

# **VALUE ADDED TAX IN NEPAL: PAST AND PRESENT**

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**A Thesis**

**Submitted To:**  
**Office of the dean**  
**Faculty of Management**  
**Tribhuvan University**

**In Partial Fulfillment of the Requirement for the Degree of  
Master of Business Studies (M.B.S.)**

**Kathmandu, Nepal**  
**March, 2014**

**RECOMMENDATION**

This to certify that the thesis

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**VALU ADDED TAX IN NEPAL: PAST AND PRESENT**

Has been prepared as approved by this department in the prescribed format of the Faculty of the Management. This thesis is forwarded for examination.

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## VIVA-VOICE SHEET

We have conducted the viva- voice examination of the thesis presented

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And found the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for Master Degree of Business Studies (M.B.S.)

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## DECLARATION

I hereby declare that the work reported in this thesis entitled " Value Added Tax In Nepal: Past and Present" submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the degree of Master of Business studies (MBS) Under the supervision of Prof. Dr. Kamal Deep Dhakal of Shanker Dev Campus, T.U.

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## **ACKNOWLEDGEMENT**

I have a great pleasure to express my heartiest gratitude and sincere thanks to my thesis advisor Pror. Dr. Kamal Deep Dhakal, Shankar Dev Campus, Putalisadak, Kathmandu, Who guided me throughout this research. And i shall ever remain indebted to him for his valuable direction, useful suggestion and creative comments during the course of preparing this thesis.

I extended my sincere thanks to department of management, Shankar Dev Campus for providing me such a chance of conducting thesis. I would like to thank Thesis committee for their meaningful suggestion and complement.

I would also like to acknowledge the contribution of my wife Mrs. Shabitri Nepal and my whole family members, teachers, colleagues and seniors at my office for their love, cooperation and continuous support.

I assume the full responsibility for my mistake and shortcomings in this thesis work.

Dev Narayan Paudel

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## Abbreviation

AD	Anno Domini
BS	Bikram Sambat
CPN(UML)	Communist Party Nepal United Marxists and Leninist
GDP	Gross Domestic Product
GNP	Gross National Product
GON	Government of Nepal
HMG	His Majesty Government
IMF	International Monetary Fund
IRD	Inland Revenue Department
MOF	Ministry Of Finance
MST	Manufacturing Sales Tax
PAN	Permanent Account Number
RST	Retail level Sales Tax
SAARC	South Asian Association For Regional Cooperation
TU	Tribhuvan University
UK	United Kingdom
UNDP	United Nation Development Program me
UNIDO	United Nations Industrial Development Organization
USA	United States of America
USAID	United States Agency For International Development
VAT	Value Added Tax
WCO	World Custom Organization
WST	Wholesale Sales Tax
WTO	World Trade Organization

## **CHAPTER -I**

### **INTRODUCTION**

#### **1.1 Background**

In the present situation, government spends lot of money to fulfill the responsibility of its people. That responsibility may be either for security or for health, for education or other development activities or for peace or to make secure from other states etc. However without resources the state would be constant. Civil personal, army, police, teacher etc depend on state's fund. To spend lot of money government needs funds that are raised by internal and external way. "The government revenue comes from different sources like grants, administrative income, business income, Tax and foreign aid and loans. Among these most important source of government revenue is taxation. Customs, excise duties, value added tax, corporate and personal income taxes are the examples of the sources of tax revenue. The main objective of taxation is to collect revenue.

The government passed the act for getting tax revenue and collecting the tax as per the act. There are different methods adopted to collect the tax departing the tax into two part as direct and indirect tax. Income tax, gift tax, interest tax, property tax vehicle tax, house and land tax are the examples of direct tax. Sales tax (turnover tax), entertainment tax, excise duty, Customs duty, value added tax are examples of indirect tax. Among different indirect tax, the value added tax is the most important part of taxation.

The value added tax is broad based indirect tax. The term value added tax is not word wise. The term exists in English form value added tax. It is nearest from the French word added value tax. In some states, the VAT is preferred to say as Goods and service tax. VAT is general consumption tax assessed on the value added to good and services. VAT was introduced in France in 1954 A.D. to replace the multistage sales tax in order to avoid the undesirable effects particularly cascading and pyramiding. The first country introducing VAT in Asia is Vietnam. Vietnam introduced VAT in 1973 but avoided in the same year and again rose in 1999. Our neighboring country China introduced VAT in 1984. India also has used VAT from 2005. Nepal introduced VAT in 16 November 1997. However the concept of this tax in Nepal was introduced in early years of

1990's. Government of Nepal included the concept of introducing VAT in Nepal in its 8th plan. Finance act 1992 and 1994 introduced two tier sales tax to make the base of implementing VAT. VAT task force was formulated in 1993 in technical assistance of USAID which suggested the steps to be followed while implementing the VAT in Nepal. It drafted the VAT law as well. High level tax system Review tax force headed by Prof. Madan Dahal suggested implementing VAT in Nepal 1995 VAT related act and rules were enacted in 1995 and 1996 respectively.

In Nepal VAT was brought to replace sales tax, contract tax, Hotel tax, and entertainment tax. VAT is a modern tax system to improve the collection of taxes to increase efficiencies for the administration and to do inter link among custom, income tax and excise duty.

## **1.2 Statement of Problem.**

Nepal is a land located and poor develop country in south Asia. More than 74% of Nepalese people are depended on agriculture which contributes only 34.33% of G.D.P. The per capita income of Nepal is also very poor which nearly \$658 is. The country's total annual import is more than annual export which shows that Nepal is very poor country in the world. In this condition Government of Nepal decided to introduce VAT in Nepal from the fiscal years 2054/055 B.S. with replacement of sales tax, entertainment tax, hotel tax and contract tax. Preliminary work was started since the fiscal year 050/051 B.S. to introduce VAT. After the midterm election 2051 B.S, there was frequent change in the government in Nepal. This government instability disturbed its smooth functioning for a certain period. However the coalition government of CPN (UML), Rastriya Prajatantra Party and Sadbhavana Party did commitment to introduce it from Mansir 1, 2054 (16 November 1997) for this purpose VAT registration work had been already started from Baishakh 2054 B.S.

When the VAT was introduced in Nepal, at that time many private sectors had been seen opposite of VAT. The government of the Nepali congress in the budget speech of the fiscal year 2054/055 decided to implement VAT system in spite of the objection of the business community. VAT is directly related with goods and

service. It makes the relation with seller, distributor, dealer retailer and consumer. According to the view of consumer, it can be said that there are some difficulties in VAT system of Nepal.

According to the business community of Nepal, VAT is not applicable in Nepalese context because it increases tax burden to consumer and creates difficulties to administration as a problem of uncompleted of manpower in tax system. However the government claims that VAT is a modern and scientific tax system, which does not increase unnecessary tax burden.

Keeping this controversial situation in view the study has tries to deal with the following issue.

- a) What changes can be noticed in revenue structure before and after implementation VAT?
- b) What is the share of VAT in total revenue GDP and tax revenue?
- c) What are the trends of VAT registration and its cancellation?

### **1.3 Objectives of the Study**

The main objective of this study is to analyze the value added tax in Nepal, in past and present. The specific objectives of this study are as follows.

- I. To examine the change in revenue structure before and after implementation of VAT.
- II. To examine the contribution of VAT in total revenue and TAX revenue.
- III. To examine the number of tax payers registered under VAT system and cancelled the registration under VAT system.

### **1.4 Significance of the Study**

The causes for the persisting fiscal deficit are small resource base therefore, Nepal has to depend upon external resources but self sustaining development impossible only if eternal resources are utilized optimally, for strengthening

internal resources of revenue collection, Nepal has adopted vat administration and policy as an ingredient of fiscal sector reform. The major objective vat is:

- ) Expanding the base of tax i.e. bringing more goods and services under the tax net.
- ) Export promotion.
- ) Reducing economic in efficiencies.
- ) Acceleration of the development peace through more resource mobilization.
- ) Evolving a simple and transparent tax system.

But, majority of Nepalese people far unknown about various aspect of vat even though valuables 16 years have already been spent.

So, this study mainly focus in those aspect which are unknown to general public like theoretical aspect of vat structure and administration of vat in Nepal, significant of vat in the contest of fiscal sector reform, existing practical problem of vat in Nepal.

Vat come into operation one and half decade even though people are unknown about various aspect of it vat being itself a complicated and modern tax system, more efforts should be more on actual circumstances.

### **1.5 Limitations of the Study**

Any subject could not be studied in without limit time frame. Every study have own limitation. Like this VAT has also some limitation. The main limitations of the study are maintained below.

- I. The information and dates are collected from Inland Revenue department, ministry of finance and other concerned officers.
- II. Due to time and resource limitation mainly secondary dates are used in this study.
- III. All the aspect of VAT is not examined in this study.

## **1.6 Organization of the Study**

The organizations of the study are divided in five chapters. They are:

### **Chapter - I Introduction**

The first chapter includes general introduction of VAT, statement of problem, objective of study, importance of the study, limitation of study and organization of study.

### **Chapter - II Conceptual Framework and Review of literature.**

The second chapter included about literature survey of books, journals, and thesis.

### **Chapter – III Research Methodology**

The third chapter deals with the research methodology including research design, nature and sources of data, procedure of analysis and presentation of data.

### **Chapter - IV Presentation and Data Analysis.**

The fourth chapter deals with the presentation and analysis of gathered data using variable statistical tools like table, chart, diagram, percentage and major findings of the study are also included in this study.

### **Chapter - V Summary, Conclusions and Recommendation**

The fifth chapter deals with summary, conclusion and recommendation. At the end of this thesis, bibliography is also incorporated.

**CHAPTER -II**  
**CONCEPTUAL FRAMEWORK AND REVIEW OF**  
**LITERATURE**

**2.1 Conceptual Frame Work**

**2.1.1 Tax Revenue**

Tax is the main source of government. Mainly there are two types of tax revenue, Direct tax revenue and Indirect tax revenue. Direct tax is that type of tax which is really paid by the tax payer. Direct tax is the sum of personal and corporate income tax, property tax, vehicle tax, interest tax and others. Indirect tax is that type of tax, which is levied on one person and paid by another person. Indirect tax is the sum of excise duty, goods and service based tax. Direct tax is important than indirect tax for the economy. Direct tax is more progressive than indirect tax. Social Justice can be established by direct tax. On the other hand both higher income group and lower income group are equally responsible to pay indirect tax.

In development economic like USA, UK etc, direct tax plays a leading role for the internal resource mobilization, where as in developing countries like Nepal indirect tax plays pioneering role by dominating direct tax. In general how much direct tax can mobilize the internal resource shows the magnitude of economic development but in the context of Nepal indirect taxation is the principle source of general review. So convert the economy in the channel of development, it is necessary to increase the show of direct tax.

Tax policy has various objectives among them.

- a) To increase growth rate in relatively short period to the maximum possible extent.
- b) Flexibility in tax structure and maximum revenue productivity.
- c) To have equitable distribution of income and property.
- d) To increase the employment saving and investment.
- e) To minimize regional disparity.

## **A. Direct Tax Revenue**

A direct tax is a tax paid by a person on who is legally imposed. In direct tax, the person paying and bearing tax is the same. Direct tax is a tax on income and property. The characteristics of a direct tax are equitable as per the property or income, certainty as per the process of payment, amount to be paid time of payment elastic in nature. The example of direct tax revenue are income tax, property tax, vehicle tax, interest tax, expenditure tax death tax, unite tax etc.

### **Merits**

- a) It is equitable as it is imposed on person as per the property or income.
- b) Time procedure and amount of tax to be paid is known with certainty.
- c) It is elastic, the government can change tax rate with the change in the level of property or income.
- d) It enhances the consciousness of the citizen tax payers feel burden of tax and so they can insist the government to spend their contributions for the welfare of the community.

### **Demerits**

- a) It gives mental pinch to the tax payers they have to curtail their income to pay to the government.
- b) Tax payers fell in convenience as the government imposes tax progressively.
- c) Tendency to evade tax may increase to avoid tax burden.
- d) It is expensive for the government to collect tax individually.

In Nepal, direct tax revenue is the sum of income tax, land tax, property tax, vehicle tax, tax on registration and other. Nepal is levying for different type of income tax namely individual income tax, corporate income tax, house rent and interest tax. In dividable tax included all forms of income and the government has given exemption. Corporate income tax is levied on the net profit of the corporation (company). House rent tax levied on the house rent received by the individual and housing company and

the interest tax is levied on the interest received on deposit and investment (bond). Property tax levied on each real property at late rate. Wealth tax is levied on person's wealth in the progressive way. Registration tax is levied on the transfer of ownership or the rights of use of immovable property under the name of house show the structure of direct tax revenue in Nepal.

## **B. Indirect Tax Revenues**

An indirect tax is a tax imposed on one person but partly or wholly paid by another. it is that tax where the person pays the tax and the person bearing the tax are different. An indirect tax is a tax on goods and services. The main features of indirect tax are convenient to pay, mass participation, limited evasion shifting of incidence. The consumer pays the tax to the business person, not the government etc. The examples of indirect taxes are customs, excise value added tax and so on. The merits and demerits of indirect tax revenue are

### **Merits**

- a) It is convenient as the tax payer does not have to pay lump sum amount for tax.
- b) There is mass participation; each and every person getting goods or services has to pay tax.
- c) There is less chance of tax evasion as the tax payers pay the tax collected from consumers.
- d) The government can check on the consumption of harmful goods by imposing higher taxes.

### **Demerits**

1. It is uncertain, as demand fluctuates, tax will also fluctuate.
2. It is a regretful as the tax burdens to the rich and poor same.

3. It has bad effect on consumption, production and employment. Higher taxes will reduce all of them
4. Most of the taxes are included in the price of goods or services as a result; taxpayers do not know how much tax they are paying to the government.

A major contributing item on indirect tax revenue of Nepal is sales or VAT. The basic objective of sales tax or VAT is to collect revenue. It is the tax that imposed on the value addition in each stage of production or deals. In Nepal, value added tax was introduced in 1997 replacing the sales tax, entertainment tax, hotel tax and contract tax. Right now the rates of value added tax in Nepal are 13 % and 0 %. The contribution of this tax to Nepalese tax is around 30.71 percent. The following table shows the structure of indirect tax revenue.

### **2.1.2 Meaning of VAT**

Value added tax is the latest innovation in the field of indirect tax system. VAT is the youngest member of sales tax family. It is a broad based indirect tax. The term VAT exists, in English from value added tax. It is nearest from the French term added value tax. VAT is a sales tax in advanced form. It is imposed on different stages. It is the tax imposed on added value of good and service. Value added tax is on of the form of indirect tax too. Encyclopedia of taxation and tax policy says "value added tax is a broad based tax on business designed to measure net value generated in a country" Being a broad based tax it is imposed on producer, wholesaler, retailer and consumers also. It is related to both the goods and services. It is levied on industry as well as commerce. Accordingly, It measures net value generated in a country i.e. GDP.

According to Indian Tax institute, VAT is " a tax imposed on the seller of goods and services based on value added by their respective units." value added tax is also known as goods and services tax or added value tax it is a tax system that aims to minimize tax evasion and increase resource mobilization It is imposed on value added amount in each stage and therefore, is equivalent to multi-stage sales tax. In consist to sales tax. VAT is imposed on added value of production and

distribution. The value is added in the form of profit, rent, wages, salary etc. The following table shows simple process of calculation the VAT.

**Table - 2.1**

**Process of Calculating VAT**

<b>Stage of sales</b>	<b>Net purchase price (A)</b>	<b>Sales price (B)</b>	<b>Value added</b>	<b>VAT @ 13%</b>
Manufacture	100	200	100	13
Wholesaler	200	350	150	19.50
Retailor	350	500	150	19.50
<b>Total</b>	<b>650</b>	<b>1050</b>	<b>400</b>	<b>52</b>

*Source: Arbitrary figure estimated during the study.*

From this example, Researcher can say that the value added tax collected in varies steps of production as a placement on the basis of the value added in the process of doing business. Again  $VAT = \text{Value added tax rate} \times \text{Let value added}$  be 400 and tax rate is 13% then  $VAT = 13\% \text{ of } 400 = 52$ .

**2.1.3 Evolution of VAT**

VAT is the most recent innovation in the field of taxation. The concept of VAT was developed for the first time by Dr. Wilhelm V. Siemens in Germany in 1919 A.D. The concept of VAT was developed further in 1949 by a tax mission to Japan headed by Prof. Carl S. Shoup. The tax however, remained as only a topic of academic interest until 1953 A.D. In 1954 France introduced a VAT covering the industrial sector the tax was however, limited up to the wholesale level. By the end of 1960s only eight countries including France, Brazil, Germany, Netherlands, and Sweden etc. had introduced VAT.

In Asia, Vietnam introduced VAT in 1973 but avoided in the same year and again used in 1999 A.D. Out of eight countries of the SAARC region, five countries have implemented VAT system. Republic of Pakistan introduced the system on November 1, 1990, for the first time in the region. VAT in Pakistan is applicable in transactions up to wholesale stage only. Bangladesh introduced the system in

1991 but VAT is applicable in transactions of production and import stage only. The Nepal and Sri Lanka too introduced the system in 1997 and 1998 respectively. Nepal introduced VAT in 16 November 1997 with replacement sales tax, contract tax, hotel tax and entertainment tax. Unlike above Nepal has implemented full VAT system i.e. VAT is required in retail transactions also. India has introduced the system in some prescribed regions of the country on April 1<sup>st</sup>, 2005.

As the data provide by IMF the rapid and seemingly irresistible rise of the VAT is probably the most important tax development of latter twentieth century and certainly the most breathtaking. Fifty nine years ago the tax was a child in the revenue sectors. Value added tax is the most efficient tax system developed so far. The system operates in a way that it becomes beneficial to all concerned. Under the system tax authority can collect more government revenue in one hand on the other hand consumers can have relatively cheaper commodities as the systems helps government to reduce tax rates.

Now a day around 160 countries have introduced VAT system across the world. The system has been chief source of revenue of the governments of those countries. About 70% of people of the world live in VAT. IMF, UNIDO, WTO, WCO etc. organization are focusing on political, social policy. After liberalization of the decade of the 1970s, VAT started to spread world wise. Good result of VAT in the implemented countries attracted to apply VAT in the virgin countries. From this fact researcher find out some more countries are in process to adopt the system.

Nepal introduced VAT in November 1997. However the concept of this tax in Nepal was introduced in early years of 1990s. GON included the concept of introducing VAT in Nepal in its 8th plan Finance act 1992 and 1994 introduced two tier sales tax to make the base of implementing VAT. VAT task force was formulated in 1993 in technical assistance of USAID which suggested the steps to be followed while implementing the VAT in Nepal. It drafted the VAT law as well high level tax system review task force headed by Prof. Madan Dahal suggested implementing VAT in Nepal in 1995. VAT related act and rules were enacted in 1995 and 1996 respectively.

<b>VAT Adopting Year</b>	<b>Countries</b>
1954	France
1960	Ivory coast
1961	Senegal
1967	Brazil, Denmark
1968	Germany, Uruguay
1969	Nether land, Sweden
1970	Equator, Luxemburg, Norway
1971	Belgium
1972	Ireland,
1973	Austria, Bolivia, Italy, United Kingdom, Isle of man
1974	Argentina, Chile, Columbia, Costarica, Nicaragua
1976	Honduras, Israel, Peru
1977	Korea, Panama
1980	Mexico
1982	Haiti, Ecuador
1983	Domineer, Republic Guatemala.
1984	China
1985	Indonesia, Turkey
1986	Morocco, New Zealand, Niger, Portugal, Spain, Taiwan, Bolivia, Ajores, Madeira
1987	Grenada, Greece,
1988	Hungary, Philippines, Tunisia.
1989	Japan, Malawi
1990	Iceland, Kenya, Pakistan, Trinidad And Tobago
1991	Bangladesh, Fiji, Egypt, Benin, Mali
1992	Algeria, Armenia, Azerbaijan, Cyprus, Elsalvador, Estonia, Kazakhstan, Russia, Tajikistan, Thailand, Turkmenistan, Ukraine, Uzbekistan, Moldova, Paraguay, South Africa, Belarus,
1993	Burkina Faso, Czech Republic, Paraguay, Poland, Rumania, Georgia, Slovak Replica, Venezuela, Armenia, Faroe islands, Nigeria.

1994	Bulgaria, Finland, Lithuania, Singapore Researchers samara, Madagascar, Samoa.
1995	Gabon, Ghana, Switzerland, Zambia, Mauritania, Togo, Latvia.
1996	Albania, Guinea, Uganda
1997	Bar Bados, Congo Republic, Nepal
1998	Croatia, Mongolia, Sri Lanka, Tanzania, Vanuatu, Moldova, Ghana, Mauritius.
1999	Cambodia, Cameron, Mozambique, Papua New Guinea, Slovenia, Malta, Vietnam, Kyrgyzstan
2000	Australia, Chad, Macedonia, Namibia, Sudan
2001	Rwanda, Kosovo, Senegal, Central African republic, Jordan, Guinea Bissau.
2002	Lebanon, Ethiopia, Botswana
2004	Zimbabwe, Siberia
2005	India, Tonga
2006	Bosnia harjgovina
2007	Guyana,
2008	Jersey, Iran, Mozambique
2009	Nive, Sierra Leone, Laos, Burundi
2010	Grenada, Saint Kits and Nevis
2012	Democratic Republic of Congo, Seychelles
2013	Gambia,

*Note : Out of 160 countries Eight countries are not United Nations (UN) member states. Azores, Taiwan, Faroe Island, Isle of man, Jersey, Kosovo, Madeira, Niue.*

*Source: website: K:\Vat implementing.htm*

#### **2.1.4 Types of VAT**

The types of VAT are determined on the basis of treatment of capital goods of a firm. Input tax paid for capital goods is allowed or not is the fundamental question in the study of types of VAT. Basically there are three types (i.e. consumption

type, income type and Gross National product (GNP) type) of VAT. They are described below.

**a) Consumption Type VAT**

This is the popular types of VAT type Nepal also applies this type. Under this type VAT excludes all capital goods purchased from other firms. In the year of purchase, all are excluded from the tax base while depreciation is not deducted from the tax base in subsequent years. The base of tax is consumption since investment is relieved from taxation under these types.

Consumption Type VAT = Gross domestic product - cost of intermediate goods  
cost of capital goods.

**b) Income Type VAT**

The income type VAT does not exclude capital goods purchased from other firms from the tax base in the year of purchase. This type however excludes depreciation from the tax base in subsequent years. Under this system the tax falls both on consumption and net investment and the conceptual tax base of this variant is the net national income.

Income type VAT = Gross receipt - cost of intermediate goods- depreciation

**c) Gross National Product. (GNP) Type VAT**

Capital goods purchases are not excluded from the tax base, under this type Capital goods purchase by a firm from other firms are not deductible for the tax base in the year of purchase. It also does not allow the deduction of depreciation from the tax base in subsequent years. Tax is levied both on consumption and gross investment. The tax base of this type is gross domestic product.

GDP type VAT= Gross receipts- cost of intermediate goods.

### **2.1.5 Method of Calculating VAT**

Consumption types of VAT system is popular and widely, adopted in the world. In this type the real taxpayer is consumer but the service follower are only the tax collector agent. They are registered on government revenue (tax) office. There are mainly three method of computing VAT liability. They are given below.

#### **a) Addition Method**

In production or distribution, there are same process and involve the means of production under this method, tax base is obtained by adding the payments made by the firm to the factors of production employed in production processes such as wages, rent, interest and profit. This method is suitable for income types of VAT.

#### **b) Subtraction Method**

One can assume that under this method tax base is determined through the means of subtraction by its name. Very simply value added is found out through purchase minus from the sales and rest of the amount regarded base for tax. Under this method value added is determined as net turnover the net turnover is obtained by subtracting the cost of materials from sale proceeds. This method is suitable for consumption type VAT.

$$T = f (\text{out puts}) - t (\text{in puts})$$

#### **c) Tax Credit Method**

The tax base to deposit to the government is calculated deducting the tax paid to purchase or receives the goods and services from the tax collected or charged in the sales. Under this system, tax is imposed on total value of sales and taxpayers are allowed to deduct from their gross tax liability the taxes already paid by their suppliers and pass on to them. As compared to subtraction method which deducts purchased from sales and levies tax on the difference, tax on purchase is subtracted from the tax on sales under this method. This method is also known as movece method or this method is also called indirect subtract method in that it calculates the value added indirectly while calculating the tax,

$T = t(\text{output}) - t(\text{input})$

Out of three methods of computation VAT. Tax credit method is widely used.

### **2.1.6 VAT and International Trade.**

When Nepal was entered in WTO at that time Government of Nepal has made major commitment to economic liberalization with the view to adopting international trade. Globalization made the world in a small village. Foreign investment, trade, tourism are affected by the policies of nation. Fiscal policy, Monetary policy, commercial policy, revenue policy etc impact the trade and development. In the case of international trade, for applying VAT, there are two alternative. These two principles or alternative largely depends on the goods and the policies of nation. These two alternatives are found regarding international trade in the system.

#### **i) 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. A country applying this principle taxed all exports and free imports. VAT is charged in the country where goods are originated and goods imported are free of VAT under this principle. Export is taxable and import is received from tax liability under the origin principle. Addition, subtraction and tax credit there three method of consumptions of VAT can be applied equally under this system but tax credit method is not suitable because tax rate importing country needs to compute export is discouraged under the origin principle due to equal tax burden as domestic supply.

#### **ii) Destination principle**

Under this principle tax for import and tax free for exports, is known as destination principle of VAT. Under a destination principle of VAT all exports are allowed to free tax and all imports are tax paid. Under the basic destination

rule, tax would be collected at importation and the firm would receive credit for this tax and a refund when the products are exported.

### **2.1.7 Freeing from VAT**

Some goods and services are left free from VAT or not taxable goods and services known as freely from VAT. Such provision makes the tax administration simple and promotes equity among tax payers. There are mainly three provision of freeing form VAT they are,

- i) Exemption
- ii) Zero rating.
- iii) Threshold.

#### **i) Exemption**

The supply where the VAT is not imposed is exempt supply. This is not taken into account in determining whether a trader is a taxable person or not. Accordingly input tax attributable to it is not normally available for credit. The objective of the government is to make the vender free from the responsibility for registering and paying tax, but to keep some tax on the final purchaser exemption is a suitable measure.

In Nepal several goods and services are exempt from VAT. Exemption are generation particularly on administrative and social ground the list of goods and services which are tax exempt are given schedule 1 of the act, amended by finance act 2070 are as follows.

- ) Basic agricultural products.
- ) Goods of Basic needs like water fuel wood and coal, kerosene and salt.
- ) Live animal and animal products.
- ) Agricultural inputs such as seeds, fertilizer pesticides, agriculture equipment, pots to be used for poultry purpose birds and animal feeds etc.
- ) Medicine, Medical and similar health services.

- ) Education including the provision of research in a school or university the provision of professional or vocational training or refresher train and the provision of education in a school or university and supply of goods made in connection with such service.
- ) Books newspapers etc including books, news papers, newsletters and periodicals and newsprint.
- ) Artistic and cultural goods and services carving services painting etc, cultural program, admission to libraries, museums etc.
- ) Passengers and goods transportation services covering air transport non - tourist passenger trains partition (except cable car) and goods.
- ) Personal or professional service including personal services rendered by artists. Sportsmen, authors, writers, designers, translators and interpreters, institutionally or individually.
- ) Other goods or services including postal related services, financial and insurance service, printing related services, ornaments electricity, raw wool, battery operated tempo, their chassis and battery, alternative energy related items, airplane related items, fire brigade and ambulance, jute goods, industrial machinery, woolen carpets and related items cotton items, goods of philanthropic purpose personal goods imported which it free of tariff due to personal belongings.
- ) Land and building
- ) Betting, Casinos, Lotteries.

## **ii) Zero Rating**

Zero Rating means taxing goods or services with zero rates. In this model the goods and services are taxable but the government defines the criteria of zero rating. The zero –rate is a tax rate of nil. Zero rate is equivalent to complete exemption. The zero rate is applied to goods supplied for export. Although no tax is charged on a supply. The input tax paid on it is available for credit. It is

opposite of exempt supply because the tax paid input in case of exemption is not credited. Zero rated items according to the value added Tax Act 2052, schedule 2 are:-

1. Goods or services purchased or imported by his majesty king, Her majesty Queen, His majesty crown prince, and other members of the Royal Family, ( Abolished by the declaration of parliament of Jestha 2065)
2. Export of goods
  - ) Goods exported outside the Nepal or,
  - ) Goods shipped for use as stores on a flight to an eventual destination outside the Nepal or,
  - ) Goods loaded for use as stores on aircraft to a destination outside the Nepal or as merchandise for sale by retail or supplied to persons in the cause of such a flight.
3. Export of Services:
  - ) A supply of services by a person resident in the Nepal and having no business establishment, assent or legal representative acting on his behalf in the Nepal.
4. Imports of goods and services by accredited diplomats.
5. Medical industries can get zero rate facility if they intended.
6. Local purchase from those which were provided exemption from sales tax as per the agreement made previously.

**iii) Threshold**

In most of the VAT system small suppliers having transactions of up to mention limit are not required to register. The amount determined for that purpose is known as threshold. The main objective of threshold is to make easy to tax administrator to administer and to make easy to small supplier in doing his

business. The threshold amount varies from country to country and time to time. It depends on number of factors like revenue requirement, administrative capacity, status of the recording system in the economy etc. to make simplicity VAT Act 1995 and Rules 1996 have fixed the threshold in Nepal. The provisions are

- i) Provided that any person who imports in to the Nepal goods value at 10,000 rupees or more at one time for commercial purpose shall have to register is transaction.
- ii) In case any person has reason to presume that his transaction shall exceed twenty million rupees in the coming three months he shall submit an application setting out such conditions to the concerned tax officer in the format as set forth in schedule one for the registration of the transactions.
- iii) If the amount of transactions carried out by any person exceeds twenty million rupees in absence of conditions where presumption could not be made as set forth in sub rule (a.) The person carrying out such transaction shall submit an application to the concerned the officer in the format set forth in schedule for registration of the transactions with in thirty days of the date on which such excess occurs.
- iv) If the amount of transactions of any consultant Rs one hundred thousand or more yearly that consultant shall have to register in the concerned tax officer.
- v) The transaction of government purchase and construction more than thirty five thousand shall have to register in the VAT office.

#### **2.1.8. Tax Rates**

Rates means positive rate excluded zero rate. Design of tax rate structure is chiefly influenced by revenue requirement, administrative, simplicity, efficiency types of products, tax burden etc. Without tax rate one cannot determine the tax liability of concern party. Before the application of VAT there were different rates in sales tax, hotel tax, entertainment tax and contract tax. Now according to VAT

system, theoretically and practically, the rate of VAT may be diversified into two rates they are:-

**i) Single VAT Rate**

In simple single VAT rate means a VAT of which tax is fixed only at one number. The tax rate has direct impact on the tax compliance, consumption as well as investment. It has crucial role in the context of economic development of a country and requires to be levied in the ideal rate. About 90% VAT applier countries are following the single rate. It is simple to understand easier to calculate. For example, Let us suppose 13 percent is a VAT rate fixed for all level for VAT purpose. The fixed VAT rates is known as single VAT rate.

**ii) Multiple VAT Rate:-**

In concept, multiple VAT rate means more than two kinds of VAT rate which are fixed on the basis of the commodities and the services nature. The multiple tax rate system encourages the tendency of the tax evasion, difficulty to administer affect the equity etc. The multiple VAT rate system is economically inefficient as well multiple rate has to classify the goods and services into groups. For example suppose VAT rates are 1%, 2%,3% for first, second and third goods respectively for VAT purpose. Those fixed VAT rates are known as multiple VAT rate.

**2.2 Review of Literature**

**2.2.1 Review of Related Studies**

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 labor 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 forms. 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 (1997) made detail analysis of VAT by means of paper entitled "Value Added Taxation in Developing Economies" published in the book

The major findings derived by the author are as follows:

- ) VAT is regarded as sales tax.
- ) The distinctive feature of the VAT is that of 'fractional' impact without cascading effects, since, the tax applies at multi-stages but only to value-added.
- ) 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.
- ) 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).
- ) The most important requirements of successful operation of VAT are its universality and simplicity.

- ) This portion covers the details of the implementation aspects of VAT.
- ) The tax law should be drafted by the lawyers related to the tax jurisdictions.
- ) 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.
- ) Registration of the business firms should be operated in great care.
- ) Tax returns may be filed at relatively frequent intervals.
- ) A computer system is the basic need of VAT operation.
- ) 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 (1983) 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 posses a corresponding increase may be substantial.

In the book "Government Finance in Developing Countries" Richard Goode described VAT as the most important tax innovation of the second half of the 20<sup>th</sup> 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.

In a seminar "Value Added Tax on Asia" organized by IMF/UNDP, Alan A. Tait (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.

- ) VAT provides new buoyant revenue based and improves tax system in terms of neutrality and efficiency.
- ) Experience broadly shows that VAT contributes from 12 percent to 30 percent of revenue in most countries representing above 5 to 10 percent of gross national product.
- ) 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.
- ) It is preferable that VAT has the capacity of covering all the stage of production to the retail level and the services.
- ) VAT simply changes relative prices but not the overall price increase. Tax increase should be deflationary.

Dr. Khadka (1994), 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.

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:

- ) Increase the tax revenue by broadening tax base.
- ) Make the system more transparent and elastic.
- ) Prevent tax evasion.
- ) 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.

Gyawali, Achyut [Himalayan Times (Nepali)] in Falgun 8, 2057 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 business men 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.

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 (2003) 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, 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 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 concluded that in total taxpayers, only 31 to 35% taxpayers paid tax regularly to government. From this article he tried to analyze the contribution of VAT in revenue and effectiveness of VAT in Nepal.

Subedi, (April, 2013) Artha, A journal of Public finance and Economy, In his Artical "assessment of Value Added Tax through Its productivity" Pointed out major issue and described about VAT. The major finding of his article are pointed as:

- ) Expansion of exempt schedule and narrowing the tax base.
- ) Threshold problem which is working as the shield to bring all taxpayers in the tax net.
- ) Billing enforcement problem is the major one which has barred to make VAT a total success. The seller is reluctant to issue the invoices.

- ) Unawareness among general people about the importance of benefit of invoices.
- ) Low valuation declared in the custom point which is working as the starting point of under invoicing of the goods.
- ) Low compliance by the registration taxpayers.
- ) Fixation of low ex-factory price in international production and further under valuation by whole seller and retailers.
- ) Use of fake and forged invoices for tax credit.
- ) Lack of ethical code of conduct for tax auditors and professionals.
- ) Existence of strong and active informal sector particularly on border trade.
- ) Weak enforcement strategy of the tax administration.
- ) Low compliance of compulsory registration of goods and services.
- ) Increasing non filer, Zero and credit filer and decreasing of debit filers.
- ) So many taxes rebate.

Gabriel Temesgen (Nov.2013) Researchjournal's journal of Accounting Vol.1, No.1 "Problem and Prospects of Value Added Tax (VAT) Implementation In Tigiri Regional States" mainly focused on this study consumers and business community to assess their perception towards VAT and point out of the major bottlenecks in its implementation. Based on the results of the analysis and discussions of the data of this study, provided the following conclusion.

- ) Most consumers are concentrated on the areas of merchandise and service sectors.
- ) The data shows that while the intent that the benefit of the system goes to the society. Most of the respondents felt that the government is the sole beneficiary of the system.
- ) The data for the request on the approval of business on their registration of VAT payment system is very suggestive on the fact that although the government authorities have disseminated information on the importance of VAT to VAT paying business, the required correct perception on the system and the willful registration of the business has not yet come to the desired level.

- ) Although most VAT payer business are located in electrified major cities. Significant of them have not yet started using the VAT registration machine.
- ) Significant portion of the VAT payers have negative perception about the fairness of the payment across the business.
- ) Many businesses have confirmed that there has been a significant turn down in the number of their customers following the implementation of VAT system.
- ) Majority of the consumers get to know about VAT from government media, thus it can be concluded that the government media has played an important role in awareness creation of the system, nevertheless, considerable number of the consumers have never heard of the system prior its implementation.
- ) Based on the survey it can be remarked that majority of the respondents have relatively good perception towards VAT on understanding the rational for paying VAT.
- ) Many consumers believe that VAT has been the very reason for business firms to impose higher price on products or service delivered and in some cases, they believe that the rate of VAT charged is more than double since it is imposed on the total price of the product.
- ) Significant number of VAT registered businesses fails to offer VAT receipts up on payment, providing used VAT receipts as a means evade from the system.
- ) The level of enforcing business firms to provide bill during payments is low as majority of the consumers fail to ask for receipt during payments, similarly many consumers fail to tear down the receipt as it give the chance to use illegal businesses for tax evasion.

### 2.2.2 Review of Thesis

Manamohan Thapa had completed a thesis on "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.

- ) VAT should be extended through retail level as a bulk of tax performance to generate more revenue.
- ) 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.
- ) It is necessary to design a well-trained and skilled functional organizational pattern.
- ) Close cooperation between private and government sector is required.
- ) The existing laws of VAT should be revised.
- ) Issuing invoices for every taxable sells must be made compulsory.
- ) The open boarder should be managed by controlling the boarder side secret business.
- ) The illegal and unrecorded business should be penalized by the authority.

Subedi, (2004) in his dissertation "VAT in Nepal: An Analysis of its problem and prospect" analyzed 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:

- ) VAT is superior than 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

) Due to the lack of experts, skill manpower in the VAT administration on the auditing system which is one of the most important part operation is not effective.

) The prospect of VAT entirely depends 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 analyzes 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.

### **2.3 Research Gap**

In this way various books, papers, dissertations, reports, articles, journals and other reference materials have been reviewed while preparing the dissertation. But there are not sufficient study conducted in such particulars topic that “Value added tax in Nepal, Past and Present” in Nepal most of the studies were related with theoretical aspect. The previous researchers were not able to explain the research gap but this study is focused to review the research gap in Nepal and it concluded that there is a huge research gap. Besides this the country is also facing the increasing burden of foreign loan. They have not shown the number of debit return filer, credit return filer and zero return filer. Besides this, the revenue performance of VAT is not properly studied. Only the limited challenges for VAT implementation are explained. In this study, the area of challenges for effective VAT implement in Nepal is studied. They are not explaining the VAT rules and regulation. Such special studies have not conducted yet so, this study is different from other related studies. VAT is being an important factor to government tax revenue so that its real situation and exact contribution n GDP, total revenue and tax revenue are also found out which made for effective VAT implementation in Nepal.

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

## **CHAPTER - III**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

Methodology states the method in which data have been extracted and discoursed, the tools that have used in interpretation of such data to fulfill the objectives. This study is undertaken to examine the condition of value added tax in Nepal, past and present. Actually this is a review of past and present situation of VAT system in Nepal. More specifically to fulfill objective describe about research design, nature and sources of data, tools, procedure of presentation and analysis etc.

#### **3.2 Research Design**

A research design is a plan for the collection and analysis of data. It is not possible for a researcher to conduct a research present without a research design. Normally research design becomes either primary data or secondary data or both. Most of data and information of the study are concerned with past phenomena of the performance either they are numerical or opinions, the studies have made the base of past rustles of VAT and to analyze it. After collection of past data and experience, this study uses its own procedure. Therefore this study also followed analytical as well as descriptive research design.

#### **3.3 Nature and Sources of Data**

In order to achieve good result of this research, the researcher collected secondary data from different sources.

##### **3.3.1 Sources of 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, 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 IRD department, economic review and indicators form Nepal Rastra Bank etc. and other relevant records and data related to this study.

### **3.4 Presentation and Data Analysis**

The information collected from different sources i.e. primary and secondary is processed for tabulation and analysis. For the purpose of analysis, generally simple statistical tools have be used which are as follows.

- a) Simple percentage
- b) Simple Average
- c) Graphs, chart, and diagrams.
- d) Other statistical tools.
  - Time series,
  - Trend line etc.

## CHAPTER -IV

### PRESENTATION AND ANALYSIS OF DATA

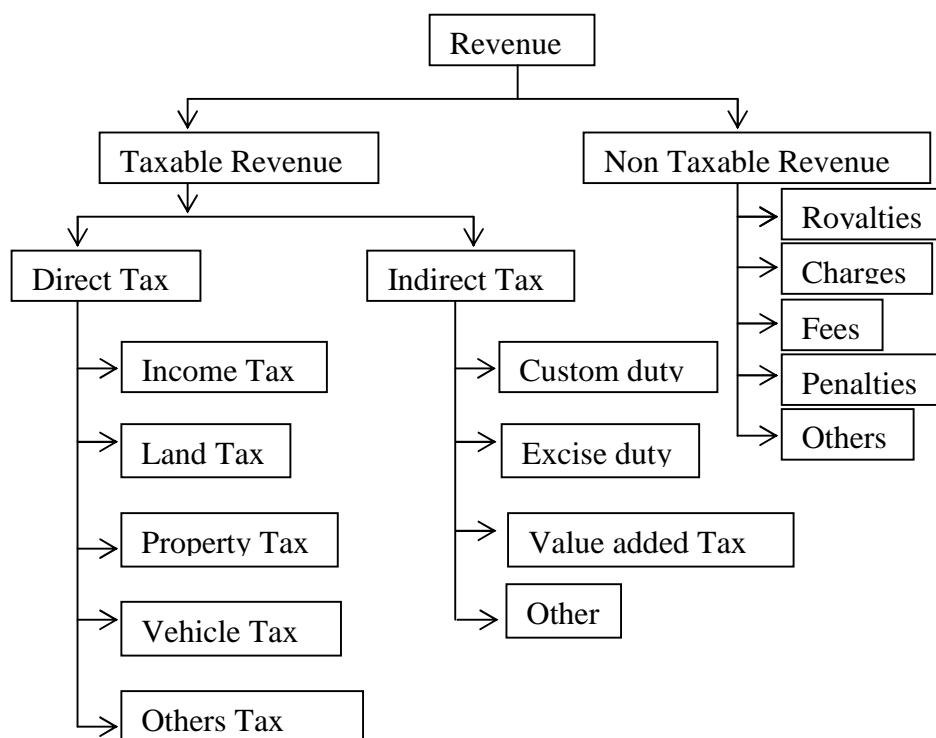
#### 4.1 Nepalese Tax Structure

##### 4.1.1 Total Revenue Structure

This section of this chapter is concerned with the total revenue structure of the government of Nepal. Total revenue is divided into two parts, i.e. taxable revenue & non taxable revenue.

Table 4.1 presents the total revenue structure of the government. The presentation has been made for the period before and after introduction of VAT.

##### Structure of Total Revenue



Source: Economic Survey 2012/13, MOF, Kathmandu

Both tax revenue and non tax revenue are equally important for the government. The structure of tax revenue and non-tax revenue is mostly determined by the type of economy that the government adopts. In capitalist economy, amount of tax revenue is generally higher than non tax revenue and socialist economy, the amount of non tax revenue is generally high.

In Nepalese economy amount of tax revenue is generally higher than that non tax revenue. The following table shows the total taxable and non taxable revenue of country.

**Table 4.1**  
**Structure of Total Revenue before and after VAT**

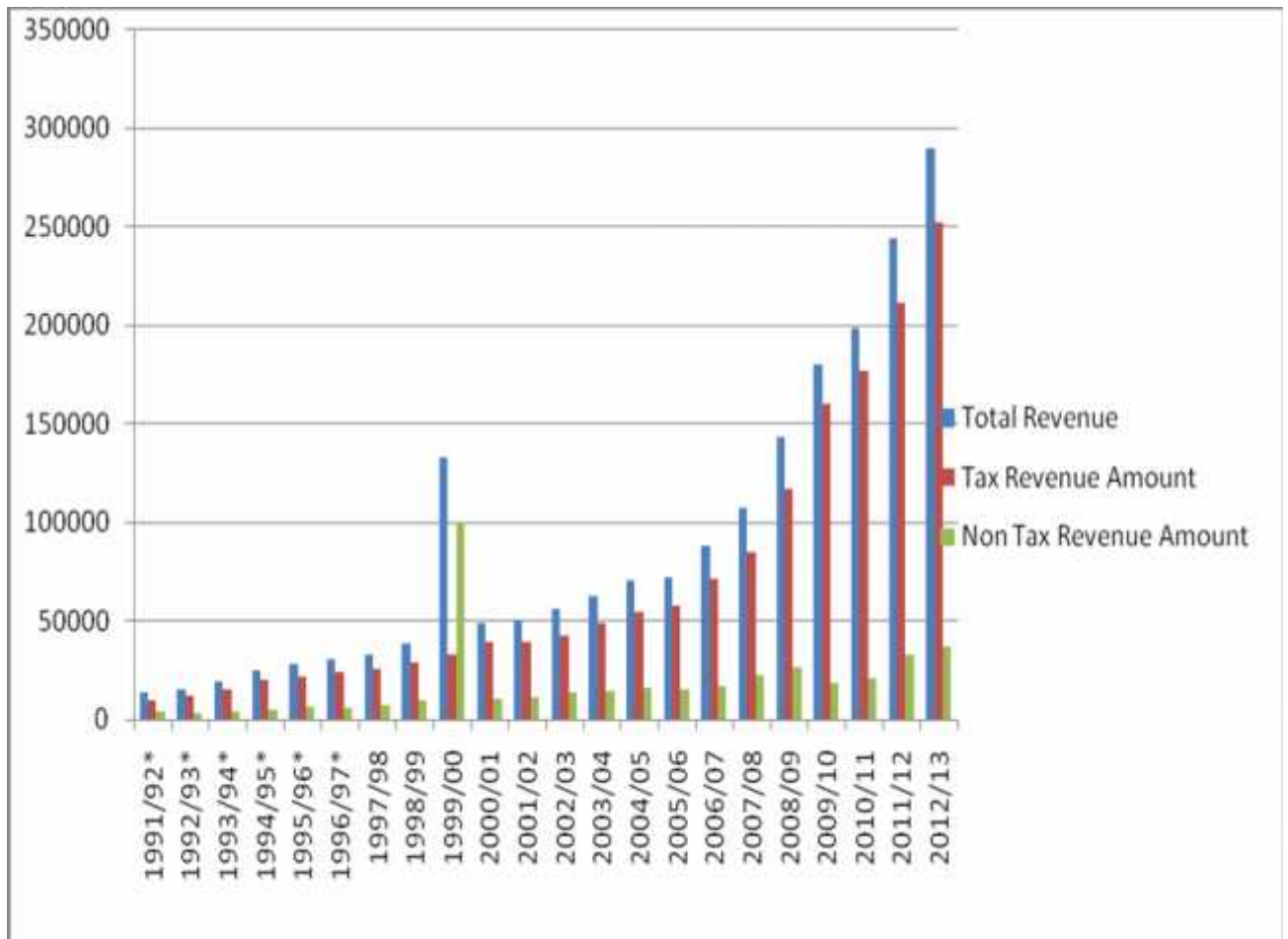
(Rs in millions)

Fiscal Year	Total Revenue	Tax Revenue		Non Tax Revenue	
		Amount	%	Amount	%
1991/92*	13512.7	9875.6	73.1	3637.1	26.9
1992/93*	15148.4	11662.5	76.99	3485.9	23.01
1993/94*	19580.9	15371.5	78.5	4209.4	21.5
1994/95*	24605.1	19660	79.9	4945.1	20.1
1995/96*	27893.1	21668	77.7	6225.1	22.3
1996/97*	30373.5	24424.3	80.4	5949.2	19.6
Average Growth Rate	21852.3	17110.3	77.8	4742.0	22.2
1997/98	32937.9	25939.8	78.7	6998.1	21.3
1998/99	38251.3	28752.9	77.2	9498.4	22.8
1999/00	132866.7	33152.1	77.3	99714.6	22.7
2000/01	48893.9	38865.1	79.5	10028.8	20.5
2001/02	50445.6	39330.6	78	11115	22
2002/03	56229.8	42586.9	75.7	13642.9	24.3
2003/04	62871	48713	77.3	14158	22.7
2004/05	70122.7	54104.7	77.2	16018	23
2005/06	72282.1	57430.4	79.5	14851.7	20.5
2006/07	87712.2	71126.7	81.1	16585.5	18.9
2007/08	107622.5	85155.5	79.1	22467	20.9
2008/09	143474	117051	81.6	26422	18.4
2009/10	179945	159785	88.8	18205	11.2
2010/11	198376	177227	89.3	21148	10.7
2011/12	244374	211722	86.6	32651	13.4
2012/13	289604	252572	87.2	37032	12.8
Average Growth Rate	113500.5	74433.9	80.9	23158.5	19.1
Total	1947122.4	1546176.6	0.0	398987.8	0.0

Source: Economic survey 2012.13 MOF

Note: The years marked with \* represent the period before the introduction of VAT and the years not marked with \* represent the period after the introduction of VAT.

**Figure -4.1**  
**Structure of Total Revenue before and after VAT**



Source: Economic Survey 2012/13, MOF, Kathmandu

The table 4.1 and bar graph presents the structure of total revenue before and after VAT. A period between 1991/92 and 2012/2013 are covered in the study, which is divided into two parts. Period from 1991/92 to 1996/97 respectively represents the period prior the introduction of VAT and period from 1997/98 to 2012/2013 represents the period after the introduction of VAT.

The average contribution of tax revenue and non tax revenue on total revenue before the introduction of VAT is 17110.3 millions and 4742 millions respectively and after introduction of VAT is 74433.9 millions and 23158.5 millions respectively. Such as the contribution of average growth rate of tax revenue and non tax revenue on total revenue before the introduction of VAT is 77.8 % and 22.2% respectively, same as the contribution of average growth rate of tax revenue and non tax revenue on total

revenue after the introduction of VAT is 80.9% and 19.1 % respectively. The above figure proves that the contribution of tax revenue on total revenue is increased after the introduction of VAT. The contribution of tax revenue on total revenue in year 1991/92 is 73%. This slightly increased up to the year 1996/97. In year 1996/97, it reached to 80.4%. On the other hand, the contribution of non-tax revenue on total tax is 20% which is decreasing order. It reached to 19.6% in year 1996/97. It proves that tax revenue was in increasing order and non tax revenue is in decreasing order before the implementation of VAT. But after implementation of VAT in year 1997/98, the contribution of tax revenue come down to 78.7% and does not cross 80% till 2005/06. On the other hand the contribution of non tax revenue increase to 21.3% in year 1997/98 and does not fall below 20% till 2005/06, which proves that the role of tax revenue is very much important in revenue mobilization of Nepal and to meet the increasing government expenditure. Tax revenue has been placed as a major source of government revenue in Nepal.

#### **4.1.2 Structure of tax revenue**

Tax is the main source of government. Mainly there are two types of tax revenue, Direct tax revenue and Indirect tax revenue. Direct tax is that type of tax which is really paid by the tax payer. Direct tax is the sum of personal and corporate income tax, property tax, vehicle tax, interest tax and others. Indirect tax is that type of tax, which is levied on one person and paid by another person. Indirect tax is the sum of excise duty, goods and service based tax. Direct tax is important than indirect tax for the economy. Direct tax is more progressive than indirect tax. Social Justice can be established by direct tax. On the other hand both higher income group and lower income group are equally responsible to pay indirect tax.

**Table 4.2**  
**Structure of Total Tax Revenue**

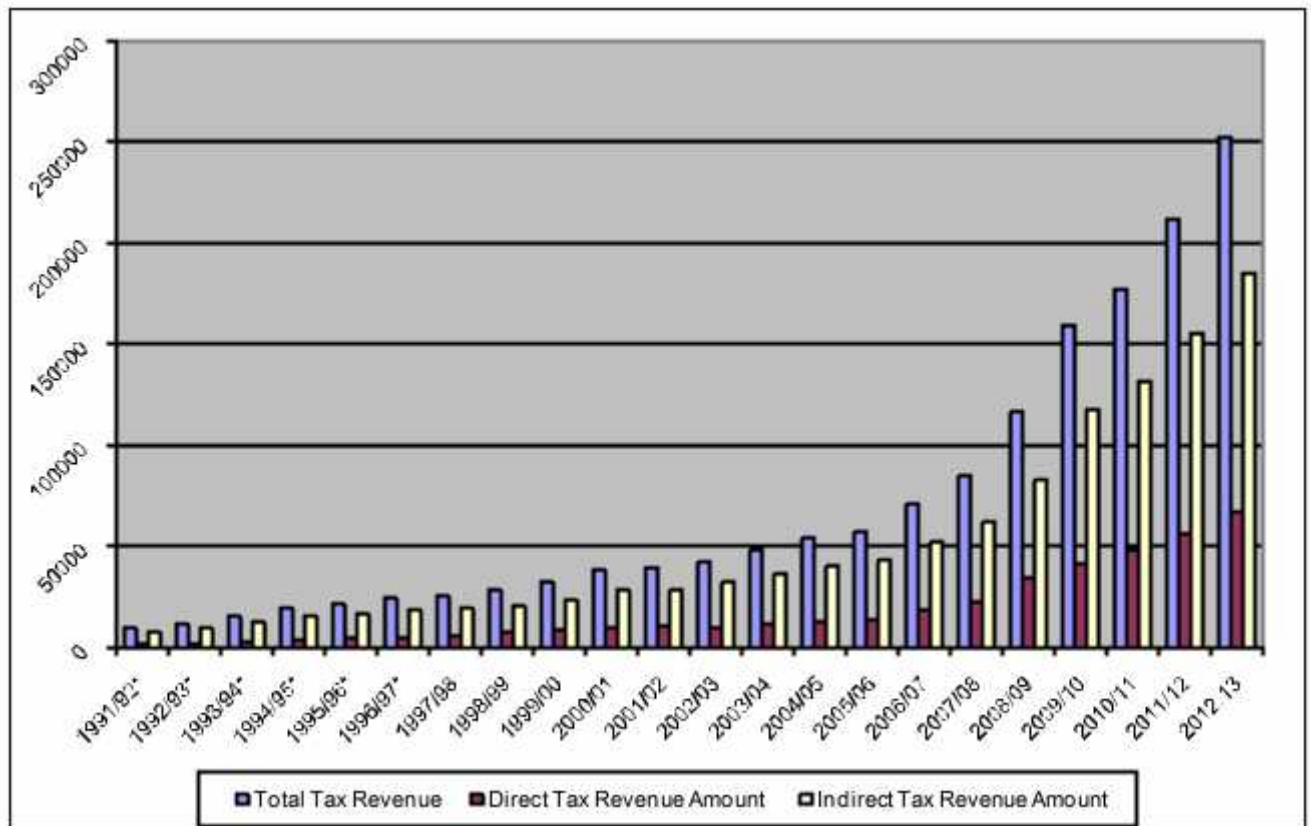
(Rs in millions)

Fiscal Year	Total Tax Revenue	Direct Tax Revenue		Indirect Tax Revenue	
	Amount	Amount	%	Amount	%
1991/92*	9875.60	1595.20	16.15	8280.40	83.85
1992/93*	11662.50	2036.20	17.46	9626.30	82.54
1993/94*	15371.50	2855.30	18.58	12516.20	81.42
1994/95*	19660.00	3849.30	19.58	15810.70	80.42
1995/96*	21668.00	4655.90	21.49	17012.10	78.51
1996/97*	24424.30	5340.00	21.86	19084.30	78.14
Average Growth Rate	17110.30	3388.65	19.80	13721.65	80.20
1997/98	25939.80	6187.90	23.85	19751.90	76.15
1998/99	28752.90	7515.40	26.14	21236.80	73.86
1999/00	33152.10	8951.50	27.00	24200.70	73.00
2000/01	38865.10	10199.40	26.24	28705.70	73.86
2001/02	39330.60	10597.60	26.94	28733.00	73.06
2002/03	42586.90	10105.70	23.73	32481.20	76.27
2003/04	48713.00	11912.60	24.45	36260.40	74.44
2004/05	54104.70	13071.80	24.16	41032.90	75.84
2005/06	57430.40	13968.10	24.32	43462.30	75.68
2006/07	71126.70	18980.30	26.69	52146.40	73.31
2007/08	85155.50	23087.70	27.11	62067.80	72.89
2008/09	117051.00	34320.00	29.32	82731.00	70.68
2009/10	159785.00	41750.00	26.13	118035.00	73.87
2010/11	177227.00	48655.00	27.45	131595.00	74.25
2011/12	211722.00	56446.00	26.66	155276.00	73.34
2012.13	252572.00	67679.00	26.80	184894.00	73.20
Average Growth Rate	90219.70	23964.30	26.56	66413.10	73.61
Total	1546176.60	403759.90	26.11	1144940.10	74.05

Source: Economic survey 2012.13 MOF

Note: The years marked with \* represent the period before the introduction of VAT and the years not marked with \* represent the period after the introduction of VAT.

**Figure -4.2**  
**Structure of total Tax revenue Bar graph**



Source: Economic Survey 2012/13, MOF

The table 4.2 and bar graph presents the structure of total Tax revenue before and after VAT. A period between 1991/92 and 2012/2013 are covered in the study, which is divided into two parts. Period from 1991/92 to 1996/97 respectively represents the period prior the introduction of VAT and period from 1997/98 to 2011/2013 represents the period after the introduction of VAT. The average contribution of direct tax revenue and indirect tax revenue on total tax revenue before the introduction of VAT is 3388.65 millions and 13721.65 millions respectively and after introduction of VAT is 23964.3 millions and 66413.4 millions respectively. Such as the contribution of average growth rate of direct tax revenue and indirect tax revenue on tax, total revenue before the introduction of VAT is 19.21% and 80.79% respectively, same as the contribution of average growth rate of direct tax revenue and indirect tax revenue on total tax revenue after the introduction of VAT 26.56% and 73.4% respectively. The above figure shows that the average percentage of indirect tax is decreasing after introduction of VAT. After implementation of VAT it helps to increase income tax

and other direct tax due to its catch up effect. The trend of the revenue, direct tax, indirect tax shows the confidence with amount collection as direct tax and indirect tax are increasing order.

**Table - 4.3**  
**Percentage increase of direct tax Revenue and Indirect tax revenue as compound to previous year**

(Rs in millions)

Fiscal Year	Direct Tax Revenue		Indirect Tax Revenue	
	Amount	% Increased	Amount	% Increased
1991/92*	1595.2	0	8280.4	0
1992/93*	2036.2	27.6	9626.3	16.3
1993/94*	2855.3	40.2	12516.2	30
1994/95*	3849.3	34.8	15810.7	26.3
1995/96*	4655.9	21	17012.1	7.6
1996/97*	5340	14.7	19084.3	12.2
1997/98	6187.9	15.9	19751.9	3.5
1998/99	7515.4	21.5	21236.8	7.5
1999/2000	8951.5	19.1	24200.7	14
2000/2001	10199.4	13.9	28705.7	18.6
2001/2002	10597.6	3.9	28733	0.1
2002/2003	10105.7	0.7	32481.2	10.9
2003/2004	11912.6	17.9	36260.4	11.6
2004/2005	13071.8	9.7	41032.9	13.2
2005/2006	13968.1	6.9	43462.3	5.9
2006/2007	18980.3	35.9	52146.4	20
2007/2008	23087.7	21.6	62067	19
2008/2009	34320	48.7	82731	33.3
2009/2010	41750	21.6	118035	42.7
2010/2011	48655	16.5	131595	11.5
2011/2012	56446	16.0	155276	18.0
2012/13	67679	19.9	184894	19.1
Total	403759.9		1144939	
Average	789167.1		52042.7	

Source: Economic survey 2012.13 MOF

Note: The years marked with \* represent the period before the introduction of VAT and the years not marked with \* represent the period after the introduction of VAT.

The table 4.3 presents the percentage increase of direct tax Revenue and Indirect tax revenue as compound to previous year . A period between 1991/92 and 2012/2013 are covered in the study, which is divided into two parts. Period from 1991/92 to 1996/97 respectively represents the period prior the introduction of VAT and period from 1997/98 to 2012/2013 represents the period after the introduction of VAT. From the above table, researchers can say that the increase percentage of direct tax revenue is decreasing order in beginning years. After implementation VAT, it is going increasing order than after in the year 2002/03, the increasing percentage of direct tax revenue is almost zero (0.7). After this in the year 2012/2013, it is in increasing order.

In the other hand the increasing percentage of indirect tax revenue is increase and decreasing order. In the year 1991/92, the increasing percentage is 16.3. Then after in the year 1997/98, increasing percentage is 3.5. After implementation the VAT in the year 2002/03, the increasing order is 10.9 then after in the year 2007/08, it is reached in 19.0 percent.

#### A. Structure of direct tax revenue

A direct tax is a tax paid by a person on whom it is legally imposed. In direct tax, the person paying and bearing tax is the same. Direct tax is a tax on income and property. The characteristics of a direct tax are equitable as per the property or income, certainty as per the process of payment, amount to be paid time of payment elastic in nature. The example of direct tax revenue are income tax, property tax, vehicle tax, interest tax, expenditure tax death tax, unite tax etc.

**Table - 4.4**  
**Structure of Direct Tax Revenue**

(Rs in millions)

F/Y	Land Revenue and registration				Tax on property profit and income				
	Land Rvenue	House and land Registration	Total	% of Direct Tax	Income Tax	Taxatio n on Vehicle	Others	Total	% Of Direc t Tax
1991/92*	65	571	636	39.9	856	68	35	959	61.1
1992/93*	69	686	755	37.1	1125	80	78	1283	63.9
1993/94*	61	772	833	29.2	1825	49	148	2022	70.8
1994/95*	35	903	938	24.4	2712	88	112	2912	75.6
1995/96*	18	1048	1066	22.2	3312	158	119	3589	77.6

1996/97*	6	1009	1015	19	3969	201	154	4324	81
Average Growth Rate	0	0	0	28.6	0	0	0	0	71.6
1997/98	4	1000	1004	16.2	4686	286	121	5093	83.8
1998/99	1	1001	1002	13.3	5350	343	819	6512	86.7
1999/00	5	1011	1016	11.4	7006	515	416	7937	88.7
2000/01	5	608	613	6	8690	356	464	9510	94
2001/02	0	1131	1131	11.3	8907	433	468	9808	88.7
2002/03	0	1414	1414	14	7268	560	864	8692	86
2003/04	0	1697	1697	14.2	8781	701	733	10215	85.7
2004/05	0	1799	1799	13.8	9709	806	757	11272	86.2
2005/06	0	2181	2181	15.6	10164	848	775	11787	84.4
2006/07	0	2253	2253	11.9	14677	995	1055	16727	88.1
2007/08	0	2941	2941	12.7	17990	1069	1088	20147	87.3
2008/09	0	5223	5223	15.2	25562	1850	1685	29097	84.7
2009/10	0	5511	5511	13.2	31355	2417	2466	36238	86.7
2010/11	0	3572	3572	7.3	37930	3022	4130	45082	92.6
2011/12	0	3588	3588	6.3	48126	3408	1324	52858	93.2
2012.13	0	4198	4198	6.2	57072	4211	2198	63481	94.3
Average Growth Rate		39919		11.8					88.1
Total	270	31617	31887	368.5	328378	14845	16487	359710	

Source: Economic Survey, 2012.13. MoF

Note: The years marked with \* represent the period before the introduction of VAT and the years not marked with \* represent the period after the introduction of VAT.

The table 4.4 presents the structure of direct Tax revenue before and after VAT. A period between 1991/92 and 2012/2013 are covered in the study, which is divided into two parts. Period from 1991/92 to 1996/97 respectively represents the period prior the introduction of VAT and period from 1997/98 to 2012/2013 represents the period after the introduction of VAT.

The contribution of average growth rate of Land Revenue and registration and Tax on property, profit and income Tax before the introduction of VAT is 28.63% and 71.67%, same as the contribution of average growth rate of land revenue and registration and Tax on property, profit and income after the introduction of VAT is 11.8 % and 88.2% respectively. The figure shows, average growth rate of land revenue & registration is decreased after introduction of VAT but other hand Tax on property, profit and income is increased. From the above table 4.4, shows the land revenue is continued decreasing from fiscal years 1994/95 to 2000/01. Then it is nil. Another land registration is increasing slowly but it is decreased in 2000/01. House and land registration increasing rate is low. The total income is Rs. 938 million from

land and revenue and registration in the fiscal year 1991/92 it is about 39.9% of total direct tax revenue. The data maintained that the total land revenue and registration is Rs 4198 in the fiscal year 2012/13. This is 6.2% of total direct tax revenue.

In another side the income tax is in increasing order. 959 million is in the year 1991/92. After sixteen year, it reached in Rs.63481 million. But decrease in 2002/03. Tax on property is increasing and decreasing order and reached from 68 million to 4211 million, like wise other tax amount is increasing and decreasing order and reached from 35 to 2198 million in total of tax on property, profit and income shows increasing order and cover 61.1 % in the fiscal year 1991/92 to 88.1% percentage in 2012/2013.

## B. Structure of Indirect Tax Revenues

An indirect tax is a tax imposed on one person but party or wholly paid by another. it is that tax where the person pay the tax and the person bearing the tax are different. An indirect tax is a tax on goods and services. The main features of indirect tax are convenient to pay, mass participation, limited evasion shifting of incidence. The consumer pays the tax to the business person, not the government etc. The examples of indirect taxes are customs, excise Value added tax and so on.

**Table - 4.5**  
**Structure of Indirect tax Revenue**

(Rs in Millions)

F/Y	Total Indirect Tax	Custom duty		Sales tax as VAT		Excised duty		Other tax	
		Amount	%	Amount	%	Amount	%	Amount	%
1991/92*	8280.4	3359	40.57	2841.4	34.31	1414	17.08	666	8
1992/93*	9626.3	3945	40.98	3438	35.71	1453	15.09	790.3	8
1993/94*	12516.2	5255	41.99	4693	37.5	1593	12.73	975.2	7.8
1994/95*	15810.7	7018	44.39	6032	38.15	1657	10.48	1103.7	7
1995/96*	17012.1	7327	43.07	6431	37.8	1944	11.43	1310.1	7.7
1996/97*	19084.3	8309	43.54	7127	37.34	2298	12.04	1350.3	7.1
Average Growth Rate	13721.65	5868.83	42.42	5093.73	36.8	1726.5	13.14	1032.6	7.52
1997/98	19751.9	8502	43.04	7132	36.11	2886	14.61	1231.9	6.3
1998/99	21236.8	9518	44.82	8765	37.11	2953	13.91	883.8	4.3
1999/00	24200.7	10813	44.68	10259	40.72	3128	12.93	404.7	1.3
2000/01	28705.7	12552	43.73	12382	41.97	3771	13.14	334.7	0.8

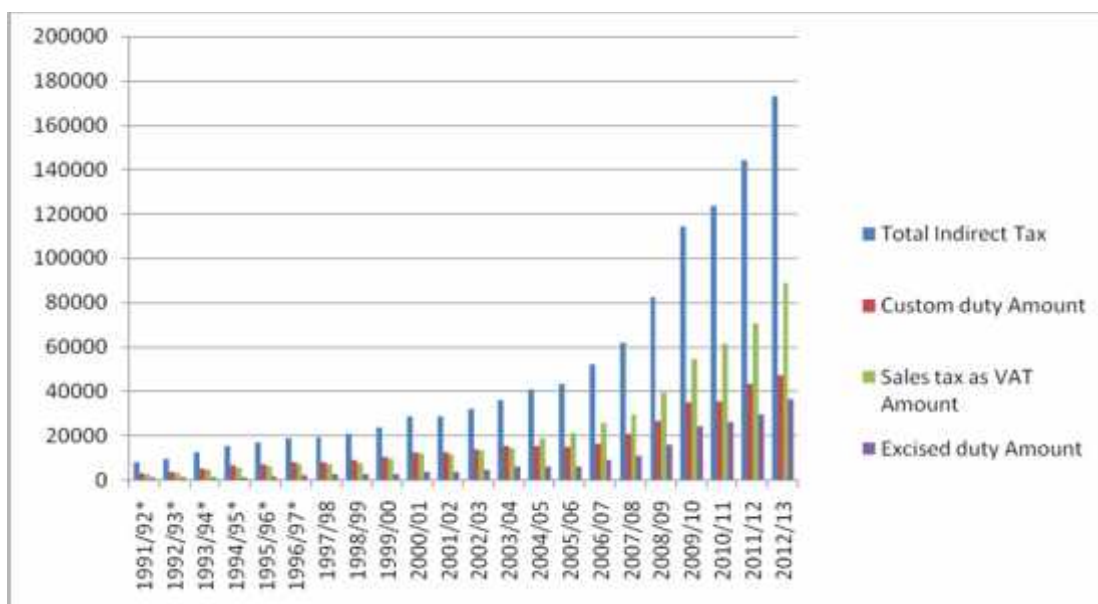
2001/02	28733	12659	44.06	12267	41.64	3807	13.25	303	3.2
2002/03	32481.2	14236	43.83	13460	41.44	4785	14.73	0.2	2.3
2003/04	36260.4	15555	42.9	14479	39.93	6227	17.17	-0.6	0
2004/05	41032.9	15702	38.27	18885	46.02	6446	15.71	-0.1	0
2005/06	43462.3	15344	35.3	21611	49.72	6508	14.97	-0.7	0
2006/07	52146.4	16708	32.04	26096	50.04	9343	17.92	-0.6	0
2007/08	62067.8	21063	33.94	29816	48.04	11190	18.03	-1.2	0
2008/09	82713.65	26792	32.39	39700	48.00	16220	19.61	1.65	0
2009/10	114392.71	35150	30.73	54920	48.01	24306	21.25	16.71	0
2010/11	124801	35713	28.62	61663	49.41	26338	21.10	1087	1
2011/12	145659	43390	29.79	70930	48.70	30016	20.61	1323	1
2012/13	175135	47444	27.09	88951	50.79	36542	20.87	2198	1
Average Growth Rate	40966.41	21321.31	37.20	30587.00	44.85	12154.13	16.86	486.34	1.33
Total	1115110.5	376354		519954.4		204825		13977.06	

Source: Economic Survey, 2012/13. MOF

Note: The years marked with \* represent the period before the introduction of VAT and the years not marked with \* represent the period after the introduction of VAT.

Note: Custom duty included tax on industrial product and liquor control other tax included entertainment tax. hotel tax, air high tax and other.

**Figure - 4.3**  
**Structure of indirect tax revenue**



Source: Economic Survey, 2012/13. MOF

The table 4.5 and bar graph present the structure of indirect Tax revenue before and after VAT. A period between 1991/92 and 2012/2013 are covered in the study, which is divided into two parts. Period from 1991/92 to 1996/97 respectively represents the period prior the introduction of VAT and period from 1997/98 to 2011/2012 represents the period after the introduction of VAT.

The contribution of average growth rate of custom duty, sales tax as VAT, excise duty and other tax before the introduction of VAT is 42.42%, 36.8, 13.14% and 7.52%, same as the contribution of average growth rate of custom duty, sales tax as VAT, excise duty and other tax after the introduction of VAT is 37.2%,44.85%,16.86% and 1.3% respectively. The figure shows, average growth rate of custom duty & other Tax after introduction of VAT is decreased, but other hand sales tax as VAT and excise duty is increased after introduction of VAT. From the above table 4.5, researchers know that the custom duties are increase in silently. In the year 1991/92, duty is 3359 million, now it is reached in 47444 million in the year 2012/2013 like this sales tax, excise duties and other are also changed highly. In the fiscal year 1991/92, there amount was 2841.4 millions, 1414 million and 666 million respectively. The situation of other tax is somehow difference then other taxes it was increased up to year 1996/97 (before implement of VAT) and starts to decrease after implementation of VAT and it is nil in latest fiscal year. The main reason of its decline after implementation of VAT is replacement of entertainment, hotel and contract tax by VAT.

#### **4.2 Analysis of Different Aspects of VAT.**

Value added tax is general consumption tax, assessed on the value added to goods and services. In some countries including Australia, Canada, New Zealand and Singapore this tax is known as "goods and service tax" and Japan it is known as "Consumption tax". It is a general tax that applies in principle, to all commercial activities involving the production and distribution of goods and the provision of services. It is a consumption tax because it is borne ultimately by the final consumer. It is not charge on companies. It is charged as a percentage of prices, which means that the actual tax burden is visible at each stage in the production and distribution chain. It is an indirect tax in that the tax is collected from someone other than the person who actually bears the cost of the tax.

#### 4.2.1 Sales Tax/VAT on GDP Before and After VAT

To know the contribution of sales tax/VAT on GDP on current price, it would be desirable to examine the sales tax or VAT revenue in GDP. The following table indicates the share of sales tax/ VAT revenue in GDP.

**Table 4.6**  
**Sales Tax/VAT on GDP before and after VAT**

(Rs. In millions)

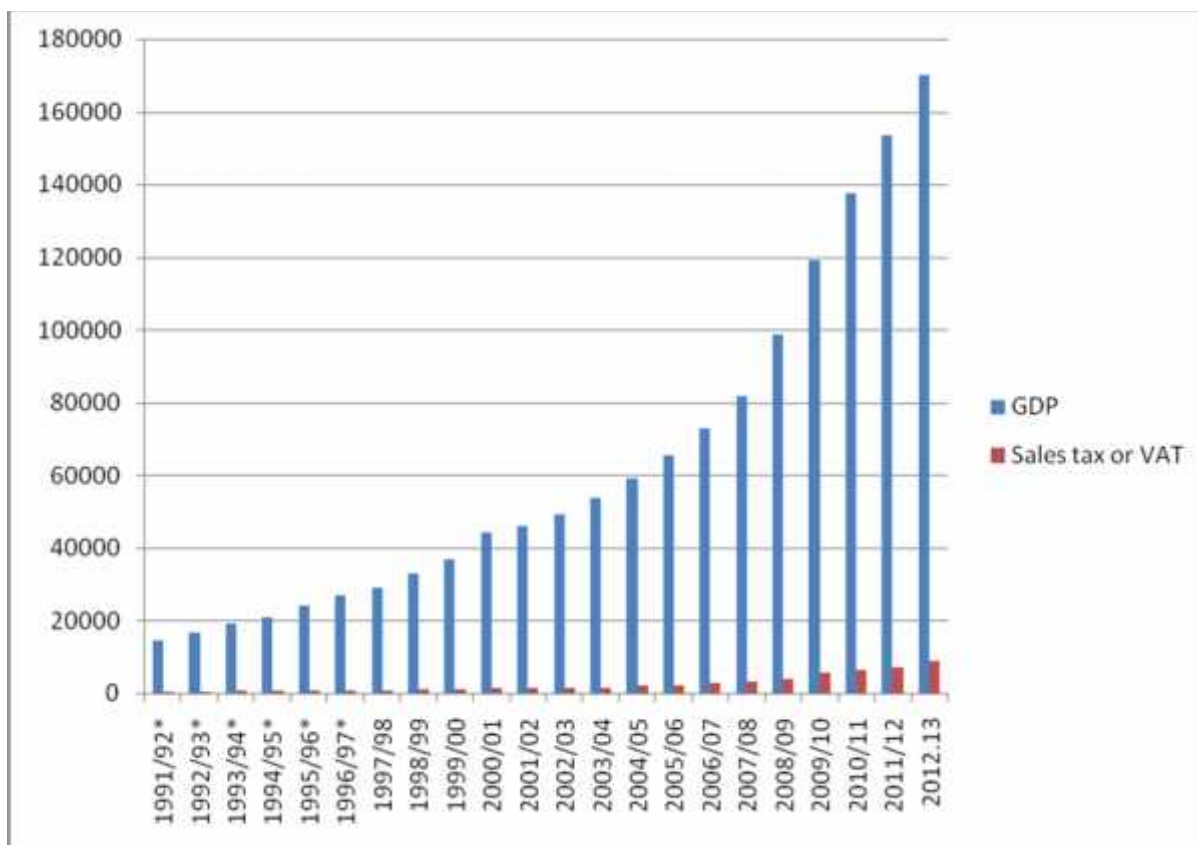
<b>Fiscal Year</b>	<b>GDP</b>	<b>Sales tax or VAT</b>	<b>% GDP</b>
1991/92*	14493	284	1.95
1992/93*	16535	344	2.08
1993/94*	19160	470	2.45
1994/95*	20998	603	2.9
1995/96*	23939	643	2.7
1996/97*	26957	713	2.6
Average Growth Rate	20347	509.5	2.5
1997/98	28970	713	2.5
1998/99	33002	876	2.65
1999/00	36625	1025	2.80
2000/01	44151	1238	2.80
2001/02	45944	1226	2.67
2002/03	49223	1346	2.73
2003/04	53674	1448	2.70
2004/05	58941	1888	3.20
2005/06	65408	2161	3.30
2006/07	72783	2609	3.58
2007/08	81566	2982	3.66
2008/09	98827	3970	4.02
2009/10	119277	5492	4.60
2010/11	137495	6166	4.48
2011/12	153600	7093	4.62
2012.13	170119	8895	5.23
Average Growth Rate			3.47
Total	1371687	52185	70.24

Source: Economic survey 2012.13 MOF

Note: The years marked with \* represent the period before the introduction of VAT and the years not marked with \* represent the period after the introduction of VAT.

The table 4.6 and bar graph present the percentage of sales tax or VAT on gross domestic product before and after VAT. A period between 1991/92 and 2012/2013 are covered in the study, which is divided into two parts. Period from 1991/92 to 1996/97 respectively represents the period prior the introduction of VAT and period from 1997/98 to 2012/2013 represents the period after the introduction of VAT.

**Figure - 4.4**  
**Sales Tax/VAT on GDP Bar graph**



Source: Economic Survey 2012/13, MoF

The contribution of average growth rate of sales tax or VAT on GDP before the introduction of VAT is 2.5%, same as the contribution of average growth rate of sales tax or VAT on GDP after the introduction of VAT 3.5% respectively, which shows that the average growth rate is in increasing year and year after VAT introduction. The above table also shows that the sales tax or VAT is increasing form the fiscal year

1991/92 to the year 2012/2013. After implementation of VAT the increasing order of VAT is high. In the fiscal year 1991/92, the sales tax or VAT revenue was 1.95 % of GDP that reached to 2.6 % in the year 1996/97. The contribution of sales tax or VAT on GDP reaches to 5.23 percentage in the Fiscal year 2011/2013. In Average the contribution of sales tax/VAT increase after implementation VAT.

#### 4.2.2 Sales Tax/ VAT on Total Revenue and Indirect Tax

To know the contribution of sales tax/VAT on total tax revenue and total indirect tax revenue, it would be desirable to examine the share of sales tax /VAT revenue in total revenue and indirect tax revenue.

The following table indicates the share of sales tax/VAT in total revenue and indirect tax revenue before and after VAT.

**Table - 4.7**

#### **VAT on Total Tax Revenue and Indirect Tax Revenue before and after VAT**

(Rs. In millions)

Fiscal Year	Total Tax Revenue	Total indirect tax	Sales tax or VAT		
			Amount	% of total tax	% of indirect tax
1991/92*	9875.6	8280.4	2840	28.77	64.31
1992/93*	11662.5	9626.3	3438.2	29.49	36.47
1993/94*	15371.5	12516.2	4693.1	30.53	37.5
1994/95*	19660	15810.7	6032	30.7	38.2
1995/96*	21668	17012.1	6431	29.7	37.8
1996/97*	24424.3	19084.3	7127	29.18	37.34
Average Growth Rate	17110.3	13721.67	5138.72	29.73	41.94
1997/98	25939.8	19751.9	7132	27.24	36.06
1998/99	28752.9	21236.8	8765	30.48	41.27
1999/00	33152.1	24200.7	10259	30.95	42.39
2000/01	38865.1	28705.7	12382	31.86	43.13
2001/02	39330.6	29292.8	12267	31.19	41.88
2002/03	40896	32481.2	13459	32.91	41.44
2003/04	48713	36260.4	14478	29.72	39.93
2004/05	54104.7	41032.9	18885	34.90	46.02
2005/06	57430.4	43462.3	21610	37.63	49.72

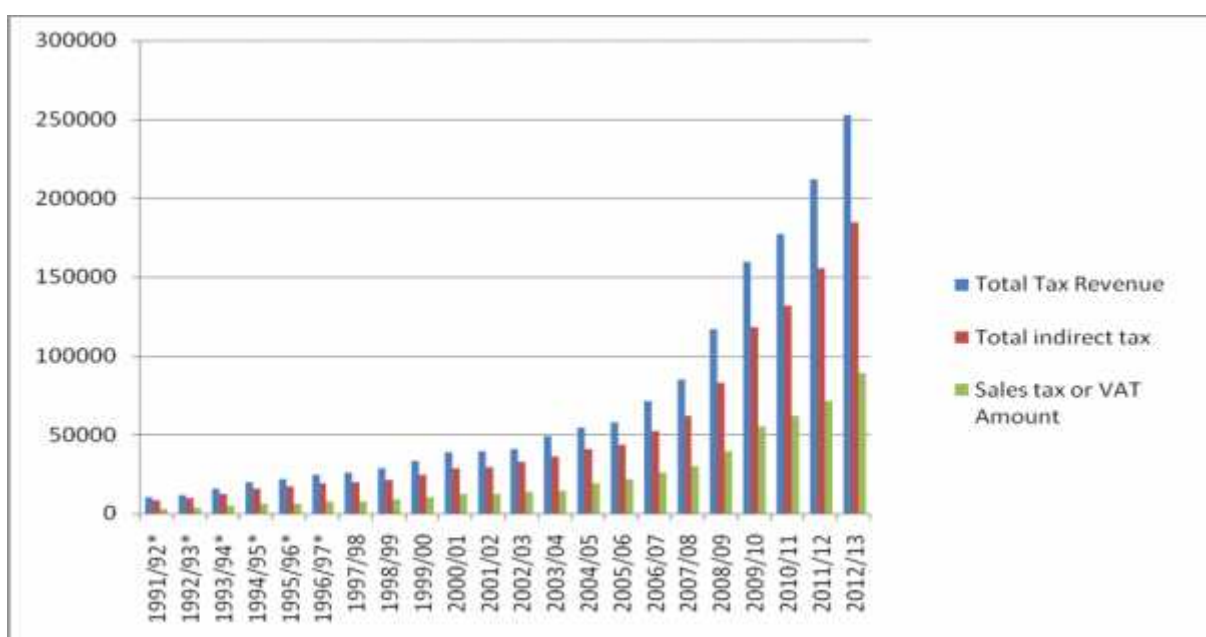
2006/07	71126.7	52146.4	26095	36.69	50.04
2007/08	85155.5	62067.8	29815	35.01	48.04
2008/09	117051	82731	39700	33.92	47.99
2009/10	159785	118035	54920	34.37	46.53
2010/11	177227	131595	61663	34.79	46.86
2011/12	211721	155276	70930	33.50	45.68
2012/13	252571	184894	88951	35.22	48.11
Average Growth Rate	90113.9	66448.1	30706.9	33.15	44.69
Total	1544483.7	1145499.9	521872.3	708.75	966.71

Source: Economic Survey 2012/13, MOF

Note: The years marked with \* represent the period before the introduction of VAT and the years not marked with \* represent the period after the introduction of VAT.

**Figure - 4.5**

**VAT on Total Revenue and Indirect Tax Revenue before and after VAT**



Source: Economic Survey 2012/13, MOF

The table 4.7 and bar graph present VAT on total tax revenue and indirect tax revenue before and after VAT before and after VAT. A period between 1991/92 and 2012/2013 are covered in the study, which is divided into two parts. Period from 1991/92 to 1996/97 respectively represents the period prior the introduction of VAT and period from 1997/98 to 2011/2013 represents the period after the introduction of VAT.

The contribution of average growth rate of VAT on total tax revenue and indirect tax revenue before the introduction of VAT is 29.73% & 41.94%, same as the contribution of average growth rate of VAT on total tax revenue and indirect tax revenue after the introduction of VAT 33.15% & 44.69% respectively, which shows that the average growth rate of total tax is increased but other hand indirect tax is decreased after VAT introduction. From the above table 4.7, researcher can says that the sales tax/VAT is the important sources of government revenue. Which occupy more than Thirty three percent of total tax revenue and more then Fourty four percent of total indirect tax revenue of the government of Nepal. The contribution of sales tax/ VAT on total tax revenue in the year 1991/92 was 28.77 % and on indirect tax revenue in the same year was 64.31 %. The contribution of sales tax or VAT on total tax revenue and indirect tax revenue in the year 1996/97 was 29.18 % and 37.34 % respectively. In the year of VAT implementation the tax revenue and indirect tax revenue is in decreasing order. Now after some year, in the year 2012/2013 the contribution of sales tax/VAT on total tax revenue and indirect tax revenue are 35.22% and 48.11% respectively after implementation of VAT the contribution of VAT sales tax on total tax revenue and indirect tax revenue is in increasing order.

#### **4.2.3 Replacement of Sales, Entertainment, Hotel tax and Contract Tax by VAT**

Sales tax was the important part of indirect tax. A tax based on the sales of goods and services imposed for generating revenue is sales tax. Entertainment tax, hotel tax and contract tax researchers imposed separately with different laws. VAT was introduced with replacement of existing sales tax, entertainment tax, hotel tax and contract tax. Mainly sales tax converted in to value added tax and others are subsidiary.

Sales tax is completely replaced by VAT but hotel, entertainment and contract tax have not been replaced in such way. A small amount of revenue used to be collected under the name of entertainment, hotel and contract tax but their contribution on total is remarkable reduced after the implementation of VAT. Now all the above taxes are being completely replaced by value added tax.

**Table - 4.8****Replacement of Sales, Entertainment, Hotel and Contract Tax by VAT**

(Rs in 10 million)

F/Y	Total		SalesTax / VAT		Contract Tax		Hotel Tax		Entertainment Tax	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
1991/92*	2884.2	100	2840	86.5	21.3	6.5	19.1	5.8	3.8	1.2
1992/93*	3495.1	100	3438.2	85.8	29.3	7.3	22.3	5.6	5.3	1.3
1993/94*	4761.9	100	4693.1	87.2	35.7	6.6	21.9	4.1	11.2	2.1
1994/95*	6114.5	100	6032	88	50.5	7.4	22.9	3.3	9.1	1.3
1995/96*	6530.8	100	6431	86.6	61.3	8.3	28.4	3.8	10.1	1.4
1996/97*	7229.6	100	7127	87.4	61.1	7.5	30.1	3.7	11.4	1.3
Average Growth Rate	5169.3	-	5138.72	-	43.2	-	24.12	-	8.48	-
1997/98	7221.9	100	7132	88.8	76.2	9.5	4.6	0.6	9.1	1.1
1998/99	8829.4	100	8765	92.4	61.8	7.2	0.2	0.02	2.4	0.3
1999/00	10299.6	100	10259	96	37.5	3.7	0.2	0.01	2.9	0.3
2000/01	12415.4	100	12382	97.3	30.4	2.5	0.01	-	3	0.2
2001/02	12297.3	100	12267	97.5	30.1	2.5	-	-	0.21	0.1
2002/03	13459	100	13459	100	-	-	-	-	-	-
2003/04	14478	100	14478	100	-	-	-	-	-	-
2004/05	18885	100	18885	100	-	-	-	-	-	-
2005/06	21610	100	21610	100	-	-	-	-	-	-
2006/07	26095	100	26095	100	-	-	-	-	-	-
2007/08	29815	100	29815	100	-	-	-	-	-	-
2008/09	39700	100	39700	100	-	-	-	-	-	-
2009/10	54920	100	54920	100	-	-	-	-	-	-
2010/11	61663	100	61663	100	-	-	-	-	-	-
2011/12	70930	100	70930	100	-	-	-	-	-	-
2012/13	88951	100	88951	100	-	-	-	-	-	-
Average Growth Rate	30723.10	-	30706	-	14.75	-	0.31	-	1.10	-
Total	522585.72	-	521872	-	495.2	-	149.71	-	68.51	-

Source: Economic Survey 2012/13, MOF

Note: The years marked with \* represent the period before the introduction of VAT and the years not marked with \* represent the period after the introduction of VAT.

The table 4.8 presents the replacement of Sales, Entertainment, Hotel and contract tax by VAT before and after VAT before and after VAT. A period between 1991/92 and

2012/2013 are covered in the study, which is divided into two parts. Period from 1991/92 to 1996/97 respectively represents the period prior the introduction of VAT and period from 1997/98 to 2012/2013 represents the period after the introduction of VAT.

The contribution of average growth rate of Sales, Entertainment, Hotel and Contract Tax before the introduction of VAT is 86.92%, 7.27%, 4.38% & 1.4%, same as the contribution of average growth rate of Sales, Entertainment, Hotel and contract tax after the introduction of VAT 98.13%, 1.69%, 0.04%, & .13% respectively. From the above figure, it proves that the average growth rate of sales tax or VAT is increased after introduction of VAT but in other hand, Entertainment, Hotel and contract tax all are decreased. Value added tax is implemented to replace the sales tax, entertainment tax, Hotel tax and contract tax. In total of 328.3 million where the amount of sales tax, contract tax, hotel tax and entertainment tax contribute serially are Rs. 284.1, Rs 21.3, Rs 19.1 and Rs 3.8 in the fiscal year 1991/92 respectively. In the year 1996/97, the sales tax, contract tax, hotel tax and entertainment tax was 712.7, 61.6, 30.1 and 11.4 respectively. When VAT was introduced the sales tax was completely replaced by it. After VAT contribution of contract tax, hotel tax and entertainment tax on total of four is decreasing year after year and in year 2002/03, their contribution is zero. Which shows that value added tax completely replace these four taxes in year 2002/03. Now VAT is able to replace sales tax, entertainment tax, hotel tax and contract tax completely.

#### **4.2.4 Trend of VAT Registration and Deregistration**

Registration and getting VAT certificate is the first function of both tax administration and business person. The numbers of sales tax registrant were 2045 at the time of introduction of VAT in 1997. Out of the threshold are registrants voluntary in VAT. Business community was opposition in the beginning and they discouraged to register in the VAT. Commitment of government, the registrants are increasing yearly and the private sector also favor of it. In the beginning there are two departments in the introduction of VAT. VAT department and Income tax department. In the past, some researchers registered in VAT department, to improve the revenue collection, refund, registration, audit, data management both revenues department and VAT department

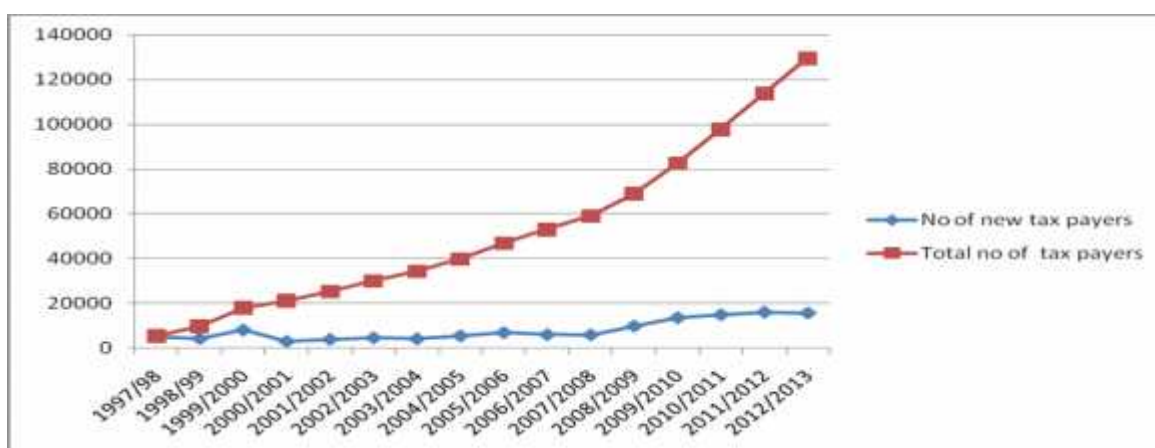
merged with the re-structurally inland Revenue department. Total registrants in PAN (Permanent Account Number) are 623439 and VAT are 129713 till 2012/13. The registration and registration cancellation can be seen from the following table.

**Table - 4.9**  
**Trend for VAT Registration**

Fiscal Year	No of new tax payers	Total no of tax payers	Increasing % of tax payers
1997/98	5237	5237	
1998/99	4405	9642	84.11
1999/2000	8205	17947	85.09
2000/2001	3146	21093	17.53
2001/2002	4056	25149	19.23
2002/2003	4723	29872	18.23
2003/2004	4302	34174	14.4
2004/2005	5602	39776	16.39
2005/2006	7055	46831	17.73
2006/2007	6134	52965	13.1
2007/2008	6076	59041	11.99
2008/2009	9987	69008	13.07
2009/2010	13676	82684	19.81
2010/2011	15047	97731	18.19
2011/2012	16188	113919	16.56
2012/2013	15794	129713	13.86

Source:-IRD, Annual Report, 2069/70

**Figure - 4.6**  
**Trend for VAT registration**



Source:-IRD, Annual Report, 2069/70

From the above table 4.9, researcher can say that the total no of tax payer is in increasing order because the total number of new tax payer or total no of tax payer is

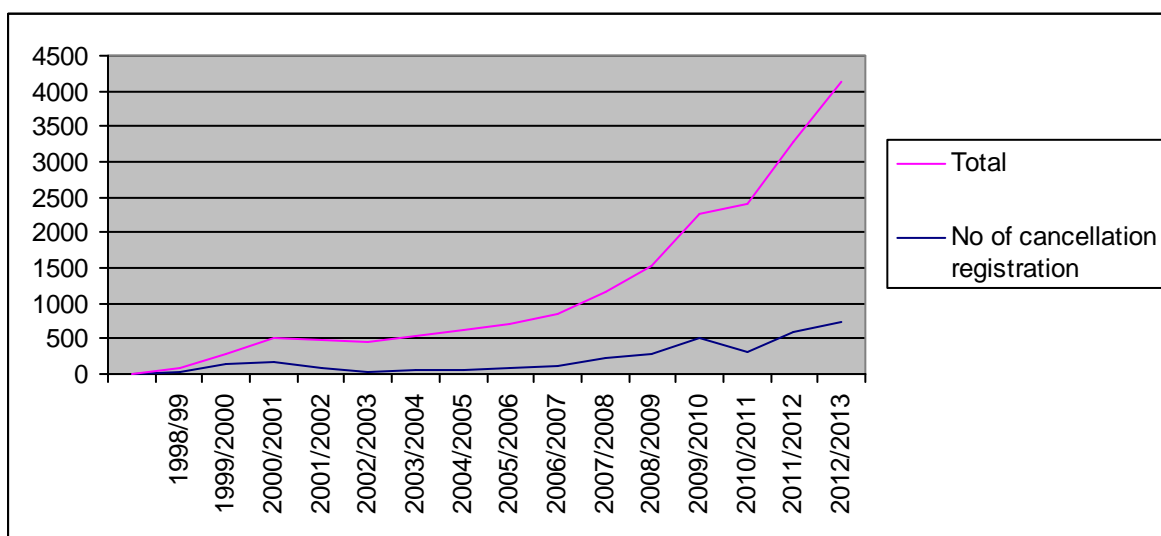
5237 in the Fiscal year 1997/98 (i.e. VAT implementation period). After this, in 2012/13, the total number of new tax payer and total numbers of tax payer are 15794 and 129713 respectively.

**Table - 4.10**  
**Number of Tax payer Deregistration.**

<b>Fiscal Year</b>	<b>No of Deregistration</b>	<b>Total</b>	<b>Percentage</b>
1998/99	36	36	0.7
1999/2000	132	159	1.64
2000/2001	170	329	1.83
2001/2002	80	409	1.93
2002/2003	18	427	1.69
2003/2004	59	486	1.62
2004/2005	63	549	1.6
2005/2006	78	627	1.57
2006/2007	105	732	1.56
2007/2008	217	949	1.79
2008/2009	284	1233	2.08
2009/2010	519	1752	2.53
2010/2011	322	2074	2.5
2011/2012	604	2678	2.74
2012/2013	730	3408	2.99

Sources:-IRD, Kathmandu,

**Figure - 4.7**  
**Number of Tax Payer Deregistration**



Source:- IRD, Kathmandu.

Deregistration is the regular process of VAT. There are many reasons to cancel the registration like it is the corporate organization closed, individual ownership being death, partnership, dissolved, nil trisection year, zero report, confusedly registered etc.

In the above table in the year 1998/99 the no. of deregistration is 36 and it is increasing order. In the year 2012/13, the number of cancellation is 730.

#### 4.2.5 VAT revenue collection

Value added tax is the best form of sales tax, which is natural regarding method of production and helpful in generates more revenue collection. Because of its broad coverage, naturally, transparency and fairness, VAT will generate more revenue with less distortion. The revenue collection from VAT in different fiscal year is presented below.

**Table - 4.11**  
**Trend of Revenue Collection from VAT**

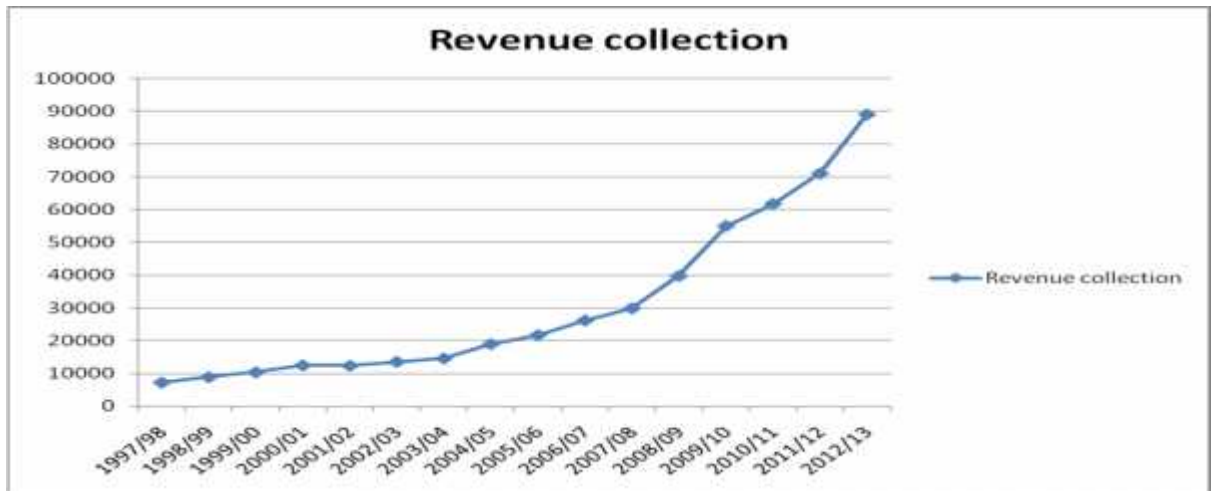
(Rs in Millions)

<b>Fiscal Year</b>	<b>Revenue collection</b>	<b>% Change</b>
1997/98	7132	0
1998/99	8765	22.89
1999/00	10259	17.04
2000/01	12382	20.69
2001/02	12267	-0.92
2002/03	13459	9.71
2003/04	14478	7.57
2004/05	18885	30.4
2005/06	21610	14.4
2006/07	26095	20.8
2007/08	29815	14.26
2008/09	39700	33.15
2009/10	54920	38.33
2010/11	61663	12.27
2011/12	70930	15
2012.13	88951	25.4
Average	30706.94	17.56
Total	491311	280.99

Source: Economic Survey 2012/2013, MOF

**Figure - 4.8**

**Trend of Revenue Collection from VAT**



Source: Economic Survey 2012/2013, MOF

From the above table 4.11, researchers can clear that the value added tax revenue is increasing year to year. VAT generated about 7132 million in the fiscal year 1997/98. In the year 1998/99, it reached up to 8765 million that is 22.89% more than previous year similarly it is increase year to year. In the year 2007/08, it is increased 14.26 % to previous year. Though VAT collection has reached Rs. 88951 million in the fiscal year 2012/13. Despite the various difficulties in the implementation of VAT, the collection trend of revenue through VAT is not bad. Value added tax is increasing radically except fiscal year 2001/02. there are many facilities in value added tax i.e. minimum rate, tax credit, tax refund, deregistration ,zero tax rate, threshold, exemption facilities in value added tax, now tax rate is 13 percent. It is expected that VAT will generate more and more revenue in the days to come when it is implemented effectively and efficiently. Since VAT is broad based tax it will provided a stable base of revenue to the government.

### 4.3 Major Findings

After presentation and analysis the data, in this chapter some important findings are given for study. The major findings are given below.

- a) Value added tax system has been implementing in Nepal has completed sixteen years, it has the target to increase 0.25 percent GDP per year but due to various complexities and problem this tax system has not been able to achieve the expected level of success.
- b) The government expenditure is increasing continuously but a revenue resource is very limited which led to the country to fiscal crises. The major cause of persisting fiscal deficit in Nepal is due to the poorly designed and defected tax system which cause inadequate mobilization of resource.
- c) In Nepalese tax structure; indirect tax is more important than direct tax from the point of view of revenue generation. Before implementation of VAT the contribution of direct tax ratio was around 19.80 percent but after VAT is around 26.56%. Indirect tax contribution before implementation VAT was around 80.20 percent and after VAT it is around 73.61%.
- d) There are three kinds of indirect tax revenue. These are custom duties, sales tax/VAT and exercise duties. In average custom duties is the main and sales tax is the second position in indirect tax revenue. But in this year from 2006/07, around fifty percent of indirect tax revenue covered the VAT revenue. The VAT contributed the 50 percent in total indirect tax revenue.
- e) The contribution of sales tax was 1.95 on GDP in fiscal year 1991/02. Value added tax contribute in average around 3.47 percent of GDP in Nepal. Its contribution on GDP reached to 5.23 percent in year 2012/13.
- f) There is no significant change in revenue structure before and after implementation of value added tax.
- g) Before implementation of VAT, there are various types of tax; those were hotel tax, contract tax, entertainment tax and sales tax having different tax rates. Either the tax rate was less or more than VAT. Hotel tax was between 10 to 14 percent, sales tax was 15 percent, contract tax was more than 100 percent the flat rate 10 percent of VAT replaced and made simplicity and easier.

- h) Number of tax payers registered under VAT has been increasing year after year but their increasing ratio in latest year seen unsatisfactory. The total number of registered tax payers (under VAT) reached to 129713 in the year 2012/13.
- i) Imports generate more VAT revenue than domestic production. Thus import is the main base of VAT in Nepal.
- j) Projection of VAT coming 10 years shows the optimistic future by the base of implemented the past sales tax and VAT.
- k) Number of deregistration trend is going increasing order. In 2012.13, 730 tax payers deregistered their business.

**CHAPTER -V**  
**SUMMARY, CONCLUSION AND**  
**RECOMMENDATIONS**

**5.1 Summary**

Taxation has played an important role in the economic development of each country. Value added Tax is modern Tax system. It is a kind of indirect tax imposed on value added on goods and services by business firm at the successive stage of production and distribution. Value added tax was brought to replace by sales tax, contract tax, hotel tax and entertainment tax. VAT is scientific system of taxation. The types of value added tax are classified in three forms such as (a.) consumption types as invoice/Tax credit method (b.) Income type as subtraction method in connection with deducting facility in subsequent then otherwise addition method and(c.) Gross national production of addition method.

VAT has been regarded as one of the most important innovation in the field of taxation. The evaluation of VAT is the most significant event in the history of commodity tax. German scholar Dr William Von siemens, father of VAT, was the founder of value added tax. He developed the concept of VAT in 1919 AD. The concept of VAT was developed further in 1949 by a tax mission to Japan led by earls S, soup. Any country did not introduce VAT until 1953. In 1954, VAT was first introduced by France to cover the industrial sector alone limiting the tax up to the wholesale level. In 1960, this tax was adopted by Ivory Coast. In 1967, Brazil and Denmark adopted this tax system, there after much other country started adopting this tax. Now 160 countries of the world have been implementing VAT in their economy up to 2013.

In Nepal, 1996/97 budget announced that VAT would be implemented from 1<sup>st</sup> Marga 2054, however full fielded VAT was effective from 1<sup>st</sup> Bhadra 2056. Value added tax act has already been enacted in 1996 to regulate actual practice of VAT. According to value added tax Act 1996, the tax rate is 10 percent and export are subject to a rate of zero percent. There is provision of threshold and exception in VAT Act 1996. Single positive rate of 10 percent, now this rate is changed to 13 percent from 1<sup>st</sup> Magh 2061.

VAT is not only important in the economy but also the other related portion may be easier than replaced tax system. The methods are available to compute of VAT. There are addition method, subtraction method and Tax credit method. Addition method includes salary wages, interest, profit etc. Under the subtraction method, value is determined as net turn over, which is obtained by subtracting the cost of material from sales proceeds. Tax credit method is popular in these methods. In practice invoice is the important document in tax credit method. Comparatively easier and simplicity, tax credit method is also adopting for computing VAT in Nepal.

There are two principle of VAT, origin principle and destination principle. Origin principle advocates the theme that “Tax all goods and services where they are originated or produced that relieved those goods from taxes which are imported from abroad. Under a destination principle of VAT, all exports are allowed to free tax and imports are subject to tax. Nepal has been adopting destination principle of VAT.

## **5.2 Conclusion**

There is no significant change in revenue structure before and after implementation of value added tax. The contribution of tax revenue is 80.9 percent and non tax revenue is about 19.1 percent. Increasing rate is not high. In the 16 years it is increase more than three times in the amount. In this situation mainly the VAT revenue collection is unsatisfactory. The inland Revenue Department should celebrate “Registration Month” as like as “PAN Saptaha”

Both direct and indirect tax is increasing in very low percentage in recent years. So government tax authorities should identify the reason, believed it and take corrective action. Value added tax is implemented for the replacement of sales tax, entertainment tax, hotel tax and contract tax. Therefore the rate of VAT should be decrease from 13 percent to increase the tax base and cover other sector which is exempt area for develop main sources internal revenue . In this way the ratio of VAT collection will be increased.

The base of value added tax should be increased instead of increasing the rate of VAT. in order to increase amount of revenue collection through VAT. Unfortunately

the government increased the rate of VAT from 10 percent to 13 percent in 1<sup>st</sup> Magh 2061, after seven years of VAT Implementation.

The increasing rate of registrant tax payer is not satisfactory because it is in decreasing order. Therefore the tax authority should pay attention toward it. Government should facilitate to small business person to registration under the VAT. The exempted list should be limited and it helps to increase the registration and collection.

### **5.3 Recommendation**

1. 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.
2. Providing various facilities to VAT registrants can increase VAT compliance. The tax administration can select genuine businessmen and reward them.
3. There should be close cooperation between the private sector and government sector for the successful implementation of VAT system.
4. 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.
5. Special incentives should be provided to small business person to increase registration trend.
6. To make VAT effective, It is essential to create an environment which invoices are issued properly, accounts are maintain accurately, tax is based in transaction, there is acceptance of the taxpayers accounts and fair competition among industrialist and businessman should be established.
7. 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 has 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.

8. 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.
9. The existing exemption and zero rating lists are 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
10. This is the age of public private partnership for the development of nation. When the co-partners are way from their objectives it arise the problems. Without the coordination of private sector with government, the mission could not be kissed. In this way coordination is the compulsory function of government and private sector.

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