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RESOURCE MOBILIZATION THROUGH VAT IN NEPAL

RESOURCE MOBILIZATION THROUGH VAT IN NEPAL

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By

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December 2007

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LETTER OF RECOMMENDATION

The thesis entitled "RESOURCE MOBILIZATION THROUGH VAT IN NEPAL" has been prepared by Mr. Sunil Datta Baral under my supervision. I hereby recommend this thesis for examination by the Thesis Committee as a partial fulfillment of the requirements for the Degree of MASTER OF ARTS in ECONOMICS.

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APPROVAL SHEET

We certify that this thesis entitled "RESOURCE MOBILIZATION THROUGH VAT IN NEPAL" by Mr. Sunil Datta Baral to the Central Department of Economics, Faculty of Humanities and Social Sciences, Tribhuvan University, in partial fulfillment of the requirements for the Degree of MASTER OF ARTS in ECONOMICS has been found satisfactory in scope and quality. Therefore, we accept this thesis as a part of the said degree.

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ABBREVIATIONS

BS	Bureau of Statistics
CA	Chartered Accountant
CEDECON	Central Department of Economics
CTM	Chief Tax Manager
CTO	Chief Tax Officer
DANIDA	Danish International Development Agency
DG	Director General
EC	European Countries
EU	European Union
FY	Fiscal Year
GDP	Gross Domestic Product
GNP	Gross National Product
HIID	Hervard Institute for International Development
IMF	International Monetary Fund
IRD	Inland revenue Department
IRO	Inland Revenue Office
MoF	Ministry of Finance
MST	Manufacturing Level Sales Tax
NCC	Nepal Chamber of Commerce
NCCI	Federation of Nepal Chamber of Commerce and Industry
NG	Nepal Government
SAARC	South Asian Association for regional Cooperation
SSAFTA	South Asian Free Trade Arrangement
USAAID	United State Agency for International Development
VAT	Value Added Tax
WST	Wholesale Level Sales Tax
WTO	World Trade Organization

CHAPTER I

INTRODUCTION

1.1 Background of the Study

Economic Development is the main goal of the developing countries. To achieve this goal, developing countries aim to attain sustainable high growth rate, reduction in the inequality of resources so as to best satisfy the wants of the society. Though, the developing countries are directed towards these objectives, the condition of them has not improved yet due to lack of sufficient resources required for development. To solve these problems, the states need to play an active role for higher resource mobilization and the circumstances explain that indirect taxation is the proper way to achieve effectiveness in resource mobilization.

Indirect taxes are indirectly imposed on a person or an organization which are comprised of Excise duty, custom duty, sales tax, entertainment tax and VAT etc. These taxes are shifted to other people. In a developing country like Nepal, indirect tax play a vital role as compared to direct tax. Indirect tax contributes nearly 75% in total tax revenue and rest 25% by direct tax.

VAT is the most recent innovation in the field of taxation. It is levied on the value added of goods and services. VAT is an improved version of sales tax. It is levied at different stages of production and distribution. It is a multistage tax, which is connected at the different stages of production and distribution, sales of both domestically produced and imported goods and services.

Emergence of VAT dates back to 1919 A.D. German industrialist Wilhem Van Siemens proposed the tax to replace multistage turnover in

taxes in Germany. In that time Germany did not apply VAT but it reduced the rate of multistage sales tax. The concept of value added tax (VAT) was developed further in 1949 by a tax mission to Japan lead by professor Carls S. Shoup. This mission recommended the Euka Kachi-Zei (VAT) for Japan in order to avoid the undesirable and unintended effects of Japanese enterprises and turnover taxes in place at that time. That issue was considered seriously but Japanese government decide not to implement it. No country applied VAT till 1953. The modern VAT first appeared in France in 1954 A.D. It covered industrial sector that extended to the wholesale level. Following France several other countries such as Senegal, Algeria, and Morocco (1960) introduced VAT, that was limited to import and manufacturing stage only. Thereafter, Brazil (1967), Uruguay (1968), Ecuador (1970), Bolivia (1973) and Argentina (1975) introduced VAT in their countries subsequently. Many European countries such as Denmark, Sweden and Norway also adopted VAT during 70s and 80s VAT spread to Asian countries such as Vietnam (1973), Korea (1977), China (1984) and Indonesia (1985).

In South Asia, Pakistan introduced VAT in 1990 A.D., following by Bangladesh (1991) and Sri Lanka (1995).

In the Nepalese context, the tax system review task force constituted by Nepalese government in 1995 under the chairmanship of Professor Madan K. Dahal proposed and recommended to implement VAT in lieu of sales tax, hotel and entertainment tax and Nepalese government implemented it in 16 Nov. 1997. However, VAT came into full operation in Feb. 1998.

In the implementation of VAT, majority of business community strongly protested against VAT and they were severely criticizing VAT. They said that VAT increases the cost of business, it is complicated and

encourages corruption. A series of discussions were held between the government and representatives of the business community.

Thus, the business community tried till the last moment to postpone the implementation of VAT. But, the government went on their schedule to implement. However, it extended the deadline to three months, and VAT became the effective tool for the collection of revenue of the government. In total tax revenue the contribution of VAT is more and more attractive. There is tremendous scope for increasing the revenue from VAT. The sound implementation of VAT will obviously increase its contribution in coming days. VAT is a scientific tax system, which is the most popular and transparent system. But, there are some issues or problems in VAT such as in: administration, cooperation, refund, policy etc. To overcome the problems, the government should make almost all the people aware and well informed about it. Not only from the side of government but the business community must also support for the sound implementation of VAT. So VAT is a revenue productive tax. It also removes the misuses of sales tax and contributes to increase internal revenue and reduce foreign loans. Thus because of many features and contribution future prospects of VAT are good enough. From the past experiences of VAT in Nepal, it would show the clear picture of its incoming future as well.

Finally, the threshold, which was earlier said to be NRS. 4.5 million was brought down to NRs. 2 million and VAT rate is changed to 13 percent from 10% in an. 15th January 2005.

1.2 Statement of the Problem

With the common characteristics of developing countries such as: rapid population growth, increasing unemployment, resource constraint and high dependency in agriculture, low living standard and poor

infrastructure etc., Nepal is also a developing country situated between two rising nations India and China. To fulfill the aspiration of its people it needs more revenue obtained through the effective mobilization of resources. But Nepalese resource mobilization is still poor that does not cover the growing expenditure. Government expenditure is increasing while there is no equivalent increment in government revenue, such as unbalanced growth in revenue and expenditure has resulted in massive revenue expenditure gaps or budgetary deficit in the economy.

Thus, fiscal deficit is increasing due to growing expenditure of the government instead of the low revenue performance in Nepal. In addition the country is also facing the increasing burden of foreign loan.

In order to increase revenue, different sources are available but they have their own merits and demerits, that's why, government should try to mobilize resource through such measure which has less trouble and more benefits.

Grants are based on several political considerations. In our past experience, grant volume is decreasing and amount of loan is increasing. On the other hand, grant is not the permanent solution. It can never be a substitute to domestic resource and can never be remedy too. Non tax revenue is raised form private sector but it has low base and can't mobilize adequate fund. Loan has to be repaid from the amounts of regular expenditure. Furthermore, foreign loan may drag the country into debt trap.

In this way, other sources of government fund except tax seems to be not effective. Only taxation is the major and effective source of revenue. In fiscal year 2006/07, it is estimated to collect around NRs. 85 billion as revenue including NRs. 70 billion from taxes and NRs. 15 billion from non-tax revenue. It is estimated 26.5% from custom duty,

40% from VAT, 18% from income tax, 12% from excise duty and 4% from others.

Nepalese tax system is still dominated by custom duties but Nepal has entered the member of WTO (World Trade Organization). It should be able to reduce the custom duties drastically in between 0.5% to 20%. So, it is expected that VAT would be a major instrument to avoid deficit financing. Sales tax is found to suffer from very low tax base, cascading effect and distortion effect, but, VAT is considered as the best form of sales tax within the merit of self-pricing, catch up effect, broad base etc. So there is no alternative available except increasing effectiveness of it to mobilize internal resource effectively. Thus VAT may be the optimal solution to resource gap and high dependency of foreign aid.

However, the problems at VAT in Nepal is still a matter of discussion. Mainly, the individual businessmen are reluctant to pay VAT, even the consumers are not aware of taking VAT invoice. Uneducated individuals are scared whether the VAT is raising prices. Low voluntary tax compliance, cumbersome legal and administration procedures, weak tax administration and tax evasion are still prevailing. There is controversy with regard to the multiple or single rate of VAT. There is problem related to the threshold also. Even though, no another best alternative except itself is seen for a long far away.

The study will seek to find out the answer of the following investigation.

- a. Is VAT an effective instrument for resource mobilization?
- b. What is the contribution of VAT in total tax revenue, indirect tax?
- c. What are the problems associated with VAT and its prospect?

1.3 Objective of the Study

The research work will focus on following specific objectives:

- a. To analyze the trends in composition of VAT in Nepal.
- b. To examine the laws and regulations of VAT.
- c. To analyze the problems and prospects of revenue mobilization through VAT in Nepal.

1.4 Significance of the Study

Because of ineffectiveness in mobilization of resources, Nepal has been facing a serious resource gap for many years and this trend seems to be continued in future if not manage properly in time there by leading the economy in the state of external dependency. Since VAT is a powerful tool to mobilize the resource effectively and the study has evaluated the contribution of VAT in resource mobilization. The study has given major focus on resource mobilization through VAT in Nepal. Moreover, the study has examined the laws and regulation of VAT, problems and prospects of VAT in Nepal. The research work has identified research gap and beneficial to that people who are curious to know about VAT. So this study deserves special significance.

1.5 Organization of the Study

The study has been divided into ten parts. Chapter one concentrates on introductory part of the study. Introduction chapter contains background of the study, statement of the problems, objective of the study, significance of the study, research methodology and limitations of the study.

Chapter two is concerned with review of literature.

Chapter three is concerned with research methodology, research design, methodology of data collection, and statistical tools used under research methodology.

Chapter four deals with theoretical aspects of VAT.

Chapter five deals with analysis of the structure and composition of revenue.

Chapter six deals with empirical analysis.

Chapter seven contains statistical analysis of VAT.

Chapter eight describes about problems and prospects of VAT for resource mobilization.

Chapter nine deals with legal provisions relating to VAT.

Chapter ten contains summary of major findings, conclusion and recommendations.

1.6 Research Methodology

This research study has focused particularly on the mobilization of resource through VAT, its laws and regulations and problems and prospects. The study follows the analytical cum descriptive research design which has been supported by both primary as well as secondary data.

1.6.1 Population and Sample

In order to benefit the research work, 50 sample size has been selected out of total population. Persons included in the sample are carefully selected. The respondents have been divided into five groups, out of which 15 are consumers and service holder, five are tax experts, 15 are business person, 10 are tax students and 5 are tax officers.

1.6.2 Primary Data

Primary data and information have been collected through field survey by administering questionnaire to the selected sample of

population. Which includes: tax experts, tax officers, business persons, and consumers (tax students, general public and service holders).

1.6.3 Secondary Data

The secondary sources of data are information derived from books, journals, newspaper, reports, dissertations, economic survey and budget speeches of various fiscal years, publication of CEDA etc.

1.6.4 Tools for Analysis

To make research objective, find to accurate result and practicable, different tools are used. The information received in different aspect of VAT from primary and secondary sources was first processed for tabulation and analysis. For the purpose of analysis generally simple statistical tools have been used which are as follows:

1. Simple percentage
2. Bar diagram and trend line
3. Other statistical tools
 - Trend analysis
 - Coefficient of correlation

1.7 Limitations of the Study

To keep the research work feasible, to keep study in track, to go according to plan, the researcher has to barricade the research from same limitations. The following are the limitations of this study.

1. No attempts have been made to examine the reliability of the secondary data.
2. For primary data collection Kathmandu valley has been selected purposively.
3. The research study covers the period from FY 1997/98 to FY 2005/06.

CHAPTER II

REVIEW OF LITERATURE

2.1 Review of Related Studies at International Level

Carl S. Shoup (1969), in his famous book "Public Finance" considered value added tax as the latest and probably the final stage in historical development of general sales tax, imposed on the value added by the business firms. He explained VAT, as the difference between sales proceeds and the cost of materials etc. purchased from other firms, which is the tax base of a VAT. He further added, a firm adds value added by processing or handling these purchased items with its labour force and its own machinery, building or other capital goods.

While talking about the types of VAT and its practicability i.e. GNP, income and consumption Musgrave and Musgrave (1976), in their book "Public Finance and Theory and Practices" had preferred the latest type of VAT as more applicable and reliable one for both efficiency and quality, which was similar to the retail sales tax and seemed to be more practical for poor countries. Likewise the invoice method for calculation was more preferable and did have the advantage of the value added approach.

Regarding the problem of VAT, Musgrave and Musgrave remarked, "A sales tax may be imposed on either single or multiple form. If the later one is implemented in the value added (rather than turnover) sense, it turns to be equivalent to a corresponding single tax. At each and every stage the value of product is increased and this price rises accordingly, which is the 'value added-' the tax base."

John F. Due made detail analysis of VAT by means of paper entitled "Value Added Taxation in Developing Economies" published in the book "Taxation and Development Edited by N.T. Many and published by

praeger publishers on the contribution of UN in 1976. The study contained theoretical and implementation aspects of VAT in developing countries. In the real sense, it was the additional theoretical base for VAT which applied and made useful theoretical methodology and made useful recommendations for its implementation.

The major findings derived by the author are as follows:

- i. VAT is regarded as sales tax.
- ii. The distinctive feature of the VAT is that of 'fractional' impact with out cascading effects, since, the tax applies at multi-stages but only to value-added.
- iii. Criteria recommended for evaluation of the tax in developing countries:
 - a. Acceleration of economic growth
 - b. Optimal use of available resources
 - c. An acceptable pattern of income distribution
 - d. Reasonable price stability
 - e. Political stability
 - f. Avoidance of foreign domination of the economy.
- iv. VAT is entirely acceptable form of sales tax in comparison to other forms of sales taxes (especially to overcome from the disadvantageous of turnover tax).
- v. The most important requirements of successful operation of VAT are its universality and simplicity.
- vi. This portion covers the details of the implementation aspects of VAT.
 - i. The tax law should be drafted by the lawyers related to the tax jurisdictions.

- ii. If VAT is being replaced for another form of sales tax, the same administrative organization and personnel can be utilized and training should be provided.
- iii. Registration of the business firms should be operated in great care.
- iv. Tax returns may be filed at relatively frequent intervals.
- v. A computer system is the basic need of VAT operation.
- vi. Inspections and audit should be operated separately by the related careers, crosschecking is the best option.

In the paper entitled "Value Added Tax in the Republic of Korea" Choir Kwang judged the impact of VAT in Korea. The government of Republic of Korea introduced general type of VAT of European model in 1977 with the objective of; simplification of tax restructure and administration, the promotion of exports, capital formation and maintenance of neutrality in indirect tax system. The government spent a good number of years for preparation and became success to convey the message that the adoption of VAT benefited the business person in Korea. It showed a good impact on the investment. In its overall evaluation the VAT has broadened tax base, reduced evasions, increased revenue and solved major problems associated with the previous taxes.

Besides the positive impact stated above, the Republic of 'Korea' experience with VAT had made it clear that it was not so simple in practice. It created more or less arbitrary distortions in trade and consumptions and inequalities in the distribution of tax burden. VAT poses a corresponding increase may be substantial.

In the book "Government Finance in Developing Countries" Richard Goode (1986), described VAT as the most important tax innovation of the second half of the 20th century and it was classified as a

form at sales tax as consumption. The tax applied to the value added at production and distribution that is to sales precedes less purchase of material input and certain services.

Due and Meyer (1988) Examined the VAT in Dominican Republic. Ignoring the hostile reactions of business sector, labour union and even political parties. Vat was introduced in 1983 in Dominican Republic. The increased record-keeping requirement became the main issue in the medium and small sizes business dominated economy of Dominican, also the belief that VAT was responsible for the inflation become another obstacle, but the inflation was due to other reasons. There was general agreement that the enforcement of the tax hadn't been adequate mainly because of lack of personnel. evasion was wide spread, many firms failed to register. The overall evolution of the tax in the country, therefore remained rather negative. While the tax has brought additional revenue, the inadequate enforcement and failure to extend it to the commercial sector as planned, and the use to making shift, distorting system in the latter have resulted in serious failure to attain the advantage of complete value added tax. The experience of the country with the tax provides a warning to other developing countries not to attempt to use a value added tax expanding beyond to import and manufacturing sectors without careful consideration of the ability of the wholesale and retail sector to operate the tax, and general attitude of these sectors towards the tax.

In a seminar "Value Added Tax on Asia" organized by IMF/UNDP, Alan A. Tail (1991), presented a paper entitled "VAT policy issues: structure, regressively, inflation and exports" in Jakarta of Indonesia and later arranged on the occasional paper (88) IMF Washington D.C edited by the same author in 1991, mainly concerned on

the policy issue of VAT by illustrating some theoretical as well as empirical proofs.

1. VAT provides new buoyant revenue based and improves tax system in terms of neutrality and efficiency.
2. Experience broadly shows that VAT contributes from 12 percent to 30 percent of revenue in most countries representing above 5 to 10 percent of gross national product.
3. VAT is alternative of retailer sales tax. However both do not fully tax the unofficial business but the under reporting of sales value will show up under the VAT.
4. It is preferable that VAT has the capacity of covering all the stage of production to the retail level and the services.
5. VAT simply changes relative prices but not the overall price increase. Tax increase should be deflationary.

Lastly, at least if VAT cannot promote exports world, it makes the system easier. A VAT administration is affected by the decisions regarding: whether all retail sales are included, should services be taxed, choice of proper rates and the treatment of capital goods, financial services, food, small traders.

2.2 Reviews at National Level

Dr. Rup Bahadur Khadka in an article "VAT versus MST and WST" published in "Rising Nepal, June 16, 1994" which compared VAT and different forms of sales tax and found VAT to be superior and meaningful. The writer discussed about sales tax collecting at the import/manufacturing point i.e. MST and tax as wholesale level i.e., WST with VAT. Dr. Khadka has emphasized on following points:

- The VAT would have a broader base than the existing MST and WST because VAT would be broadly applied, in addition to the limited scope MST/WST.
- VAT would be more natural than the existing MST and WST. Because in MST and WST cascading problem emerged.
- The existing MST discriminated against the domestic product and imports. VAT would put an equal burden on both imports and domestic products.
- VAT would be little difficult in administration.
- Further due to the "catch up" effect VAT would minimize the problem of understatement of import duties tax. Factory price which was very series under the existing commodity taxes.

Nepalese economy with its features like import-based, high dependency in agriculture, etc. does not suit the existing taxes with the problems of cascading, tax evasion, pyramiding effect etc. Since VAT has helped to remove all these problems so in comparison, VAT is strong and superior than MST and WST.

HMG (1995), formed a high level task force to review Nepal's' tax system, leaded by Prof. Dr. Madan K. Dahal and made 'very useful recommendations for implementing VAT in Nepal. The report suggested VAT instead of existing sales tax and service based taxes like hotel, entertainment, contract tax as a long-term tax reform. It emphasized the VAT in Nepal to:

- a. Increase the tax revenue by broadening tax base.
- b. Make the system more transparent and elastic.

- c. Prevent tax evasion.
- d. Make the tax system more efficient and promoting export more easily.

After analyzing the various aspect of tax structure and the position of the economy, the report finally recommended the following aspect to be incorporated before adopting the VAT in Nepal.

- A functional organization pattern.
- Development of effective tax refunds system.
- Research and development.
- Extensive taxpayers education programme.
- Computerization for calculating VAT operating and administration
- Measure to increase self compliance

Nepal Chamber of Commerce (1997), in a study analyzed the possible effects of VAT in the Nepalese economy. Dr. Puspa Raj Karnikar headed the team. The main findings of the study are as follows:

- VAT effects adversely in price level.
- It increases the price of imported goods.
- The account keeping requirements of VAT would increase the tax compliance cost and cost of doing business that would affect the small traders adversely.
- Ultimately increases the cost of production and hence reduces the export business.
- It would be unjustifiable on social ground.
- Because of inefficient revenue administrative VAT cannot implemented successfully. So it is untimely to implement VAT.

The study report suggested for partial value added tax (VAT) on some commodities. It was in favour of phase-wise implementation of VAT. The study analysed negative impact of VAT ignoring its positive impact.

Narayan P. Silwal in his book "Value Added Tax: A Nepalese Experience" (1999) had expressed his practical experience about VAT. The book covers all aspect of VAT. In writer's word "VAT is an all stages non-cascading tax system. It extends to all levels of production and distribution. Similarly, it covers all stages and services. Any discrimination in taxing goods or services or exempting any of them renders VAT ineffective." The book gives main focus on Nepalese tax system. The book clearly analyze why the government of Nepal introduced VAT. HMG announced retail level sales tax at the rate of 10% covering a whole range of goods and services. There was no procedural law to administer it. When RST introduced in Nepal, literacy level was just meager and billing and record keeping was fanciful. In this situation, required revenue could not take place, which in turn into the development expenditures. So that a modern, efficient and neutral tax like VAT was therefore preferred to get rid of past anomalies.

The writer expressed a version by borrowing HMG declaration that – "The government of Nepal does not have the option of doing nothing. Major changes must be made in order to make tax administration fair, efficient and effective. The hostility, harassment and corruption that currently exist between the tax office and the business community must end if Nepal is to have a modern tax system. The business wants the system changed and willing to pay a reasonable tax but they want the system transparent and fair."

Narayan Silwal suggested that factors affecting VAT design take also into consideration. A poorly designed VAT accompanied by weak administration would just drain the treasury. So utmost care is necessary while designing a VAT. According to him the following factors were considered while designing a VAT in Nepal.

- Tax base issues
- Rate structure issues
- Exemption issues and
- Threshold issues

Finally the author reached in a conclusion that the introduction of VAT provides an opportunity to sweep away the cobwebs and revamp a substantial part of the tax administration. In every country, where it has been implemented properly, the VAT has proved itself as revenue productive tax. However, the benefit from VAT depends upon its coverage.

Gyawali, Achyut [Himalayan Times (Nepali)] in February 20, 2000 in his article "VAT and its implementation" pointed out major issues and described about VAT. The major findings of his article are pointed as:

- The businessperson of VAT exempted goods and having transactions below threshold need not register in VAT.
- Business firms having transactions below threshold with the business of taxable goods are volunteer to register in VAT.
- The businessmen and industrialist transfer the collected amount of VAT to government so they are the mediator.
- The level of awareness of general customer needs to be increased they must know about VAT whether it rises prices of commodity

or not, whether they are paying VAT to exempted goods or to non-registered businessmen.

- If consumer pay VAT to non-registered businessmen it is worthless since non-registered businessmen cannot collect VAT. If they collect VAT there is a provision to pay double amount of collected as punishment.

Rup Khadka in his book "The Nepalese Tax System" (2000) examined and evaluated the value added tax in Nepal from its introduction to its impact on the economy.

VAT is one of the most important chapter in this book. This chapter particularly covers the reasons for adopting VAT, basic features, operation of VAT, VAT implementation, revenue performance, existing problems of VAT, future strategy, including various data and illustrations.

The book points out following reason for the introduction of VAT in Nepal.

- The first and important reason was to develop a stable source of revenue by broadening the tax base.
- Nepalese tax system is massively dominated by custom duties but the contribution of custom duties has been decreasing due to reduction in import tariff in line with the liberal economic policies adopted since 1992/93 and in line with the custom duties reform taking place around the world since the early 1990s.
- It was necessary to introduce VAT in Nepal to generate revenue required for improving its deteriorating macro-economic performance.

- The adoption of VAT was also essential to establish an account based modern transparent tax system.

Nepalese VAT possesses some basic features as mentioned in this book, they are pointed as:

1. Nepal has adopted a consumption type of VAT.
2. VAT is based on the destination principle.
3. VAT is broad-base tax.
4. VAT is levied with a single positive rate of 10%.
5. Exports of goods and services are zero-rated.
6. Some goods and services are exempted from VAT.

The level of registration threshold is fixed at Rs. 2 million.

Regarding the revenue performance, Khadka was optimistic that VAT would generate more and more revenue in the days to come when it was fully operational.

Pointing out the existing problems of VAT in Nepal, the author stated "It is not easy to implement a broad-based VAT in the present Nepalese context where smuggling and under valuation are common and the amount of unauthorized trade is considered to be very significant. This type of trade does not come in the tax net. Since VAT tries to dismantle this type of trade, it is not easily acceptable by those traders who are involved particularly in unauthorized cross-boarder trade. It has also been common to grant many exemptions and incentives under various taxes, including the sales tax system. VAT intended to abolish them, which was necessary to broaden the tax base and rationalize the tax system."

Dahal, Madan Kumar (2001), in his article "A few words about VAT" has written "VAT is a 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 that it is revenue buoyant and highly instrumental for resource mobilization especially in an economy with an acute shortage of resources." He further added, Nepal has entered into a major global tax system with the introduction of VAT. VAT is an account-based tax that leads to transparency and accountability both as the part of taxpayers and collector. Open border, non-magnetized economy, non-issuance of invoice etc. are major problems that would marginalize the prospects for resource mobilization in Nepal. This calls for introducing stringent regulations to deal with the delinquency of tax, maintaining records properly and improving efficiency of VAT administration. The success of Vat will have significant bearing on the economy of Nepal."

Dr. Roop Jyoti in an article "Problems in VAT Implementation" published in June 15, 2003 in Deshantar magazine, tried to describe the problems of Vat and they are pointed as:

- Weak in billing system.
- More and unnecessary goods and services are in the area of exemption .
- Potential taxpayers are ignoring registration .
- Unsatisfactory tax-return.
- Delay in tax-return processing.
- Increase in unpaid tax amount.
- Discussion about the threshold.

Finally, Dr. Jyoti concluded that all these problems of VAT are avoidable. Strong and smooth administration could avoid these problems and VAT should be effective to generate more and more revenue.

Pandit, Shakti Prasad in an article "VAT nine years' published in Kantipur January 15, 2006: Emphasized in revenue collection from VAT and refund of VAT. After analyzing nine years condition of VAT he seemed to be optimistic and expressed his satisfaction. He further concluded that Nepal Government (NG) collected Rs. 7120 million in Fy 2054/055 from VAT. Among which Rs. 2100 million was from domestic and Rs.5020 million from import. In Fy 2062/63 total VAT collection was Rs. 21930 million among whom Rs. 13870 million was from import and 8060 million from domestic sources.

Mr. Pandit also focused on the tax refund. In tax refund case in Fy 2055/056 Rs. 80 million was refunded, then in Fy 2062/063 Rs. 4057 million refunded. Pandit also talked about the registration. In total registration, 72% taxpayers submitted their returns in Fy 2061/062. In which 30 to 35% submitted debt statement, 36 to 42% submitted their credit statement and remaining don't show their transactions.

Finally, Pandit Shakti Prasad concluded that in total taxpayers, only 31 to 35% taxpayers paid tax regularly to government. Form this article he tried to analyze the contribution of VAT in revenue and effectiveness of VAT in Nepal.

2.3 Review of Important Dissertations

Manamohan Thapa did a thesis in "Resource Mobilization through VAT in Nepal" in 2003. The main objective of the research was to examine VAT as an instrument for internal resource mobilization and to recommend for making VAT effective. The researcher provided following recommendations to the tax authorities.

- a. VAT should be extended through retail level as a bulk of tax performance to generate more revenue.
- b. The important sections of VAT offices like as tax refund, tax audit, taxpayers services, investigation, return processing and registration should be separated for successful operation.
- c. It is necessary to design a well-trained and skilled functional organizational pattern.
- d. Close cooperation between private and government sector is required.
- e. The existing laws of VAT should be revised.
- f. Issuing invoices for every taxable sells must be made compulsory.
- g. The open boarder should be managed by controlling the boarder side secret business.
- h. The illegal and unrecorded business should be penalized by the authority.

Subedi, Babu Ram (2004) in his dissertation "VAT in Nepal: An Analysis of its problem and prospect" analysed the problem and prospect prevailing in the VAT. The study followed descriptive and analytical research design. To come over the conclusion, the researcher used both primary as well as secondary data. The main focuses of the thesis are:

- i. VAT is superior then any other types of sales tax, while comparing VAT with other form of sales tax such as:
 - a. Economic efficiency
 - b. Supporting economic growth
 - c. Excess burden
 - d. Equity norms
 - e. Simplicity of administration
 - f. Price stability

- ii. Due to the lack of experts, an skill manpower in the VAT administration on the auditing system which is one of the most important part operation is not effective.
- iii. The prospect of VAT entirely depend on its implementation aspect. VAT has bright prospect in Nepal only when it can be implemented in a successful way further. The successful featuring depends upon the strong, fair, capable, honesty and efficient administration, strong political commitment, cooperation between private and government sector etc.

Finally, the researcher has recommended the following points:

- Consumer should be made aware of taking invoices which is their fundamental right and responsibility to nation.
- Government should try to make strong commitment to produce healthy business environment.
- The level of public awareness about VAT and its importance should be increased.
- Taxpayer should be provided better services with due regard and honour to them.
- For the proper implementation of VAT price should be uniformly prevailed in the market.
- Tax collection and payment activities should be made transparent.
- Many traders sell both VAT able and non VAT able goods from a single shop. They may sell both goods at a time. This creates a problem for separating the tax and non-taxed goods. The government should try to separate them.

Panthi (2006) in his dissertation "Implementation Scenario of VAT in Nepal" focused the major problems on effective implementation of VAT and gave suggestions and idea to resolve these problems. The study

was conducted on the basis of primary and secondary data. To make research work attractive, different statistical tools like table, bar diagram, pie chart, trend bar etc. have been used. The thesis mainly analyze the different types of problems in successful implementation of VAT. The writer has emphasized following major problems.

- ↪ Inefficient billing and invoice system.
- ↪ Tax refund process.
- ↪ Problems on registration.
- ↪ Open boarder and unauthorized trade.
- ↪ Weak administration and problems of trained and skilled manpower.
- ↪ Large exempted goods and services.
- ↪ Money minded tax officers.

Mr. Panthi deeply analyzed the problems of VAT. In his research, the following findings are also available:

- ↪ Revenue collection through VAT is fluctuating.
- ↪ Taxpayer's registration on VAT is increasing.
- ↪ Most of the tax returns should be credit note.
- ↪ Revenue collection ratio through VAT is depending on import business.
- ↪ Future of VAT is progressive.
- ↪ Consumers are unaware, they do not demand valid bills.
- ↪ Open boarder is a main hindrances.
- ↪ Tax officers are beginning with the businessmen for their financial benefits.

Gautam (2006) in his thesis "Attitude of people towards VAT and its effectiveness in revenue mobilization" talked about the contribution of VAT in government revenue and problem faced by it. The writer has used different type of questionnaire to various rank employees. The researcher

used both primary as well as secondary data and descriptive as well as analytical research design.

The researcher has reached in the following conclusions:

- ⇒ VAT is a kind of indirect tax which is found to be superior than any other tax system for recollecting the internal revenue. The contribution of VAT in total revenue, total tax revenue and total indirect tax is more and higher.
- ⇒ The import VAT revenue is higher than internal VAT revenue.
- ⇒ Poor management is also cause of ineffective resource mobilization.
- ⇒ The growth rate of registrants is increasing. It shows the implementation status was satisfactory but due to lack of transparency in business activities, weak crosschecking mechanism, transaction manipulation practices conclude that many potential taxpayers are out of VAT.
- ⇒ The price change on goods and services may create double problems for taxpayers.

2.4 Research Gap

The country has experienced the VAT about a decade but very few studies have been conducted on the topic of VAT in Nepalese context. Above all researchers have conducted in different sense either in worldwide coverage or in particular case of any country. Furthermore they were related only with the theoretical aspect. In this study, the researcher has tried to evaluate Nepalese VAT with respect to resource mobilization. This study also analyses problems emerged in VAT, further, an attempt has been made to examine the legal aspect and prospect of VAT as well.

CHAPTER III

RESEARCH METHODOLOGY

3.1 Research Design

The research study focuses particularly on the mobilization of resource through VAT, its laws and regulations and problems and prospects. So the materials of information relating Vat taxation and its various theoretical aspect, empirical results and experiences are taken in the way of this study for its good picture. Actually this is a review of VAT since its conception, decisions, preparation, implementation and results achieved till now. On the basis of survey and by administering the questionnaire and by collecting the published quantitative and qualitative data, this study has tried to analyze and describe the results of the survey. This study follows the analytical cum descriptive research design, which has been supported by both primary as well as secondary data.

3.2 Population and Sample

In order to benefit this research work, 50 sample size is selected out of total population. Persons included in the sample are carefully selected. The respondents have been divided into five groups. The following table shows the group of respondents and the size of samples.

Table No. 3.1

Groups of Respondents and Size of Samples from Each Group

S.N.	Group of respondents	Sample size
1	Consumers and service holder	15
2	Tax experts (economist)	5
3	Business persons	15
4	Tax students	10
5	Tax officers	5
Total		50

3.3 Nature and Sources of Data

Primary as well as secondary data have been collected in order to achieve the real and fact result. All the possible and useful data and views as far available have been collected. The major sources of data are as follows:

3.3.1 Primary Data

The major tool used for the collection of primary data is distribution of a questionnaire to a responsive of a persons. A set of questionnaire was developed and distributed to the selected respondents in order to get accurate and actual information. The questionnaire was distributed to different tax groups.

3.3.2 Secondary Data

The secondary sources of data are the information derived from books, journals, newspapers, reports and dissertations etc. The major sources of secondary data are: economic survey of various fiscal years and budget speeches, Ministry of Finance, publication of CEDA, Tribhuvan University, reports and records of department of taxation, Ministry of Finance, dissertation related to VAT available at Central Library of T.U., publications of VAT projects, publication of VAT department, economic review and indicators form Nepal Rastra Bank etc. and other relevant records and data related to this study.

3.4 Data Collection Procedure

As stated above, data have collected from both primary and secondary sources. Primary data have collected through administration of a questionnaire to responsive persons. A set of questionnaire was developed and distributed to the selected respondents in order to get a accurate and actual information, interviews, informal dialogues and

discussions with the concerning scholars have used to some extent with the concerned persons. And secondary data have been collected from different published documents, budgets speech, previous studies, previous research articles, consultant's reports etc.

3.5 Data Processing and Analysis

Processing means a series of operations on data in a research, so as to obtain desire outcome. Analysis means the categorizing, ordering, manipulating and summarizing of data to obtain answers to research questions. The collected information have compiled and tabulated in different headings. These data have to be patronized and graphed into different way so as to make research understandable even at a glance. Different statistical tools at techniques are included to craft the collected data into published form so as to obtain desire objective.

3.6 Tools for Analysis

To make research objective, find to accurate result and practicable, different tools are used. The information received in different aspect of VAT from primary and secondary sources was first processed for tabulation and analysis. For the purpose of analysis generally simple statistical tools have been used which are as follows:

4. Simple percentage
5. Bar diagram and trend line
6. Other statistical tools
 - Trend analysis
 - Coefficient of correlation

CHAPTER IV

THEORETICAL ASPECT

4.1 Introduction

Value added is the value that a producer or firm (whether manufactures, distributor, advertising agents etc.) add to his/her raw materials or purchases before selling the new or imported products or services. That is, inputs (the raw materials, transport, rent, advertising and so on) are brought, people are paid wages to work on these inputs and when the final goods and services are sold, some profit is left. So, value added can be looked at from the additive side (wage + profit + rent + interest) or from subtraction side (outputs – inputs).

$$\begin{aligned}\text{Therefore, value added} &= \text{Wage} + \text{Profit} + \text{Rent} + \text{Interest} \\ &= \text{Output} - \text{Input}\end{aligned}$$

If we wish to levy a tax rate (t) on this value added, there are four basic forms that can produce identical results:

- t (Wages + Profit): The additive – Direct account method
- t (Wages) + t (Profit): The additive – Indirect Method
- t (Output – Input): The subtractive – Direct Method
- t (Output) – t (Input): The subtractive – Indirect method

4.2 Types of VAT

VAT has been classified on several bases. The most important of them is the classification of Vat on the base of its treatment to capital goods. Capital goods are such goods which are used more than a year in order to serve or produce revenue goods. VAT can be classified in three categories according to the capital goods are treated. They are: GNP type, income type and consumption type.

1. GNP types: When the firms are not permitted to deduct even the amount of depreciation on capital goods, the tax is imposed on GNP. The base of tax is total consumption goods plus all final product capital goods. The base of tax in GNP types = Gross investment + Consumption = GNP.
2. Income types: In this case, it is not the output of the consumption goods only which is taxed but also capital goods from which depreciation is deductible. Thus, it becomes a tax on net national product and the tax base is the same as that of a personal income tax without exemptions. The base of the tax in income types = GNP – Depreciation i.e. Net investment + Consumption = NNI (Net National Income).
3. Consumption types: Under the consumption type of VAT, all capital goods purchased from other firms in the year of purchases are excluded from the tax base while depreciation is not deducted from the tax base in subsequent year. Since investment is not relieved from the taxation under this variant, the base of tax is consumption. The base of tax in consumption types = Gross National Product – Gross Investment = GNP – GI = Total consumption expenditure.

This consumption type is also called full-fledged VAT because the coverage is very wide. This type is also known as comprehensive VAT.

Among these three types of VATs, consumption type has been widely used in several countries in Europe and elsewhere. The reasons for popularity is:

- It is attractive from the point of view of tax administration as there is no need to distinguish between the purchase of intermediate goods and capital goods under this type – as it is necessary under other two types.
- It is more attractive than income type from the consideration of foreign trade because it is compatible with the destination principle of taxation.

Tax under each of them is as follows:

$T = f(y)$: GNP type

$T = f(y-D)$ Income type

$T = f(y-I)$: Consumption type

Where, $y = \text{GNP}$; $D = \text{Depreciation}$ and $I = \text{Gross Investment}$.

4.3 Methods of Computation of VAT

VAT can be computed by the following three methods:

- a. Addition method: Under this method, value added is computed by adding up all income generated or factor income (wage, profit, etc.) during the production and distribution process and then VAT rate is applied to the value added to get VAT payable. This method is appropriate for the income type of VAT that includes in its base the rewards to all factors.
- b. Subtraction method: Calculation of VAT payable in this method requires a subtraction of gross purchases from the gross sales of a business enterprise during a period and applies VAT rate to the remainder. This method is appropriate for consumption type of VAT.
- c. Tax credit method: This method is also known as invoice method. In this method value added is never calculated to get VAT. What actually done first, gross tax is calculated by applying the tax rate to total sales value during a tax period and then the taxpayer is allowed to credit the tax paid on this purchase during the same period to get the net VAT payable. The net VAT payable therefore is the tax paid on sales (or outputs) minus the tax paid on purchases (input). The tax credit method is also called indirect subtraction method, in that, it calculates the value added indirectly while calculating the tax. Calculation of VAT payable in methods may be expressed as follows:

Addition method: $T = f(\text{wages} + \text{rent} + \text{interest} + \text{profit})$

Subtraction method: $T = f(\text{Output} - \text{inputs})$

Tax credit method: $T = F(\text{outputs}) - f(\text{inputs})$

A simple example of the calculation of value added tax liability under three different methods is given in the table below:

Table No. 4.1
Calculation of VAT Liabilities Under Three Different Methods (VAT Rate 13%)

A. Addition method	Stages of production and distribution			
	Manufacturer	Wholesaler	Retailer	Total
a. Wages	1000	550	750	2300
b. Rent	300	150	150	600
c. Interest	150	100	50	300
d. Profit	350	200	250	800
e. Value added (a+b+c+d)	1800	1000	1200	4000
f. VAT liability (13% of e)	234	130	156	520
B. Subtraction method				
a. Sales	8600	9600	10800	29000
b. Purchase	6800	8600	9600	25000
c. Value added (a – b)	1800	1000	1200	4000
d. VAT liability (13% of c)	234	130	156	520
C. Tax Credit method				
a. Sales	8600	6000	10800	29000
b. Tax on sales	1118	1248	1404	3770
c. Purchase	6800	8600	9600	25000
d. Tax on purchase	884	1118	1248	3250
e. Net VAT liability (b-d)	234	130	156	520

Source: Arbitrarily estimated figures.

Note: All sales and purchases are exclusive at tax (assumed).

In above table, VAT liabilities are same under three methods. In order to get same VAT liability, there should be equality between the

rates applied under each of the methods. In addition method, here we get value added by adding what a business had incurred during his transaction including profit. In subtraction method, value added has been calculated by subtracting business purchase from the sales amount and in tax credit method, we directly calculated VAT liability by subtracting what he has paid during his purchased and what he has collected during his sales.

In most of the countries including Nepal, tax credit method has been adopted. Here, tax credit method has been explained in detail.

Table No. 4.2
Calculation of VAT Liability Using Tax Credit Method

(VAT at the rate 13%

Stages	Purchase value (a)	VAT paid on purchased (b)	Sales value (c)	Gross Vat liability on sales (d)	Net VAT payable to government (e) $e = d - b$	Actual sales price (c + d)
Farmer	0	0	200	26	$26 - 0 = 26$	226
Manufacturer	200	26	400	52	$52 - 26 = 26$	452
Wholesaler	400	52	500	65	$65 - 52 = 13$	565
Retailer	500	65	700	91	$91 - 65 = 26$	791

Source: Arbitrarily estimated figures.

Note: Both sales and purchase value exclude tax liability.

In above table, VAT amount is calculated on bases of sales value and the actual payment to the government is the difference what the businessman has paid on his purchase and what he has collected on his sales. In this example, government get Rs. 26 from farmer, Rs. 26 from

manufacturer, Rs. 13 from wholesaler and Rs. 26 from retailer as a VAT. In aggregate, Rs. 91 has been collected a VAT and actual collection by the government from different is also Rs. 91.

4.4 Principles of VAT

While considering the international trade, the principles of VAT have great significance. Whenever international trade between two countries is considered, cross boarder adjustment is necessary. For the purpose of imposing VAT, principle of VAT can be divided into origin and destination principle. Choice between these two principles largely depends on the goods and the policies of nation, accession of international trade, computing methods and types of VAT.

4.4.1 Origin Principle

Under this principle, goods and services produced in a country are taxed at the place where they are produced or rendered irrespective of whether they are consumed there or not. It implies that all exports are taxable and all imports are non-taxable. Where there is border or cross country trade this principle gives preference to imported goods and services over domestic production because all exports are treated as taxable whereas all imports are treated as non-taxable. These sorts of principle may be beneficial where common trade is existed like European union. Otherwise rest of the countries do not prefer this principle.

4.4.2 Destination Principle

Contrary to the earlier, destination principle is imposed at the place where it is produced or rendered. Neither it has preferred imported goods or services nor the domestic goods or services. Equal preference is given to both imported as well as domestic product. In this ground it is assumed

as neutral principle. For the purpose of boosting exports, many countries prefer to apply this principle of taxation.

4.5 Structure of VAT

4.5.1 Coverage

VAT is the improved version of sales tax. So the coverage of VAT should be as broad as possible. Unlike retail sales tax, it should be levied on the value added at each stage of production and distribution. Each person carrying on taxable business or transaction should be made liable to VAT. Larger be coverage of VAT, greater will be the revenue collected. Therefore the coverage of VAT should be made as broad as possible.

4.5.2. Exemption

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

4.5.3 Zero Rating

Zero rating means that a trader is fully compensated for any VAT he pays on input. Such a zero rated trader is wholly a part of VAT system. A trader liable to zero rate is liable to an actual rate of VAT,

which just happens to be zero. Therefore such a zero rated trader is wholly a part of VAT system and makes a full return for VAT in a normal way.

Zero rating increases the burden considerably on the part of both taxpayers and the tax administration. So in Nepal, it is limited to the export only.

4.5.4 Rates

It is desirable to levy VAT with a single positive rate in order to make the VAT system simpler. This is because multiple rates make tax administration more complicated. Under multiple rated VAT, there is need to classify commodities into different groups according to their rate. Businessman has to keep separate record.

Multiple rates make tax system inefficient from the economic point of view. It gives an incentive to the producer to divert their resources from higher rated to lower rated goods and services to save the tax payment. Similarly, it stimulates a consumer to divert their resources from higher rated to lower rated commodities. Thus, multiple rates create scope for tax evasion. On the other hand, a single rate makes VAT very less costly, easy to comply with and easy to administer.

4.6 Operation of VAT

Registration: All vendors carrying on taxable business must be registered for VAT. However, registration must not be mandatory for small vendors having an annual return below the thresholds.

Invoicing

Invoices are the initial documents for VAT control and are most essential under VAT system. Every registered producer or vendor is

required to issue on invoice for each taxable sale. There are two types of invoices:

a. Tax invoice

The tax invoice will required the name and address of the seller and purchaser, the sellers PAN number and invoice number, the date of transaction and description of the sale including the number of items purchased, the unit of each items and notion of any discounts.

The tax invoice must be prepared in three copies and clearly identified as a tax invoice. The original copy is to be given to the purchaser, the second copy is to be retained for audit purpose while the bottom copy is for use by the seller in preparing a record of transaction.

b. Abbreviate invoice

This is the simple type of invoice for registered sales to unregistered persons, who should be considered final consumer under the VAT system. VAT registrants may make an application to use on abbreviated invoice and tax office may allow its use subject to the certain condition.

The following information must be recorded on the abbreviated invoice.

- An identifying number issued in sequential order.
- The name, address and registration number of the vendor.
- The data of transaction.
- A sufficient description to identify the goods or services supplied.
- The total amount of money paid, including VAT.

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

Books of Account

Every VAT registrant requires keeping records of all the invoices either received or issued, including the serial number and date of issue. In general, VAT liability is determined on the basis of the accounts kept by the taxpayers himself. The record should be kept in such a way that VAT authorities are able to check the accuracy of the VAT returns. Such records are kept fairly for long time generally 4 to 6 years. In general account must be maintained on the accrual basis. VAT liability should be calculated accordingly. This is because if it is levied only on the cash basis, taxpayers might delay payments. VAT registrants are required maintain purchase and sales books and its list of all the sales and purchase in the corresponding book. They are also required to prepare for a VAT account.

a. Purchase Book

VAT registrants are required to maintain an account of their business purchase for VAT purpose purchase book refers to the account of the VAT registrant, which includes all the transactions for business purchase. The record must be kept on the basis of invoice. At the end of the each accounting period, the VAT registrant must total the amount of taxable purchases/imports; tax exempt purchase, imports and tax paid on purchase/imports.

b. Sales Book:

Similarly, VAT registrants are also required to maintain an account of their sales for VAT purpose. Sales book is also an invoice-based account. At the end of each accounting period VAT registrants needs to total the taxable account (standard and zero rated) and tax-exempt sales, they have made in that period and tax collected on sales. If they make both taxable and tax exempt purchase and sales, they are required to calculate the proportion of input tax they are entitled to the tax period.

c. VAT Account

Vat registrants are also required to maintain the VAT account. It is monthly summary of taxable purchases and sales and VAT paid on purchases and changed on sales.

Tax credit and tax refund: Taxpayers (vendors) allowed to deduct their input tax from output tax. This is known as tax credit or tax invoice method of tax computation.

The refund is the difference of gap between output tax and input tax, when the amount of input tax is higher than the amount of output tax. Such a situation generally arises in the case of exports because exports are zero-rated and in order to relieve them from the burden of the VAT tax refund takes place. Here output tax means tax amount which is collected on sales and input tax means paid amount on purchases. The taxpayer may apply to the inland revenue office for a refund only if the taxpayer is a regular exporter with more than 50% of his sales exported or has more input tax than output tax for a continuous period of at least 6 months.

Auditing: Auditing is the universal method for the control of VAT and prevention of tax evasion. The purpose of the VAT audit is found out according to the law and regulation, the actual VAT liability of the taxpayers.

Administration

Here, administration leads VAT administration. Administration means the management of affairs. Its organization should be strong and reached to the grass root level so that policies and programmes of government can be functioned to the people. VAT administration is responsible for setting operational guidelines, programme development and evaluation, design of forms and instructions, statistical analysis, budget development and resource allocation.

CHAPTER V
AN ANALYSIS OF STRUCTURE AND COMPOSITION OF
REVENUE

5.1 Revenue Structure of Nepal

Even after the introduction of planned development, Nepal has been facing growing resource gap rapidly. This need has specially pronounced the urgency in domestic resource mobilization. But in developing nation like Nepal, portions of foreign grants and loans are increasing and have produced bitter experiences. The repayment of principal and interest has produced burden and has decreased resource for the social welfare activities and no doubt that the existence of government proofs by the activities of government which enhance the economic and social status of the people. In order to perform such social oriented programs, government needs huge amount of resources. Such type of economic revenues is collected from internal and external sources. Total revenue is comprised up of total tax revenue and total non-tax revenue. Tax revenue consists of customs, taxes imposed upon consumption and production of goods and services, taxes as property and income etc. And non-tax revenue is composite of fees, fines, penalties, dividend, interest, sales of goods and services and other miscellaneous receipts.

5.1.1 Share of Tax and Non-Tax Revenue in Total Revenue

The share of tax revenue and non-tax revenue in total revenue has been shown in the following table:

Table No. 5.1**Share of Tax Revenue and Non-Tax Revenue in Total Revenue****Rs. in million**

Fy	Tax revenue		Non-tax revenue		Total revenue	
	Amount	%	Amount	%	Amount	%
1997/98	25940	78.75	6998	21.25	32938	100
1998/99	28753	77.19	8498.1	22.81	37251	100
1999/00	33152.1	77.29	9741.6	22.71	42894	100
2000/01	38865.1	79.49	10028.8	20.51	48894	100
2001/02	39330.6	77.97	11115	22.03	50446	100
2002/03	42587.0	75.74	13642.7	24.26	56229.7	100
2003/04	48173.0	77.25	14158.0	22.75	62331	100
2004/05	54104.7	77.16	16018	22.84	70123	100
2005/06	57430.4	79.43	14851.7	20.57	72282.1	100

Source: Economic survey of various fiscal years, MOF.

The above figure shows that in the composition of total revenue, tax revenue has dominant role because the figure shows in Fy 1997/98 total revenue is Rs. 32938 millions where 78.75% is contributed by tax revenue and remaining by the non-tax revenue. This tendency continues and in Fy 2005/06 total revenue is 72282 million and 79.43% has been contributed by total tax revenue.

5.1.2 Composition of Tax Revenue

The following table shows the composition of tax revenue and the share of direct and indirect tax in total tax revenue:

Table No. 5.2
Composition of Tax Revenue

Rs. in million

Fy	Direct tax		Indirect tax		Total tax revenue	
	Amount	%	Amount	%	Amount	%
1997/98	6013.104	23.18	19926.896	76.82	25940	100
1998/99	7516.1	26.15	21236.8	73.85	28752.9	100
1999/2000	8951.5	27	24200.6	73	33152.1	100
2000/01	10159.4	26.15	28705.7	73.85	38865.1	100
2001/02	10597.5	26.95	28733.1	73.05	39330.6	100
2002/03	10105.8	23.73	32481.2	76.27	42587.0	100
2003/04	11912.6	24.73	36260.4	75.27	48173	100
2004/05	13071.8	24.17	41032.9	75.83	54104.7	100
2005/06	13968.1	24.32	43462.3	75.68	57430.4	100

Source: Economic survey of various fiscal years.

Total tax revenue is composed of direct and indirect tax revenue. The tax on customs, consumption and production is known as indirect tax whereas direct tax is imposed on income and capital. From the above table, the share of indirect tax on tax revenue is significantly higher than direct tax. In Fy 1997/98 the share of indirect and direct tax to total tax revenue is 76.82 and 23.18 respectively. Similarly in Fy 1998/99, 1999/00, 2000/01, 2001/02, 2002/03, 2003/04, 2004/05 and in 2005/06 the share of indirect and direct tax is 73.85 and 26.15, 73 and 27, 73.85 and 26.15, 73.05 and 26.95, 76.27 and 23.73, 75.27 and 24.73, 75.83 and 24.17, 75.68 and 24.32 respectively.

From the above data we can conclude that in developing countries like Nepal indirect tax plays a vital role in revenue generation.

5.1.3 Composition of Indirect Tax

Indirect tax, a popular approach concerning taxation implied in the world is a very powerful missile of fiscal policy adopted especially for the optimum level of resource mobilizing with the principle of more gain form the taxpayers and no pain to the taxpayers.

In short, indirect tax is imposed on one person but is paid partly or wholly by another person so the impact and incidence of tax are on different persons.

The major components of indirect tax in Nepalese tax structure constitute: custom duty, excise duty, sales tax/VAT, contract tax etc. Custom duties are composed of import duties and export duties. Other components of indirect tax: entertainment tax, hotel tax and other tax contribute very nominal share because they are included in VAT since 1997. However, mainly indirect taxes can broadly be divided into two parts:

- a. Custom duties
- b. Taxes on consumption and production

The following table shows the composition of indirect tax:

Table No. 5.3
Composition of Indirect Tax

Rs. in million

Fy	Indirect tax	Customs		Tax on consumption and production	
		Rs.	%	Rs.	%
1997/98	19926.896	8502.234	42.67	11424.662	57.33
1998/99	21456.208	9517.710	44.36	11938.498	55.64
1999/00	24597.166	10813.319	43.66	13783.897	56.04
2000/01	29135.254	12552.065	43.08	16583.189	56.92
2001/02	29292.783	12658.748	43.21	16634.035	56.79
2002/03	33040.703	14236.393	43.09	18804.312	56.91
2003/04	36961.012	15554.794	42.08	21406.218	57.92
2004/05	41839.381	15701.555	37.53	26137.826	62.47
2005/06	43465.519	15343.676	35.31	28121.843	64.699

Sources: Budget speeches of various years.

Clearly table shows that the custom takes very important place in the composition of indirect tax, although it is continuously decreasing.

According to the table in Fy 1997/98 total indirect tax revenue is Rs. 19,926.896 million among which custom contributes 42.67% and tax as consumption and production contributes 57.33%, it increases continuously and reaches 64.699% in Fy 2005/06.

5.1.4 Tax GDP Ratio in Nepal

The tax GDP ratio has been shown in table 5.4, the table shows rather disappointing scenario of tax GDP ratio for the study period. In Fy 2000/01 the ratio is 9.40 which has fallen to 9.13 in Fy 2001/02, again it slightly increases to 9.25 in 2002/03, the hide and seek continues and it is estimated to be 10.44 at 2006/07.

Table No. 5.4
Tax GDP Ratio in Nepal

Rs. in million			
Fy	GDP	Total tax revenue	% of GDP
2000/01	413429	38865.1	9.40
2001/02	430397	39330.6	9.13
2002/03	460325	42587.0	9.25
2003/04	500699	48173.0	9.62
2004/05	548485	54104.7	9.86
2005/06 ^R	603673	57430.4	9.51
2006/07 ^P	670589	70046.18	10.44

Source: Economic survey and budget speeches of various fiscal years.

Where,

R = Revised estimate

P = Preliminary estimate

5.2 Composition and Contribution of VAT Revenue

VAT is most scientific innovative and powerful tax with built in quality of universal application for both developed and developing economics. The biggest virtue of VAT is that it is revenue buoyant and highly instrumental for resource mobilization especially an economy with an acute shortage of resources. Including entertainment tax, hotel tax and sales tax VAT has been adopted in Nepalese economy since 1997 and has established itself as a best instrument of resource mobilization carrying out the important role in total revenue, total tax revenue and indirect tax.

5.2.1 VAT as a % of Total Revenue

The following table shows the contribution of VAT in total revenue.

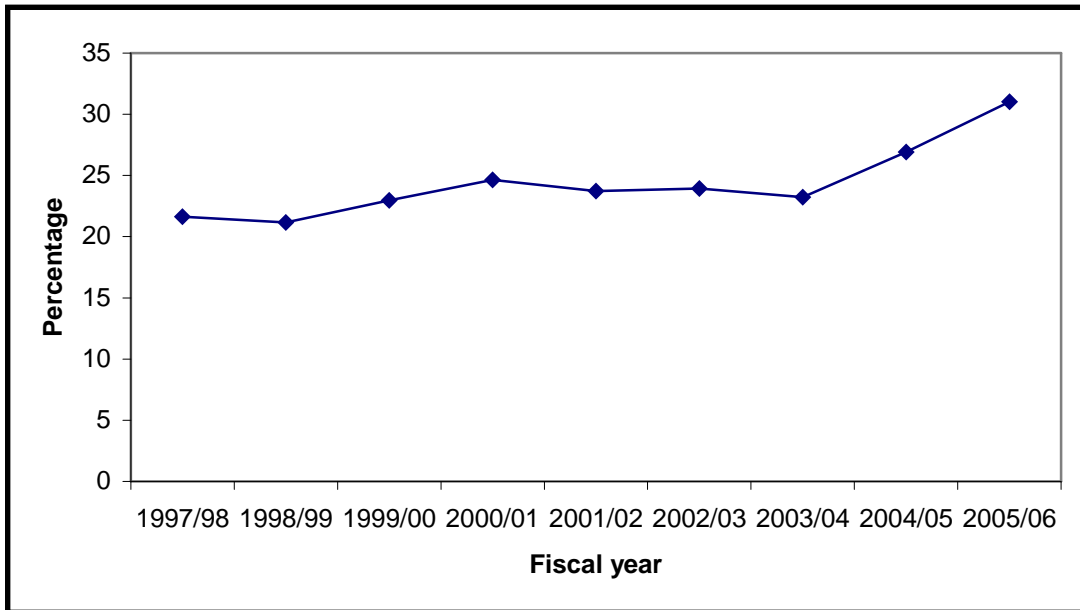
Table No. 5.5
Contribution of VAT in Total Revenue

Rs. in million

Fy	Total revenue	VAT revenue	% of VAT revenue
1997/98	32937.901	7122.618	21.62
1998/99	37251.038	7882.247	21.16
1999/00	42893.78	9854.903	22.97
2000/01	48893.561	12047.76	24.64
2001/02	50445.491	11963.974	23.72
2002/03	56229.791	13459.709	23.94
2003/04	62331.028	14478.907	23.23
2004/05	70122.742	18885.4	26.93
2005/06	72282.065	21613.043	29.9

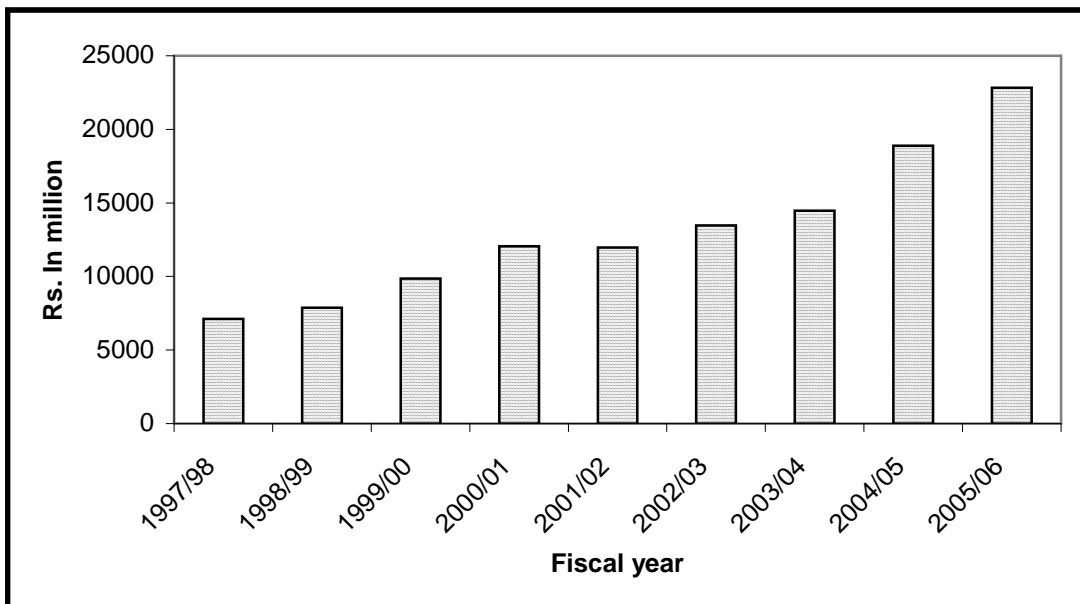
Source: Budget speeches of various years.

Figure No. 1
VAT as % of Total Revenue



Similarly, presenting in another way:

Figure No. 2
Share of VAT in Total revenue



5.2.2 Contribution of VAT in Total Tax Revenue

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

Table No. 5.6
VAT Revenue as a Percentage of Total Tax Revenue

Rs. in million

Fy	Total tax revenue (Rs.)	VAT Rs.	Contribution of VAT in total tax revenue %
1997/98	25940	7122.618	27.46
1998/99	28753	7882.247	27.41
1999/00	33152	9854.905	29.73
2000/01	38865	12047.760	31
2001/02	39331	11963.974	30.42
2002/03	42587	13459.709	31.60
2003/04	48173	14478.907	30.06
2004/05	54105	18885.4	34.90
2005/06	57427	21613	37.63

Source: Budget speeches of various fiscal years, MOF.

As indicated above table, VAT revenue was 27.46% of total tax revenue in Fy 1997/98. During the study period of 9 years, the percentage trend of VAT revenue to total tax revenue is in increasing trend. The share of VAT revenue in total tax revenue is increased from 27.46% to 30.42% in Fy 1997/98 to 2001/02. The trend continues has reached to 37.63 in Fy 2005/06. Hence the contribution of VAT in total tax revenue is more and attracting further it is in increasing style.

5.2.3 Share of VAT in Total Indirect Tax

The following table shows the share of VAT in total indirect tax.

Table No. 5.7
Share of VAT in Total Indirect Tax

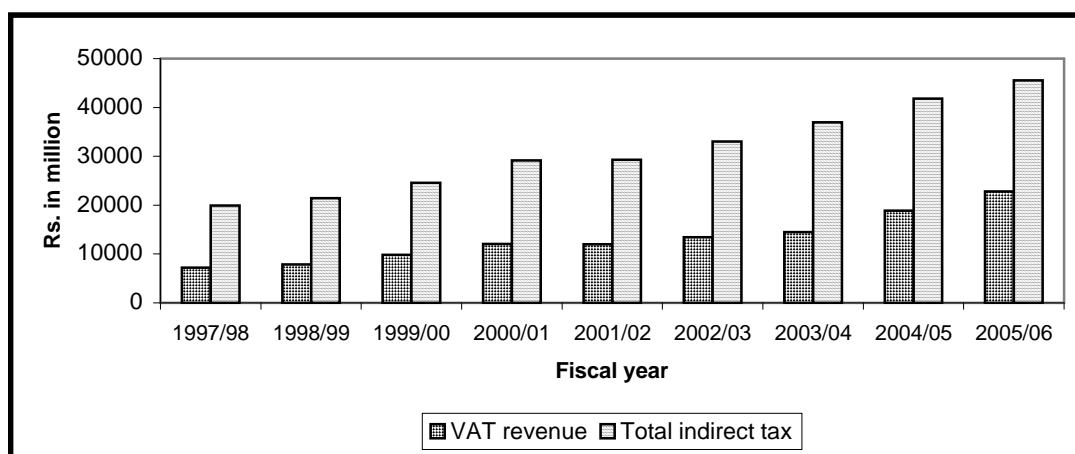
Rs. in million

Fy	Total indirect tax	VAT revenue	Percentage of VAT revenue
1997/98	19926.896	7122.618	35.74
1998/99	21456.208	7882.247	36.74
1999/00	24597.166	9854.905	40.06
2000/01	29135.254	12047.76	41.35
2001/02	29292.783	11963.974	40.84
2002/03	33040.705	13459.709	40.74
2003/04	36961.012	14478.907	39.17
2004/05	41839.38	18885.4	45.14
2005/06	43465.519	21613.043	49.72

Source: Budget speeches of various years.

The table shows that the contribution of VAT in total indirect tax revenue is more and attractive. According to the figure provided in the table contribution of VAT in Fy 1997/98 to total indirect tax is 35.74% and has been increased upto 49.72% in Fy 2005/06.

Figure No. 3
Share of VAT in Total Indirect Tax



5.2.4 Share of VAT in Total GDP

As shown in the table 5.8, the share of VAT in GDP is 2.91 in Fy 2000/01, it has decreased to 2.77 in 2001/02 with the slight increment it has reached to 2.92 in 2002/03 then again with the little decrease it is at 2.89 in Fy 2003/04 thereafter it is in increasing trend and has been estimated to be 3.94 at 2006/07.

Table No. 5.8
Share of VAT in Total GDP

Rs. in million

Fy	GDP	VAT revenue	% of VAT revenue
2000/01	413429	12047.76	2.91
2001/02	430397	11963.97	2.77
2002/03	460325	13459.7	2.92
2003/04	500699	14478.9	2.89
2004/05	548485	18885.4	3.44
2005/06 ^R	603673	22824.8	3.78
2006/07 ^P	670589	26423	3.94

Source: Economic survey and budget speeches of various fiscal years.

Where,

R = Revised estimate

P = Preliminary estimate

5.2.5 The Composition of VAT Revenue

The revenue collection from VAT can be divided into two major components as domestic and imports. The current trends show that about one third of total revenue comes through domestic products and two third form imports the following table shows the trend in composition of VAT revenue.

Table No. 5.9
Composition of VAT Revenue

Rs. in million

Fy	Total VAT revenue	Domestic product		Imports amount	
		Amount	%	Amount	%
1997/98	7122.618	2100.903	29.50	5021.715	70.50
1998/99	7882.247	2812.765	35.68	5069.482	64.32
1999/00	9854.903	3725.703	37.80	6129.204	61.20
2000/01	12047.760	4744.720	39.38	7303.040	60.62
2001/02	11963.974	4609.072	38.52	7354.902	61.48
2002/03	13459.709	4831.128	35.89	8628.58	64.11
2003/04	14478.907	5604.134	38.71	8874.773	61.29
2004/05	18885.4	6614.973	35.03	12270.427	64.97
2005/06	21613.043	8150.502	37.72	13462.543	62.28

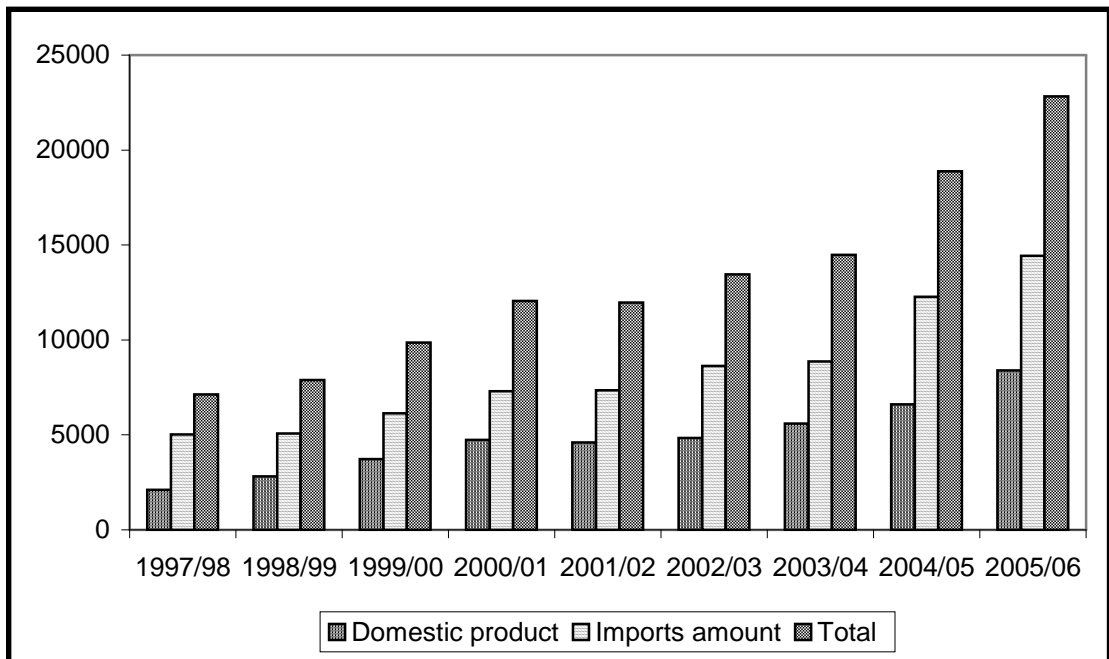
Source: Budget speeches of various fiscal years.

In fiscal year 1997/98 the share of domestic products and imports in total VAT revenue was 29.50% and 70.50 respectively whereas in fiscal year 1998/99 their share was 35.68% and 64.32% respectively.

Likewise in FY 1999/2000, 2000/01, 2001/02, 2002/03, 2003/04, 2004/05, 2005/06 the share of domestic products and import was 37.80 and 62.20, 39.38 and 60.62%, 38.52 and 61.48, 34.89 and 64.11, 38.71 and 61.29%, 34.03 and 64.97, and lastly 37.72 and 62.28 percent respectively.

What the figure shows is that the share of imports in total VAT has been declining continuously as share of domestic products has been increasing.

Figure No. 4
Composition of VAT Revenue



CHAPTER VI

IDENTIFICATION OF PERCEPTION OF THE STAKEHOLDERS: EMPIRICAL FINDINGS

There have been various empirical studies conducted before and after the implementation of VAT system in Nepal. It is viewed that this system has not been implemented effectively as expected. There was a strong opposition from the business community during the earlier period of VAT implementation. In that time there was a negotiation between private sector and government on the different aspect and provisions of VAT. After that VAT was extended through the retail level and thus implemented in its full-fledged form. In the beginning period of VAT implementation, there was a lack of skilled and trained manpower and officers: administrative structure was not set up properly. But later different informative programs seminars and meetings were held to make the businessmen, consumers and people known to the VAT.

Now, business community is also in favour of VAT and further demanding to identify all the traders having taxable capacity and include in to the tax net. In such situation an empirical study is done to know the views of persons and different fields on different aspect of VAT.

For the purpose of survey, different questionnaire were prepared to know the opinion of the various persons of different field including tax experts, tax officers, businessmen, consumers (including service holders and tax students) about all sides of VAT. The sample for this survey has been taken from different fields as given in the table below:

Table No. 6.1
Sample Size of the Field Survey

Respondents	Sample size
Tax experts	5
Tax officers	5
Businessman	15
Consumers	
i. tax students	10
ii. service holder	5
General public	10
Total	50

6.1 Results of the Survey that was Conducted on Tax Experts/Tax Officer

6.1.1 VAT as the Best Instrument of Resource Mobilization

Theoretically VAT is the best form of taxation but practically, it depends upon the environment provided by the country for its implementation. It is necessary to know whether VAT is an appropriate means of raising fund or not. The views of its appropriateness regarding its revenue collection can be shown in the following table.

Table No. 6.2
Views on VAT as a Best Instrument of Resource Mobilization

Respondents	Yes		No		To some extent		Total	
	No.	%	No.	%	No.	%	No.	%
Tax experts	5	100					5	100
Tax officers	5	100					5	100
Total	10	100					10	100

Source: Field survey, 2007.

According to the field survey, all the tax experts and VAT officers viewed VAT as the best instrument for resource mobilization.

6.1.2 Well Functioning of VAT in Nepal

VAT is the most scientific, innovative and powerful tax in field of taxation however VAT in itself is nothing but it is only the means for enhancing the revenue of government. Until the functioning is not proper it all goes in vain. Hence a question was asked to tax experts and tax officers that "is VAT well functioning in Nepal?" The result of the survey has been presented below:

Table No. 6.3
Views on Well Functioning of VAT in Nepal

Respondents	Yes		No		To some extent		Total	
	No.	%	No.	%	No.	%	No.	%
Tax experts	-	-	-	-	5	100	5	100
Tax officers	2	40	-	-	3	60	5	100
Total	2	20	-	-	8	80	10	100

Source: Field survey, 2007.

The above result shows that 100% of tax experts and 60% of the tax officers found VAT is well functioning in Nepal to some extent. However 40% of tax officers found VAT is certainly well functioning in Nepal. In aggregate only 20% viewed about the well functioning of VAT in Nepal whereas 80% of the respondent viewed it to some extent.

6.1.3 Problem Mostly Faced by Government to Collect VAT

Businessmen are main taxpayer group in VAT system. The taxpayers have to prepare sales and purchase account of all transaction. They must compulsorily give and receive bills while selling and purchasing goods and services. They must compulsorily register in the

VAT system if their transaction meets the threshold. To find out the view on what kinds of problem the government is mostly facing to collect VAT among: registration, account keeping and billing, the question was asked the respondents and the results have been presented below:

Table No. 6.4
Views on the Problem Mostly Faced by the Government to Collect VAT

Respondent	Registration		Account keeping		Invoice		All		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Tax experts					4	80	1	20	5	100
Tax officers					5	100	-	-	5	100
Total					9	90	1	10	10	100

Source: Field survey, 2007.

In the outcome, 80% of the tax experts and 100% of the tax officers reached at the conclusion that the problem mostly faced by the government to collect VAT is on invoice and 20% of the tax experts argued that the government is facing all the mentioned problem. Similarly in aggregate, 90% of the respondents found problem on invoice and 10% concluded to be all.

6.1.4 Most Haunting Problem

The taxpayers as well as the tax collectors must be more conscious for the successful implementation of VAT because it is new and advanced tax system. After experiencing the VAT almost a decade it is found that the success of VAT basically depends on its proper implementation aspects. In our country there are many problems of VAT among them the respondents were asked to identify the most haunting

problem among: political instability, open boarder, unbilling/underbilling, administrative incapability, unawareness of public and lack of experts. And the result of survey has been presented below:

Table No. 6.5
Views on Most Haunting Problem at VAT in Nepal

Respondents	Political instability		Open boarder		Uninvoice/Underinvoice		Adminis. incapability		Unawareness of public		Lack of experts		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
Tax experts			1	20	3	60	1	20	-	-	-	-	5	100
Tax officers					5	100	-	-	-	-	-	-	5	100
Total			1	10	8	80	1	10	-	-	-	-	10	100

Source: Field survey, 2007.

From the above survey, 60% of the tax experts, 100% of the tax officers viewed that uninvoice/underinvoice is the most hunting problem in the effectiveness of VAT. Whereas 20% of tax experts viewed in favor of open boarder and 20% viewed in administrative incapability.

6.1.5 Administrative Incapability

An effective and efficient administration is crucial for the proper implementation of VAT. The tax administration should be strengthened significantly. The VAT as modern and complex tax cannot be handled properly without an efficient and modernized administrative set up. Hence a question was asked to respondents to answer now the administrative incapability is arises and the results have been presented below:

Table No. 6.6
Views on Administrative Incapability

Respondents	Recruitment policy is not good		Corruption		Government has not computerized system		Lack of proper training		Political instability		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
Tax experts			1	20			4	80			5	100
Tax officers	2	40					3	60			5	100
Total	2	20	1	10			7	70			10	100

Source: Field survey, 2007.

From the field survey, 80% of the tax experts and 60% of the tax officers provided their views regarding administrative incapability arises due to lack of proper training. But only 20% of the tax experts and non of the tax officers viewed administrative incapability arises due to corruption. And 40% of the tax officers found that administrative incapability arises because recruitment policy is not good.

6.1.6 Sufficiency of Legal Provisions and Rules of VAT

The government has prepared VAT act 2052 B.S. and VAT regulations 2053 B.S. The documents of these enactment carry all the matters such as VAT administration and its operation, the tax officers and its authorities (duty and responsibility), taxpayers and their responsibility, the procedure of VAT collection, identification of new taxpayers, monitoring, cores checking, penalties and punishment. The field survey has been conducted to find out whether the present act and regulation are sufficient or not with reference to current system of VAT. The outcome of the respondents on this aspect has been presented in the table below:

Table No. 6.7

Views on Sufficiency of Legal Provisions and Rules of VAT

Respondents	Yes		No		To some extent		Total	
	No.	%	No.	%	No.	%	No.	%
Tax experts	2	40	-	-	3	60	5	100
Tax officers	3	60	-	-	2	40	5	100
Total	5	50	-	-	5	50	10	100

Source: Field survey, 2007.

From the above outcomes, 40% of tax experts and 60% of the tax officers supported that the existing laws and regulations of VAT are sufficient whereas 60% of tax experts and 40% of tax officers viewed that the existing laws and regulations are sufficient to some extent.

Out of the 10 respondents 50% viewed that existing laws and regulations are sufficient and 50% viewed that they are sufficient to some extent.

6.1.7 Whether the Legal Provisions Must be Revised

Table No. 6.8

Views on Whether the Legal Provisions Must be Revised

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
Tax experts	2	40	3	60	5	100
Tax officers	3	60	2	40	5	100
Total	5	50	5	50	10	100

Source: Field survey, 2007.

The above survey shows that 40% of the tax experts and 60% of the tax officers reviewed that the existing laws and regulations must be reexamined or revised to add new but 60% of tax experts and 40% of tax officers seemed to be satisfied with the existing laws and regulations.

Hence in aggregate 50% of the total respondents viewed on favour of change and 50% of them were satisfied.

6.1.8 Superiority of Single Rated VAT to Multi-rated VAT

Because of multiple rates, tax reforms become much more complicated to both taxpayers and tax officers. Multi-rated VAT is difficult to administer and difficult to taxpayers to apply and calculate in case of mixed transaction. On the other hand, the logic of advocating multiple rates is that the VAT rate originally 10% and now 13% is very high and is causing tax evasions. It is making difficult to bring lots of exempted items within the tax net. So the survey was conducted to find out "is single rated VAT is good enough than multi-rated VAT? and the results of the survey has been shown below:

Table No. 6.9

Views on Superiority of Single Rated VAT to Multi-Rated VAT

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
Tax experts	3	60	2	40	5	100
Tax officers	5	100	-	-	5	100
Total	8	80	2	20	10	100

Source: Field survey, 2007.

According to the survey, 60% of the tax experts and 100% of the tax officers argued that single rated VAT is good enough than multi-rated VAT however 40% of the tax experts refused the superiority of single rated VAT to multi-rated VAT in the context of Nepal. The aggregate figure shows that 80% of total respondents are in favour of single rated VAT and 20% are in favour of multi-rated VAT.

6.1.9 Whether the Government Should Follow the Multi-Rated VAT

Table No. 6.10

Views on Whether the Government should Follow the Multi-Rated VAT

Respondents	Yes		No		I don't know		Total	
	No.	%	No.	%	No.	%	No.	%
Tax experts	2	40	2	40	1	20	5	100
Tax officers	-	-	5	100	-	-	5	100
Total	2	20	7	70	1	10	10	100

Source: Field survey, 2007.

From the field survey, it is found that 40% of the tax experts, and 100% of tax officers argue that government should not follow the multi-rated VAT however 40% of the tax experts suggested to follow the multi-rated VAT and 20% of tax experts were unknown about it.

6.1.10 Most Specific Objectives of VAT in Nepal

The ultimate goal of the government is to achieve the sustainable economic development and accelerate the rate of economic growth. The main tax policy of a government is to intensify the rate of saving and investment to achieve higher rate of economic growth. Thus, the VAT is an ideal tax to achieve high incremental saving ratio and there by attain higher rate of growth in the economy. Economic growth of a country depends on the various aspects. The role of tax system significantly affects the country's economic development and equal distribution of development. So from this view, higher the revenue collection from VAT means higher will be the growth of national development. Therefore, VAT has many objectives, among them respondents were told to choose the most specific one and the outcome of the survey in the aspect is summarized in the table below:

Table No. 6.11**Views on Most Specific Objectives of VAT in Nepal**

Respondents	To enhance the revenue of gov ⁿ .		To meet the gov ⁿ . expenditure		To narrow the gap between rich and poor		To achieve the goal of national dev ⁿ . and equal dist ⁿ .		To check inflation		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
Tax experts	4	80	-	-	-	-	1	20	-	-	5	100
Tax officers	5	100	-	-	-	-	-	-	-	-	5	100
Total	9	90	-	-	-	-	1	10	-	-	10	100

Source: Field survey, 2007.

According to the field survey, 80% of the tax experts and 100% of the tax officers concluded that to enhance the revenue of the government is the most specific objectives of VAT in Nepal but 20% of tax experts argued that to achieve the goal of national development and equal distribution is the most specific objectives of VAT in Nepal.

6.1.11 Effort Most Needed to Make VAT Effectively Successful

According to Prof. Dr. Madan K. Dahal the success of VAT will have significant bearing as the economy of Nepal. So it is the need of country to make VAT effectively successful and also the circumstances speak that there is no other alternative available. Except increasing the effectiveness of itself. The survey was conducted in order to find out the view on most needed effort to make VAT effectively successful and the result has been presented below:

Table No. 6.12**Views on Effort Most Needed to Make VAT Effectively Successful**

Respondents	Strengthen and improve VAT admin.		Trained and educated officers		Improve VAT laws and regulation		Public awareness program		All		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
Tax experts	1	20	1	20	-	-	-	-	3	60	5	100
Tax officers							3	60	2	40	5	100
Total	1	10	1	10			3	30	5	50	10	100

Source: Field survey, 2007.

From the above survey, 20% of tax experts emphasized on strengthen and improve VAT administration, 20% of experts focused on trained and educated officers and 60% of the tax experts favoured to all options as the efforts most needed to make VAT effectively successful. Similarly, 60% of the tax officers viewed on public awareness programme and 40% of the tax officers reached at the conclusion that all explained efforts are most needed to make VAT effectively successful.

6.1.12 Effort the Government has to Make to Collect VAT

Having the great pressure for development all developing countries like Nepal need higher revenue collection form internal sources. For that the effective collection from VAT has great significance. Almost developing countries depend upon the external resource such as foreign aid, foreign loan and financial assistance. So these countries tried to seek to stand on the internal revenue through VAT system. On the context of Nepal it has been passed a decade experiencing the VAT, but the collection from VAT is not so satisfactory. Now the time has come, that the government has to make some special efforts to collect VAT

successfully. Here, the survey was conducted to know about it. The results of the survey has been presented below:

Table No. 6.13

Views on the Effort the Government has to Make to Collect VAT

Respondents	Penal system		Reward system		Self actualization		All		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Tax experts					2	40	3	60	5	100
Tax officers					2	40	3	60	5	100
Total					4	40	6	60	10	100

Source: Field survey, 2007.

According to the field survey, 60% of the total respondents viewed that penal system, reward system and self-actualization all efforts are necessary to collect VAT whereas 40% of them emphasized on self-actualization. Among the total respondents 40% of tax experts and 40% of tax officers focused on self actualization and remaining suggested to make all efforts to collect VAT.

6.1.13 Better Prospect about VAT

Table No. 6.14

Views on Better Prospect about VAT

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
Tax experts	5	100			5	100
Tax officers	5	100			5	100
Total	10	100			10	100

Source: Field survey, 2007.

According to survey, all the respondents were totally optimistic about the better prospect of VAT.

The empirical findings from the survey conducted on consumer.

6.2 Result of the Survey that was Conducted on Consumer

6.2.1 About the Rate of VAT at 13%

Table No. 6.15
View about the Rate of VAT at 13%

Respondents	High		Low		Moderate		I don't know		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
General consumer	3	30	1	10	4	40	2	20	10	100
Service holder	-	-	2	40	3	6	-	-	5	100
Tax students	1	10	3	30	6	60	-	-	10	100
Total	4	16	6	24	13	52	2	8	25	100

Source: Field survey, 2007.

From the field survey, it is found that most of the respondents (52%) were of the view that the existing VAT rate of 13% is at moderate type, about 16% of total respondents found that the existing VAT rate of 13% is high and about 24% found it low however about 8% were unknown about it. Among total respondents 30% of general consumer, 10% of tax student and none of service holder found it high. Similarly 10% of general consumer, 40% of service holder and 30% of tax student found it low and 40% of general consumer, 60% of service holder and 650% of tax students found it moderate. But 20% of general were unknown about.

6.2.2 Raising Price Due to VAT System

The business community in the earlier days of VAT implementation opposed VAT showing the cause that VAT would increase price level. And even after a decade of VAT implementation consumers complain that the businessmen charge more price without

following the act of VAT. Here a survey has been made to get the information from the respondents to find out price due to VAT system.

Table No. 6.16
Views on Raising Price Due to VAT

Respondents	Yes		No		I don't know		Total	
	No.	%	No.	%	No.	%	No.	%
General consumer	6	60	3	30	1	10	10	100
Service holder	1	20	4	80	-	-	5	100
Tax students	4	40	6	60	-	-	10	100
Total	11	44	13	52	1	4	25	100

Source: Field survey, 2007.

In the outcome 44% respondents reached at the conclusion that there is a rise in price due to VAT system, 52% claimed for not rise in price and 4% have no idea at all. The study shows 60% of general consumers 20% of service holder and 40% of tax students agreed that VAT raises the price. But 30% of general consumer 0% of service holder and 60% of tax student disagreed that VAT raises price lastly 10% of general consumer were unknown about it.

6.2.3 Whether VAT is Very Important Instrument of Government for Resource Mobilization

VAT, a latest innovation in the field of taxation, is being preferred by many countries of the world, is superior over sales tax system. In the total tax income VAT plays a major and attractive role because of its merits. However a survey was conducted to know whether VAT is very important instrument of government for resource mobilization and results of the survey has been shown below:

Table No. 6.17

Views on Whether VAT is very Important Instrument of Government for Resource Mobilization

Respondents	Yes		No		I don't know		Total	
	No.	%	No.	%	No.	%	No.	%
General consumer	7	70	1	10	2	20	10	100
Service holder	5	100	-	-	-	-	5	100
Tax students	9	90	-	-	1	10	10	100
Total	21	84	1	4	3	12	25	100

Source: Field survey, 2007.

According to the field survey most of the respondents i.e. 84% of total respondents seemed positive toward VAT and accepted VAT as very important instrument of resource mobilization however 4% of total respondents were of negative view and 12% of respondents were unknown about it. Among the total respondents 70% of general consumers, 100% of service holder and 90% of tax student accepted VAT as very important instrument of government for resource mobilization.

6.2.4 Most Responsible Group for Tax Evasion

Any tax system may not provide the expected yield when there exist tax evading 100 loopholes. Evasions of tax not only loses the revenue but also creates economic distortions, market imperfections etc. However tax-evading practice is a general phenomenon in any country and it cannot be solved perfectly but it must be minimized as far as possible. Generally, business enterprises are more responsible for tax evasion but it is not true all the time. There are other group such as consumers, tax administration, for their direct or indirect benefit may be supporting, or encouraging business enterprises for tax evasion. The opinion survey was conducted to provide the views on most responsible

group for tax evasion among businessmen enterprises, tax administration, consumers or all and the finding has been presented below:

Table No. 6.18
Views on Most Responsible Group for Tax Evasion

Respondents	Business enterprises		Tax administration		Consumers		All		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
G. consumers	-	-	2	20	1	10	7	70	10	100
S. holders	1	20	-	-	-	-	4	80	5	100
T. student	-	-	-	-	1	10	9	90	10	100
Total	1	4	2	8	2	8	20	80	25	100

Source: Field survey, 2007.

From the above outcomes, 80% of the total respondents supported that all of them are responsible for tax evasion, 8% of them blamed as consumers, 8% of them found tax administration as most responsible and 4% of them found business enterprises as most responsible group for tax evasion.

6.2.5 Action the Government should Take to Control Corruption

Corruption is one of the most dangerous obstacle in the path of effectiveness of VAT. Therefore, the administration should be very watchful to prevent any kind of mal practice, fraud and tax evasion. Almost care should be taken to prevent any kind for bidding and corruption. Tax officials should be effectively monitored. Here the survey was conducted to know about the question: what action the government should take to control corruption. The result has been given below:

Table No. 6.19
View on the Action the Government Should Take Control
Corruption

Respondents	Penalty		Monitoring		Total	
	No.	%	No.	%	No.	%
General consumer	4	40	6	60	10	100
Service holder	-	-	5	100	5	100
Tax students	-	-	10	100	10	100
Total	4	16	21	84	25	100

Source: Field survey, 2007.

Field survey shows that 40% general consumer agreed that penalty can control the corruption whereas 60% of the consumer, 100% of tax students emphasized on the monitoring to control corruption act of the total respondents only 16% believed in penal system.

6.2.6 About Asking Bills

Consumer must be aware of taking invoices which is their fundamental right and responsibility to the nation. The survey was conducted to test the awareness percentage of the consumers about bill and the result has been presented below:

Table No. 6.20
Views on Asking Bills After Purchasing Goods

Respondents	Yes		No		Sometime		I don't know		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
General consumer	-	-	1	10	7	70	2	20	10	100
Service holder	1	20	-	-	4	80	-	-	5	100
Tax students	1	10	-	-	9	90	-	-	10	100
Total	2	8	1	4	20	80	2	8	25	

Source: Field survey, 2007.

From the outcome, 70% of general consumer, 80% service holder and 90% of tax student viewed that they ask for bill sometime however 20% of service holder and 10% of tax students claimed that they ask for bill after purchasing but 10% of consumer denied to ask bill similarly 20% of the general consumer replied that they don't care about bill. In this way, 8% of total respondents were quite conscious about bill, 4% of total respondents seemed to be quite irresponsible, 8% of total respondents were on taking care about bill and 80% of them replied they ask bill for sometime.

6.2.7 About the Most Haunting Problem

Table No. 6.21

Views about the Most Haunting Problem on Effectiveness of VAT

Respondents	Political instability		Open boarder		Unbillilng/underbilling		Administr. incapability		Unawareness of public		Lack of experts		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
	G. consumer	4	40	3	30	-	-	1	10	2	20	-	-	10
S. holder	1	20	1	20	-	-	1	20	2	40	-	-	5	100
T. students	-	-	4	40	5	50	-	-	1	10	-	-	10	100
Total	5	20	8	32	5	20	2	8	5	20	-	-	25	100

Source: Field survey, 2007.

The above survey shows that 40% of the general consumer, 20% of the service holder, non of the tax student pointed out political instability as most haunting problem similarly 30% of the general consumer, 20% of the service holder and 40% of tax student found open boarder as most haunting problem. None of the general consumer and service holder and 50% of tax students were disappointed with unbilling/underbilling. 10% of the general consumer, 20% of service holder felt administrative incapability as most haunting. And family 20% of general consumer, 40% of service holder and 10% tax students insisted on unawareness of public

but none of the respondents found lack of experts as most haunting problem. In aggregate, 20% pointed out political instability, 32% pointed out open boarder, 20% of pointed out unbilling/under billing, 8% pointed out administrative incapability, 20% pointed out unawareness of public as most haunting problem in the effectiveness of VAT.

6.2.8 Effort the Government has to Make to Collect VAT

Table No. 6.22

Views on the Effort the Government has to Make to Collect VAT

Respondents	Penal system		Reward system		Self actualization		Total	
	No.	%	No.	%	No.	%	No.	%
General consumer	4	40	1	10	5	50	10	100
Service holder	-	-	-	-	5	100	5	100
Tax students	-	-	4	40	6	60	10	100
Total	4	16	5	20	16	64	25	100

Source: Field survey, 2007.

According to the field survey, 40% of general consumer and non of service holder and tax students believed in penal system. Similarly 10% of general consumers and 40% of the tax students insisted on reward system and finally 50% of general consumer, 100% of service holder and 60% of tax students advised in self actualization. Hence 16% of total respondent emphasized on penal system, 20% of total respondent emphasized on reward system and finally 64% of them believed in self actualization.

6.2.9 Bright Future of VAT

The international experience shows that VAT has been effective to the revenue mobilization. However, it cannot be said properly that it will

be advantageous and effective in future until effective implementation is in proper direction. The views of respondents in this aspect has been presented below:

Table No. 6.23
Views on Bright Future of VAT

Respondents	Yes		No		I don't Know		Total	
	No	%	No	%	No	%	No	%
G. consumer	5	50	-	-	5	50	10	100
Service holder	3	60	-	-	2	40	5	100
Tax students	8	80	-	-	2	20	10	100
Total	16	64	-	-	9	36	25	100

Source: Field survey, 2007.

According to the field survey, 64% of total respondents were totally optimistic that future of VAT is bright but 36% of total respondents were unknown about it.

6.2.9 Request for Asking Bills after Filling the Questionnaire

Tax invoice is a crucial document for VAT as it establishes the seller liability for tax and purchaser's entitlement to credit. As the last question of the questionnaire the respondents were requested to ask bill while purchasing goods. And the result has been shown in the following table:

Table No. 6.24
View on Request for Asking Bills After Filling the Questionnaire

Respondents	Yes		No		I don't know		Total	
	No.	%	No.	%	No.	%	No.	%
General consumer	8	80	-	-	2	20	10	100
Service holder	5	100	-	-	-	-	5	100
Tax students	10	100	-	-	-	-	10	100
Total	23	92	-	-	2	8	25	100

Source: Field survey, 2007.

Survey shows that 92% of the total respondents took it seriously and promise to take bills after purchasing but 8% of total respondents replied that they don't care. Among the total respondents 80% of general consumer, 100% of service holder and 100% tax students assured that they will ask for bills in future.

6.3 Results of the Survey Conducted on Businessmen

6.3.1 Rate of VAT

Nepal has adopted single rated VAT replacing the sales tax that was of 15%. Likewise, other taxes i.e. contract tax, entertainment tax hotel tax were not below 15% on average. But VAT rate is subject to 13% rather it was at the rate of 10% till 15th January 2005. Due to broader base and coverage, it has been expected to have greater revenue yield on percent rate structure. In such situation, field survey was conducted to identify the rate structure of VAT. The following table shows the views on this manner.

Table No. 6.25

Views on Rate of VAT

Respondents	High		Low		Moderate		I don't know		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Businessmen	11	73.33	-	-	4	26.66	-	-	15	100

Source: Field survey, 2007.

According to the survey result most of the businessmen about 73.33% of total population replied that the existing VAT rate is high and the remaining 26.66% of businessmen agreed that the existing VAT rate is moderate.

6.3.2 Billing System

Bills are the initial documents for VAT control and are most essential under VAT system. All businessmen have to receive the bills or

actual transaction price while importing and buying of goods and services and compulsory be given the bills to the purchaser. The businessmen have to pay the amount of difference between tax collected in sale and tax paid on purchase to the VAT office. He has to pay the income tax as well as on the profit of his transaction. Thus the billing system is the backbone of the VAT system. But in Nepal, the billing system has been one of the major problem. So the question is designed to show the comments on billing system of VAT. The outcome of the field survey in this aspect is given below:

Table No. 6.26
Views on Billing System

Respondents	Possible		Impossible		Costly		Total	
	No.	%	No.	%	No.	%	No.	%
Businessmen	8	53.33	1	6.6	6	40	15	100

Source: Field survey, 2007.

The outcome prevails that about 53% of businessmen found the billing system as possible whereas about 7% found it impossible and 40% found that billing system is costly.

6.3.3 Demand for the Bill

As explained above bills are the backbone of VAT system and are the very crucial documents. However knowingly or unknowingly all are responsible in the non-issuing of the invoices. Even customer don't ask for the bills after purchasing goods and services. Some of them are just neglecting the bills and some of them are unaware about it. Thus the survey was conducted to know how much % of the customers demand for the bills. The result in this aspect is given below:

Table No. 6.27
Views on Demand for Bills

Respondents	Less than 25%		Between 25% to 50%		More than 75%		None		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Businessmen	5	33.33	4	26.66	6	40	-	-	15	100

Source: Field survey, 2007.

According to the survey result presented above about 33% of the businessmen replied that only less than 25% of total customer demand for the bill, about 26% businessmen replied that between 25 to 50% of total customer demand for the bills and 40% of the businessmen replied that more than 75% of the consumer demand for bills.

6.3.4 Sufficiency of Present Threshold

According to the VAT enactment, the threshold purse is 2 millions, if the turnover of small vendors is below the fixed threshold small vendors have legal exemption form VAT. Here a question may arise how much the present threshold consequence specially to the small vendors by giving a facility of tax exemption, and has been a confusing and doubtful because of shortage of statistical figure. However the following table shows the views of businessmen about present threshold.

Table No. 6.28
View on Sufficiency of Present Threshold

Respondents	Yes		No		I don't know		Total	
	No.	%	No.	%	No.	%	No.	%
Businessmen	5	33.33	6	40	4	26.66	15	100

Source: Field survey, 2007.

According to the figure provided by the survey about 33% of the businessmen agreed that present threshold is enough, about 40% of businessman claimed that present threshold is not enough and about 27% of the businessmen were unknown about.

6.3.5 Impact of VAT on Business Enterprises

In general, business sector is directly affected by the policy of the country or taxation policy of the government. Though VAT system is considered as neutral regarding the methods of production and distribution, a survey was conducted to know the empirical results about the impact of VAT. The result of the survey can be illustrated as:

Table No. 6.29

Views on the Impact of VAT on Business Enterprises

Respondents	Positive		Negative		Neutral		Total	
	No.	%	No.	%	No.	%	No.	%
Businessmen	8	53.33	3	20	4	26.66	15	100

Source: Field survey, 2007.

According to the field survey about 53% of total respondents agreed that impact of VAT in business enterprises to positive, among them 20% claimed as negative and about 27% found it as neutral effect on business enterprises.

6.3.6 Most Responsible Group for Tax Evasion

Tax is the moral liability of the people of the country, but this morality seems to be weak in almost all nations and it is almost in alarming situation in developing country like Nepal. Tax evasion not only reduces the revenue but also create distortions, market imperfectness etc. Generally business may be taken more responsible for tax evasion. There are another group such as consumers and administration who always

support business enterprise for tax evasion for their direct or indirect benefits. The survey was conducted to know the responsible group for tax evasion and the result has been shown in the table:

Table No. 6.30

Views on Responsible Group for Tax Evasion

Respondents	Business enterprises		Tax administration		Consumers		All		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Businessmen	1	6.66	1	6.66	1	6.66	12	80	15	100

Source: Field survey, 2007.

Form the above outcome, 80% of respondents believed that all of groups are responsible for tax evasion. Among them about 7% surprisingly explained business enterprises as most responsible for tax evasion whereas 7% claimed that consumers group is most responsible for tax evasion.

6.3.7 Behaviour of Tax Personnel

The behaviour of the tax personnel must be such which provide incentives to the taxpayers. The tax personnel must always be conscious about the fact that their rude behaviour could disappoint taxpayer. It would better if the tax personnel behave in friendly manner, advising are helpful. To know the result the survey was conducted in this aspect and result has been summarized below:

Table No. 6.31

Views on the Behaviour of Tax Personnel

Respondents	Helpful and completely works in time		Completing works very slowly and steady manner		Most of the workers postponed for tomorrow		Spend much work time to search faults and defect of taxpayer		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Businessmen	7	46.66	1	6.6	1	6.6	6	40	15	100

Source: Field survey, 2007.

From the above result, 46.66% of respondents agreed that tax personnel are helpful and completely work in time, 6.6% of them blamed for working very slow and steady manner, about 6.6% of them viewed that most of the workers postpone for tomorrow, and finally 40% of respondents found tax personnel as spending much work time to search faults and defect of taxpayers.

6.3.8 Most Haunting Problem

The taxpayers as well as the tax collectors must be more conscious for the successful implementation of VAT because it is new and advanced tax system. After experiencing the VAT almost a decade it is found that the success of VAT basically depends on its proper implementation aspect. In our country there are many problems of VAT among them the respondents were asked to identify the most haunting problems among: inadequate manpower with little knowledge about VAT, geographical issues, ineffective tax administration, tax unconsciousness of the people, open boarder and unauthorized trade and improper billing system. The result of the survey has been presented below:

Table No. 6.32

View on Most Haunting Problem of VAT in Nepal

Respondents	Inadequate manpower with little knowledge about VAT		Geograph issues		Political issues		Ineffective tax adm.		Tax unconsciousness of the people		Open boarder and unautho. trade		Improper billing system		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
Businessmen	2	13.3	-	-	3	20	2	13.3	3	20	3	20	2	13.3	15	100

Source: Field survey, 2007.

According to the field survey about 13% of respondent indicated inadequate manpower with little knowledge about VAT as most haunting problem. Similarly, 20% of them found political issues as most haunting problem, about 13% of them found ineffective tax administration, 20% of them found tax unconsciousness of people, 20% of them found open boarder and unauthorized trade and lastly 13% found improper billing system as most haunting problem of VAT in Nepal.

6.3.9 Sufficiency of Legal Provisions and Rules of VAT

The government has prepared VAT act 2052 B.S. and VAT regulations 2053 B.S. The documents of these enactment carry all the matters such as VAT administration and its operation, the tax officers and its authorities (duty and responsibility) taxpayers and their responsibility, the procedure of VAT collection, identification of new taxpayers, monitoring, cross checking, penalties and punishment. The field survey has been conducted to find out whether the present act and regulation are sufficient or not with reference to current system of VAT. The outcome of the respondents as this aspect has been presented in the table below:

Table No. 6.33

View on Sufficiency of Legal Provisions and Rules of VAT

Respondents	Yes		No		Moderate		I don't know	
	No.	%	No.	%	No.	%	No.	%
Businessmen	3	20	6	40	5	33.33	1	6.6

Source: Field survey, 2007.

Source results that most of the respondents reached at the conclusion that the legal provisions of VAT are not sufficient however about 20% of them were satisfied with the current legal provision, about 33.33% found it moderate over about 6.6% were unknown about it.

6.3.10 Whether Tax Personnel Check all of the Accounting Statements and Ledgers

Table No. 6.34

Views on Whether Tax Personnel Check all of the Accounting Statements and Ledgers

Respondents	Yes		Yes, most of them		Yes, some of them		No		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Businessmen	3	20	4	26.66	7	46.66	1	6.66	15	100

Source: Field survey, 2007.

According to the survey, most of the respondents are 46.66% agreed that some of the tax personnel check all of the accounting statements and ledgers. 26.66% of respondents viewed that most of them check all of the accounting statements and ledgers, 3% of respondents claimed, all of the tax personnel check all of the accounting statements and ledgers and about 6.66% of total respondents denied that tax personnel check all of the accounting statements of ledgers.

6.3.11 Major Weakness of VAT Administration

Because of the ineffectiveness of sales tax VAT has been implemented in Nepalese context however it is reported that VAT has not been functioning in the expected way and definitely there have been various weakness behind the non-functioning of VAT in expected way. The weakness of VAT administration should be found and addressed properly. Here the question was asked to the respondents to point out the major weakness of VAT administration and the result has been presented as follows:

Table No. 6.35

Views on Major Weakness of VAT Administration

Respondents	Lack of expertise		Lack of proper billing		Lack of physical infrastructure		All		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Business enterprises	4	26.66	2	13.33	-	-	9	60	15	100

Source: Field survey, 2007.

The result shows about 27% of the respondents found lack of expertise as major weakness of VAT administration, about 13% of respondent claimed lack of proper billings as major weakness whereas about 60% of total respondent agreed that all are the major weakness of VAT administration.

6.3.12 Superiority of VAT Over Sales Tax

VAT provides incentive to improve accounting system and reform in administration which creates transparency in business, in account and tax assessment. It lends to make fair share in collection, discourages

corruption and evasion. VAT has the broadest coverage which generates considerable amount of revenue than the low revenue productivity of the sales tax and VAT eliminates cascading and pyramiding effects, so VAT is considered superior than sales tax. The survey result in this aspect has been summarized in the table below:

Table No. 6.36

Views on Superiority of VAT Over Sales Tax

Respondents	Yes		No		Total	
	No.	%	No.	%	No.	%
Business enterprises	13	86.66	2	13.33	15	100

Source: Field survey, 2007.

According to field survey, about 87 of respondents provided their view regarding superiority of VAT over sales tax, about 13% of them viewed in opposite.

6.3.13 Whether VAT will be Effective in Future

Theoretically, the Nepalese VAT system ha no weak provision. It is one of the best models in the world. In practice however is not effective as expected even today. It is the need of country to make VAT effective in present and future by addressing the related drawbacks. Until the strong commitment to implement VAT properly emerges nothing can be said about the possible results and effects. The results of the survey about this has been summarized below in the table:

Table No. 5.37

Views on Whether VAT will be Effective in Future

Respondents	Yes		No		I don't know		Total	
	No.	%	No.	%	No.	%	No.	%
Business enterprises	10	66.66	4	26.66	1	6.6	15	100

Source: Field survey, 2007.

Most of the respondents i.e. about 66.66% were optimistic about the effectiveness of VAT in future, about 26.66% of them denied the effectiveness of VAT in future and about 6.6% of respondents were unknown about it.

6.3.14 Whether Price Rises Due to VAT System

In the beginning period of VAT implementation, there was a strong opposition from the business community. The basic argument behind it was due to raise in the price from VAT. After the implementation of VAT, there was a voice from different people on price rising on commodities. Consumers also complain that the businessmen charge more price without following the act of VAT. Here, a survey has been made to get the information from the respondents to find out whether there will be raised in price due to VAT system. The views of the respondents on this aspect has been summarized below:

Table No. 5.38

Views on Whether Price Rise, due to VAT System

Respondents	Yes		No		I don't know		Total	
	No.	%	No.	%	No.	%	No.	%
Businessmen	9	60	6	40	-	-	15	100

Source: Field survey, 2007.

According to the field survey, 60% of the respondents claimed that VAT raises the price whereas 40% of them were quite calm and replied that VAT doesn't raise the price.

6.3.15 Discouragement on Illegal Business Through VAT

In Nepal, a few types of smuggling or methods of evasion of import duties can be identified. First the customs officials may not record imports, because they are transported covertly with or without the complicity of custom officials through the official parts of the entry.

Secondly, goods may come through the customs checkpoint, but are falsely declared. The growth of the smuggling activities can also attributed to the trade policies adopted by the government. The question was asked with the aim of finding out the VAT has been discouraging the illegal business or not, the result has been presented below:

Table No. 6.39

View on Discouragement on Illegal Business Through VAT

Respondents	Yes		No		I don't know		Total	
	No.	%	No.	%	No.	%	No.	%
Business enterprises	6	40	4	26.66	5	33.33	15	100

Source: Field survey, 2007.

From the outcome of above field survey 40% of the respondent agreed that VAT has discouraged illegal business, about 27% of respondent claimed that VAT has not reduced the illegal business and about 33% of them were unknown about it.

CHAPTER VII

TREND AND CORRELATION ANALYSIS OF VAT

The analysis with the help of statistical tool is performed in this chapter taking 9 years data (1997/98 to 2005/06) includes the following statistical tools.

1. Trend analysis
2. Coefficient of correlation

7.1 Trend Analysis (To Estimate the Trends in Composition of VAT Revenue)

Under this topic effort has been made to analyze trends in composition of VAT in Nepal. On the basis of 9 years of data, the revenue amount of VAT from domestic product and import has been forecasted.

Let the trend line be,

$$y_c = a + bx$$

Where,

y_c = Total amount of domestic product/import product of VAT

b = Constant which is the change in y corresponding to the change in x by one unit

a = Constant which is computed y value when $x = 0$

x = Time in the case of time series analysis

Formula to be used:

$$a = \frac{\sum y}{n}$$

$$b = \frac{\sum xy}{\sum y^2}$$

Here, in case of this study, each domestic VAT and import VAT at a time is considered as the main variable and denoted by y, x is 't' base year, here all the years are denoted by t. The following table shows the trend values of domestic product VAT and import VAT from Fy 1997/98 to 2005/06.

Table No. 7.1
Trend Value of Domestic Product VAT and Import VAT

Year (t)	Yc = a + bx (trend value of domestic product VAT)	Yc = a +bx (Trend value of import VAT)
1997/98	1936.002	4089.442
1998/99	2593.4715	5125.822
1999/00	3250.945	6162.202
2000/01	3908.4165	7198.582
2001/02	4565.888	8234.962
2002/03	5223.35	9271.342
2003/04	5880.831	10307.722
2004/05	6538.3025	11344.102
2005/06	67195.774	12380.482

Source: Appendix 1 and 2.

Therefore by the help of trend analysis we find the value of domestic product VAT and import VAT for past nine years. By adopting same formula of trend we can get the future trend value of domestic product and import product VAT which will reflect the trends in composition of VAT. Following table reveals the trend value of domestic and import VAT for next 10 years.

Table No. 7.2

**Trend of Domestic Product VAT Revenue and Import VAT Revenue
for Next 10 Years**

Fy	Trend value of domestic product VAT	Trend value of import VAT	Total VAT*	% share of domestic product VAT on total	% share of import VAT on total VAT
2006/07	7853.2455	13416.862	21270.1075	36.93	63.07
2007/08	8510.717	14453.242	22963.959	37.06	62.94
2008/09	9168.18	15489.622	24657.81	37.18	62.82
2009/10	9825.66	16526.002	26351.662	37.28	62.72
2010/11	10483.1315	17562.382	28045.5135	37.37	62.63
2011/12	11140.603	18598.762	29739.365	37.46	62.54
2012/13	11798.074	19635.142	31433.216	37.54	62.46
2013/14	12455.546	20671.522	33127.068	37.59	62.41
2014/15	13113.01	21707.9	34820.91	37.65	62.35

Source: Appendix No. 1 and 2.

* = Obtained by addition of Column 2 and 3.

From the above computation we can conclude that both total VAT revenue and its composition component are in increasing trend, however, share of revenue from domestic product in total VAT is continuously increasing, in contrary the share of VAT revenue from import is continuously decreasing in total VAT revenue.

In the above table we can see that the trend value of total VAT revenue is Rs. 21270.1075 which has been calculated by adding domestic trend value and import trend value. The contribution of domestic VAT revenue in total VAT revenue is 36.93 where the contribution of import is 63.07. The share of import in total VAT revenue is continuously

decreasing and in Fy 2014/15 it is estimated to be 62.35 where share of revenue from domestic product will be 37.65.

7.2 Correlation Analysis

The coefficient of correlation 'r' deals with the statistical technique which measure the degree of relationship or association between the variables. To fulfill the purpose of this study, this statistical tool has been used. This analysis will reflect the relationship between VAT and total revenue, VAT and total tax revenue and VAT and total indirect tax revenue to show the contribution of VAT in these particular term.

Under this chapter, Karl Pearson's correlation coefficient 'r' is used to find out the relationship among these mentioned variable. The value of coefficient of correlation is calculated in between -1 to $+1$. The negative value of 'r' signifies negative relationship between the variables i.e., increase in one variable, causes decrease in another and vice-versa.

7.2.1 The Coefficient of Correlation between VAT and Total Revenue

The coefficient of correlation 'r' between VAT and total revenue measures the degree and relationships between these two variables. The purpose of computing coefficient of correlation between VAT and total revenue is to find out whether VAT is significantly contributed in total revenue or not.

To find out the Karl Pearson's correlation 'r' between VAT and total revenue, VAT (y) is assumed to be independent variable and total revenue (x) is assumed to be dependent variable. The assumption is made that total revenue will decrease or increase as increase or decrease in VAT. The correlation between VAT and total revenue is shown in the appendix No. 3. The value of r is calculated in between -1 and $+1$. The negative value of r" signifies the opposite relationship between the

variable i.e. increase in VAT will lead decrease in total revenue and vice-versa. While positive value of r shows the positive/similar relationship between the variables. The value of r , r^2 , PEr and 6PEr between VAT and total revenue is given below:

$$r = 0.9771$$

$$r^2 = 0.9547$$

$$\text{PEr} = 0.01$$

$$6\text{PEr} = 0.061$$

From the above value of r , r^2 , PEr and 6PEr, it is found that the coefficient of correlation ' r ' between VAT and total revenue is 0.9771. This shows the highly positive relationship between VAT and total revenue. The value of coefficient determination $r^2 = 0.9547$. It means that there will be the variation in total revenue 95.47 due to VAT and remaining 4.53% by other factors, moreover r higher than the probable error (6PEr). Therefore the value of r is significant. It can be concluded that there is a significant relationship between VAT and total revenue. In another words, VAT has contributed a significant amount in total revenue of Nepal.

7.2.2 Correlation between VAT and Total Tax Revenue

To identify the impact and contribution of VAT in total tax revenue, correlation between these two variables should be calculated. To find out the Karl Pearson's coefficient of correlation ' r ' between VAT and total tax revenue, VAT (y) is assumed as independent variable and total tax revenue (x) is taken as a dependent variable. The correlation between VAT and total tax revenue is shown in appendix No. 4. The value of r is calculated between +1 to -1. The negative value of r signifies the opposite relationship between the variables and vice-versa.

$$r = 0.9849$$

$$r^2 = 0.97$$

$$PEr = 0.00673$$

$$6PEr = 0.04$$

Here, the coefficient of correlation between VAT and total tax revenue is 0.9849. It seems to be near +1. This shows that there is highly positive relationship between VAT and total tax revenue. The value of coefficient determination (r^2) is equal to 0.97 which implies that there will be the variation in total revenue 97% due to VAT and remaining 3% by other factor. Similarly 'r' is for higher than 6PE so that it can be made conclusion that the value of r is significant. VAT has large contribution on total tax revenue.

7.2.3 Correlation between VAT and Total Indirect Tax

Correlation between VAT and total indirect tax reflects the contribution of value added tax on total indirect tax. The value of correlation coefficient along with other necessary instrument of correlation shown in the appendix No. 5.

The following are the respective value of :

$$r = 0.98$$

$$r^2 = 0.9604$$

$$PEr = 0.0089$$

$$6PEr = 6 \times 0.0089$$

$$= 0.0534$$

Here, the coefficient of correlation between total indirect tax and VAT is 0.98, which is near to +1. Then it shows the positive relationship and if VAT increases total indirect tax will also increase. The value of coefficient of determination is $r^2 = 0.9604$, it means that there will be the variation of 96.04% in total indirect tax due to VAT and remaining is due to other factors. However, the value of 6PEr is less than r so value of r is significant. It can be said that VAT has major contribution on total indirect tax.

7.3 Conclusion of Trend and Correlation Analysis of VAT

Through the analysis of time series, we can conclude that there will be higher potentiality in VAT revenue. So government must pay higher attention in VAT for effective resource mobilization. After analyzing the coefficient of correlation between VAT and total revenue, VAT and total tax revenue and VAT and indirect tax, we can conclude that VAT has contributed a significant percentage in total revenue, total tax revenue and total indirect tax. Because they have higher positive relationship (near about one). Similarly, there is more than 90% variation due to VAT in total revenue, total tax revenue and total indirect tax revenue. And all these relationship are significant as $r > 6PEr$ everywhere. So VAT has significant contribution in government revenue. And all these relationship are significant as $r > 6PEr$ everywhere. So VAT has significant contribution in government revenue.

CHAPTER VIII

PROBLEMS AND PROSPECTS OF VAT WITH RESPECT TO RESOURCE MOBILIZATION

8.1 Problems of VAT

VAT has been most essential choice as ingredient of tax reforms of developing countries like Nepal, which leads to revenue enhancement and sustainable development. There is tremendous scope for in increasing the revenue form VAT and sound implementation of VAT will obviously increase its contribution. However, the system to achieve a smooth way of application has to cross many jumps and bumps. Though the country has experienced VAT a decade, the circumstances resembles to the initial phase of implementation. In spite of the most popular fiscal tool, Nepal is still facing a number of challenges which are explained below:

1. VAT billings: One of the major problems in the road of success of VAT is the non-issuance of bill by the seller. The buyers do not want to issue bill of sales with the motive of hiding the transactions and minimizing tax. Similarly, it is seen that the customers do not want a bill with the intention of paying less. This has emerged as the major problems against the success of VAT. To crush this problem the government should strengthen its administration using reward and punishment system against both the tax collectors and taxpayers.

Similarly, under invoicing at the custom point is also another burning problems in the successful implementation of VAT in Nepal. It affects billing of transactions because billing of under invoiced goods means paying high tax. The under valuation at custom points has compelled the custom administration to use reference value, which is lower in comparison to real value which in turn induces the trader. Not to

issue the real bill. It is seen that unless and until the custom valuation is improved, the VAT system will not work successfully; on the other hand, custom valuation would not be improved unless the custom rate is reduced massively. To solve this chicken or egg problem a comprehensive reform package covering both customs and tax is required.

2. Administrative incapability: Though VAT and tax departments were merged some years ago, and their duties were divided on a functional basis there is no psychological unification between their employees since IRD and IRO's are dominated by those staffs coming from income tax, many of the employees from VAT department and VAT offices are found to be experiencing uneasiness still. The traditional culture in income tax and modern culture in VAT did not coordinate well.

Hence because of traditional culture of tax administration, corruption, lack of proper training on various aspect of taxation, political interfere etc. the incapability problem in tax administration has arouse. Because of incapable tax administration there is a big gap between legal system and its actual operation.

Therefore for effective implementation qualified, intelligent, well-trained manpower are necessary. On the other hand effective monitoring is essential. Many businessmen are illiterate and cannot prepare their accounts properly and they are facing many problems while maintaining accounts. So tax administration must provide basic ideas to the traders and cooperate private traders.

3. Tax unconsciousness of public: The working of VAT lies as the assumption that each consumer takes an invoice of this purchase but due to poor public consciousness of public most of the people do not

ask for the VAT bills. The business community has been misinterpreting and also misguiding VAT to the people saying that VAT certainly raises the price level of goods. But there is no voice against such misguidance and misinterpretation. The consumers who are really interpreted to take VAT bills on their purchase are discouraged by business.

Community, most of the consumers do not demand at bills when they are asked by the businessmen to pay a ten % more amount to get VAT bills. But they do not know the fact that businessmen are covering the VAT amount in to the price of the product indirectly. Thus, by non-issuing proper bills, businessmen are cheating revenue to the government as they are collecting VAT amount form consumers indirectly.

4. Controversy with regard to single or multiple rate of VAT: There is a controversy in Nepal with regard to multiple or single rated VAT. Some people are of the view that VAT should be multiple rated having a minimum of three rates, including zero. But the tax administration opposes this on the ground of administrative difficulties. The logic of advocating multiple rates is that the VAT rate originally 10% and now 13% is very high and is causing tax evasions. It is making difficult to bring lots of exempted items within the tax net. In the context of implementing VAT by India too, where the minimum rate is 4% with the multiple rates. It seems logical to split the VAT rate with a minimum ate as necessary items and a higher rate of luxurious items.

5. Open-boarder and unauthorized trade: The other important problem in Nepal is unauthorized trade and open boarder. Though Nepal has long open boarder with its both neighbouring countries but due to the geographical inconveniences and high maintains the open boarder with China takes no more serious consideration. However, the problems

business India and Nepal is in alarming situation. People of both countries are free to enter into each other's boarder, buy goods and not paying customs for personal use. Goods brought for commercial purpose have to go through customs and pay customs duty as well as VAT.

Although there is not any measurement of unauthorized trade between Nepal and India. It is generally agreed that such trade in boarder area is considerable. Many businessmen have claimed that only a little amount of goods from India come through customs. One of the point of opposition of the businessmen opposing VAT is that VAT is not feasible due to open boarder with India and illegal imports India.

Unauthorized trade is very much organized and systematic in the boarder area. There are many organized groups active on the both sides of the boarder and these groups are responsible for illegally supplying goods from India to Nepal, Nepal to India and China to Nepal.

6. Geographical barrier: In spite of its smallness in the total area Nepal has its huge geographical inequality. The coverage of hill and mountain is approximately 83% of total area. Due to such geographical composition, there are several problems in the effectiveness of VAT in Nepal.

Due to heavy transportation cost, the people of remote area must bear the burden of higher prices of commodities. In this condition, the burden of VAT is higher in remote areas than in easily accessible areas, which is clearly inequitable and unjustifiable which in turn discourages VAT.

8.2 Prospects of VAT with Respect to Resource Mobilization

8.2.1 Existing Situation on Resource Mobilization

VAT is desired to achieve the goals of neutrality, revenue productivity, fairness and transparency etc. It is modern and effective tax system which is supposed to generate more revenue with less distortions. It is account based, invoice based and record based tax system, which checks the loopholes, such as under valuation, non-recording and unauthorized trade. It discourages such issues and problems, existing in the sales tax system. That's why, VAT is considered to be the best fiscal tool for resource mobilization, especially in an economy with acute shortage of resources. Because of all these factors. Nepal has already adopted broad based consumption type VAT, using the tax credit method. Despite the preliminary resistance, VAT is currently well received by customers as well as the business and industrial communities. There has been made a progress in revenue mobilization and infrastructures have been already prepared. No strong voice against VAT has been heard today. VAT compliance is taking momentum at a satisfactory level. The following table provides the glimpse of Nepalese structure of taxation and contribution of VAT in resource mobilization.

Table No. 8.1
Structure of Nepalese Taxation and Contribution of VAT in
Resource Mobilization

Table Landscape

According to the table, the total revenue that is comprised of non-tax revenue and tax revenue is highly dominated by the tax revenue. The table shows that in Fys 1997/98, 1998/99, 1999/00, 2000/01, 2001/02, 2002/03, 2003/04, 2004/05, and 2005/06, the total revenue is 32937.901, 37251.038, 42893.78, 48893.561, 50445.491, 56229.791, 62331.028, 70122.742 and Rs. 72282.065 million respectively. The amount of non-tax revenue and tax revenue for the corresponding year is 7998 and 25940, 8498.1 and 28753, 9741.6 and 33152.1, 10028.8 and 38865.1, 11115 and 39330.6, 13642.7 and 42587.0, 14158.0 and 48173, 16018 and 54104.7, 14851.7 and 57430.4 respectively. Following table can be concluded that, in total revenue, the average shares of non-tax revenue and tax revenue is of 22 and 78% respectively. In Fy 2006/07, total revenue has been estimated to be Rs. 87135.467 million among which, the non-tax revenue and tax revenue have been estimated to be Rs. 14843.96 million and Rs. 70046.185 million respectively.

Similarly, total tax revenue is massively dominated by indirect tax because in Fy 97198, total tax revenue is Rs. 25940 million with the share of 23.18% of direct tax and 76.82% of indirect tax. Maintaining almost the same trend, in Fy 2005/06, total tax revenue is Res. 54104.7 million with the share of 24.32% of direct tax and 75.67 of indirect tax. And, in Fy 2006/07, it has been estimated to be Rs. 70046.185 million with the estimated share of 26.25% direct tax and 73.74% of indirect tax respectively.

In the initial period of VAT implementation, i.e. in Fy 1997./98, total collected VAT revenue was Rs. 7122.618 million. Due to the lack of proper cooperation of private sector, and because of misunderstanding about VAT, the percentage increased in VAT in the comparison of previous fiscal year remained negative. However, the share of VAT in

total revenue, total tax revenue and total indirect tax remained 21.62%, 27.42% and 3.74% respectively.

With the increment in VAT revenue by 10% in Fy 98199, total VAT revenue remained Rs. 7882.247 million and occupied 21.16%, 27.41% and 36.74% in total revenue, total tax revenue and total indirect tax respectively. The percentage of increment by 25.02 and 22.25% continued in Fy 1999/2000 and 2001/02 but in Fy 2001/02, it again, remained negative. However, the increment in VAT, thereafter, remained 13%, 8%, 30.5% and 14.5% in Fy 2002/03, 2003/04, 2004/05 and 2005/06 respectively, along with the continuous increment in share in total revenue, total tax revenue and total indirect tax respectively. Finally, in Fy 2006/07, the total VAT revenue has been estimated to be Rs. 26055.001 million with the % increment by 21 and share of 30.24%, 37.24% and 50.53% in total revenue, total tax revenue and total indirect tax revenue.

From the above analysis, we can conclude that VAT has been playing a significant role in resource mobilization. The contribution of VAT in total revenue, total tax revenue and total indirect tax is in increasing trend and there is a significant progress in resource mobilization.

8.2.2 Projection of VAT for the Next 10 Years

Under this topic, effort has been made to find out revenue potentiality of value added tax in Nepal. On the basis of performance of VAT in the past years, effort has been made to forecast/estimate the amount of VAT in future. With the help of average increment of percentage in VAT from Fy 1997/98 to 2006/07^R, VAT revenue has been projected till 2016/017 holding 2006/07 as a base year.

It has been also assumed that existing base and threshold remains constant during the periods.

Table No. 8.2
Projection of VAT for Next 10 Years at Different Rates

Rs. in million

FY	VAT revenue (actual)	% increased in VAT	FY	VAT @13% estimated for 10 years	Estimated VAT @ 14%*	Estimated VAT @15%*	Estimated VAT @20%*
1997/98	7122.618	-0.05	07/08	29702.701	31987.524	34272.347	45696.463
1998/99	7882.247	10.66	08/09	33861.071	36465.768	39070.466	52093.955
1999/00	9824.903	25.02	09/10	38601.611	41570.965	44540.320	5938.093
2000/01	12047.76	22.25	010/11	44005.831	47390.89	50775.95	67701.27
2001/02	11963.974	-0.9	011/12	50166.641	54025.613	57884.58	77179.44
2002/03	13459.709	13	012/13	57189.961	61589.188	65988.41	87984.55
2003/04	14478.907	8	013/14	65196.551	70211.67	75226.78	100302.38
2004/05	18885.4	30.5	014/15	74324.068	80041.304	85758.54	114344.72
2005/06	21613.43	14.5	015/16	84729.428	91247.07	97764.72	130352.966
2006/07 ^R	26055.001	21	016/17	96591.547	104021.66	111451.78	148602.38

Growth rate for 1997/98 – 2006/07 is estimated to be 14%.

Source: Budget speeches of various fiscal years.

* = Derived for unitary method.

R = Revised estimate

From the above-mentioned tabular analysis, it can be concluded that VAT has a high trend of revenue potential. Holding our assumptions, VAT amount will be Rs. 96591.547 millions in fiscal year 2016/17 and that will be near about 3.7 times greater amount of 2006/07. Now if the government makes the provision to collect VAT by 14%.

VAT amount will be Rs. 31987.524 millions for the fiscal year 2007/08. Similarly it will be Rs. 34272.357 millions @ of 15% and 45696.463 million.

According to the table, VAT revenue @ of 14% will be Rs. 104,021.66 million for the Fy 2016/17, similarly it will be Rs. 111,451.78 millions and Rs. 148,602.38 million if applied 13% and 20% of VAT rate respectively.

Due to the significant contribution on all important indicators of economy and because of broad coverage, it is found that VAT has very high revenue potential power. If the government increases rate of VAT and tax net, VAT will have more amount of revenue generating.

Hence, we can conclude that VAT has better prospects-for resource mobilization.

CHAPTER IX

LEGAL PROVISION RELATING TO VAT COLLECTION SYSTEM

This chapter reviews only the Legal Provision relating to VAT, referring *Value Added Tax Act 2052 and VAT rules and Regulations 2053*. VAT was introduced in the fiscal year November, 1997 in Nepal. Till 2-3 years of after the VAT was introduced, it could not be practiced in full phase. Legal provisions relating to VAT are listed below:

9.1 VAT Acts, 2052

9.1.1 Bill made to Impose and Collect Value Added Tax Preambles

Whereas, 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 sale, distribution, delivery, importation, exportation of goods or services and to collect revenues effectively by regulating the process of collection, Now, therefore, parliament has made this act in the twenty fourth year of the rule of His Majesty King Birendra Bir Bikram Shah Dev.

9.1.2 Imposition of Value Added Tax (Section 5)

Under this Section VAT is imposed on goods or services supplied, imported into the Kingdom of Nepal and exported outside the Kingdom of Nepal. Tax shall be levied on the taxable value of every transaction. No tax shall be levied on the transactions of goods or services set forth in schedule 1, provided that any tax applicable on such goods or services at the time of purchase.

9.1.3 Assessment of Tax and Collection (Section 8)

There is compulsion for registered person to assess and collect tax at the taxable value. People who are outside the kingdom but receipts the

services in Nepal' also has to assess and collect tax at the taxable value in accordance with the Act and Rules there under.

9.1.4 Exemption for Small Vendor (Section 9)

A person having a transaction below the threshold should not need to register. But he can register if he wishes voluntarily. So, voluntary registration states often allow those who are not required to be registered to register voluntarily. Person can get registered number after the completion of registration process.

9.1.5 Registration (Section 10)

Three months (90 days) are given to the person engaged in any transaction from the commencement of this Act. Every person has to fill up the prescribed form for registration. A unique register number is given to such person in time with the registration certificate. After the registration he can display attested copy by the tax officer in different places of his transaction. This number is applicable for all types of transaction then-after. A person should inform the tax officer within 15 days of any changes in the information pertaining to the application for registration as required under sub-section 1 and 2.

9.1.6 Cancellation of Registration (Section 11)

There are three main conditions for the cancellation of VAT registration. The first case is where a person has been registered for VAT properly, but where the registration is no longer appropriate. This will occur where a person was required to register because the person's business activities exceed the threshold but where, subsequently, the person's level of business activities has declined to below the threshold. The second case is where the person has ceased to carry on business

activities. The final case is where the person has been registered by mistake or by misrepresentation on the part of the person.

9.1.7 Invoices to be Issued Except Otherwise Prescribed (Section 14)

Every registered person is required to issue an invoice to the recipient, in the process of supplying any goods or services. It's a duty of recipient to obtain invoice. The specimen of an invoice is prescribed in the VAT Act.

9.1.8 Unregistered Person not to collect Tax (Section 15)

Unregistered person not to need to issue an invoice or other documents showing the collection of tax. If he collects tax the tax so collected shall be assessed and collected from him.

9.1.9 Accounts of Transactions to be Kept (Section 16)

There are four conditions in this section. First deals about up to date accounts of his transaction. These accounts should be available for inspection to tax office upon his request. Second deals the content of accounts, in which date and value of transaction and registered number of party if any should be included. Thirdly, registered person may use authorized sells and purchase book and lastly every tax payer should preserve the accounts of transactions for a period as prescribed.

9.1.10 Tax Offset (Section 17)

A registered person can offset the amount of tax he has collected against the tax paid or tax due in importing or receiving goods and services related to his own taxable transactions. No offset or only partial offset is given in the case of aeroplanes, automobiles, computers and high priced other items as prescribed in Act. Offset is given only in the following conditions:

- ↳ Must be a registered person

- ↳ Should provide essential documents.

9.1.11 Assessing VAT (Section 20)

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

9.1.12 Tax Collection (Section 21)

Each taxpayer has to pay tax within a specified period. If it has not been paid within the specified period the tax officer, on the approval of the Director General may collect the tax by using any of the following methods:

- ↳ Offsetting the amount, if any is refunded to the tax payer.
- ↳ Seizing the assets (movable and immovable) of the tax payer.
- ↳ Selling the parts or full assets at a time or in a series.
- ↳ Deduction of amount is made from a corporate body owned by HMG/N or local bodies.
- ↳ Deduction of amount from tax payer's bank account.
- ↳ Deduction of amount from third parties.
- ↳ Withholding imports, exports and other transaction of the taxpayer.

Under the subsection and it is stated that tax shall not be collected past is years from the date the tax was assessed.

9.2 Value Added Tax Rules, 2053 (1997)

In exercise of the power conferred by Section 41 of the Value Added Tax Act, 2052 (1996) His Majesty's Government has framed the following Rules.

Provisions Relating to Registration

9.2.1 Application for Registration (Rule 3)

Any person engaged in any transaction at the time of the commencement of the Act shall submit an application for registration to the concerned tax officer, in the format as set forth in Schedule -1 within 90 days of the commencement of the Act. A person intended to engage in any transaction after the commencement of the Act shall submit an application for registration to the concerned tax officer, in the format as set forth in Schedule -1 prior to the commencement of such transaction. In the case of partnership, the application must be submitted along with the details of the partnership in the format as set forth in Schedule -2.

9.2.2 Investigation Into Application (Rule 4)

The tax officer may ask for additional documents for the process of registration. It shall be the duty of the applicant to submit such additional details and documents to the concerned tax officer within seven days of such demand. In case of a registrant which is not required to be registered as set forth in sub-section (3) of Section 10 of the Act, the concerned tax officer shall give a notice setting out that he is not required to be registered, to the applicant within seven days of the receipt of the application.

9.2.3 To Grant Certificate of Registration (Rule 5)

The concerned tax officer shall, if he deems it proper to register, upon making investigations pursuant to Rule 4 into the application submitted for 2 registration pursuant to Rule 3, register the transaction which the applicant has carried out or intends to carry out the transaction and grant the certificate of registration bearing Registration Number as

well in the format as set forth in Schedule -3 to the applicant, within thirty days of the date on which the application was submitted.

9.2.4 Entrepreneur Carrying out Small Transactions Need not to be Registered (Rule 6)

Any person carrying out transactions not exceeding one million rupees within the last twelve months as set forth in Section 9 of the Act need not have registered his transactions. Provided that any person who imports into the Kingdom of Nepal goods valued at one hundred thousand rupees or more per annum for commercial purposes shall have to register his transactions. But he can register voluntarily after completing the procedures of investigation.

9.2.5 Cancellation of Registration Process (Rule 12)

In case the registration of any registered person be cancelled due to the conditions referred to in sub-section (1) of Section 11 of the Act and such a registered person or his successor in the event of his absence submits to the concerned tax officer an application, setting out the conditions for cancellation of registration, accompanied by the Tax Return referred to in Schedule -11 as well as the payable tax amount, for the cancellation of registration, within thirty days of the date on which the condition for cancellation of registration occurred, or the concerned tax officer is satisfied that the registration of a registered person in existence of the conditions set forth in sub-section (1) of section 11 is to be cancelled; he (the tax officer) shall cancel the registration of such person, upon getting him to pay the remaining tax amount, and give notice thereof to the concerned registered person or his successor and the department.

9.2.6 Tax Invoices (Rule 17)

Mainly there are two conditions relating to tax invoices. At the time of supplying any goods or service by a registered person, he shall give tax invoices to the recipient. Three copies of tax invoices are essential, and the original copy is given to the recipient, the second copy to be separately recorded so that it can be produced as and when asked for by the VAT office and the third copy be recorded by the registered person for the purpose of his transaction.

9.2.7 Abbreviated Tax Invoices

To conduct retail sales of any goods and services, he should take permission from tax officer by submitting application. Then after he can use abbreviated tax invoices. When low priced goods are sold in large quantities abbreviated tax invoices is used expressing the names grossly.

A registered person who gives an abbreviated tax invoice to the recipient should maintain records thereof as below:

- ↳ To prepare and maintain a duplicate copy of the original invoice,
- ↳ Where a transaction has been carried out by maintaining a duplicate of the roll, the total thereof must be calculated and maintained everyday,
- ↳ To maintain records of the value, including tax, of each transaction.

There is provision of cancel the permission granted if registered person is found not to have maintained the records required to be maintained necessary documents to the tax officer.

9.2.8 No Weed to Give Tax Invoices

A person who carries out transactions of used goods of a value exceeding ten thousand rupees, need not issue a tax invoice in such cases

where the selling price is less than the buying price of the goods supplied by him.

Tax Return and Collection

9.2.9 To Submit Tax Return of Tax Period (Rule 26)

For the purpose of tax return a registered person should submit to the concerned tax officer the tax return of one-month tax period according to the Bikram Era, within 25 days of the expiry of that period. The tax period of a taxpayer who has registered voluntarily may be fixed at four months. But the registered person is liable in the tax expiry period of 25 days.

9.2.10 To Require to Submit a Tax Return through the Heir or Legal Representative (Rule 27)

In case any registered person dies or becomes mentally or physically incapacitated to submit the tax return, the tax officer may, considering him to have supplied the goods or services till the day preceding his death or becoming mentally or physically unable, require his heir or legal representative to submit a tax return for that period.

9.2.11 To Submit a Tax Return Individually or Jointly (Rule 28)

There is a provision of tax payment jointly or superlatively. The condition are listed below:

- ↳ Any taxpayer becomes incapable to submit a tax return or he dies; his heir or guardian,
- ↳ Any taxpayer is a legal person, any director, executive chief or any employee appointed by the management, on behalf of such a taxpayer,

↳ In case any taxpayer is a legal person and such legal person is dissolved or liquidated by the liquidator.

In other circumstances other than those mentioned above, the person concerned with the taxpayer and prescribed by the tax officer.

Assessment and Recovery of Tax

9.2.12 Tax Officer May Assess Tax (Rule 29)

If a tax officer does not satisfied with the documents of the tax payers he may asses the tax liability. The concerned taxpayer is given a time limit of seven days to submit evidence in his favor against the tax assessment order issued by the tax officer. If tax is not collected, an order including description of additional charge is issued.

9.2.13 To Pay Tax, Additional Fees and Interest Amount (Rule 30)

The concerned taxpayer shall deposit the tax, additional fees and the interest amount referred to in the tax assessment order within seven days of receipt of such an order to the concerned Tax Office.

9.2.14 Procedure of Sending Notices of Tax Assessment Order (Rule 31)

If the order is sent by tele-fax, telex or other similar electronic devises installed at the address of such taxpayer or such order is delivered to himself or at his office or through registered post to his address, it shall be deemed to have been duly delivered. In case of order not received by the tax payer he should inform the tax officer.

9.2.15 Assessment and Recovery of Tax Collected by an Unregistered Person (Role 32)

Unregistered person having collected tax should assess and recover within seven days of the issue of the tax assessment order.

9.2.16 To Submit a Tax Return Prior to Filing Appeal (Rule 34)

Prior to filing an appeal by a taxpayer against a tax assessment order made, he must submit his tax return of that period to the concerned tax officer.

9.2.17 Time-Limit for Applying for Remission of Additional Charges (Rule 36)

For the remission of the additional charges, an application shall be submitted to the Director General within thirty days of the expiry of time-limit prescribed for payment of tax. But additional charges should be granted if an application is not submitted within the time-limit.

9.2.18 Tax Assessment Period (Rule 37)

While calculating the period in case a petition has been filed with any court in regard to tax, and a stay order has been issued, the period shall be calculated by deducting the period until which the petition is decided.

9.2.19 Time-Limit for Collection of Tax (Rule 38)

While calculating the time-limit, in case an appeal has been filed, the period from the date of filing such appeal to the date of decision shall not be included.

9.2.20 Application To be Submitted (Rule 43)

For the deduction of sales tax application should be submitted to the tax office in the format prescribed by the Act and Rules. And for a claim to deduct Sales Tax or tax, the concerned taxpayer must also submit invoices of payment of Sales Tax or tax and other documentary evidence within 15 days of registration. In absence of the documentary evidence tax shall not be made. If such deduction are already made then it can be

rejected and take necessary action against such tax payer. But if the application is accepted the tax payer may deduct such taxes.

9.2.21 Provision Regarding or Services to be Supplied within the Kingdom of Nepal (Section 56)

While purchasing or acquiring the goods or services on which tax of value of ten thousand rupees is payable at a time within the Kingdom of Nepal by His Majesty's Government or the association, organization or office owned by His Majesty's Government or constitutional bodies, such goods or services shall be purchased or acquired only with a registered person.

Since the process of VAT accounts begins from the issuance of invoices, a provision has been made under Section 14 of Act for registered person to issue an invoice to the buyer while selling any goods or services and for the buyer to receive the invoices, Rule 17 deals the regulation of the section 14. Therefore mainly these two sections are reviewed, in this chapter.

CHAPTER X

SUMMARY OF MAJOR FINDINGS, CONCLUSION AND RECOMMENDATIONS

10.1 Summary of Major Findings

Value added tax is a tax imposed on "Value added" by business firms on goods and services at the successive stages of production and distribution "value added" on a commodity or services is simply the excess of sales value over purchases by a business entity. VAT is multiple stage commodity and service based, one of the best form of sales tax.

The VAT has been considered as an attractive alternative to existing indirect system, spreading around the world at a speed which is unmatched by any other tax in the recent time. It is the youngest form of taxation innovated in the second half of the twentieth century, it has been emerging as a main element of the world wide tax reforms. Since Nepal is severely defeated by the problems of fiscal deficits, resource gap and foreign debt servicing, VAT was conceived as an effective neutral and more productive tool for mobilizing domestic resources.

The VAT is collected from sellers on the basis of their "value added" at each of the stages of business process, thus the same value is never taxed twice and never produces cumulative either. Burden of the VAT is presumably shift forward to the consumer. The optimum base of VAT is gross national product. The VAT firstly launched in France in 1954 however it was introduced by German industrialist Carl F. Van Siemen.

In the Nepalese context, VAT was implemented in 16 Nov. 1997 when the tax system review task force headed by Prof. M.K. Dahal

proposed and recommended to implement VAT. The structure of Nepalese VAT is designed in VAT act 2053. Its coverage is defined with reference to both taxable transactions and taxable persons. The base of VAT is the value added by each firm through its production and distribution activities. According to VAT act 2052 the tax rate is 10% (now changed to 13%) and exports are subject to rate of zero %. There are certain cases such as exemptions and zero ratings under which commodities are tax free. A taxpayer is allowed to deduct the tax paid on purchase for his business from the collected on sales. This deduction is known as an input tax credit. Under the Nepalese VAT system, there is a provision for the refund of VAT. Such a situation arises in the case of zero rated supplies such as export. Small vendors having an annual turnover of certain amount (Rs. 2 million) are not required to register under the VAT system.

Among the various type of VAT, gross national product type, income type and consumption type, the later one excludes capital goods from its base, thus do not penalize investment and growth. It is considered to be neutral regarding the methods of production and administratively feasible. Three principal methods, ensuring the VAT base are additions subtraction method and invoice or tax credit method. The invoice method is more popular in the world. VAT paid on total purchases minus VAT paid on total sales by a firm is the net VAT liability under this method. While addition method adds factor products and sales value minus purchases under the subtraction method. The tax credit method is considered as a tool for cross-checking measures under the VAT system. In this sense, VAT is said to be self-policing in nature to adjust international trade VAT uses one of the two principles i.e., origin or destination principle. In Nepal, consumption type, tax credit method

VAT based on the destination principle with single positive rate of 13% is in practice.

Nepal introduced VAT system for several reasons. It was necessary to introduce such a tax to develop a stable source of revenue, to broaden the tax base, to promote economic growth to generate revenue required for improving its deteriorating macro economic performance, to establish an account based modern transparent tax system, to make the tax system more scientific to gain the confidence of donors, to make the Nepalese tax system effective.

The review of Nepalese tax system shows that tax revenue contributes about 80% and non-tax revenue contributes about 20% on total revenue. If we break up tax revenue into direct tax revenue and indirect tax revenue, indirect tax makes up about 76% and direct tax about 24% on total tax revenue.

Similarly, in indirect tax too, VAT plays a leading role. Since Nepal has become the member of WTO, the custom duties should be reduced to 0.5 to 20%. Thus the contribution of customs in indirect tax is in decreasing trend and will continue in future too. So it is expected that VAT would be a major instrument to avoid deficit financing. VAT contributes near about 30% on total revenue, 38% on total tax revenue and 49.72% on indirect tax revenue.

VAT a premier indirect tax to Nepalese tax structure is composed of two components: domestic and imports. About 62% of VAT revenue is generated from import. However, it is said that both domestic and import VAT revenue will be quantitatively equal in near future. In the beginning of VAT implementation in Nepal, there were huge protest against VAT. However, the number of VAT registrants has been increasing gradually reaching about 46,831 in Fy 2005/06.

In the empirical study, the analysis has been done about VAT on the basis of information collected from experts, tax officers, businessmen, tax students and consumers. The tool basically used is questionnaire. The questions were asked to 50 different individuals related to this field. Empirical as well as theoretical analysis shows that VAT is superior to other types of sales tax. Not only that, most of respondents have also viewed VAT as the best instrument for resource mobilization, bright future and discouraging illegal business. Similarly, most of the respondents (especially tax experts, VAT officers), argued that billing problem, open boarder, administrative incapability as haunting problem. They also discussed about legal provisions, choice between single or multi-rated VAT, behaviour of tax personnel, rate of VAT, need of public awareness programme etc.

Through the analysis of time series, we can conclude that there will be higher potentiality in VAT revenue. So government must pay higher attention in VAT for effective resource mobilization. After analyzing the coefficient of correlation between VAT and total revenue, VAT and total tax revenue and VAT and indirect tax, we can conclude that VAT has contributed a significant percentage in total revenue, total tax revenue and total indirect tax. Because they have higher positive relationship (near about one). Similarly, there is more than 90% variation due to VAT in total revenue, total tax revenue and total indirect tax revenue. And all these relationships are significant as $r > 6PEr$ everywhere. So VAT has significant contribution in government revenue. And all these relationships are significant as $r > 6PEr$ everywhere. So VAT has significant contribution in government revenue.

10.2 Conclusion

Value added tax puts greater significance in revenue mobilization in Nepal. The implantation of VAT, the centerpiece of government revenue enhancement effort started in Fy 1997/98. Like in any other country, the government of Nepal need revenue to fulfill the objectives of as independent state. Generating revenue means collecting taxes. There are various forms of tax system in Nepal, the decision of introduce VAT, as the form of taxation, seems to be the best for any type of country.

Introducing of VAT in Nepal is both compulsion and necessity. It cannot curtail its development projects for which more revenues required. The narrow tax base of the previous sales tax failed to generate the minimum required amount of revenue because it included only the import and manufacturing unit. Similarly, most of goods and services were exempted from tax. Income tax, however has some potential for revenue generation in Nepal. The rates of income tax are slowly dressing because government can't put more burdens on people to pay income tax. The globalization and recent trend of tax system has affected the Nepalese economy also. As we now as member of the WTO, shall need to reduce our custom duties drastically.

VAT was introduced as a part of the national tax reform programme. But VAT system in Nepal form its inception has been facing innumerable problems, which curtail its merits and effectiveness. Its progress has been slow initially due to opposition form the business community and subsequently to administrative problems.

However, the issue today is not whether VAT or no VAT but now to make VAT more effective and efficient. VAT regime is extremely challenging in a burgeoning economy like Nepal where with long open boarder, a large segment of the economy is yet to be monetized.

However, VAT is gradually moving towards its goal. In the empirical analysis most of the experts and tax officers are satisfied with the functioning of VAT in Nepal.

The biggest virtue of VAT is that it is revenue buoyant and highly instrumental for resource mobilization especially in an economy with acute shortage of resources. Despite preliminary resistance, VAT is currently well received by the customers as well as the business and industrial communities. The taxpayers education campaign and the Lucky draw scheme conducted by the IRD with objective of uplifting the level of awareness among the concerned stakeholders of the society is praiseworthy. The implementation of VAT in Nepal is an excellent lesson for other countries to study when considering the reform the indirect tax system. There has been made a progress in revenue mobilization and the infrastructural has been already prepared. No strong voice against VAT has been heard today. VAT compliance is taking momentum at a satisfactory level. There has been a positive change in the deeds of tax administrators.

10.3 Recommendations

10.3.1 Some Useful Recommendations for Administrative Reform for Better Implementation of VAT in Nepal

1. Unproductive, corrupted, inefficient staff lacking practical and specialized training is a serious problem. So, providing training to such staff is highly essential.
2. Taxpayers, customers are ignorant about VAT system. They have lack of proper knowledge about computation of tax liability, taking invoice of their purchases. So, emphasis should be given to

taxpayer education. The issuance of proper bill for every taxable sells must be made mandatory.

3. The success of VAT system is not only the success of the Inland Revenue Department, but also the success of nation as a whole. The role of general media, radio, TV, newspaper play an important role. Emphasis should be given on mass media rather than distribution of booklets and written forms to taxpayers. So, an environment of consciousness towards VAT system should be created covering general public, non-governmental and government organization.
4. Nepal's recent access to WTO demands a rule based and predictable business environment. The foremost necessity of the developing world is the sustainable growth in domestic revenue mobilization. Decreasing foreign loans and grants have compelled to tap all the sources of revenue. In this context, government should check the culture of impunity. The tax officers should be forced to properly follow the code of conduct. At the same time, the fraudulent activities of the business communities should be obliged to follow the rules and regulations by timely enforcement of laws.
5. Lots of efforts should be made to reestablish a functionally well-organized organization where the tasks are carried out in a modern, effective, efficient, transparent and service-minded manner.
6. Providing various facilities to VAT registrants can increase VAT compliance. The tax administration can select genuine businessmen and reward them.
7. There should be close cooperation between the private sector and government sector for the successful implementation of VAT system.

8. VAT collection on import is remarkably higher than domestic production, such high dependency on import is not good signal for the government therefore authority should take an effective step to encourage domestic production.
9. Special incentives should be provided to small business person to increase registration trend.

10.3.2 Some Useful Recommendations for Legal Reform for Better Implementation of VAT in Nepal

1. The existing exemption and zero rating list is rather long. Exemptions and zero rating have on impact not only on revenue collection but also on economic efficiency and administration. Thus, the existing labyrinth of exemptions and zero rating in VAT must be avoided from tax act.
2. A reasonable threshold (down from the current Rs. 2 million), wide range of supplies under the tax net would be an appropriate strategy for immediate future.
3. Government has been providing tax refund facility to business organization and foreign diplomacy and foreign aided project. Tax refund is one of the sources of tax leakage. Therefore, tax authority should manage tax refund facility properly.
4. As per the equity principle of taxation, the government may apply different rates of VAT to luxury good and essential goods. There is injustice in levying more tax on conspicuous consumption.
5. VAT laws should be effectively implemented.

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