

Recent Trend of Resources Gap in Nepal

(In percentage)

Recent trend of resource gap in Nepal (in percentage)						
Fiscal year	Total revenues	Resource gap A	Foreign grant	Resources Gap B	Foreign loan	Resource Gap C
1997/98	58.96	41.04	9.63	31.41	19.70	11.71
1998/99	62.52	37.48	7.28	30.20	19.89	10.31
1999/00	64.72	35.28	8.62	26.66	17.82	8.84
2000/01	61.24	38.76	8.46	30.30	15.09	15.21
2001/02	63	37	8.35	28.65	9.62	19.03

2002/03	66.94	33.06	13.50	19.56	5.41	14.15
2003/04	69.69	30.31	12.62	17.62	8.53	9.16
2004/05	68.37	31.63	14.03	17.60	9.03	8.57
2005/06	65.18	34.82	12.47	22.27	7.40	14.95
2006/07	65.65	34.35	11.8	22.5	7.5	14.99
Average	64.62	35.37	10.67	24.67	11.99	12.69

Source: Economic survey fiscal year 2006/2000

Above table show the composition of total revenue, foreign grants and foreign loan to total Governments expenditure .In fiscal year 1997/1998 only 58.96%of total expenditure was covered by Governments revenue. The remaining was covered by foreign grants, foreign loan and internal loan. Likewise in fiscal year 2006/2007revenue constituted 65.65% foreign grants 11.8% and foreign loan 7.50% of total expenditure. Rest 14.99% was covered by internal loan. In average revenue constituted 64.62% foreign grants 10.67% and foreign loan 11.99% of total expenditure. Rest 12.69% was recovered by internal loan.

Table shows that the major sources of Government revenue is total revenue consisting tax revenue. There is decreasing and increasing trend in foreign grant. Due to lack of capacity of Government to mobilize the resources for development objectives. Foreign assistance has been increase. Until the Government con ensure that it is able to mobilize the allocated budget the donor agencies reluctant to support.

4.9 Magnitude of Tax Revenue

Table 4.10
Magnitude of Tax Revenue

(Rs in Million)

Fiscal Year	Total revenue		Tax revenue			Non tax revenue		
	Amount	Increment %	Amount	Increment %	As% of Total revenue	Amount	Increment %	As% of total revenue
1997/98	32937.9	8.44	25939.8	6.20	78.75	6998.1	17.63	21.25

1998/99	37251	13.09	28752.9	10.84	77.19	8498.4	21.44	22.81
1999/00	42893.8	15.15	33152.1	15.30	77.29	9741.6	14.63	22.71
2000/01	48893.6	13.99	38865.1	17.23	79.49	10028.8	2.95	20.51
2001/02	50445.5	3.17	39330.6	1.20	77.97	11115	10.83	22.03
2002/03	56229.8	11.47	42587	8.28	75.74	13642.7	22.74	24.26
2003/04	62331	10.85	48173	13.12	77.29	14158	3.78	22.71
2004/05	70122.7	12.50	54104.7	12.31	77.16	16018	13.14	22.84
2005/06	72282.1	3.08	57430.4	6.15	79.45	14851.7	-7.28	20.55
2006/07	87712.1	17.6	71122.1	19.25	81.08	16590	10.48	18.92
Average	56109.9	10.23	43945.73	10.62	78.32	12164.23	8.75	21.68

Source: Economic survey fiscal year 2007/2008

Above table show that the share of tax revenue were 78.75% and 21.25% respectively to the total revenue in fiscal year 1997/1998. It means a major amount of Government revenue is collected from tax revenue. As compared to tax revenue, the contribution of non-tax revenue has a very low share in Government revenue. Such kinds of share of tax revenue and non-tax revenue has a not been changed even in fiscal year 2006/2007. In year F/Y 2006/2007, the share of tax revenue is 81.08% and non tax revenue was 18.92%.

Tax revenue is increase by 10.23%in average where as total revenue is increase by an average of 10.62%.

4.10 Composition of Direct Tax

Table 4.11
Composition of Direct Tax

(Rs in Million)

Fiscal year	Tax head					Percentage share			
	Income Tax	Land Tax	vehicle	others	Total Tax	Income Tax	Land Tax	vehicle	others
1997/98	5008.8	1004.2	174.9	0	6187.90	80.95	16.23	2.91	0
1998/99	6293.5	1003.2	219.4	0	7516.10	83.73	13.35	2.92	0
1999/00	7539.1	1015.9	396.5	0	8951.50	84.22	11.35	4.43	0

2000/01	9116.9	612.9	429.6	0	10159.40	89.74	6.03	4.23	0
2001/02	8906	1131.8	559.7	0	10597.50	84.04	10.65	5.28	0
2002/03	8132	1414.3	559.5	165.8	10271.60	79.17	13.77	5.45	1.61
2003/04	9514.5	1697.5	700.6	268.6	12181.20	78.11	13.94	5.75	2.21
2004/05	10466.1	1799.2	806.5	306.7	13378.50	78.23	13.45	6.03	2.29
2005/06	10980.5	2181.1	847.6	565.7	14574.90	75.34	14.96	5.28	3.88
2006/07	15722.0	2253.5	995.0	697.8	19668.3	79.93	11.46	5.1	3.51
Average	9167.9	1411.26	568.9	200.4	11348.46	80.78	12.43	5.01	1.78

Source: Economic survey fiscal year 2007/2008

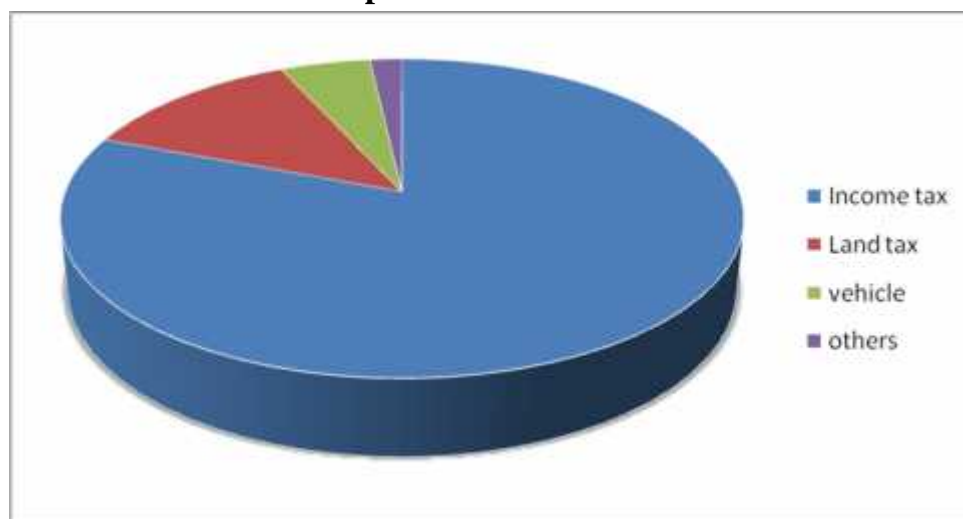
For the study, direct tax has been divided in to four parts. Viz. Income tax, vehicle tax, Land tax and other tax. Table show that in F/Y 1997/1998, the percentage share of income was 80.95%, follow by income tax 16.23% land tax, 2.91% vehicle tax and not available for other tax respectively of total tax revenue. On an average, the percentage share of income tax constitute of the total direct tax, 80.78% follow by income tax, land tax 12.43%, vehicle tax 5.01%, and other 1.78%. In between F/Y 1997/1998 to 2002/2003 the contribution from other tax was zero. In F/Y 2007/2008 the total contribution from income tax was follow by 79.93%, land tax 11.46%, vehicle tax 5.1% and other tax 3.51% respectively. The contribution on total revenue from income tax showed a Increasing trend. This increase in income tax may be attribute by VAT law forced the reluctant businessman to registered their name and file the return of the income although, there was no substantial increase in VAT itself. It helps increase the collection of income tax.

Land tax is increasing gradually on ward except in the year 2000/2001. The investment activities have not flourished with in nation due to the political instability and violence. In this situation investor might have been investing their investment in purchasing land and building. This might the reason to be increased in land tax revenue in recent years. Revenue from vehicle tax also showed a

growth trend over the studied period. It may due to increase number of vehicle in recent year before.

Figure 4.9

Composition of Direct Tax



4.11 Composition of Indirect Tax

Table 4.12

Composition of Indirect Tax

(Rs in million)

Fiscal Year	Indirect tax					As %of indirect tax			
	Tax based on international trade	Sales /VAT	Excise duty	Others	Total	% of tax based on international trade	% of sales/ VAT	% of excise duty	%of other
1997/98	8202.2	8162.9	2298.1	278.2	18941.4	43.30	43.10	12.13	1.47
1998/99	9517.7	8765.9	2953.2	235.4	21472.2	44.33	40.82	13.75	1.10
1999/00	10813.3	10259.7	3127.2	89.2	24289.4	44.52	42.24	12.87	.37
2000/01	12552.1	12382.4	3771.2	211.4	28917.1	43.41	42.82	13.04	.73
2001/02	12658.8	12267.3	3807	362.1	29095.2	43.51	42.16	13.08	1.25
2002/03	14236.4	13459.7	47875.1	442.5	32923.7	43.24	40.88	14.53	1.34
2003/04	15554.8	14478.9	6226.7	478.1	36738.5	42.34	39.41	16.95	1.30
2004/05	15701.6	18885.4	64459	516.3	41549.2	37.79	45.45	15.51	1.24
2005/06	15344	21610.7	6507.6	659.4	44121.7	34.78	48.98	14.75	1.49
2006/07	16708	26098.6	9343.2	476.3	52623.1	31.75	49.59	17.75	0.91

Average	13128	14636.8	4926.76	374.8	33066.4	39.70	44.26	14.89	1.15
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Source: Economic survey fiscal year 2007/2008

Note:-

Excise duty =Industrial product + liquor contract

Tax based on international trade =imports +exports + Indian excise returned + others

Sales Tax / VAT =Sales / VAT + Entertainment tax + Hotel tax + Contract tax

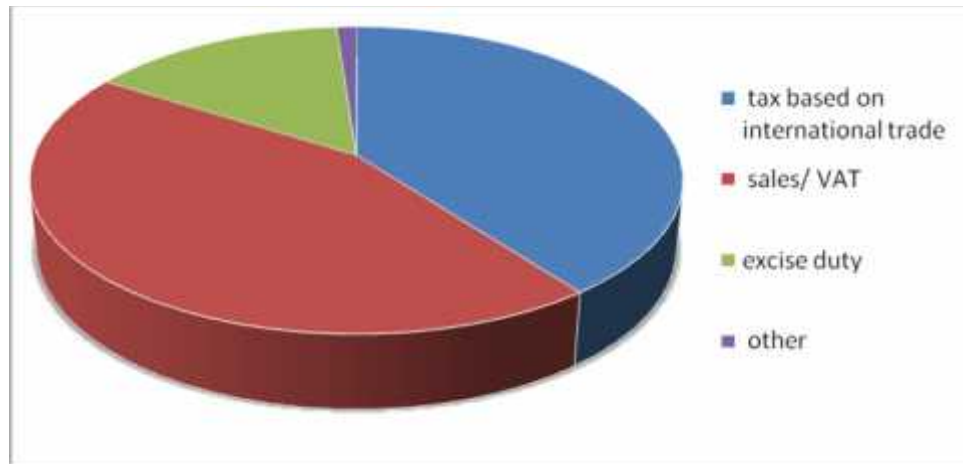
Indirect tax has been dominant role in tax revenue. Similarly, sales and value added tax has dominant position in indirect tax. For the comparison purpose taxes from contract, hotel and entertainment have been included in sales / value added tax because after the adoption of VAT all these taxes were replaced.

Table shows that, on an average the % share of revenue constitute of total indirect tax followed by international trade 39.70%, VAT 44.26%, excise duty 14.89% and other tax 1.15 %. But after the implementation of VAT the revenue received through this tax decreased from Rs 12382.4 million to 12267.3, then increased at 26095.6 million in year 2006/07. This shows that VAT collected less revenue than the four taxes that it displaced. The cause of decreasing revenue may be newly implemented VAT system which has not been well come from the business community at initial stage. It may effect from supervision and administrative capacity of tax office and not proper billing system from businessman.

The interview with FNCCI members revealed that consumer behavior is characterized by certain aspects like compulsion, luxury and planned shopping. Things like medicine, food and clothing are compulsory purchases; planned shopping is related to shopping is affected if the cost of the compulsory requirement goes up, as the budget will not permit it. And then there is luxurious shopping which happens only after the compulsory and the planned shopping have

been taken care of. But the slowdown in economy has definitely had an impact on both planned and luxurious shopping. If such shopping can not be flourishing, the VAT revenue can not be collect.

Figure 4.10
Composition of Indirect Tax



4.12 Share of VAT Revenue in GDP

Sales tax and VAT contribution to gross domestic product is shown in following table and diagram.

Table 4.13
Share of VAT Revenue in GDP

Fiscal Year	GDP	VAT revenue	(Rs in Million)
			%of GDP
1997/98	289798	8162.9	2.82
1998/99	330018	8765.9	2.66
1999/00	366251	10259.7	2.80
2000/01	393566	12382.4	3.15
2001/02	441519	12267.3	2.78
2002/03	459443	13459.7	2.93
2003/04	492231	14478.9	2.94
2004/05	536749	18885.4	3.52
2005/06	589412	21610.7	3.67
2006/07	654055	26095.6	4.0

Average	455304.2	14636.85	3.21
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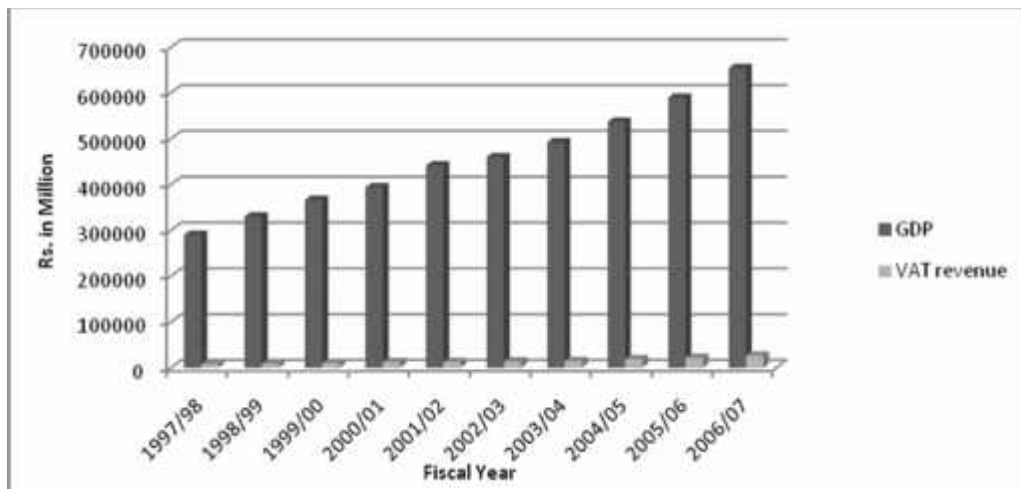
Source: Economic survey fiscal year 2007/2008

Table and diagram shows that on average the share of VAT revenue as percentage of GDP was 3.21%.

The percentage trend of VAT revenue to GDP is in increasing trend except in F/Y 2001/2002. According to estimate of GDP, and revised estimated of VAT revenue, the share of VAT in GDP is expected to 3.15% in fiscal year 2001/2002, 2002/03 and 2003/04 but it has been achieved only 2.78%, 2.93% and 2.94% respectively.

The interview with academicians revealed that the main problem of VAT arises from the businessman. They asked customer dual rate while selling goods. There are collecting VAT customer but not paid to Government. Lacks of cooperation from business community and level of consumer are the main cause of VAT.

Figure 4.11
Share of VAT Revenue in GDP



4.13 Share of VAT Revenue in Total Revenue

To examine the ratio of VAT with other data, we examine its ratio with total revenue in table and diagram.

Table 4.14
Share of VAT Revenue in Total Revenue

(Rs in million)

Fiscal year	Total revenue	VAT revenue	%of total tax revenue
1997/98	32937.9	8162.9	24.78
1998/99	37251	8765.9	23.53
1999/00	42893.8	10259.7	23.91
2000/01	48893.6	12382.4	25.33
2001/02	50445.5	12267.3	24.32
2002/03	56229.8	13459.7	23.94
2003/04	62331	14478.9	23.23
2004/05	70122.7	18885.4	26.93
2005/06	72282.1	21610.7	29.90
2006/07	88717	26095.6	29.4
Average	56210.4	14636.85	26.04

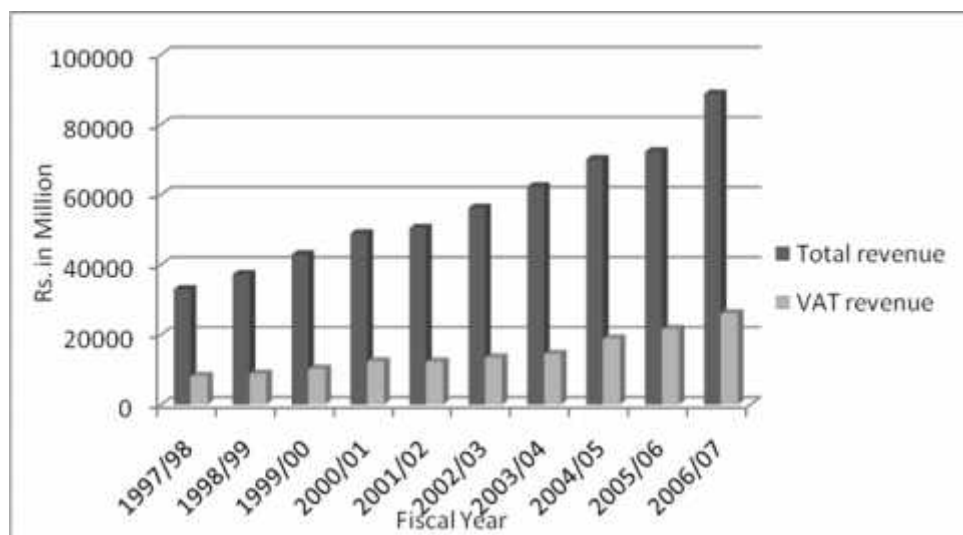
Source: Economic survey fiscal year (2007/2008)

Above table shows that on average VAT revenue to total revenue is 26.04%. The total revenue has increased each year but the % of VAT has increased each year but the % of VAT revenue with total revenue has increased and decreased slightly each year. The decreasing trend of VAT revenue to total revenue may be because VAT is new concept in Nepal. There is lack of co-ordination between business community and government, lack of proper home work before introduction VAT.

Businessman views that having to go through great burocratic hassle to pay taxes. Tax payers are still deprived of using all banks to pay the taxes. Only RBB and NBL have been allowed to make collection. Private Banks would serve effectively if they were allowed to do the job.

Figure 4.12

Share of VAT Revenue in Total Revenue



4.14 Share of VAT Revenue in Total Tax Revenue

To examine the ratio of VAT with other data, table examines its ratio with total tax revenue.

Table 4.15

Share of VAT Revenue in Total Tax Revenue

(Rs in million)

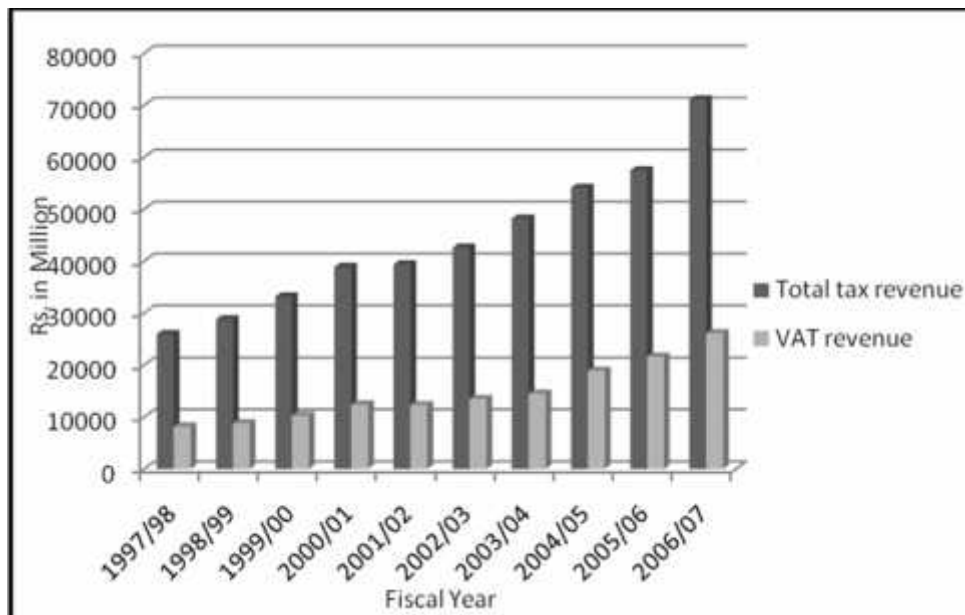
Fiscal Year	Total Tax Revenue	VAT Revenue	% of Total Tax Revenue
1997/98	25939.8	8162.9	31.47
1998/99	28752.9	8765.9	30.49
1999/00	33152.1	10259.7	30.95
2000/01	38865.1	12382.4	31.86
2001/02	39330.6	12267.3	31.19
2002/03	42587	13459.7	31.61
2003/04	48173	14478.9	30.06
2004/05	54104.7	18885.4	34.91
2005/06	57430.4	21610.7	37.63
2006/07	71127	26095.6	36.69
Average	43946.26	14636.85	33.31

Source: Economic survey fiscal year (2007/2008)

Table shows that on an average the VAT revenue is 33.31% of total tax revenue. The ratio of VAT collection with tax revenue is in increasing trend after implementation of VAT and it was significant in 2005/2006 and 2006/2007, and decreasing trend in 1998/99, 1999/00, and 2003/04. This may be due to economic slowdown. The slowdown in economy has definitely had a impact on both planned and luxurious shopping. The selling activities are in low scale the VAT revenue % is in decreasing trend.

Figure 4.13

Share of VAT Revenue in Total Tax Revenue



4.15 Share of VAT revenue in Total Indirect Tax Revenue

The collection of VAT revenue and indirect tax revenue collected in different year is shown in table and figure.

Table 4.16
Share of VAT Revenue in Total Indirect Tax Revenue

(Rs in million)

Fiscal year	Total indirect tax	VAT revenue	% of total Indirect tax
1997/98	18941.4	8162.9	43.10
1998/99	21472.2	8765.9	40.82
1999/00	24289.4	10259.7	42.24
2000/01	28917.1	12382.4	42.82
2001/02	29095.2	12267.3	42.16
2002/03	32923.7	13459.7	40.88
2003/04	36738.5	14478.9	39.41
2004/05	41549.2	18885.4	45.45
2005/06	44121.7	21610.1	48.98
2006/07	52146.4	26095.6	50.04
Average	33019.5	14636.79	44.32

Source: Economic survey fiscal year (2006/2007)

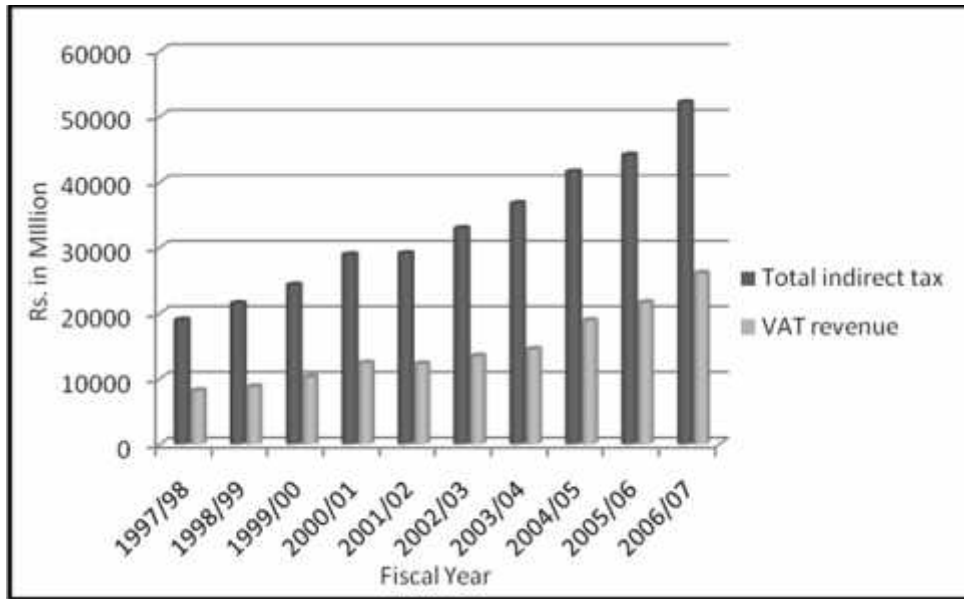
Table 4.16 shows that the share of VAT revenue in total indirect tax. On an average share of VAT in total indirect tax is 44.32%.

The ratio between VAT revenue and indirect tax was satisfactory in each year except in fiscal year 2003/2004. It may cause of the initial time of VAT Implementation. When VAT was implemented there were many problems in VAT revenue collection.

Experts view that private sector development has been the key to maintain competitiveness after accession to WTO. In the open economy, private sector has a great role to play because they produce goods and services and they perform will, the country also gets benefits. The changes in the tax structure will not make and significant difference. The tax structure has been maintained to make the system compatible. The whole system is more flexible and tax payer friendly.

Figure 4.14

Share of VAT Revenue in Total Indirect Tax Revenue



4.16 Empirical Study

An empirical investigation was conducted in order to find out the various aspects of VAT from the experience of the real world. In this empirical study, the analysis has been done about VAT on the basis of information collected from the tax payer, tax administrator (tax officer) and tax payers. The major tool used for this purpose is questionnaire.

In this study, the questions were asked to 60 different individuals related to this field. i.e. tax exports, tax administrators and tax payers. The questionnaire has covered various aspects of VAT concerning with the effectiveness of VAT (see the format of questionnaire in appendix). The respondents were asked either yes/no or selecting one alternative among different alternatives or for ranking of choices according to number of alternatives while first choice is the most important and last choice is least important. For analysis purpose choices assigned weights according to number of alternatives. If the numbers of alternative are ten

(10) then the first preferred choice gets ten points and last preferred choice gets one (1) points. Any alternative, which are not ranked, did not get any point. Total points available to each choice are converted in to percentage to set the ranked of alternatives. The choice with the highest score of percentage to set the ranked of alternatives. The choice with the highest score of percentage is ranked as the most important choice and with the lowest percentage being ranked at last choice. Information received from the respondents are tabulated and analyzed in the proper way. The following table shows the groups and no. of respondents.

Table 4.17
Group of Respondents and Number

S.N.	Group of Respondents	Number
1	VAT policy makers	15
2	Tax administrators (officer)	20
3	VAT payers (consumers)	25
	Total	60

1. Result of Empirical investigation.

a. Important factor for the effectiveness of VAT in revenue collection

To know the most important factor for the effectiveness of VAT in revenue collection in Nepal, the question is asked, “What is the most important factor for the effectiveness of VAT in revenue collection? Please rank”. The respondents were request to rank the given causes from 1 to 5 and ask to specify specified if any things. But some respondents ranked and some made tick mark. The responses of the respondents are presented as follows.

Table 4.18

Views on important factor for the effectiveness of VAT in revenue collection

S.N.	Alternatives	Respondents			Total points	Percentage	Rank
		VAT experts	Tax Adm.	VAT payers			
1	Proper implementation	26	62	74	162	20.01	2
2	Broad coverage	32	78	40	150	18.61	5
3	Tax education	46	72	37	155	19.23	4
4	Effective and efficient Adm.	52	32	95	179	22.21	1
5	Clear VAT law and regulation	22	72	66	160	19.85	3
6	Total	178	316	312	806	100	

Source: Opinion Survey

By observing the above table, according to the respondents' point of view the main important factor for the effectiveness of VAT in revenue collection are ranked as follows:

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

Other causes stated by the respondents are as follows:

- Invoice system
- Computer networking system
- Public participation.

From the above table and other discussion with respondents, it can be concluded that the main factor for the effectiveness of VAT in revenue collection are effective and efficient administration, proper implementation, clear VAT law and regulation , tax education and broad coverage.

b. Most responsible factor to make VAT ineffective in Nepal

VAT system of Nepal has been blamed that it is not efficient. To know the opinion of the respondents about the cause of most responsible factor to make VAT ineffective in Nepal, a question was asked. “which of the following factor most responsible to make VAT ineffective in Nepal’ The respondents were request to rank the given causes (their answer)from 1to 5 out of 50 respondents, more than respondents ranked but other made tick mark. For ranking purpose, opinions of the respondents are presented as follows:

Table 4.19
Most responsible factor to make VAT ineffective in Nepal

S.N	Most ineffective factor	Respondents			Total point	Percentage	Rank
		VAT experts	Tax Adm.	VAT payers			
1	Lack of consumer awareness	26	62	44	132	15.35	4
2	Weakness of governments action plan	32	104	94	220	25.58	1
3	Administrative inefficiency	46	78	96	220	25.58	2
4	Open border problem	52	72	70	194	22.56	3
5	I don't know	22	32	30	84	9.77	5
Total		178	348	334	860	100	

Source: Opinion Survey

By observing the above table, according to the respondent point of view the main causes for the creation of ineffective factor are ranked as follows:

1. Weakness of government action plan.
2. Administrative inefficiency.
3. Open border problem.
4. Lack of consumer awareness.
5. I don't know.

Other causes stated by the respondents are as follows:

- High tendency public not to pay tax.
- Lack of cooperation in tax administration.
- Lack of billing system.

From the above table and other discussion with respondents. It can be concluded that the main cause of the creation of ineffective factor of VAT are lack of consumer awareness, weakness of government action plan, administrative inefficiency, open border problem and lack of billing system.

c. Views on major problem faced after VAT regime

To achieve the expected result from VAT, the problem related to VAT must be avoided. First of all, identification of these problems is necessary and required effective steps should be implemented to avoid the problems relating to VAT. The major problems faced after VAT regime may be increase compliance cost, decrease in business competitive power, encourage unauthorized trade, problem in custom valuation and tax returned process.

Table 4.20**Views on major problem faced after VAT regime**

Respondents	Increase compliance cost		Decrease in business competitive power		Encourage unauthorized trade		Problem in custom valuation		Tax return process		Total
	No	%	No	%	No	%	No	%	No	%	
VAT experts	1	10	2	20	2	20	3	30	2	20	10
Tax Adm.	4	20	5	25	2	10	5	25	4	20	20
VAT payers	3	20	4	26.66	1	6.66	5	33.33	2	13.33	15
Total	8	17.78	11	24.44	5	11.11	13	28.89	8	17.77	45

Source: Field Survey

The empirical survey shows that 30% VAT experts, 25% tax administration, and 33.33% VAT payers shows the problem in custom valuation. While 20% VAT experts, 25% tax administration, and 26.66% VAT payers show the decrease in business captive power. Similarly 20% VAT exports, 20% tax administration and 13.33% tax exports said that there is problem in tax return process. Out of total respondents 17.18% viewed problem on increase compliance cost and 11.11% view problem on encourage unauthorized trade.

d. Essential factor to make VAT as a backbone of revenue collection

VAT is the backbone of the country's economic development. VAT is the latest innovation in the field of indirect tax system. It is an improve and modified from of sales tax. The question was asked. "To establish VAT as a backbone of revenue collection, what are the essential factor." the respondents were request to rank the given cause from 1 to 4 and asked to specify other if any things. The responses of the respondents are presented as follows.

Table 4.21**Essential factor to make VAT as a backbone of Revenue Collection**

S.N.	Alternatives	Respondents			Total Points	Percentage	Rank
		VAT experts	Tax Adm.	VAT payers			
1	More trained and qualified officers	26	62	132	220	24.44	2
2	Minimize contract with the tax officers	32	79	64	175	19.44	4
	Computerized stem for the payment of VAT	42	72	84	198	22	3
4	Collection of VAT should be given to private sector	50	37	220	307	34.12	1
Total		150	250	500	900	100	

Source: Field Survey

By observing the above table, according to the respondents' point of view the main causes for VAT as backbone of revenue collection are ranked as follows:

1. Collection of vat should be given to private sector.
2. More train and qualified officers.
3. Computerized stem for the payment of VAT.
4. Minimized contract with the Tax officer.

Other causes stated by the respondents are as follows:

- To VAT system natural and efficient.
- To increase revenue mobilization by broadening the tax base.
- To minimized the cost of tax.
- To establish a transaction based transparent tax system.

From the above table and other discussion with respondents, it can be concluded that the main causes for the creation of VAT as backbone of revenue collection are more trained and qualified officer, minimized contracted with the tax officers, computerized stem for the payment of VAT and collection of VAT should be given to private sector.

e. Impact of VAT on Nepalese Economy

The VAT provision is implemented properly and as per the sprit of the VAT. The business has to pay the difference between taxes collection on sales and tax paid on purchase to the government. So the field survey tries to know the impact of VAT on Nepalese economy.

Table 4.22
Impact of VAT on Nepalese Economy

respondents	Positive		Negative		I don't know		Total
	No	%	No	%	No	%	
VAT experts	15	100	-	-	-	-	15
Tax Adm.	25	100	-	-	-	-	25
VAT payers	13	65	5	25	2	10	20
Total	53	88.33	5	8.33	2	3.33	60

Source: Field Survey

From the empirical survey, it is found that all VAT experts and all tax administrators argue that the positive impact in Nepalese economy in VAT pay and 65% VAT payers are agreed. Similarly 25% VAT payers not agreed and 10% VAT payer were ideal about this aspect. In conclusion, we can say that VAT in Nepalese economy positive impact in economy.

f. Views on Suitable Time to Increase VAT Rate

To know the opinion a suitable time to increase VAT rate, respondents were request to selected one among the three alternatives (yes, No and I don't know) the question was asked, "Do you think it is a suitable time to increase VAT rate." The responses received from respondents are tabulated below.

Table 4.23
Views on Suitable Time to Increase VAT Rate

Respondents Responses	VAT Experts	Tax Adm.	VAT Payers	Total	
				No	Percentage
Yes	3	6	2	11	18.33
No	7	15	15	37	61.67
I don't know	5	4	3	12	20
Total	15	25	20	60	100

Source: Field Survey

The above table shows that, cent percent responses were received. Out of cent percent responses, 61.67% respondents were not agreed with increase VAT revenue. 18.33% were agreed that current VAT rare increase in suitable time. And 20% were ideal. It is concluded that the current VAT rate is absolutely correct. Majority VAT experts and tax administrators were agreed on it whereas, majority. Some respondents felt that rate is not absolutely high. But it is higher as compared to tax paying capacity of Nepalese people.

g. View on effectiveness of single rate of VAT (13%)

Because of multiple tax reform because more complicated to both tax payers and tax officers. Despite this reason many countries already implemented various tax rates according to their economic condition. But all tax administrators prefer to use a single rate of VAT to effective implementation. Like wise, Nepal has preferred a single rate of VAT which in 13% according to VAT enhancement. The

opinion survey of different respondents about the view on single rate of VAT can be presented in the following table.

Table 4.24**View on Effectiveness of Single Rate of VAT (13%)**

respondents	Efficient		Not efficient		I don't know		Total
	No.	%	No.	%	No	%	
VAT experts	15	83.33	3	16.67	-		18
Tax Adm.	16	72.73	4	18.18	2	.09	22
VAT payers	14	70	3	15	3	15	20
Total	45	75	10	16.67	5	8.33	60

Source: Field Survey

According to field survey, 83.33% VAT experts, 72.73% tax administrators and 70% VAT payers were agreed that single rate (13%) is effective to generate revenue. Among the total respondents 75% agreed with single rate, 16.67% disagreed with single rate and remaining 8.33% unknown about this matter.

h. Appropriation of Legal Provisions

Nepalese VAT administration has been suffered 11 years of implementation. The legal provision is closely related to VAT administration. Now, the vat act and rule/regulation have not covered the increasing trading and improving business. So the respondents are requested for giving their opinion about legal provision. That is given in following table.

Table 4.25**Appropriation of legal provisions**

Respondents	Appropriate		Not appropriate		I don't know		Total
	No.	%	No.	%	No.	%	
VAT experts	8	50	6	37.50	2	12.5	16
Tax Adm.	16	66.67	8	33.33	-	-	24
VAT payers	10	50	6	30	4	20	20
Total	34	56.67	20	33.33	6	10	60

Source: Field Survey

According to field review 50% tax experts, 66.67% tax administrators, and 50%, VAT payers were agreed that legal provision of VAT is appropriate. Similarly, 37.50% VAT experts, 33.33% tax administrators, and 30% VAT payers were disagreed about legal provisions of VAT. Out of total respondents, 56.67% agreed about legal provision, 33.33% disagreed and 10% are unknown about these matters.

i. Views on Effectiveness of VAT in the Future

From the past experience, it is clear that VAT will be effective tools for revenue collection in future, if it is effectively implemented. The view of various respondents on this aspect is presented in the table below.

Table 4.26
Views on effectiveness of VAT in the future

Respondents	Yes, it will be		No it will not		I don't know		Total
	No	%	No	%	No	%	
VAT experts	12	100	-	-	-	-	12
Tax Adm.	18	90	2	10	-	-	20
VAT payers	20	71.43	1	3.57	7	25	28
Total	48	80	5	5	7	11.67	60

Source: Field Survey

According to field survey, 80% of the total respondents were said VAT will be effective in future. Remaining 5% respondents were pessimistic and 11.67% respondents gave on idea about this aspect. In conclusion, we can say that VAT would be effective in future.

j. Views on Problems in the VAT Implementation

It is known that the duties and responsibility of implementation of VAT of the government and the VAT payers, tax administrator and VAT payers all are also responsible for these duties. Implementation of VAT has still a great challenge in this aspect. The field survey has been conducted to know the views of different respondents about to explore the problems on process of VAT implementation. The study shows registration, collection, and tax refunds are the main problems for the implementation process.

Table 4.27

View on Problem in the VAT Implementation

Respondents	Registration		Collection		Tax refund		Others		Total
	No.	%	No	%	No	%	No	%	
VAT experts	5	27.78	6	33.33	6	33.33	1	5.56	18
Tax Adm.	7	38.89	6	33.33	2	11.11	3	16.67	18
VAT payers	10	41.67	5	20.83	5	20.83	4	16.67	24
Total	22	36.67	17	28.33	13	21.67	8	13.33	60

Source: Field Survey

The empirical survey shows that 27.78%, VAT experts, 38.89% tax administrator and 41.67% VAT payers seemed to be unsatisfied VAT registration process. While 33.33% VAT experts, 33.33% tax administrator and 20.33% VAT payers showed the VAT collection process. Similarly 33.33% VAT experts, 11.11% tax administrators and 20.83% VAT payers said that there is problem in tax refunds. Out of total respondents 36.67% VAT experts, 28.33% tax administrators and 21.67% views problem on refund and 13.33% views problem on others.

k. Views on effectiveness of VAT administration in Nepal

Nepalese tax system was very complicated before the introducing VAT after the introducing of VAT, the system has not been more sufficient. So the essential factors for making VAT administration effective in Nepal. The respondents were ranked given cause from 1 to 5 and asked to specify other if any things. The responses of the respondents are presented as follows.

Table 4.28

Essential factors for making VAT administration effective in Nepal

S.N	Alternatives	Respondents			Total points	Percentage	Rank
		VAT experts	Tax Adm.	VAT payers			
1	Proper training to personnel	26	62	44	132	15.17	4
2	Establishment and implementation of reward and punishment system	32	104	94	230	26.44	1
3	Simple tax procedure	46	78	96	220	25.29	2
4	Simple tax law	52	72	70	194	22.30	3
5	Better information system	32	32	30	94	10.80	5
Total		188	348	334	870	100	

Source: Field Survey

By observing the above table, according to preference of the respondents the essential factors for making VAT administration effective in Nepal are ranked as follows.

1. Establishment and implementation of effective and punishment system.
2. Simple tax procedure.
3. Simple tax law.
4. Proper training to personnel.
5. Better information system.

After the analysis of above table, we concluded that establishment and implementation of effective reward and punishment system is essential factor for making VAT administration effective in Nepal. Other essential factor is simple tax procedure, simple tax law, proper training to personnel and better information respectively. And other factors are proper billing system and accounting system, effective tax auditing, and monitoring and regulating mechanism.

I. Reasons for necessity of VAT in Nepal

All developing and under developing countries need higher revenue collection from internal sources for the development. So these countries tried to sustain from internal revenue through VAT system. The following table shows the opinion of respondents why VAT is needed in Nepal.

Table 4.29
Reasons for necessity of VAT in Nepal

respondents	Increase revenue		Broad tax base		Transparency		Others		Total
	No	%	No	%	No	%	No	%	
VAT experts	5	31.25	4	25	5	31.25	2	12.50	16
tax Adm.	6	30	8	40	4	20	2	10	20
VAT experts	7	29.17	9	37.50	5	20.83	3	12.5	24
Total	18	30	21	35	14	23.33	7	11.67	60

Source: Field Survey

By the survey it is clear that 31.25% VAT experts, 30% tax administrators and 29.17% VAT payers is needed to due to increase revenue. Similarly 25% VAT experts, 40% tax administrators and 37.50% VAT payers reported that VAT has needed due to broad tax base. And 31.25% VAT experts, 20% tax administrators and 20.83% VAT payers are reported that VAT is needed due to transparency. Out of total 11.67% reported that VAT is needed due to all mention reason.

m. A view on VAT as superior to Sales Tax

VAT is developed from of sales tax system. VAT is adopted in many countries of the world. It is superior over sales tax system. The main result of survey is summarized in the following table.

Table 4.30
Views on VAT as Superior to Sales Tax

Respondents	Yes it is		No, it is not		I don't know		Total
	No	%	No	%	No	%	
VAT experts	20	100	-	-	-	-	20
Tax Adm.	15	88.24	2	11.76	-	-	17
VAT payers	15	65.22	3	13.04	5	21.74	23
Total	50	83.33	5	8.33	5	8.33	60

Source: Field Survey

According to field survey 83.33% of the total respondents provided their view regarding superior of VAT over sales tax. 8.33% of total respondents are opposite of that question and 8.33% respondents unknown about this view. In the above table show 100% VAT experts, 88.24% tax administrators and 65.22% VAT payers agreed about the superior of VAT over sales tax. Like this 11.76% tax administrators and 13.04% VAT payers said that it is not superior to sales tax. Similarly 21.74% VAT payers agreed unknown about this question. That is why it is clear that VAT is superior to sales tax in respect of revenue collection, coverage and transparent.

n. Views on your Suggestions to increase the base of VAT

The most attractive aspect of VAT is broad base. If the tax base is wide the revenue collection is more. The option survey about the view on suggestion to

increase the base of VAT in different respondents can be presented in the following table.

Table 4.31
Suggestions to Increase the base of VAT

Respondents	Include all possible sector		Incorporate agriculture sector		Others		Total
	No	%	No	%	No	%	
VAT experts	10	47.62	8	38.10	3	14.29	21
Tax Adm.	12	48	10	40	3	12	25
VAT payers	8	57.14	4	28.57	2	14.28	14
Total	30	50	22	36.67	8	13.33	60

Source: Field Survey

According to field survey, 47.62% VAT experts, 48% tax administrators and 57.14% suggested that included all possible sectors. Similarly 38.10% VAT experts, 40% tax administrators and 28.57% VAT payers suggested included incorporate agriculture sector. Out of total 13.33% responded suggested included all other possible sector. In conclusion most respondents are in favor of including all possible sectors.

o. The questions were asked “what are the challenging problems associated with VAT implementation?”

The interview with tax administration that lack of billing system and less involvement of and cooperation of business community are cause of not collecting targeted revenue. Experience of expert revealed that it is new system for Nepal. Economic slowdown, political instability and low level of consumer’s awareness area main problem associated with VAT implementation.

p. The question was asked, “What is your opinion to make VAT effective and successful?”

The interview with tax administrators to make VAT effective, it is essential to create an environment in which invoices are issued properly, accounts are maintain accurately, tax is based on transaction, there is acceptance of the tax payers correct accounts and a fair competition among industrialists and businessman should be established.

q. The questions were asked, “Please give your suggestion to make vat effective?”

VAT experts’ views that private sector development has the key to maintain competitiveness after accession to WTO. In the open economy, private sector has a great role to play because they produce goods and services and whole they perform well, the country also gets benefits. The change in the tax structure will not make any significant difference. The tax structure has been maintained to make the system WTO compatible. The whole system is made more flexible and tax payer friendly.

4.17 General Findings

- VAT has been most essential alternative of different tax reform programs for developing like Nepal. It leads to revenue enhancement, transparent and scientific tax system. There will be vital scopes for increasing the revenue from VAT in coming days.
- There was a great technical assist of foreign donors for implementing of VAT in Nepal.
- Analyzing the history of VAT registration and implementation efforts in Nepal was not easy it was a great challenging effort.
- VAT most scientific, modern, and new innovation in the field of taxation.
- Most of the customers, traders’ businessman are lacked with the concept of VAT. They are facing billing, accounting system.

- Due to different reason the operating of VAT is geographical structure, open border, traditional business system, and low public consciousness level, under valuation of pricing, corruption and accountability.

Findings from Secondary Data

- Overview the current structure of Nepal, the share of tax revenue has been greater than share of non tax revenue. The average ratio of tax revenue to total revenue is 78.32% and non tax revenue to total revenue is 21.68 %.
- In developing countries like Nepal, indirect tax play pioneering role for internal resources mobilization which is now the principle source of revenue collection. The average ratio of indirect tax revenue to total tax revenue is 80.31% and direct tax revenue to total tax revenue is 19.69% during the studying period.
- The direct tax structure, customs duties are the main contributor. But VAT is growing to be the major contributor in total indirect tax revenue.
- The contribution of VAT revenue to total revenue is in increasing trend in the in the previous year, which is beneficial for sound economic development. In F/Y 1997/98 the revenue collection from VAT was Rs 8162.9million, and it increased to Rs26095.6million in the F/Y 2006/07. average collection from VAT is 14636.8 million.
- The average ratio of VAT to total revenue collection is 26.04%, VAT to total tax revenue collection is 33.31%, VAT to total indirect tax revenue collection is 44.32%, and VAT to GDP ratio is 3.21% during the studying period.

4.19 Empirical Findings/Findings from Primary Data

- Revenue collection from depend on most important factors which effect its effective and efficient administration. Opinion survey show that the main important factor for the effectiveness of VAT in revenue collection in effective and efficient administration. 22.21% respondents take it as a main

- factor, other factor are proper implementation, clear VAT law and regulation' tax education and broad coverage.
- The most responsible factor to make VAT ineffective in Nepal was weakness of government action plan. 25.58% respondents take it is main factor to make VAT ineffective in Nepal. Other factors are administrative inefficiency, open border problem and lack of consumer awareness.
 - Opinion survey shows that the main problem faced after VAT regime was custom valuation. 28.89% agreed on problem on custom valuation, 24.44% agreed on decrease in business competitive power, 17.78% agreed in increase compliance cost, 17.77% agreed problem on tax return process and 11.11% agreed on encourage unauthorized trade.
 - VAT is the backbone of the revenue collection; the most essential factor was collection of VAT should be given to private sector. 34.12% respondents take it is a main factor, other essential factor are more train and qualified officers, computerized stem for the payment of VAT and minimized contract with the tax officers.
 - Opinion survey show that 88.33% respondents have there is positive impact of VAT in Nepalese economy.
 - From the study it was found it is not suitable time to increase VAT rate. Because 61.67% respondents was not agreed.
 - Single rate of VAT is effective, because 75% respondents were views that single rate of VAT was effective, only 16.67% respondents were view that single rate of VAT wasn't effective.
 - Opinion survey shows that most of the respondents have satisfied with appropriation of legal provisions. 56.67% respondents have satisfied with appropriation of legal provisions, 33.33% have not satisfied with appropriation of legal provision, and 10% respondents has unknown about this factor.

- In opinion survey most of respondents were think VAT will be effective in future. Out of 80% respondents agreed vat will be effective in future.
- The VAT implementation process is not satisfactory in Nepal. Opinion survey shows that the main problem in the process of VAT implementation is registration 36.67% respondents take it as a main problem in the process of VAT implementation.
- VAT administration has not achieved the expected results. All of the respondents were suggest the essential factors for making VAT administration effective in Nepal are as below. 26.44% respondents agreed establishment and implementation and punishment system.
- Other essential factors are simple tax procedure, simple tax law, proper training to personnel and better information system.
- VAT is necessity of VAT in Nepal. Out of total respondents 35% respondents was agreed with broad tax base. Similarly 30% respondents was agreed increase revenue and 23.33% view that the transparency.
- Most of the respondents are in favor on the view of superior of VAT to sales tax. Out of total respondents 83.33% was favored on superior of VAT over sales tax. 8.33% was not favored and 8.33% was unknown about this matters.
- VAT has not possible sectors which are easy to implement. According to field survey, 50% were favored in including all possible sectors, 36.67% were favored in incorporate agriculture sector.
- Personnel discussion in respondents' views on problem of VAT effectiveness was weak owing to the lack of practice of issuing and receiving invoices. Similarly there may be problem of under invoicing at the customs has not been reduce.

CHAPTER - V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Taxation and economic development are interrelated. Taxation has an important role in country's economic development. In recent decades, many developing countries around the world have begun to focus their attention on reforming their poorly designed defective tax structures as an integral part of their development efforts. Such reforms have broken some older leanings and estimated some new trends and axioms.

VAT in Nepal was introduced as a major parts of the overall tax reform program initiated in the early 1990s. it has been spread all over the world with in a short span of time. It has gain popularity that any tax system had gained earlier in the history of taxation in such a short period.

Nepal introduced a consumption type invoicing method VAT based on the destination principle with a single stage positive rate of 13% as a major part of tax reforms. The number of sale tax registrants was 2045 at the time of introducing of VAT in 1997. Despite the negative impact on VAT registrant due to compromise made from time to time, the number of VAT registrant increased gradually. In fiscal year 2006/2007 the number of registrants reached 52965.

The credited and debited in Nepal is higher than global general standard. It is found that percentage of debit return was increased and credit return was decrease.

The numbers of Non-filers, suspended and cancelled have been increased. The % of non-filer has been increased from 4.30% to 28.18%. The % of suspended has been increased from 0.02% to 1.93% and the cancelled their registration has been increased from 0.37 to 4.56% various. Obstacles were encountered in the process of VAT implementation. Despite it, the VAT revenue has been increasing gradually. In fiscal year 1998/1999, the VAT revenue was Rs 8162.9 million and fiscal year 2005/06, it has increased Rs 26724.2 million.

The figure showed that Government is unable to achieve their targeted VAT revenue collection. In year 1998/99, only 93.06% targeted revenue was collected. In year 2006/07, 98.76% targeted revenue was collected. In other years around 84% of targeted revenue was collected. The number of VAT refunding has been increasing gradually.

Lottery programmed was introduced to enhance billing habits. At beginning month Magh 2060, 40258 coupons was issue. It is increase to 113921 in month of Ashad in 2063. The program was effective but can not achieved targeted revenue. There is big resources gap. The main source of Government revenue is total revenue. In 1996/97, the resource gap was 59.88% after deducting total revenue. In 2005/06, the resource gap was 65.65% it shows that the Government revenue is in decreasing.

In an average, the Government tax revenue was 78.32 of total revenue. It was increasing at the rate of 10.62% is in average. It was satisfactory. The direct tax revenue consist income tax, vehicle tax, land tax and other tax. Among them, income tax contributes 80.78%, land tax 12.43% vehicle tax 5.01% and other tax 1.78% in an average. The income tax has highest contribution on direct tax.

The indirect tax revenue consists, tax based on international trade, sales/VAT tax, excise duty and others. VAT contributes 39.70, 44.26%, 14.89% and 1.15% of total indirect tax respectively on an average. This shows that VAT collected less revenue than the four taxes that it displaced. In an average, the VAT contributes 3.21% of GDP 26.04% of total revenue, 33.31% of tax revenue and 44.32% of indirect tax.

There has been a positive trend in registration revenue collection and refund. Taxpayer level of compliance has been improving slowly. If the provision is implemented properly and as per the VAT, the means could guide the Government resources towards meaningful destination. Expert and interviewed persons say that if sufficient effort is made, the target revenue collection can be achieved.

5.2 Conclusion

There may be various key challenges persisting to effective implementation of VAT system. From the study of various data trend and experience of VAT offices shows the following problem:

- There may be weak owing to the lack of practice of issuing and receiving invoices. Similarly there may be problem of under invoicing at the customs has not been reduced.
- There may be misunderstanding between tax payer and tax administrator for refund of tax. One blames the VAT system has not been put in to proper practice while others complain that there is refund owing to the fact that the tax payers don't even comply with simple formalities.
- There may be lack of publicity and effective monitoring. In the implementation of VAT the main glitch has been in terms of the lack of public awareness. Until a time when a situation is created where the consumer himself/herself, it will be an uphill road for VAT.

- The fragile political situation and economic slowdown may be the cause of implementation VAT effectively. There was a change in the government 17 times in the period of 18 years(2046 up to 2065)
- A weak and unmotivated tax administration may be the cause of ineffective implementation of revenue collection. There is many positive remained vacant for a long time public service commission, high turnover of officers by the public service commission, high turnover of personal and general disinterest in VAT as the VAT administration was considered the least attractive in the revenue administration.
- The difficulties to implement may be the merger of VAT and income tax administration in 2001. Merged entity was dominated by the management of the former tax administration.
- In the absence of invoice/proper invoice, it is not possible to maintain proper accounts. In some causes vendors are maintaining two set of accounts; i.e. one for their business purpose and another for tax purpose.
- Lack of proper book keeping has resulted in a discouraging status of returns, which can be seen from the excessive number of credit return.
- As of June 2005, the accumulated tax credit was Rs 4598 million and this may due to the non issuance of invoices and/or misuse of credit mechanism.
- Some public enterprises have not been depositing the VAT collection in the treasury due to their liquidity problem and some taxpayers do not pay VAT due to their large credit sales and so on.

According to researcher and interviewed person, in the first two years, since many compromises were made in the principles of VAT due to political instability and frequent change in government economic slowdown. VAT could not be fully implemented. In our environment where the tax awareness is minimal, the practice of maintaining tax accounts is negligible or improper, smuggling and under

valuation is rampant and tax leakages take place with negotiations between the tax payer and the political instability only aggraded the situation and made it more complex. Until these trends are resolved, there will not be significant VAT collection have been eliminated.

5.3 Recommendations

The implementation of VAT has not devoid the challenge yet. To establish this tax on a completely successful scale and to make it a part of the daily life of the people requires much bigger efforts than what we have now.

Nepal has been undergoing through server fiscal crises due to limited sources of revenue and increasing Government expenditures. The trend of 10 years (18996/97to 2006/07) shows revenue expenditure gap. The country is heading toward debt trap situation. In the wake of such a crisis Nepal has adopted VAT. According to interviewed person and researcher, to overcome the major challenges faced in the implementation of VAT. The following measure could be adopted.

- A collection strategy needs to be developed and implemented effectively in order to collect the increasing amounts of arrear. To improve billing condition on the market needs regular supervision, audits and investigation. Consumer education is required to promote the use of invoice.
- While the design of the retuned system is good, it has not been implemented properly. It is necessary that the refund procedure be implemented in a timely and proper manner and that both tax payer and tax official be education on the procedure to prevent any misuse of the refund procedure.
- Awareness program on VAT about value added tax should be carried out so that consumer may become aware of the tax. Recently the Government has introduced a lottery program to encourage demanding invoice during

- purchase. All conscious citizens should be alert and aware regarding these facts.
- The fragile political situation should be ended for economic development, peace and mandatory.
 - For effective implementation, big responsibilities remain with the shoulders of tax administration. Therefore the administration has to implement this tax in the right spirit of VAT. In depth training must be provided to tax officials to expertise them in the field of taxation.
 - To establish VAT invoices in the forms of a campaign, college students could be hired and mobilized. This could provide the student part time employment and also enhance publicity. It would be appropriate to mobilize such students to find out the status and presence of VAT in the market. If group of students are placed In busy market places, it creates psychological pressure on the vendors to issue invoices. Similarly, they could be also used to collect information on various issues of VAT.
 - To make VAT effective and transparent, unnoticed inspection on the road of goods being transported from time to time would discourage incorrect business transaction should be banned to promote real business.
 - It is essential to widen the base of the domestic commodity tax system and increase revenue mobilization. The administration should expand audit and investigation activities in order to identify and remove artificial credit.
 - To make VAT effective, it is essential to create an environment in which invoices are issued properly, accounts are maintain accurately , tax is based on transaction, there is acceptance of the taxpayers correct accounts and a fair competition among industrialists and businessmen should be established.
 - The proper co-ordinations among various Government departments involved in revenue collection must be maintained.

- Computer networking system should be established in all the customs point with department so that related information can be accessed to all the concerned officials. Internet facilities must be provided to concern offices for the access of international price.

VAT would definitely help to increase revenue collection of Nepal, if implemented properly. The present situation of VAT shows that the system need for understanding and commitment at the political level and administration level.