

## **ISSUES AND IMPACT OF VAT IN NEPAL**

**Jitendra Prasad Upadhyay (Ph D)\***

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### **Abstract**

*VAT is a form of indirect taxation which is levied on the value-added goods & services. Like all taxes, VAT is subject to evasion and offers distinctive opportunities for evasion. In fact, VAT is currently well received by the consumers as well as business and industrial communities. VAT is an account base tax that leads to transparency and accountability both on taxpayers and tax collectors.*

*This study has focused about the impact of VAT on Government Revenue and GDP and tries to find out various problems associated with VAT collection system that need to be addressed by the revenue department for the fruitfulness of the VAT system towards the revenue mobilizations and economic development of the country.*

*Nepal introduces VAT system to introduce a tax system to develop a stable source of revenue, promote economic growth, generate revenue required for improving economic performance, establish modern, scientific and transparent tax system and make tax system more effective.*

### **Background**

Economic development has been one of the main objectives of all the developing countries. Achievement of high rate of economic growth, reduction of income disparities & poverty and improvement of living standard of people are some major issues towards which most of the government efforts have been directed, in many developing countries. Likewise, in Nepal, the role of government is very important to build up infrastructure and to alleviate the abject poverty. For this, revenue plays avital role. Nonetheless, revenue generation is a challenging task in itself. The foreign aids are one of the main sources of revenue collection in Nepal. But majority of the developing countries have demonstrated that there are negative effects of foreign aid, international grants & loans to finance the development activities. Thus, the government should depend on its own resources for generating revenue. The government can collect revenue from taxable and non-taxable sources. Tax is a key source for revenue generation and mobilization (Subedi, 2005).

Both direct and indirect taxes are equally important for the development of the country and its people. Indirect tax system plays an important role in the economic development of a country and VAT is the most popular form of indirect tax. VAT is one of the components of indirect taxes developed in the past, is probably the best tax system that had never been at the top of the tax system. VAT is an important instrument for mobilization of internal resources, and mobilization of internal resources decrease the pressure of VAT in economic activities.

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\* (Associate Professor, Tribhuvan University, Nepal)



## VAT in Nepal

Nepal introduced VAT in November 1997. However, the concept of this form of tax in Nepal was introduced in early years of 1990s. The Government of Nepal included the concept of introducing VAT in Nepal in its 8<sup>th</sup> plan. Finance Act, 1992 and 1994 introduced two-tier sales tax to make the base of implementing VAT. VAT Task Force was thus 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 suggested implementing VAT in Nepal in 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. It has been designed to collect the same revenue as the four taxes it replaces. It is believed that successful implementation of VAT will help to generate customs duties & income tax also and it is expected to enhance the revenue collection and it is closely associated with the GDP. The self-policing and catch up effect of vat has turned out to be the rationale of the VAT system.

The framework of the Nepalese VAT system is specified in the VAT Act and Regulations. The VAT system is also governed to some extent by the Finance Act, 1999. Some procedural matters relating to VAT are also introduced through operating manual. The government has also introduced some notifications relating to the VAT system. Similarly, the VAT Department has issued several circulars on various procedural matters from time to time (Khadka, 2001).

## Objectives of the Study

The main objectives of the study are:

- a. To explore the current scenario of VAT in Nepal.
- b. To analyze the contribution of VAT to GDP, total revenue and tax revenue
- c. To analyze the issues and problems of the tax payers, business people and experts about VAT

## Methodology Used

This study has followed both descriptive and empirical approach of research. A questionnaire survey has been conducted for getting the answer of research questions. The questionnaire includes 22 questions in total, out of which 3 questions have been asked to taxpayers only, 6 questions to businesspeople only, 12 questions to experts only and 1 question to all. In order to increase the reliability and number of responses, personal visits to each and every respondent were made to distribute and collect the questionnaire.

Three and Five scale Likert Scale has been used for analysis.

Cronbach's Alpha test has been done to test the reliability of data. Every variable has been tested and it was found that every variable reliability test was above 73%.

Similarly, the secondary data has been collected from the following sources:

- a. Published and unpublished reports and articles
- b. Annual report of Inland Revenue Department (IRD) the Government of Nepal
- c. Economic Survey of Ministry of Finance, the Government of Nepal
- d. Websites

Total number of respondents was 70, out of which 40 respondents were from tax payers, 20 respondents from business organization and 10 respondents from tax experts.

## Analysis and Findings

### Composition of Tax Revenue in Total Revenue

Tax revenue is one of the main sources of the government revenue. The composition of non-tax revenue in Nepalese tax system is of the following factors such as charges, fees, fines, forfeitures, receipts, income of commodities and services, dividends, royalty, sales of fixed assets, principle and interest payment etc.

The contribution of tax revenue used to be more than 85 percent and non-tax revenue almost 15 percent. The shares of tax revenue and non-tax revenue in total revenue have been shown in the following table:

**Shares of VAT, Other Tax, Non-tax Revenue on Total Revenue**  
**Table 1**

(Rs. in billions)

F.Y.	VAT		Other Tax		Tax Revenue		Non-tax Revenue		Total Revenue	
	a		b		c = a + b		d		e = c + d	
	Rs.	%	Rs.	%	Rs.	%	Rs.	%	Rs.	%
<b>2013/14</b>	100.97	28.31	211.47	59.3	312.44	87.61	44.18	12.39	356.62	100
<b>2014/15</b>	118.49	29.19	237.46	58.51	355.95	87.70	49.91	12.30	405.86	100
<b>2015/16</b>	127.75	26.5	293.35	60.87	421.1	87.37	60.86	12.63	481.96	100
<b>2016/17</b>	166.46	27.61	381.02	63.21	547.48	90.82	55.31	9.18	602.79	100
<b>2017/18</b>	206.86	28.6	452.63	62.57	659.49	91.17	63.85	8.83	723.34	100

Source: IRD, Annual Report 2017/18

Table 1 shows that the contribution of tax revenue has been more than 80 percent and non-tax revenue has been in between 8 to 13 percent in every year. Out of total revenue contribution of VAT has been in between 26 to 30 percent in every year. Thus, it is clear that tax revenue has significant role in Nepalese economy.

### Contribution of VAT, Tax Revenue, Non-tax Revenue & Total Revenue to GDP

Gross domestic product (GDP) is the total of goods and services produced in the country's territory by residents and non-residents, regardless of its collection between domestic and foreign claims. Contribution of total revenue and tax on GDP measures the consistency of the growth of tax and revenue with the corresponding growth in Gross National Product. This is an indicator of the utilization of taxable capacity.

**Contribution of VAT, Tax Revenue, Non-tax Revenue and Total Revenue to GDP**

**Table 2**

(Rs. in billions)

F.Y.	GDP	VAT	Tax Revenue	Non-tax Revenue	Total Revenue	VAT to GDP	Tax Revenue to GDP	Non-tax Revenue to GDP	Total Revenue to GDP
	Rs.	Rs.	Rs.	Rs.	Rs.	%	%	%	%
<b>2013/14</b>	1964.54	100.97	312.44	44.18	356.62	5.14	16.1	2.25	18.5
<b>2014/15</b>	2130.15	118.49	355.95	49.91	405.86	5.56	16.75	2.34	19.1
<b>2015/16</b>	2253.163	127.75	421.1	60.86	481.96	5.67	18.85	2.7	21.43
<b>2016/17</b>	2642.595	166.46	547.48	55.31	602.79	6.3	20.72	2.09	22.81
<b>2017/18</b>	3007.246	206.86	659.49	63.85	723.34	6.88	21.93	2.12	24.05

Source: IRD, Annual Report 2017/18

Table 2 explains that contribution of total revenue to GDP has increased from 18.5 percent to 24.05 percent from 2013/14 to 2017/18. Similarly, contribution of tax revenue to GDP also has increased from 16.1 percent to 21.95 percent. But the contribution of non-tax revenue to GDP has been in between 2 to 3 percent and contribution of VAT to GDP has been in between 5 to 7 percent in every year. Thus, it is clear that contribution of tax revenue plays vital role in the economic development of the Nepal.

### Sources of VAT: Internal Trade and Import of Goods & Services

VAT is mainly collected from two sources, internal trade and import of goods and services. Due to destination principles of VAT, exported goods are exempt from VAT.

**VAT Collection: Internal and Import**  
**Table 3**

(Rs. in billions)

F. Y.	Internal Sources	From Import	Total VAT Collection
2013/14	34.4	66.67	100.97
2014/15	39.55	78.94	118.49
2015/16	49.82	77.94	127.75
2016/17	61.12	105.34	166.46
2017/18	76.22	130.64	206.86

Source: IRD, Annual Report 2017/18

Table 3 explains that between the two sources of tax, import VAT occupies the significant place. It is almost doubled in every year from 2013/14 to 2017/18. Both sources of VAT play the significant role in the revenue collection.

From the implementation of VAT system in the country in 1998, there is gradual increase in VAT collection till now. In F/Y 2013/14, the collection is Rs.100.97 billion which is increased by 17.35% in F/Y 2014/15 and reached to Rs.118.49 billion. There is an increment of 26.52% in 2015/16 to 104.87% in 2017/18 from 2013/14 and reached to Rs.206.86 billion in 2017/18.

### Sources of internal VAT

The various sources of Internal VAT are

**Sources of Internal VAT**  
**Table 4**

(Rs. in billions)

S N	Particulars	2013/14	2014/15	2015/16	2016/17	2017/18	Total	%
1	Production	11.32	12.86	16.2	21.2	26.08	87.66	33.58
2	Sales & Distribution	7.89	9.22	13.34	15.02	18.74	64.21	24.6
3	Contract & Consultancy	5.85	6.54	8.24	10.2	13.94	44.77	17.15
4	Tourism Industries	1.43	1.76	1.4	1.87	2.16	8.62	3.3
5	Reverse Charge	1.64	2.05	2.0	2.57	3.99	12.25	4.69
6	Other Services	6.22	7.14	8.64	10.26	11.26	43.52	16.67
	<b>Total</b>	<b>34.36</b>	<b>39.56</b>	<b>49.82</b>	<b>61.12</b>	<b>76.18</b>	<b>261.84</b>	<b>100</b>

Source: IRD, Annual Report 2017/18

Table 4 shows that total VAT collection from internal source has been increased to Rs.34.36 billion to Rs.76.18 billion from the 2013/14 to 2017/18. 'Production' contributes 33.58 percent followed by 'Sales & Distribution' by 24.6 percent, 'Contract & Consultancy' by 17.15 percent and 'Other Services' by 16.67 percent.

### Analysis of Primary Data

Threesets of questionnaires including 26 questions have been distributed among 40 Taxpayer (Consumer and Employee), 10 Businesspeople and 10 Experts.

### Taxpayers (Consumers)

Three questions have been asked to the Taxpayers (Consumers and Employee)

#### 1. Knowledge about VAT System of Tax Collection

Most of the people are not aware of VAT system of tax; the following table explains the knowledge of VAT to the taxpayers

**Table 5**  
**Knowledge of VAT**

	<b>Respondents</b>	<b>% of Respondent</b>
Know	20	50
Little	8	20
Don't Know	12	30
<b>Total</b>	<b>40</b>	<b>100</b>

Table 5 shows that 50% respondents are aware about VAT system of tax collection, 20% respondents know little about it and 30% respondents don't know about VAT system of tax collection. This indicates that still VAT awareness is not at a satisfactory level.

#### 2. Asking for VAT Bill while making Purchase

Most of the people don't ask for the VAT bill for their purchase of the goods and services, the following table focus on the awareness of respondents about VAT bill.

**Table 6**  
**Asking VAT Bill while making Purchase**

	<b>Respondents</b>	<b>% of Respondent</b>
Always	8	20
Sometimes	12	30
Never	20	50
<b>Total</b>	<b>40</b>	<b>100</b>

Table 6 shows that 50% respondents don't ask for the VAT bill. Only 20% respondents have been asking for bill which is very low rate. This indicates that respondents are not conscious in taking bills. Most of them are unaware of the importance of the bill for the goods they purchase. They think VAT bill increases the price of the goods.

#### 3. VAT Rate is Relevant or Not

Most of the people have been feeling that rate of VAT i.e. 13% on products and services fixed by the government are very high; the following table elucidates the respondents view about rate of VAT.

**Table 7**  
**Rate of VAT**

	<b>Respondents</b>	<b>% of Respondent</b>
Very High	10	25
High	20	50
Moderate	8	20
Low	2	5
Very Low	0	0
<b>Total</b>	<b>40</b>	<b>100</b>

Table 7 shows that 75 percent respondents said that rate of VAT among different products and services are very high. Only 5 percent respondents said that the rate is low. This indicates that respondents are not satisfied with the VAT rate to different products and services charged by government. They think that rate of VAT increases the price of the goods and services.

### **Businesspeople**

Six questions have been asked to the businesspeople from different business organizations

#### **4. Issue and Receive VAT Invoices in every Sales and Purchase**

In most of the cases sales or purchases are not billed, so the following table explains to identify the situations of invoices.

**Table 8**  
**Issues and Receive VAT Invoices**

	<b>Respondents</b>	<b>% of Respondent</b>
Always	8	40
Sometimes	6	30
Never	6	30
<b>Total</b>	<b>20</b>	<b>100</b>

Table 8 explains that only 40 percent respondents always issues VAT bills while sales and receive VAT bill when purchase, which is very low. But 30 percent respondents said that they never receive or issue VAT bill whereas 30 percent said that they issue VAT bill when the consumer asks for the VAT bill. Thus, great efforts should be necessary to improve the trend of issuing invoices.

#### **5. Difficulties in maintaining the Books and Records of VAT**

Most of the businesspeople find it difficult to maintain the books of accounts; the following table shows different reasons of not maintaining books and records of VAT by businesspeople.

**Table 9**  
**Difficulties in maintaining Books and Records**

	<b>Expensive to Maintain</b>	<b>%</b>	<b>Lack of Skill Manpower</b>	<b>%</b>	<b>Consumer Unwillingness</b>	<b>%</b>	<b>High Penalty for Mistake</b>	<b>%</b>
Strongly Agree	2	10	5	25	6	30	3	15
Agree	3	15	5	25	4	20	4	20
Moderately	3	15	5	25	3	15	2	10
Disagree	8	40	2	10	3	15	5	25
Strongly Disagree	4	20	3	15	4	20	6	30
<b>Total</b>	<b>20</b>	<b>100</b>	<b>20</b>	<b>100</b>	<b>20</b>	<b>100</b>	<b>20</b>	<b>100</b>

Table 9 clearly explains that ‘Lack of Skill Manpower’ 75 percent and ‘Consumer Unwillingness’ 65 percent are the main reasons for difficulties in maintaining books and records. ‘Expensive to Maintain’ and ‘High Penalty for Mistake’ are also other factors for difficulties in maintaining books and records.

#### **6. Payment of VAT Timely and Accurately**

The following table focuses on businesspeople think regarding payment of VAT accurately and timely.

**Table 10**  
**Payment of VAT Timely and Accurately**

	<b>Respondents</b>	<b>% of Respondent</b>
Strongly Agree	5	25
Agree	6	30
Moderately	4	20
Disagree	3	15
Strongly Disagree	2	10
<b>Total</b>	<b>20</b>	<b>100</b>

Table 10 shows that only 55 percent respondents agreed that they paid their VAT timely and accurately. But 25 percent respondents did not agree on it. This indicates that government should develop policies and encourage to businesspeople to pay their VAT timely and accurately for better revenue collection.

#### **Experts**

Twelve questions have been asked to the experts

#### **7. Reasons for adopting VAT System curtailing previous Sales Tax, Entertainment Tax, and Hotel Tax in Nepal**

The following table explains on expert’s views why Nepal has adopted VAT system of tax collection

**Table 11**  
**Reasons for adopting VAT**

	<b>Promoting Economic Growth</b>	<b>%</b>	<b>Fair and Transparent Tax System</b>	<b>%</b>	<b>Avoiding Double Taxation</b>	<b>%</b>	<b>Increasing Tax Revenue</b>	<b>%</b>
Strongly Agree	4	40	5	50	3	30	3	30
Agree	3	30	3	30	4	40	5	50
Moderately	3	30	2	20	3	30	2	20
Disagree	0	0	0	0	0	0	0	0
Strongly Disagree	0	0	0	0	0	0	0	0
<b>Total</b>	<b>10</b>	<b>100</b>	<b>10</b>	<b>100</b>	<b>10</b>	<b>100</b>	<b>10</b>	<b>100</b>

Table 11 shows that every expert agreed that VAT system in Nepal is applied to make tax system more effective and transparent, for promoting economic growth, increasing tax revenue and avoiding double taxation. This also avoids the cascading effect of taxation.

### 8. Loopholes in the System for Tax Evasion

Loopholes on taxation system cause the huge revenue loss to the government; the following table explains the reasons of loopholes in the tax system

**Table 12**  
**Loopholes in Tax System**

	<b>Threshold Limit</b>	<b>%</b>	<b>Tax Refund System</b>	<b>%</b>	<b>VAT Exempted Goods and Services</b>	<b>%</b>	<b>Low Valuation at Custom</b>	<b>%</b>
Strongly Agree	1	10	3	30	2	20	3	30
Agree	3	30	4	40	2	20	4	40
Moderately	2	20	1	10	2	20	3	30
Disagree	2	20	1	10	2	20	0	0
Strongly Disagree	2	20	1	10	2	20	0	0
<b>Total</b>	<b>10</b>	<b>100</b>	<b>10</b>	<b>100</b>	<b>10</b>	<b>100</b>	<b>10</b>	<b>100</b>

Table 12 explainsthat 'Low Valuation at Custom' by 100 percent is the major loophole followed by 'Tax Refund System' 80 percent and 'Vat Exempting Goods and Services' & 'Threshold Limit' 60 percent each. All respondents support this fact.

### 9. Points to be considered for the Control of Tax Leakages

The government should be careful and to make the effective policy to overcome every loophole in the tax system, the following table focuses on the control mechanism of tax leakage.

**Table 13**  
**Control of Tax Leakages**

	<b>Tax Auditing</b>	<b>%</b>	<b>Proper Valuation</b>	<b>%</b>	<b>VAT Registration Compulsory</b>	<b>%</b>	<b>Awareness about VAT</b>	<b>%</b>
Strongly Agree	2	20	4	40	3	30	2	20
Agree	3	30	4	40	3	30	3	30
Moderately	2	20	1	10	2	20	2	20
Disagree	2	20	1	10	1	10	2	20
Strongly Disagree	1	10	0	0	1	10	1	10
<b>Total</b>	<b>10</b>	<b>100</b>	<b>10</b>	<b>100</b>	<b>10</b>	<b>100</b>	<b>10</b>	<b>100</b>

Table 13 explains that 'Proper Valuation' by 90 percent is the major control tool of tax control followed by 'VAT Registration Compulsory' 80 percent and 'Tax Audit' & 'Awareness about VAT' 70 percent each. All respondents support this fact.

The government should make the effective policy, acts and directives for the control of tax leakages in the country. Taxpayers should be encouraged by making proper tax planning and developing awareness program about VAT system.

### Consumers, Businessperson and Experts

#### 10. Who is responsible for effectiveness of the VAT system?

Question about the responsible stakeholder for effectiveness of the VAT system has been asked to all the respondents

**Table 14**  
**Responsible for Effectiveness VAT System**

	<b>Taxpayers</b>	<b>%</b>	<b>Businesspeople</b>	<b>%</b>	<b>Experts</b>	<b>%</b>
Government	18	45	8	40	3	30
Tax Department	10	25	4	20	3	30
Business Organizations	6	15	4	20	2	20
Consumers	6	15	4	20	2	20
<b>Total</b>	<b>40</b>	<b>100</b>	<b>20</b>	<b>100</b>	<b>10</b>	<b>100</b>

Table 14 shows that 60 percent respondents each from 'Businesspeople' & 'Experts' and 70 percent 'Taxpayers' have agreed that Government and Tax Department are responsible for effectiveness of VAT system. Besides Business Organizations and Consumers are also responsible for this. For the effective revenue mobilization all the stake holders of the VAT system come together but there is no doubt that the government and tax department are more responsible for effectiveness of VAT system.

## Conclusion

Every developing country seeks to achieve the economic development and ensure the rapid rate of economic growth. Effective taxation may play a vital role for economic development of the countries. VAT is a form of indirect taxation which covers the value added to each commodity by a firm during all stages of production and distribution. It is a modern tax system which enables to efficient collection system and reduced tax evasion. VAT is based on the principle of self-assessment system. VAT applies to supplies of goods and services for consideration other than exempt goods by taxable persons.

In Nepal, VAT replaces the old Sales Tax, Contract Tax, Hotel Tax and Entertainment Tax. This Act classifies good and services under three categories they are 'Vat able goods & services', 'exempted goods & services' and 'zero-rated goods & services'. It is applied at a single rate i.e. 13% based on addition of value of the goods and services at each stage in the process of supply and delivery of goods and services. The success of a VAT system depends upon the proper recording of accounts, registration of business, effective billing system and so on.

In Nepal, VAT collection is under valuation; meanwhile, public awareness about VAT is very low. The salesmen are not used to issuing bills and the consumers to receiving them. A bold vision, efficient leadership, efficient bureaucrats, honest taxpayers and systematic infrastructure are required for effective VAT collection.

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