# INCOME TAX MANUAL

**Ministry of Finance**

**Islamic Republic of Afghanistan**

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**Islamic Republic of Afghanistan**
**Ministry of Finance**
**Afghanistan Revenue Department**

No: RSI - 508877
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**Circular**

**Subject: Ministerial Authorization of the Income Tax Manual**

In accordance with paragraph 2 of Article 108 of the Income Tax Law 2009 published in Official Gazette No. 976 dated 18 March 2009, I hereby endorse the Income Tax Manual 2009, which has been approved by review of the Department of Revenue.

From the date of this circular, all officers of the Government of Afghanistan charged with the administration of the Income Tax Law 2009 shall abide by the interpretation and application of the provisions of the Income Tax Manual.

I hereby order that the Income Tax Manual be published and distributed by the Revenue Department in such manner as the Revenue Department considers appropriate. This order includes website posting.

This circular comes into effect on the date it is signed.

Dr. Omar Zakhilwal
Minister of Finance
Islamic Republic of Afghanistan

## INTRODUCTORY COMMENTS

This Income Tax Manual is issued under the authority granted to the Ministry of Finance by Article 108(2) of the Income Tax Law 2009. The purpose of this Income Tax Manual is to provide additional guidance to the Afghanistan Revenue Department and others regarding the interpretation and application of the Income Tax Law 2009. While particular reference is made to the Afghanistan Revenue Department throughout this Manual, that term should be read as meaning and including revenue offices in mustofiats.

In reviewing the Income Tax Manual, the reader should understand that all legal and natural persons are considered to be residents of Afghanistan unless otherwise noted. In addition, any references to accounting terms including, but not limited to, “revenue”, “gross profit”, “operating expenses” and “net profit” are to generally accepted accounting concepts unless the provisions of the law provide otherwise. These concepts are addressed and defined by the International Accounting Standards Board. Until Afghanistan develops its own accounting standards, the Afghanistan Revenue Department shall accept the use of terminology and standards set forth by the International Accounting Standards Board.

In this manual, each Article of the Income Tax Law is given separately, followed immediately by the regulations pertaining to that Article. The provisions of the Law are incorporated in the manual and made a part of the regulations.

Each regulation is identified by a reference number. The first part of the reference number identifies the Article of the Law which is explained by the regulation. The second part of the reference number identifies each separate explanation of the Article.

These rules and regulations should be carefully read and studied to the end that we may have a fair, uniform, and consistent application and enforcement of the Law. The rules as written must be followed and the taxes collected as set forth. No change or alteration can be made unless authorized by the Ministry of Finance. Instructions, directions, and forms are considered to be a part of the regulations.

No one sentence, rule or regulation states all the Law. The entire rule must be considered in its application to any particular situation. All rules and regulations must be considered together and taken as a whole to determine the construction and interpretation of the Law.

The reader should also understand that the Income Tax Manual is only one of several sources of additional guidance. More detailed guidance regarding specific Articles of the Income Tax Law may also be found in procedures, guides, policy statements and rulings. The reader is encouraged to visit the Ministry of Finance’s website, www.mof.gov.af/tax, to obtain additional information about income tax laws in Afghanistan.

# CHAPTER 1

# GENERAL PROVISIONS

## Article 1 - Article 11

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| Article 1 | <u>Authority</u> (1) This Law is established under the authority of Article 42 of the Constitution of Afghanistan for the purpose of tax determination and tax payment.<br><br>(2) Tax is a compulsory payment collected from natural and legal persons in accordance with the provisions of this Law for the purposes of financing of government and social welfare without the taxpayer receiving any direct goods or services from the government.<br><br>(3) Any tax deducted or collected by the government or non government agencies in accordance with the provisions of this Law shall be paid to a specific government (Ministry of Finance) bank account. |

1.1 The Income Tax Law has been enacted for the purpose of tax assessment and collection on the basis of economic and social circumstances and respecting social justice in accordance with Article 42 of the Constitution of Afghanistan.

Article 42 of the Constitution of Afghanistan (1382) provides that:

- every Afghan is obligated to pay taxes and duties to the government in accordance with the provisions of law.
- no taxes and duties are enforced without the provisions of law.
- the rate of taxes and duties and the method of payment are determined by law on the basis of observing social justice.
- this provision is also applied to foreign individuals and agencies.
- taxes collected shall be delivered to the State account.

This law was passed by Parliament and subsequently endorsed by the President of the Islamic Republic of Afghanistan. The law came into effect on the date of the Presidential decree.

1.2 This Income Tax Manual is issued based on the authority granted to the Ministry of Finance by Article 108(2) of the Income Tax Law. The purpose of this Income Tax Manual is to provide guidance to the Ministry of Finance, and in particular the Afghanistan Revenue Department, and others regarding the interpretation and application of the Income Tax Law. Application of the Income Tax Law Manual is obligatory for all tax collection agencies.

*<u>Remark</u>**:** The contents of Income Tax Manual shall not be inconsistent with the Income Tax Law. Whenever tax administration or others confront a problem in interpretation or application of a provision in the Income Tax Manual, they should*

*refer the matter to the Legal and Policy Directorate of the Afghanistan Revenue Department for clarification.*

1.3 Under the Article 42 of the Constitution of Afghanistan and Article 1 of Income Tax Law, the payment of tax is a legal responsibility and application of this law is obligatory on all persons who, under the provision of this law, are liable to pay tax. The purpose of imposing and collecting tax is to fund the expense of national budget for providing public welfare, defending territorial integrity and funding other expenses of government. Tax is imposed and collected by government in accordance with provisions of this law.

1.4 As tax is collected to fund country's national budget, and is used based on budgetary allocation, all taxes collected, in accordance with the provisions of this Law, from domestic or international sources by state and non state agencies shall be transferred to a single treasury account determined by the government (Ministry of Finance). Ministry of Finance (Afghanistan Revenue Department) and mustofiats have direct responsibility for applying the provisions of Income Tax Law and administrating the imposition and collection of tax levied by the Income Tax Law.

Article 2 Tax implementation (1) Tax shall be imposed on all income of natural and legal persons derived from Afghan sources in and out of the country, and on the income of residents of Afghanistan derived from non Afghan sources and from out of Afghanistan in accordance with the provisions of this Law.

(2) A natural or legal person shall be considered a resident of Afghanistan if:

1. The person has their principal home in Afghanistan at any time during the tax year; or

2. The person is present in Afghanistan for a period or periods aggregating to one hundred eighty-three days in the tax year; or

3. The person is an employee or official of the Government of Afghanistan and has been assigned to perform services abroad at any time during the tax year; or

4. An entity has been established during the tax year or has the center of its administrative management in Afghanistan.

*Afghan sources*: the income which is derived by residents of Afghanistan from sources within Afghanistan and from State properties outside Afghanistan.

*Non Afghan sources*: the income which is derived by residents of Afghanistan from other countries sources within Afghanistan.

*Internal sources*: the income derived by persons from Afghan and non Afghan sources within Afghanistan.

2.1 The following definitions shall apply for the purpose of this Income Tax Manual:

a. A “corporation” is a legal entity:

1. incorporated under a firm name;

2. for any commercial , industrial or services purpose not prohibited by law;

3. having a determined basic capital represented by negotiable share certificates;

4. whose liabilities shall be satisfied only by the assets of the corporation; and

5. in which the liability of shareholders shall be limited to the unpaid amount of their subscribed shares.

b. A “limited liability company” is a legal entity:

1. incorporated under a firm name;

2. for commercial, industrial or services purposes;

3. having a determined basic capital represented by non-negotiable partners’ certificates;

4. whose liabilities shall be satisfied only by the assets of the limited liability company and

5.. in which the liability of its partners is limited to the amount of their subscribed capital unless the company's articles of incorporation or the laws of Afghanistan specifically provide for greater liability.

2.2 A natural person’s “principal home” is determined using a facts and circumstances test. In determining whether a natural person has a “principal home” within Afghanistan, the following factors shall be taken into account:

1. whether the natural person owns or rents the home in Afghanistan;

2. whether the natural person owns or rents a home in a different country;

3. the amount of time the natural person spends in Afghanistan and the amount of time the natural person spends in other countries;

4. the location of the natural person’s family; and

5. the length of time the natural person has owned his or her home in Afghanistan and the length of time that the natural person has owned a home in one or more other countries.

*Example 1*. *Azizi owns a home in Bamiyan province. Azizi also rents an apartment in Uzbekistan. Azizi spends half of his time in Bamiyan and half of his time in Uzbekistan during the year. The fact that Azizi purchased a home in Afghanistan, but only rents a home outside of Afghanistan suggests that Azizi’s “principal home” is in Afghanistan.*

*Example 2*. *Azizi owns a home in Kabul City. Azizi also owns a home in Tajikistan. Azizi spends more time in Tajikistan than he spends in Kabul. Azizi’s principal home is not in Afghanistan.*

*Example 3*. *Azizi owns a home in Bamiyan province. Azizi has owned the home for three years. Azizi recently purchased a home in Uzbekistan. Azizi spends an equal amount of time at his home in Bamiyan province and his home in Uzbekistan. Because Azizi has historically owned his home in Afghanistan, and all other factors are neutral, Azizi's principal home is in Afghanistan. If, in the subsequent year, Azizi spent more time in Uzbekistan and less time in Afghanistan, then Azizi's principal home would not be in Afghanistan.*

*Example 4*. *Azizi rents an apartment in Kabul City. Azizi also rents an apartment in Tajikistan and Pakistan. Azizi stays at his Kabul City apartment for 150 days during the year. He spends 107 days in his apartment in Tajikistan. He spends 108 days in his apartment in Pakistan. Azizi's principal home is in Afghanistan.*

*Example 5*. *Azizi rents an apartment in Kabul City where he, his wife and three children stay. Azizi also owns an apartment in Karachi, Pakistan. Azizi spends most of his time during the year working in Pakistan. His wife and children remain in Kabul City. The fact that Azizi's family continues to reside in Afghanistan suggests that Azizi's principal home is in Afghanistan.*

2.3 A legal entity is considered to be resident in Afghanistan if the legal entity is formed under the laws of Afghanistan.

*Example:* *Company A is an entity that is registered as a corporation under Afghan commercial law. Company A's board of directors holds all of their meetings outside of Afghanistan. Company A's president lives and works outside of Afghanistan. Company A is a "resident" of Afghanistan.*

2.4 A legal entity can also be considered to be resident in Afghanistan if the "centre of its administrative management" is within Afghanistan. Whether a legal entity shall be considered to have the "centre of its administrative management" in Afghanistan will be determined based on a facts and circumstances test. In making this determination, the following factors should be considered:

1. Whether the managers of the entity are physically present in Afghanistan when making decisions on behalf of the legal entity.

2. The number of decisions made by the managers while physically present in Afghanistan compared to the number of decisions made by the managers while physically present outside of Afghanistan.

3. Whether the managers of the entity are residents of Afghanistan.

*Example 1*. *A corporation is formed in Tajikistan. The corporation has three directors. One of the directors is an Afghan resident. The other two directors are residents of Tajikistan. The directors hold four meetings every year. One meeting is held in Kabul City. Three meetings are held in Tajikistan. The centre of the corporation's administrative management is not in Afghanistan.*

*Example 2*. *A corporation is formed in Tajikistan. The corporation has three directors. Two of the directors are Afghan residents. The other director is a resident of Tajikistan. The directors hold four meetings every year. Two meetings are held in Kabul City. Two meetings are held in Tajikistan. The centre of the corporation's administrative management is in Afghanistan.*

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| Article 3 | <u>Tax (fiscal) year</u> (1) The tax year is the solar (Hejiri Shamsi) year which starts on the first day of Hamal (21 March) and ends on the last day of Hoot (20 March) of that year.<br><br>(2) A legal person wishing to use a tax year other than that provided in paragraph (1) of this Article shall apply, in writing, to the Ministry of Finance setting out the reasons for the change of that person's tax year to another twelve-month period. The Ministry of Finance may grant such application but only where the application is justifiable.<br><br>(3) Permission to use a different tax year under paragraph (2) of this Article shall take effect from the date specified by the Ministry of Finance by notice in writing.<br><br>(4) The Ministry of Finance is authorized to withdraw the approval granted under paragraph (3) of this Article when required. |

3.1 Income tax applies to income within a defined period which is the solar year. Except as is provided in Article 3(2) of the Income Tax Law, the taxable year begins on the first day of Hamal and ends with the last day of Hoot of the same year.

3.2 Because the Income Tax Law uses an annual accounting concept it does not matter when a person earns his or her income during the year. Thus, a legal person that earns Afs. 12,000 in one month and does not operate during the other 11 months of the taxable year will have to pay the same amount of tax as a legal person that earns Afs. 1,000 per month for twelve (12) months.

3.3 Income belonging to one taxable year may not be included in the income of another taxable year. If a person starts a business during the latter part of one taxable year and continues the business into the following taxable year, the income from the business shall not be combined in computing the person's tax, even though the person may have conducted the business for twelve (12) months or less in total.

<u>*Example:*</u> *A company starts a business in the last three months of 1384 and continues the business for nine additional months in 1385. The company has no business for the last three months of 1385 nor did it have any other income during 1384 and 1385. Although the company's business was conducted for a total period of 12 months, the company's income was earned in two taxable years. Therefore, the company's tax for each of the years is computed separately. Thus, the company's business income earned in the three months of 1384 is the company's taxable income for 1384; and the business income in the nine months of 1385 is company's taxable income for 1385.*

3.4 Article 3(2) allows a legal person (but not a natural person) to apply, in writing, to the Ministry of Finance for a different taxable year than the standard fiscal year and for the Ministry to grant such an application where the reasons for it are regarded as justifiable.

3.5 The Ministry of Finance will regard an application for an alternative taxable year as justifiable where:

(1) a legal person in Afghanistan is a subsidiary organization of a parent organization established outside Afghanistan in a country with a different taxable year,

(2) where that parent organization prepares consolidated financial statements for tax purposes in that foreign country, and

(3) requiring the legal person in Afghanistan to prepare its financial statements on the basis of the Afghanistan fiscal year would impose significant additional tax compliance costs for that legal person.

3.6 The Ministry of Finance will regard an application for an alternative taxable year by a legal person as not justifiable where the only reason for the application is because the employees of the legal person are paid on a different pay period basis than the fiscal year. The additional tax compliance costs faced by employers in such situations are not regarded as significant enough to warrant the Ministry of Finance having to recognize a different taxable year for the employer (or its employees).

3.7 In any situation where a request for an alternative accounting year is regarded by the Ministry of Finance as justifiable, the Ministry will inform the legal person of this in writing (according to Article 3(3) of the Law) setting out the commencement date of the change and expected tax payment dates which will be determined by the Ministry to ensure that neither the legal person nor the Government of Afghanistan obtains an unduly favourable tax position as compared with payments by other taxpayers.

Remark: The procedure for change of fiscal year is provided in a separate Guide.

Article 4 Tax calculation (1) The income tax of legal persons shall be 20 percent of taxable income for the tax year.

(2) Income in foreign currency shall be converted to afghanis for purposes of taxation. The rate of conversion shall be the average of open (current) rates used by Da Afghanistan Bank to purchase such foreign money at the end of each month.

(3) The income tax of natural persons shall be the amount calculated in accordance with the following schedule:

| | |
|---|---|
| From Afs.0 to Afs.5,000 monthly | 0% |
| From Afs.5,001 to Afs.12,500 | 2% |
| From Afs. 12,501 to Afs. 100,000 | 10% + Afs. 150 fixed amount |
| From Afs. 100,000 and above | 20% + Afs.8,900 fixed amount. |

4.1 Under Article 4 (1) of Income Tax Law, 20% tax is charged on the taxable income of all legal persons. Taxable income is the income after deduction of all deductible expenses in accordance with this Law.

*Example:* *Pirozbam Construction Company earned Afs. 5,500,000 gross income during the tax year. It spent Afs. 2,500,500 to generate gross income. According to the Article 4 (1), after the deduction of expenses (including the payment of business receipts tax), the income tax of the Pirozbam Construction Company is calculated as follows:*

| | | |
|---|---|---|
| *Total gross receipts* | | *Afs. 5,500,000* |
| *Deductible expenses* | *Afs. 2,500,000* | |
| *Business receipts tax with rate of 2%* | *110,000* | |
| *Total deductible amounts* | | *2,610,000* |
| *Taxable income* | | *2,890,000* |

| | | |
|---|---|---|
| *Income tax payable on taxable income ( 20 %)* | *Afs.* | *578,000* |
| *Business Receipts Tax* | | *110,000* |
| *Total tax payable* | *Afs.* | *688,000* |

4.2 The amount of income tax payable by a natural person is calculated by applying the schedule in Article 4 (3). Where total taxable income for a month is Afs 5,000 or less, no tax is payable. Where total taxable income for a month is more than Afs 5,000 then only the amount which exceeds Afs 5,000 will require tax to be paid.

*Example:* *The tax on Afs. 1,500,000 of annual taxable income for a natural person is computed as follows:*

| | | | | |
|---|---|---|---|---|
| Tax | first Afs. 5,000 per month | 60,000 per year | Afs. | 0 |
| 2% | on the next Afs 7,500 per month | 90,000 per year | Afs | 1,800 |
| 10% | on the next Afs. 87, 500 per month | 1,050,000 per year | Afs | 105,000 |
| 20% | On the amount over 100, 000 per month | over 1,200,000 per year | Afs | 60,000 |

| | |
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| Tax payable on Afs 1,500,00 | Afs 166,800 |

Remark: The schedule of tax rates applies to natural persons. It does not matter whether taxable income is derived from salary or wages or from business activities.

4.3 "Income in foreign money" means income received in foreign currency. Even if foreign currency is received, the taxpayer shall compute his or her tax liability in Afghanis.

*Example:* *According to the terms of a contract, a salary of USD $500.00 per month is payable to an individual taxpayer. The average free rate of exchange of Da Afghanistan Bank is $1 equals 50Afs. in the first month and $1 equals 52Afs in the second month. The individual's income in the first and second month is as follows:*

*First Month:* *$500 x 50 = 25,000 Afghanis*

*Second Month:* *$500 x 52 = 26,000 Afghanis*

*Although the amounts are paid in U.S. dollars, the individual must translate these amounts so that he or she can compute his or her tax liability in Afghanis.*

4.4 Income in foreign exchange is required to be converted to afghanis. The established rate at which DaAfghanistan Bank buys currency (the 'cash buy' rate) shall be used for the purpose of conversion. If DaAfghanistan Bank does not have an established exchange rate for a foreign currency, the foreign income is to be converted into afghanis in the following manner:

a. Based on the market value of the foreign exchange in the country where it was received at the time it was received, the foreign exchange in question is converted to U.S. dollars or another currency in which Da Afghanistan Bank trades.

b. The figure so obtained in terms of U.S. dollars or other currency is then converted into afghanis.

*Example:* *A resident of Afghanistan residing abroad earns 30,000 Canadian dollars in the tax year, but DaAfghanistan Bank does not have an established separate rate for Canadian dollars. The market value of the U.S. dollar in that country, when the income was received, was 1.14 Canadian dollars, and the price paid for U.S. dollars by DaAfghanistan Bank in Kabul was Afs. 50 during the same period. The income of the person in terms of afghanis is computed as follows:*

| | |
|---|---|
| *Step l: Change Canadian dollars to U.S dollars, that is: 30,000 divide by 1.14* | *$26,315* |
| *Step 2: Convert US dollars so obtained to afghanis, that is: 26,315 multiplied by Afs. 50* | *Afs.1,315,750* |

Article 5 <u>Tax on residents</u> (1) Tax on income of natural persons resident in Afghanistan shall be calculated as follows:

1. Income tax on taxable income including income from sources outside Afghanistan.

2. Any income tax paid to the government of a foreign country shall be taken as credit only against that part of the income tax attributable to foreign income of the taxpayer.

3. If a resident natural person derives income from more than one foreign country, the income tax credit shall be given in proportion to the income from each country as prescribed in the Income Tax Manual.

(2) All resident legal persons shall be subject to income tax on taxable income from all sources within and outside Afghanistan according to the provisions of paragraph (1) of this Article.

5.1 An Afghan resident is subject to taxation under the Income Tax Law, even if the income is attributable to services performed outside of Afghanistan.

<u>Example</u>: *An Afghan resident has written a series of articles for magazines and newspapers while stationed abroad. His income from these articles is subject to income tax in Afghanistan even though the activities that generated the income were performed outside of Afghanistan.*

5.2 An Afghan resident may claim a credit for foreign income taxes paid subject to the limitation provided in Regulation 5.3 of this Manual.

5.3 The foreign tax credit referred to in Article 5.2 of this Manual is subject to a "per country" limitation. The limitation for each country is calculated as follows:

a. The total amount of income (*i.e.*, revenue minus applicable expenses) generated by the taxpayer in the country that imposed the foreign tax is determined. This figure shall be referred to as the taxpayer's "Foreign Source Income."

b. The total Afghan income tax, before any applicable credit, is determined.

c. The total Afghan income tax is multiplied by a fraction. The numerator of the fraction is the taxpayer's Foreign Source Income. The denominator of the fraction is the taxpayer's income from all sources around the world.

<u>Example:</u> *An individual resident in Afghanistan has taxable income from Afghanistan of Afs. 2,000,000 and taxable income from foreign country A of Afs. 500,000 (after conversion). The Afghan income tax attrib-*

*utable to his total taxable income of Afs. 2,500,000 from all sources worldwide is Afs. 365,000. His foreign income tax liability accrued and paid to country A is Afs. 100,000.*

1. *Maximum credit allowable for country A:*

$$\text{total Afghan income tax Afs. 365,000} \times \frac{\text{country A's taxable income Afs. 500,000}}{\text{total taxable income worldwide Afs. 2,500,000}}$$

*= Afs. 73,000 maximum limit of income tax credit allowable*

2. *Assume that the income from outside of Afghanistan was Afs. 300,000 from country B with income tax liability of Afs, 60,000 paid and Afs, 200,000 from country C with an income tax liability of Afs. 25,000. The maximum limit of income tax credit for each country is computed as follows:*

   a. *Maximum credit for country B:*

$$\text{total Agfhan income tax Afs. 365,000} \times \frac{\text{country B's taxable income Afs. 300,000}}{\text{total taxable income worldwide Afs. 2,500,000}}$$

*= Afs. 43,800 maximum limit of income tax credit allowable for country B.*

*<u>Remark:</u> The excess credit from income tax paid to country B of Afs 16,200 cannot be carried forward or back to offset or reduce income tax payable on taxable income from country B in future or prior years.*

   b. *Maximum credit for country C:*

$$\text{total Agfhan income tax Afs. 365,000} \times \frac{\text{country C's taxable income Afs. 200,000}}{\text{total taxable income worldwide Afs. 2,500,000}}$$

*= Afs. 29,200 maximum limit of income tax credit allowable for country C*

*The amount of income tax paid in country C is Afs. 25,000. As this amount does not exceed the maximum limit, the amount of Afs 25,000 may be claimed as a credit.*

*<u>Remark:</u> No part of the excess credit from income tax paid to country B of Afs 16,200 can be added to the credit for income tax paid to country C.*

5.4 The foreign income tax credit shall be allowed only if:

1. A copy of the income tax return and the tax receipt from the country imposing the tax is submitted with the Afghan return.

2. All income from all sources is included in the Afghan income tax return.

3. No deduction has been taken for the foreign income tax claimed as a credit.

4. The other country's tax is a tax that is imposed on net income as required by Regulation 5.5 of this Income Tax Manual.

5.5 The credit for foreign tax paid is for income taxes only. The credit is not allowed for foreign taxes that are not imposed on a taxpayer's income. Whether a tax is imposed on income is determined by looking at all of the facts and circumstances. In making this determination, the Afghanistan Revenue Department should consider whether or not the foreign country permits the taxpayers to claim a reasonable amount of deductions from the taxpayer's revenue.

*Example 1:* *A citizen of Afghanistan doing business abroad pays customs duties on imports of goods sold in his/her business. Such duties are considered part of his/her cost of goods sold, but the duties cannot be used as a credit against the individual's Afghan income tax liability.*

*Example 2:* *A citizen of Afghanistan doing business abroad pays a four percent turnover tax in a foreign country amounting to Afs. 22,000 in the taxable year. His net income tax paid in that country is Afs. 1,600 for the same year. The turnover tax of Afs. 22,000 can be deducted as an expense item. The turnover tax cannot be claimed as a credit against Afghan income tax liability. Only the net income tax paid abroad, Afs. 1,600, may be claimed as a credit, and reduce the corporation's Afghan tax liability.*

*Example 3:* *Company A is an Afghan corporation that does business in Afghanistan and Pakistan. Company A is in the business of manufacturing and selling furniture. Company A is subject to a tax in Pakistan. Assume that Pakistan imposes a 2% tax on Company A's revenue minus its cost of goods sold. Although the Pakistani tax permits Company A to claim a deduction for cost of goods sold, the Pakistani tax is not a tax on income. The Pakistani tax is not a tax on income, because the tax fails to permit Company A to deduct its operating expenses, like wage expense and depreciation expense.*

*Remark:* *Taxes that are not imposed on income can nevertheless be considered deductible business expenses, but they are not allowed as a credit.*

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| Article 6 | Non-residents tax exemptions Non-resident persons are exempt from income tax imposed by paragraph (3) of Article 4 provided that the foreign country grants a similar exemption to the non-resident Afghans of that country. |

6.1 *Example: A pilot or other person performing services in aircraft in the airspace above Afghanistan is exempt from income tax in Afghanistan if all of the following conditions are met:*

*a. he/she is not a citizen or resident of Afghanistan;*

*b. his/her employer is a foreign company or government;*

*c. he/she is not residing in Afghanistan;*

*d. his/her government or employer's government does not tax Afghans in a comparable situation.*

| | |
|---|---|
| Article 7 | Non-residents payment of tax and allowable deductions (1) Non-resident natural and legal persons not engaged in trade or business are subject to income tax on the amount received from sources within Afghanistan from interest, dividends, rents, royalties, and any other income according to the provisions of this Law.<br><br>(2) Deductions allowed under this Law shall only be allowed in respect of income other than interest, dividends, rents and royalties to those non-resident legal persons which file a true and accurate tax return including all information required by this Law and the Income Tax Manual established by the Ministry of Finance. |

7.1 Certain amounts received by a non-resident are subject to withholding under Article 46 of the Income Tax Law. This withholding does not establish the taxpayer's liability under the Income Tax Law, however.

*Example:* *Feroz is an individual that is resident in Canada. Feroz receives Afs. 50,000 interest income from an Afghan corporation. The interest income is subject to 20% withholding under Article 46 of the Income Tax Law. Because Feroz earned less than Afs. 60,000 during the year, Feroz is not subject to tax in Afghanistan under Article 4 (Afs. 5,000 per month x 12 months = Afs. 60,000). Feroz can file an income tax return and claim a refund for the Afs. 10,000 that was withheld.*

7.2 A non-resident natural or legal person may claim deductions to reduce his or her income from Afghan sources if the income is not considered interest, dividends, rents or royalties. If a non-resident legal or natural person does not file a return, however, the Afghanistan Revenue Department may assess tax on the taxpayer's gross income in accordance with Article 87(5).

*Example 1:* *A Turkish corporation operates a restaurant in Kabul. The Turkish corporation operates the restaurant as a branch. It does not choose to form a new Afghan corporation to conduct the restaurant operations. During the first year of operation, the restaurant generates Afs. 10,000,000 of revenue, but incurs Afs. 7,000,000 of deductible expenses. The Turkish corporation does not file an income tax return. The Ministry of Finance will be entitled to assess the Turkish corporation tax of Afs. 2,000,000 or 20% x Afs. 10,000,000.*

*Example 2:* *A Turkish corporation operates a restaurant in Kabul. The Turkish corporation operates the restaurant as a branch. It does not choose to form a new Afghan corporation to conduct the restaurant operations. During the first year of operation, the restaurant generates Afs. 10,000,000 of revenue, but incurs Afs. 11,000,000 of deductible expenses. The Turkish corporation does not file an income tax return. The Ministry of Finance will be entitled to assess the Turkish corporation tax of Afs. 2,000,000, even though the Turkish corporation did not generate a profit during the year.*

*Example 3:* *A Turkish corporation operates a restaurant in Kabul. The Turkish*

*corporation operates the restaurant as a branch. It does not choose to form a new Afghan corporation to conduct the restaurant operations.*

*(a) During the first year of operation, the restaurant generates Afs. 10,000,000 of revenue, but incurs Afs. 13,000,000 of deductible expenses. The Turkish corporation does not file an income tax return. The Afghanistan Revenue Department will be entitled to assess the Turkish corporation tax of Afs. 2,000,000 in the first year, even though the Turkish corporation did not generate a profit during the year.*

*(b) In the second year of operation, the restaurant generates Afs. 11,000,000 of revenue, and incurs Afs. 8,000,000 of expenses. In the second year of operation, the Turkish corporation files an income tax return. The tax return shows Afs. 3,000,000 of profit, reduced by a Afs. 3,000,000 net operating loss carried forward from the first year of operation. The tax return filing is improper. Because the Turkish corporation failed to file a tax return in the first year, no portion of the first year net operating loss may be carried forward to offset the taxable income in the subsequent year.*

Article 8 Tax on business activities (1) Non-resident natural and legal persons engaged in economic, service or business activities in Afghanistan shall be subject to tax on their income from sources within Afghanistan.

(2) Deductions shall be allowed to the extent they are connected with income from sources within Afghanistan.

(3) Income derived from the operation of aircraft and by its staff under the flag of a foreign country in Afghanistan shall be exempt from tax provided that the foreign country grants a similar exemption to income from the operation of aircraft and by its staff under the flag of Afghanistan in that country.

(4) A correct apportionment of expenses with respect to sources of income within Afghanistan shall be determined as provided under this Law and the Income Tax Manual.

(5) Where a non-resident person carries on business through a branch in Afghanistan, the taxable income of the branch shall be determined as if the branch was a separate legal person, and calculated as follows:

1. payments or amounts incurred to other parts of the non-resident person's business shall be deemed to be dividends under paragraph (3) of Article 13 of this Law,

2. no deduction shall be allowed for payments or amounts incurred to another part of the non-resident person according to provisions of paragraph (2) of Article 18 of this Law, and

3. expenses incurred by the branch or another part of the non-resident person's business that is related directly to the earning of gross income of the branch shall be treated as expenses incurred by the branch as a separate legal person.

8.1 A non-resident legal or natural person is subject to Afghan tax on all income from Afghan sources.

*Example 1:* *An Afghan subsidiary of a foreign corporation purchases goods from its parent foreign corporation. To finance an exceptionally large purchase, the subsidiary borrowed US$100,000 from the parent company. The loan bears interest at a rate of six per cent. The interest expense is deducted by the subsidiary corporation in determining its net income. This expense is income of the foreign corporation from sources in Afghanistan, and is subject to a tax of 20 per cent. The payer must withhold tax pursuant to Article 46.*

*Example 2:* *An individual that is not resident in Afghanistan owns all of the stock of a subsidiary in Afghanistan. The subsidiary was capitalized with Afs. 100,000. The Afghan subsidiary generated Afs. 1,000,000 of profit during its first year of operation. The subsidiary distributes Afs. 1,050,000 to its sole shareholder during the year. Of this distribution, Afs. 1,000,000 is treated as a "dividend" within the meaning of Article*

*45 of the Income Tax Law. As such, the distribution is subject to withholding of Afs. 200,000. The corporation must withhold the tax under Article 46. The remaining Afs. 50,000 distribution is considered a return of invested capital, and is not subject to Afghan tax.*

*Example 3:* *A French corporation licenses certain rights to use telecommunications technology to an Afghan corporation in exchange for a yearly royalty. The French corporation and the Afghan corporation are unrelated to each other. The royalty is computed as 5 percent of the Afghan corporations's net sales every year. Net sales for the first year were Afs. 1,000,000. Five percent of 1,000,000 equals 50,000. Thus, the royalty is subject to tax of 20 percent of 50,000 or Afs. 10,000. The licensee must withhold tax under Article 46.*

8.2 Payments of Afghan source income to a partnership are deemed to be made to the partnership's partners.

*Example 1.* *Wahid is an Afghan resident individual. Jack is a citizen of the United Kingdom. Wahid and Jack form an Afghan partnership to conduct business in Kabul City. Wahid owns 20% of the partnership. Jack owns 80% of the partnership. During the course of their business, the partnership makes a loan to an unrelated Afghan corporation. The partnership earns Afs. 800,000 of interest on the loan in the first year. Because the interest is paid by an Afghan corporation, it is considered to have an Afghan source. The Afghan borrower will have to withhold tax equal to 20% of that amount, or Afs. 160,000. Eighty percent, or Afs. 128,000, is allocable to Jack, a UK person. The balance is allocable to Wahid.*

*Example 2.* *The facts are the same as in Example 1, except that Wahid and Jack own a UK limited liability partnership, not an Afghan partnership. The results are the same.*

8.3 Income of a foreign airline derived from operations in Afghanistan is subject to taxation under the Income Tax Law unless the government of the country under whose flag the foreign airline operates grants a reciprocal exemption from taxation to citizens or companies of Afghanistan.

8.4 Income received by foreign airline companies from sales in Afghanistan or from business originating in Afghanistan is subject to taxation. If the taxable income from such operations cannot be determined from the records of the company, the Ministry of Finance may, in proportion to its activities in Afghanistan, allocate a portion of the company's worldwide profits during the taxable year to its activities in Afghanistan.

8.5 A registered foreign trader may in fact be a branch of a foreign corporation or limited liability company. The actual circumstances and facts, not appearances, must govern determinations by the Ministry of Finance. If a foreign company has a branch operating in Afghanistan, it is doing business in Afghanistan and its profits from sales in Afghanistan are taxable. Criteria for distinguishing an independent trader from a branch of a corporation or limited liability company include:

| | Independent Trader | Branch of Company |
|---|---|---|
| a. | Has no salary from company, depends on mark-up for income. | Employees of company receive salaries or commissions from company. |
| b. | Company has no investment in business of trader. | Office equipment, office space, etc., belong to the company. |
| c. | Company has no control of trader. Contract or franchise agreement may control the activities of a trader. | Company can discharge representatives or employees of branch or can close the branch. |
| d. | Trader purchases from foreign company and sells to his customers. | Branch does not purchase from company, but obtains orders from customers to be filled by the company. |
| e. | Imports usually belong to the trader before sale to the customers. | Imports belong either to the company or the customer. |
| f. | Trader may be extended credit by foreign company. | No need for credit. Any credit extension is to customers. |
| g. | Usually handles products of many different companies. | Usually handles only the products of the home office. |

Careful review of the method of operation and the relationship of the trading establishment to the company is necessary before any determination of its nature can be made. The criteria listed above are indicative, not conclusive. Other aspects may shed light on the question of its being an arm of a foreign corporation or limited liability company, thereby bringing that corporation or limited liability company under provisions of Article 8 of the Income Tax Law.

*Example 1:* *A Pakistani corporation produces bottled water and sells the bottled water in Kabul using an Afghan resident as its representative. The Afghan resident is not considered an employee of the Pakistani corporation. The Pakistani corporation tells the Afghan resident the price that must be charged for each bottle of water. The Pakistani corporation also tells the Afghan resident where the water may be sold. The Afghan resident receives a commission based on the number of bottles that the Afghan resident sells. The Afghan resident is entitled to sell bottled water produced by other corporations. The Afghan resident is an independent trader. The Pakistani corporation does not have a branch in Afghanistan, because the Afghan resident does not receive a fixed salary and is not restricted to selling one type of water.*

*Example 2:* *The facts are the same as in Example 1, but the Afghan resident is prohibited by contract from selling bottled water produced by any of the Pakistani corporation's competitors. The Afghan resident is not an independent trader. The Pakistani corporation should be considered as having a branch within Afghanistan.*

8.6 A foreign corporation or limited liability company selling its products in

Afghanistan through persons who are employees of the foreign corporation or limited liability company, is subject to taxation on profits derived from its sales in Afghanistan.

*Example*. *A Pakistani corporation sends one of its employees to Afghanistan to sell products manufactured by the Pakistani corporation. The employee actually solicits sales while he is physically present in Afghanistan. When a sale is made, the Pakistani corporation ships products directly from Pakistan to the customer in Afghanistan. The activities of the Pakistani employee constitute a "branch" of the Pakistani corporation. The profits attributable to the branch are subject to tax in Afghanistan.*

8.7 If the books of a foreign company engaged in business in Afghanistan are not kept so as to show its taxable income derived from its activities in Afghanistan separately from that derived from its activities in other countries, then the Ministry of Finance shall allocate part of its taxable income from its world-wide activities to its activities in Afghanistan. The taxable income of such a company that can be attributable to its activities in Afghanistan is computed as follows:

Step 1: The gross income of the company from its world-wide activities, as shown by its latest report or financial statements, is determined.

Step 2: After the deductions of Chapter 2 of the Income Tax Law, its net income before taxes from world-wide activities is computed.

Step 3: The amount of taxable income (computed in step 2) is divided by the gross income (determined in step 1). The quotient so determined is the percentage of profit from its world-wide activities.

Step 4: The total gross income from its activities in Afghanistan is multiplied by the percentage of profit (determined in step 3). The product so obtained will be its gross income before taxes from its activities in Afghanistan.

*Example:* *A foreign company which owns heavy construction equipment is engaged in several countries in the business of leasing such equipment to persons and other companies. This foreign company signs a contract under which it leases some of its heavy construction machinery to persons and companies located in Afghanistan for Afs. 6,000,000. The books of the foreign company do not show its operating expenses in Afghanistan. Instead, its books show Afghan expenses along with the operating expenses of the company in several countries. The taxable income of this company can be determined as follows:*

*Step 1:* *The gross income of the company from its world-wide activities is determined from the latest profit and loss statement of the company. Assume this figure is Afs. 25,000,000.*

*Step 2:* *Using the exemptions and deductions of Chapter 2 of the Income Tax Law, the taxable income (net income before taxes) from its world-wide activities is computed. Assume this figure is Afs. 2,500,000.*

<u>Step 3</u>: *The taxable income from the world-wide activities, namely Afs. 2,500,000, is divided by gross income from the world-wide activities, namely Afs. 25,000,000. The quotient so determined is the percentage of profit from its world-wide activities, namely:*

*2,500,000 ÷ 25,000,000 = 0.1 = 10%*

<u>Step 4</u>: *The total gross income of the company from its activities in Afghanistan, namely, Afs. 6,000,000, is multiplied by 10 per cent, that is, the percentage of the profit of the company from its world-wide activities. The product so obtained is the amount allocated as the taxable income of the company from its activities in Afghanistan, namely:*

*10% x Afs. 6,000,000 = Afs. 600,000*

<u>Step 5</u>: *The taxable income from Afghanistan of Afs. 600,000 is multiplied by 20 per cent (the tax rate for companies). The tax for the company which is payable to Afghanistan, is:*

*20% x Afs. 600,000 = Afs. 120,000 tax*

8.8 As a general rule, a foreign corporation or limited liability company is considered to be doing business in Afghanistan if it has a place of business or permanent establishment in Afghanistan. A foreign company is considered not to be doing business in Afghanistan if its sales are to a broker, an independent dealer, an agency of the State, etc., or if it has no permanent establishment in Afghanistan.

If the foreign corporation or limited liability company is doing business in Afghanistan, its income from such business is taxable. If it is not doing business in Afghanistan, its income from business with Afghanistan is not taxable.

For the purpose of taxation under the Income Tax Law:

a. A place of business is defined as follows:

A <u>place of business</u> is the place in which the business of the enterprise is wholly or partly carried on.

b. Any one the following shall be considered to be a <u>permanent establishment</u>:

1. a place of management;

2. a branch;

3. a factory;

4. an office;

5. a workshop;

6. a warehouse;

7. a mine, quarry, or other place of extraction of natural resources;

8. a construction, installation or assembly project;

9. a permanent sales exhibition; and

10. a wholly or partly owned subsidiary, provided that this subsidiary is an enterprise in Afghanistan, that a foreign company participates directly or indirectly in the management, control or capital of the enterprise, or the same persons participate directly or indirectly in the management, control,or capital of the enterprise and a foreign company, and if in either case such conditions are made or imposed between the two in their commercial or financial relations that differ from those which would be made between independent companies.

c. A person acting in Afghanistan on behalf of a foreign company shall be deemed to constitute a permanent establishment of that company in Afghanistan if any one of the following conditions are met:

1. He/she has and commonly exercises in Afghanistan an authority to conclude contracts in the name of the foreign company.

2. He/she commonly maintains in Afghanistan a stock of goods or merchandise from which he/she regularly delivers goods or merchandise for or on behalf of the foreign company.

3. He/she commonly secures orders in Afghanistan exclusively or almost exclusively for the foreign company itself, or for other companies which are controlled by it or which have a controlling interest in it. This provision shall apply regardless of whether such orders are placed in the name of the representative or directly by another middleman or ultimate purchaser.

*Example 1:* *A Japanese corporation manufactures replacement auto parts. The Japanese corporation asks an Afghan resident to solicit orders for these parts from mechanics and garages in Afghanistan. The Afghan resident travels throughout Afghanistan. When the Afghan resident finds a mechanic or garage that is interested in purchasing the auto parts, the Afghan resident will prepare a contract for the supply of these parts to the mechanic or the garage. The Afghan resident and the mechanic will negotiate price and terms, and the Afghan resident and the mechanic will sign the contract. The Japanese corporation should be considered to have a permanent establishment in Afghanistan by virtue of the Afghan resident's*

*activities.*

*Example 2:* *A Japanese corporation manufactures replacement auto parts. The Japanese corporation asks an Afghan resident to solicit orders for these parts from mechanics and garages in Afghanistan. The Afghan resident travels throughout Afghanistan. When the Afghan resident finds a mechanic or garage that is interested in purchasing the auto parts, the Afghan resident will ask the mechanic if he is interested in entering into a supply contract. The Afghan resident and the mechanic will negotiate price and terms, and the Afghan resident will then send the contract to the Japanese corporation for review and approval. If the Japanese corporation approves the contract, an employee of the Japanese corporation will execute the contract (not the Afghan resident). The Japanese corporation should not be considered to have a permanent establishment in Afghanistan due to the Afghan resident's activities.*

| | |
|---|---|
| Article 9 | <u>Tax on foreign governments and international organizations</u><br>The tax liability of foreign governments, international organizations, and their non-resident employees in Afghanistan on income derived from sources within Afghanistan shall be determined by the provisions of existing agreements, treaties and protocols with the government of Afghanistan. |

9.1 Salary and wages of an Afghan resident are subject to taxation regardless of the identity of the employer.

*<u>Example 1</u>:* *Salary or wages of an Afghan resident employed by a foreign embassy in Kabul is taxable in Afghanistan.*

*<u>Example 2</u>:* *Salary or wages of an Afghan resident employed in Afghanistan by a foreign organization that has been granted immunity from taxation by treaty or contract with the State is taxable even though the treaty or contract grants exemption to foreign employees of the organization.*

9.2 Salary or wages of a citizen of a foreign country employed by his/her government in Afghanistan are exempt if one of the following conditions exist:

a. a treaty between that government and Afghanistan provides for exemption;

b. international law, custom, or usage so dictates.

*<u>Example</u>:* *Income of foreigners from their employment in Afghanistan as officials of a diplomatic mission of their country is not subject to taxation.*

Article 10 Tax exempt organizations (1) Contributions and income received from the necessary operations of organizations fulfilling the following conditions shall be exempt from tax:

1. The organization must be established under the laws of Afghanistan.

2. The non-profit organization must be established and operated exclusively for educational, cultural, literary, scientific, or charitable purposes.

3. Contributors, shareholders, members or employees, either during the operation or upon dissolution of the organization mentioned in sub-paragraphs 1 and 2 of this paragraph, must not benefit from the organization.

(2) The procedure for exemption from income tax for organizations mentioned in paragraph (1) of this Article shall be provided in the Income Tax Manual.

10.1 An organization meeting the requirements set forth in Article 10 of the Income Tax Law is exempt from income tax. However, the organization cannot itself determine that it is a "Tax Exempt Organization". The Afghanistan Revenue Department makes that determination from facts set forth in the Application for Exemption along with information and documentation required for determining this status. If the Ministry of Finance issues an unfavorable ruling, the taxpayer may appeal to the court and the court will determine whether the requirements to assign tax exempt status are satisfied.

10.2 Contributions and income received from the necessary operations of organizations fulfilling the following conditions laid down in Article 10 (1) of Income Tax Law are exempt from tax:

(1) That the organization must be established under the laws of Afghanistan. The relevant statute is the Law on Non-Governmental Organizations (NGOs) notified in Official Gazette No. 857 on 15 Saratan 1384. It recognizes the following types of organizations as NGOs provided the conditions stated and the procedure given in the Law on NGOs is followed:

(a) An "organization" is a domestic or foreign non-governmental, non-political and not-for-profit organization;

(b) A "domestic organization" is a domestic non-governmental organization which is established to pursue specific objectives;

(c) A "foreign organization" is a non-governmental organization which is established outside of Afghanistan according to the law of a foreign government and which accepts the Afghanistan laws on NGOs;

(d) An “international organization” is a non-governmental organization which is established outside of Afghanistan according to the law of a foreign government and which is operating in more than one country;

(e) A “Not-for-profit organization” is one which:

(i) cannot distribute its assets, income or profit to any person, except for the working objectives of the organization; and

(ii) cannot use its assets, income or profits for private benefits, directly or indirectly, to any founder, member, director, officer, employee, or donor of the organization, or their family members or relatives.

(f) “Umbrella organizations” are the working structures created for the purpose of expansion, improvement and implementation of activities and completion of projects. Three or more organizations, for the purpose of cooperation and better coordination of their work with relevant governmental agencies, may form a coordinating organization as a non-governmental organization (NGO) under Law on NGOs. Their legal entity status as an NGO is confirmed by the High Evaluation Commission (HEC) and the NGOs as provided in Law on NGOs.

All the above organizations must be registered, certified and regulated by the Ministry of Economy under the Law on NGOs. However, registration under the Law of NGOs does not necessarily confer a right upon the organization to be exempt under Article 10 of the Income Tax Law.

(2) That such an organization must have been established and operated exclusively for educational, cultural, literary, scientific, or charitable purposes. Article 13(3) of the Law on NGOs makes it obligatory that the application for establishment of an NGO shall contain the “goals and type of activity” of the organization. However, these goals and objectives may not necessarily be in line with the second condition for exemption of the organization under Article 10(1) 2 of the Income Tax Law. Therefore, not all NGOs may necessarily qualify for tax exemption.

(3) That the contributors, shareholders, members or employees must not benefit from the organization either during its operations or upon its dissolution. This is peculiar feature of not-for-profit organization under the Law on NGOs. For tax exemption these conditions must be fulfilled.

10.3 An organization established in Afghanistan under Law on NGOs and requiring approval of their tax exemption status under Article 10 of the Income Tax Law shall apply to the Afghanistan Revenue Department on the prescribed form and in the prescribed manner laid down in the relevant guide issued for this purpose. Both the application form and the guide are available from the tax information page on the Ministry of Finance website. The application shall be accompanied by certain documents like a copy of the Constitution,

Memorandum and Articles of Association, Rules and Regulations or by-laws of the NGO, as the case may be. Copies of balance sheet and six-monthly accounts prepared in accordance with International Accounting Standards (IAS) and submitted to Ministry of Economy along with copy of assessment made by the High Evaluation Commission are also the requirements for the application. After the status of the applicant has been determined, the Afghanistan Revenue Department will issue a Private Ruling to the applicant regarding its status as a "Tax Exempt Organization" for specified sources of income stated therein.

10.4 Just as a government enterprise is not exempt from income taxes, so an established commercial enterprise owned by an organization qualifying for exemption under Article 10 of the Income Tax Law is not exempt.

*Example 1:* *An Afghan corporation is formed to operate a school solely for educational purposes. The corporation receives donations and provides education to elementary school children for free, or at substantially low rates. The school happens to own a bookstore which sells books to both students and non-students. The bookstore competes with other bookstores in the surrounding area. The managers of the bookstore seek to operate the bookstore at a profit. Although the operation of the school may be exempt from taxation, the bookstore is not exempt.*

*Example 2:* *A charitable institution (tax exempt under Article 10) owns most of the shares in an Afghan industrial corporation. Though controlled by the charitable institution, the income of the Afghan industrial corporation is taxable. The dividends received by the charitable institution from the Afghan industrial corporation are also taxable.*

*Remark:* *The Afghan industrial corporation is entitled to claim a deduction for dividends paid to the charitable institution so long as withholding tax has been paid on those dividends.*

| | |
|---|---|
| Article 11 | Tax exemptions of government The income of agencies and departments of the State and of municipalities shall be exempt from tax. Government enterprises shall be excluded from the provisions of this Article. |

11.1 Though wholly owned by the Government of Afghanistan, the Central Bank is a Government enterprise and so its income from commercial operations is subject to income tax and to the business receipts tax.

11.2 Commercial or proprietary ventures (such as restaurants, hotels, etc.) of the Government or of its municipalities are considered "Government enterprises" and are not exempt from taxation under the Income Tax Law. Each venture must submit a balance sheet of its commercial operations and thus pay both the business receipts tax and the income tax in the same manner as privately owned ventures of the same nature.

*Example:* *An agency of the State owns and operates a hotel from which in the year 1384 it receives income from the rent of rooms, sale of food, catering services, souvenirs, postcards, etc., totaling Afs. 1,925,000. Of this total, Afs. 1,522,000 was from rent of rooms and Afs. 403,000 was from sales of supplies from its gift shop. In the same year, deductible operating expenses totaled Afs. 1,590,000. The agency of the State must pay the following taxes for its hotel operation:*

| | | |
|---|---|---|
| ***Business Receipts Tax:*** | | |
| *a) 10% of receipts from Room Rental,food and catering services (Afs 1,522,000)* | *152,200* | |
| *b) 2% of Sales of Gift Shop Items (Afs. 403,000)* | *8,060* | |
| *Business Receipts Tax* | | *160,260* |
| ***Income Tax:*** | | |
| *Total Income* | *1,925,000* | |
| *Operating Expenses* | *(1,590,000)* | |
| *Income Before Business Receipts Tax* | *335,000* | |
| *Less: Business Receipts Tax* | *(160,260)* | |
| *Net Taxable Income* | *174,740* | |
| *Income Tax (20% of net taxable income)* | | *34,948* |

# CHAPTER 2

# DETERMINATION OF TAXABLE INCOME

## Article 12 – Article 20

| Article 12 | Definitions |
|---|---|
| | Taxable Income is the total of all receipts of an individual, corporation, limited liability company, or other legal persons less those exemptions and deductions authorized under this Law.<br><br>Exemptions are deductions from income of the taxpayer given in accordance with the provisions of this Law.<br><br>Deductions are expenses of production, collection, and preservation of income which are allowed, by provisions of this Law, to be deducted from receipts.<br><br>Expenditures and costs not specifically defined as exemptions or deductions are not deductible.<br><br>Net Operating Loss is the amount that exceeds income after allowance of deductions prescribed in this Law. |

12.1 Except as provided in the Income Tax Law, no expenditure may be subtracted from the income tax itself. Article 5 of the Income Tax Law provides for deduction of foreign income taxes paid on foreign income from the income tax due on such foreign income under the Income Tax Law of Afghanistan.

Except for foreign taxes, which are deductible from the tax itself, all other deductible expenses are deducted from income, and not from the Afghan income tax that is otherwise due.

12.2 Personal expenses are not deductible in computing taxable income.

*Example 1: An Afghan resident operates a restaurant in Kabul. The Afghan resident chose not to form a corporation or limited liability company to own the restaurant. The resident employs a waiter, named Azizi, and a cook, named Asad. The Afghan resident pays each of Azizi and the cook Afs. 100 per day. The resident also pays his son, Farhiha, Afs. 80 per day. Farhiha occasionally visits the restaurant, but he does not wait tables or cook any food. The Afghan resident may only deduct Afs. 200 per day as wages expense. The Afs. 80 paid to Farhiha each day are not deductible expenses. Because Farhiha does not actually work at the restaurant, the amounts paid to him represent personal expenses that cannot be deducted.*

*Example 2: An Afghan resident operates an electrical supply store in Kabul which sells generators and switches and electrical adaptors. The Afghan resident decides to purchase a large electrical generator. The resident does not offer the large electrical generator for sale to the public. The resident does not use the generator as a backup generator to power the lights in his store. Instead, the resident uses the generator to power the lights and stoves in his house. The cost of the generator cannot be deducted against the income of the business. The amounts paid for the generator represent personal expenditures that cannot be deducted.*

12.3 The Business Receipts Tax, Customs Duty, and any other tax (other than the Income Tax imposed under the Income Tax Law itself) can be deducted or added to the cost of an asset.

(a) A tax can qualify as a business expense that is deductible from gross receipts if the taxes were incurred pursuant to the conduct of a business and do not relate to the acquisition of a specific asset.

*Example 1: An Afghan company operates a restaurant through which it provides food and beverages for immediate consumption within its establishment. The Afghan company generates 1,300,000 Afghanis of revenue for the year. The Afghan company is subject to the business receipts tax according to Article 64(1) of the Income Tax Law. Under Article 66(5), the applicable rate of business receipts tax for a restaurant providing superior services is 10%. The restaurant also incurred operating expenses of Afs. 700,000. The Afghan company's taxable income is therefore calculated as follows:*

| | |
|---|---|
| *Assessable Income* | *1,300,000* |
| *Less: Business Receipts Tax* | *(130,000)* |
| *Subtotal* | *1,170,000* |
| *Less: Deductible Expenses* | *(700,000)* |
| *Taxable Income:* | *470,000* |
| *Income Tax (20%)* | *94,000* |

*Example 2: Azziz is an Afghan resident that owns all of the issued stock of an Afghan corporation. The Afghan corporation imports certain raw materials like screws, bolts, glue, and upholstery, that the Afghan corporation uses to produce furniture. The imports are subject to import duty. The Afghan corporation can deduct these import duties, because they were incurred in the course of conducting the Afghan corporation's business of manufacturing furniture.*

*Example 3: Azziz imports various DVDs and compact disks from Pakistan and India for his personal use. Azziz pays import duties on these imports. The duties are not deductible from gross receipts in computing Azziz's tax liability.*

(b) If the tax was incurred to acquire an asset and the tax is not allowed to be claimed as a deduction, the tax must be added to the cost of acquiring the asset.

*Example: Company A is an Afghan corporation that imports trucks which it uses in its transportation business in Afghanistan. Company A has to pay import duties with respect to the trucks. The import duties have to be added to the cost of the trucks. The import duties are not allowable as an income tax deduction. (But note a deduction by way of depreciation will be allowable under Article 18(1)7).*

Article 13 Receipts subject to tax (1) The following receipts are subject to income tax:

1. salaries, wages, fees and commissions,
2. all receipts derived from business, industry, construction and other economic activities,
3. receipts from sale of movable and immovable property,
4. interest, dividends, rents, royalties, rewards, prizes, winning from lotteries, *bakhshishis* (gratuities, bonus payments etc.),
5. distributive shares of partnership income,
6. any other income from labor, capital, or economic activity,
7. income from other circumstances provided in this Law.
8. any other income which has not been provided in this Law.

(2) Dividends mean any distribution by a company in money or in property and any benefit provided to shareholders in their capacity as shareholders including:

(1) any tangible or intangible assets;

(2) shares in the company;

(3) discounts on any purchases from the company;

(4) loans to shareholders; and

(5) the use of any property of a company.

(3) Where a branch in Afghanistan of a non-resident person (as defined in Article 8 of this Law) pays or incurs an amount to the non-resident person or any person connected to the non-resident person, that amount will be treated as a dividend.

13.1 A receipt does not have to be in the form of currency, coin, or money to be subject to taxation. The fair market value of property in whatever form or kind received as compensation is taxable income to the recipient.

*Example 1:* *An Afghan resident owns and operates an electrical supply store in Kabul. The store sells electrical generators, switches and basic appliances. Normally, the resident only accepts cash as payment. Once, however, the resident accepted a used car as payment for an electrical generator that typically sold for Afs. 60,000. Even though the resident did not receive cash, the resident is treated as having received the equivalent of Afs. 60,000.*

*Example 2:* *An Afghan resident operates a small carpet store in Kabul. The store sells a variety of carpets that are manufactured throughout Afghanistan. The Afghan resident employs 10 people. One of the*

*employees, Azziz, does a very good job during the year selling carpets and providing customer service. The Afghan resident decides to pay Azziz an Afs. 10,000 bonus, over and above his normal wages for the year to compensate him for his efforts. Even though the Afs. 10,000 bonus is a bakhshishi, Azziz must include the amount in his income during the year.*

*Example 3:* *An Afghan resident operates a restaurant in Kabul City which provides Afghan cuisine to customers. One of the resident's waiters is Wahid. Wahid earns Afs. 100 per day working at the restaurant, but also receives tips and gratuities from the people that eat at the restaurant. Wahid must include the gratuities in his income during the year even though the amounts are in excess of his normal wages.*

13.2 When an Afghan resident receives a debt instrument, or note, in exchange for services or property, the face amount of the debt or note shall be presumed to equal its fair market value. The same principle applies in finance lease transactions where the lessor receives a debt instrument, or note, in exchange for making available the leased asset to the lessee. Nevertheless, if the interest rate on the debt or note is substantially above or below market, the fair market value of the note shall be determined by looking at what the appropriate interest rate on the note should have been if the interest rate used were a market rate based on all of the relevant facts and circumstances. The rules under Articles 97 and 98 may be used to determine what a market rate of interest is.

*Example:* *An Afghan resident ("Seller") sells a car to another Afghan resident ("Buyer") for a five-year note with a face amount of Afs. 1,000,000 and bearing an interest rate of 5%. The note has a payment schedule as follows:*

| | |
|---|---|
| *Year One* | *Afs. 230,974.80* |
| *Year Two* | *Afs. 230,974.80* |
| *Year Three* | *Afs. 230,974.80* |
| *Year Four* | *Afs. 230,974.80* |
| *Year Five* | *Afs. 230,974.80* |

*The payments are amortized as follows:*

| *Year* | *Payment* | *Interest* | *Principal* | *Balance* |
|---|---|---|---|---|
| *1* | *230,974.80* | *50,000* | *180,975* | *819,025* |
| *2* | *230,974.80* | *40,951* | *190,024* | *629,002* |
| *3* | *230,974.80* | *31,450* | *199,525* | *429,477* |
| *4* | *230,974.80* | *21,474* | *209,501* | *219,976* |
| *5* | *230,974.80* | *10,999* | *219,976* | *-0-* |
| | *1,154,874.00* | *154,874* | *1,000,000* | |

*The Seller has a cost basis of Afs. 800,000 in the car. The Seller reports Afs. 200,000 of gain with respect to the car in year one, and has to recognize interest as shown in the above table, assuming the payments are made promptly on the note each year.*

*Upon audit, and based on a review of the facts and circumstances, the Afghanistan Revenue Department determines that a market rate for the*

*note would have been only 2%. Because the true market rate of interest was lower than 5%, the actual value of the note was higher than its face amount of Afs. 1,000,000. The true value of the note was really Afs. 1,088,690 and the note would amortize as follows:*

| *Year* | *Payment* | *Interest* | *Principal* | *Balance* |
|---|---|---|---|---|
| *1* | *230,974.80* | *21,774* | *209,201* | *879,489* |
| *2* | *230,974.80* | *17,590* | *213,385* | *666,104* |
| *3* | *230,974.80* | *13,322* | *217,653* | *448,452* |
| *4* | *230,974.80* | *8,969* | *222,006* | *226,446* |
| *5* | *230,974.80* | *4,529* | *226,445* | *-0-* |
| | *1,154,874.00* | *66,184* | *1,088,690* | |

*As a result of the audit, the Seller would have to recognize gain of 288,690, an increase of Afs. 88,690 over what was reported on the Seller's tax return. This increase reflects the fact that the note was really worth more than what the Seller reported. The Seller would recognize interest income each year as set forth in the foregoing schedule assuming the payments are made promptly on the note each year.*

13.3 Partners of a partnership must recognize the partnership's income or loss as it accrues under the partnership's method of accounting.

*Example.* *Azziz and Wahid are Afghan residents that are partners in a partnership. Azziz owns 60% of the partnership and Wahid owns 40% of the partnership. The partnership generates Afs. 1,000,000 of profit in its first year. Azziz must recognize Afs. 600,000 and Wahid must recognize Afs. 400,000 on their income tax returns.*

*Remark: Unlike corporations and limited liability companies, partnerships are not required to use the accrual method of accounting. See Article 37 and guidance issued pursuant thereto. If, however, a partnership chooses to use the accrual method of accounting, the partners are required to recognize their distributive share of the partnership's income using the accrual method.*

13.4 The receipt of cash or property by a legal entity in exchange for the issuance of equity interests in that entity is not considered taxable income to that entity.

a) If a corporation, limited liability company, or partnership issues stock or partnership interests to a person in exchange for property, the issuance of stock or partnership interests shall be neutral to the corporation, limited liability company or partnership that issued the stock or the interest. The person transferring the property, however, will have to recognize gain or loss unless the transferor's gain is excluded from income under Article 14.

b) If a corporation or limited liability company issues stock to an existing shareholder or partner as a dividend, the dividend shall be neutral to the issuing corporation or limited liability company. The recipient will not be taxed on the receipt of the dividend, but will have a zero cost basis in the shares or interest received. This basis must be aggregated with the basis in the shareholder or partner's existing shares in order to compute an average stock basis.

*Example 1:* *Two Afghan residents, Azziz and Wahid, own all of the issued stock of an Afghan corporation in equal shares. The corporation generated Afs. 100,000 of profit in the first year of operation. The corporation chooses to distribute Afs. 50,000 to Azziz, and 10 additional shares to Wahid in lieu of cash. The Afs. 50,000 received by Azziz is a taxable dividend. The 10 additional shares received by Wahid is not taxable, but Wahid takes the shares with a Afs. 0 cost basis. The earnings of the corporation are decreased by Afs. 50,000. There is no effect on the corporation from issuing the 10 additional shares.*

*Example 2:* *In 1384, an individual purchased 100 shares of stock in a corporation at a total cost of Afs. 3,600. In 1385 the corporation declared a stock dividend and the individual received 20 additional shares. His average cost is Afs. 30 per share. The additional shares do not constitute taxable income in 1385 unless the individual sells them in 1385. If he keeps all of the new shares in 1385 and sells some or all of the new shares in 1386, the proceeds from the sale must be declared as income in 1386. If he sells 50 shares for Afs. 40 a share and receives Afs. 2,000, his gain is Afs. 500 and is reportable as income.*

Individual's Stock Record and Costs

| | | | | | |
|---|---|---|---|---|---|
| Purchased | 1384 | 100 | shares @ Afs. 36 per share | Afs. | 3,600 |
| Stock Dividend | 1385 | 20 | shares @ Afs. 0 per share | Afs. | 0 |
| 120 shares @ average cost of Afs. 30 per share | | | | Afs. | 3,600 |
| Sold 1386 50 shares @ Afs. 30 per share | | | | Afs. | 1,500 |
| Remaining After Sale 70 shares @ avg. cost of Afs. 30 per share | | | | Afs. | 2,100 |

Computation of Gain on Sale

| | | | | |
|---|---|---|---|---|
| Sold | 1386 | 50 shares @ Afs. 40 per share | Afs. | 2,000 |
| Cost | | 50 shares @ Afs. 30 per share | Afs. | - 1,500 |
| Gain reportable as income | | | Afs. | 500 |

c) If a corporation or limited liability company issues stock or partnership interests to an employee as compensation, the corporation, or limited liability company shall be entitled to a deduction equal to the value of the stock issued in the same year that the employee recognizes the value of the stock or partnership interest as a receipt. The employee will only recognize the value of the stock or partnership interest as a receipt in the year when the stock is not subject to a substantial risk of forfeiture. A share of stock is subject to a substantial risk of forfeiture if there are real and meaningful restrictions on the holder's ability to sell or transfer the stock.

*Example 1:* *Two Afghan residents, Azziz and Wahid, form an Afghan corporation to operate a farm. Azziz and Wahid each own 50 percent of the corporation. They agree to hire Adib to manage their farm for them. To compensate Adib, the corporation pays Afs. 100 per day of work and 10 shares of stock at the end of the harvest. The 10 shares of stock are unrestricted. Adib can sell the shares to whomever he wants. The shares are worth Afs. 10,000. Adib must recognize and report as receipts Afs. 100 per day that he works plus the value of the shares that*

*he receives (Afs. 10,000) at the end of the year. The corporation is entitled to deduct the Afs. 100 per day that it pays Adib plus the value of the shares that it issues to Adib (Afs. 10,000).*

*Example 2:* *The facts are the same as in Example 1, except that the shares that Adib receives are subject to a number of restrictions. Specifically, Adib cannot sell any of the shares for three years. Moreover, if Adib ceases to be an employee of the corporation at any time during the next three years (because his employment is terminated or because he quits) the shares will be forfeited and will revert to the corporation. In this case, Adib does not have to recognize the value of the shares in the year that they are issued. The corporation cannot claim a deduction for the value of the shares when they are issued. If, after three years, Adib remains an employee of the corporation and the restrictions are lifted, Adib will have to recognize the value of the shares at that time. Thus, if the shares are worth Afs. 12,000 in the third year, Adib must recognize Afs. 12,000. The corporation will be entitled to a deduction of Afs. 12,000 in the same year.*

13.5 The taxation of stock options differs depending on whether the stock option is issued as compensation for services or for property.

a) Stock options that are issued as compensation are not subject to tax unless or until they are exercised. The corporation that employs the individual is not permitted to claim a deduction unless or until the employee recognizes the income associated with the exercise of the stock option.

*Example:* *An officer of a corporation exercises a stock option privilege which, under the terms of his employment, allows him to purchase a specified number of shares of stock of the corporation each year at a favorable price. The difference between the market value of the stock on the day he acquired it and the amount which he paid for it must be declared as income. Thus, if the officer purchased 10 shares of stock at Afs. 500 per share, and the market price of the stock was Afs. 750 per share on the day he acquired the stock, he must report the difference (Afs. 7,500 – Afs. 5,000 = Afs. 2,500) as income in the year in which he acquired the stock. The corporation is entitled to a deduction of Afs. 2,500 in the same year.*

b) The tax consequences of stock options that are issued for property are held "open" until the option is exercised or lapses.

*Example 1.* *Azziz is an Afghan resident that owns a car which he purchased for Afs. 100,000 three years ago. Azziz now wants to sell the car. Wahid likes the car and wants to purchase the car, but he does not have the money at the present time. Azziz offers Wahid an option to purchase the car at any time during the next twelve months for a price of Afs. 80,000. Wahid pays Azziz Afs. 10,000 for this option. Six months later, Wahid exercises the option and pays Azziz Afs. 80,000. Wahid takes the car with a cost basis of Afs. 90,000. Azziz recognizes receipts of Afs. 90,000 (Afs. 80,000 price + Afs. 10,000 option premium). Azziz therefore has a 10,000 loss on the sale of his car (Afs. 100,000 cost base – Afs. 90,000 proceeds).*

*Example 2*. *The facts are the same as in Example 1, except that Wahid does not exercise the option. At the expiration of the option's term, Wahid has lost Afs. 10,000. Wahid may not deduct the Afs. 10,000 unless the Afs. 10,000 represent a business expense. See Articles 13 and 19. Azziz must recognize the Afs. 10,000 as income when the option lapses, because Azziz received Afs. 10,000 but was not required to transfer any cash or property in return when the option expired.*

13.6 A dividend may be taxable to the shareholders even though it is not formally declared. A dividend includes any benefit that a corporation confers on a shareholder to the extent that the corporation has sufficient earnings.

*Example 1*. *Naqibullah owns all of the issued stock of an Afghan corporation. The corporation has accumulated Afs. 10,000,000 in earnings. The corporation operates two car rental centers. One center is in Kabul and another is in Mazar-e-Sharif. The center in Mazar-e-Sharif allows Naqibullah's son, Azziz, to use its rental cars whenever he wants without paying for them. The manager of the Mazar-e-Sharif center estimates that the rents foregone equal Afs. 100,000 per year. Naqibullah will be considered to receive a deemed dividend from his Afghan corporation of Afs. 100,000.*

*Example 2*. *Naqibullah owns all of the issued stock of an Afghan corporation. The Afghan corporation purchases television sets from abroad and sells them to customers in Afghanistan. The television sets normally sell for Afs. 10,000 Occasionally, Naqibullah will purchase a set from one of his stores for Afs. 8,000. Every time that Naqibullah purchases a television set for Afs. 8,000, Naqibullah will be considered to have received a distribution of Afs. 2,000. If the corporation has sufficient earnings, the distribution will be considered a dividend. Otherwise, the distribution will be considered a tax-free return of invested capital or a capital gains distribution.*

*Remark: See Article 43 and the regulations promulgated pursuant thereto for the consequences to a corporation that distributes appreciated property to its shareholders.*

13.7 Any distribution by a company, whether in money or property or any other benefit, to a shareholder will be treated as a dividend. The distribution must be received by the shareholder in the person's capacity as a shareholder. If the distribution is provided for any reason unrelated to the person's capacity as a shareholder, then the distribution will not be treated as a dividend.

*Example 1:* *Azeem is a shareholder of Kabul Construction Corporation. An earthquake damages the block of apartments where Azeem and other unrelated people live. As an act of charity, Kabul Construction Corporation agrees to repair the building for no cost. Even though Azeem has received a benefit ie the repair of his accommodation from Kabul Construction Corporation, he has not received that benefit because he is a shareholder in Kabul Construction Corporation. Rather, Azeem has received the benefit as a resident of the block of*

*apartments. The value of the repairs to Azeem's apartment will not be deemed to be a dividend.*

Where a benefit is provided to a shareholder in a form other than cash, the benefit will be treated as a dividend to the extent that the shareholder receives the benefit for less than its market value.

<u>*Example 2:*</u> *Bashir is a shareholder of Ace Electrical Company. The company sells electrical goods to the public. The shareholders are allowed to buy goods from the store for 25 percent of their market value (which is less that the cost of the goods). For the year 1385, Bashir buys goods with a market value of Afs 10,000 from the store and makes payment of Afs 2,500. Bashir has received tangible property from the company for less than market value because he is a shareholder of the company. Bashir therefore has received a dividend from the company. The amount of the dividend is the market value of the goods he has received less the amount he has paid. Therefore, Bashir will have received a dividend of Afs 7,500 in the 1385 year.*

This principle will apply to all forms of benefit received by a shareholder in their capacity as a shareholder for less than the market value to the public. Any tangible or intangible assets or shares in the company provided to a shareholder will be treated as a dividend to the extent that the shareholder has not paid market value. Loans by the company to shareholders will be treated as a dividend to the extent that the shareholders benefit from conditions of the loan more concessional than loans provided by commercial banks to their customers.

<u>*Example 3:*</u> *Fayez is a shareholder of Hotel Safrini Corporation. Because he is a shareholder, he receives a loan of Afs 200,000. Fayez is required to repay Afs 202,000 after one year ie the amount of the loan plus 1 percent interest. If Fayez had taken the loan from a commercial bank, the amount to be repaid after one year would have been Afs 210,000 ie the amount of the loan plus 5 percent interest. Fayez has received a benefit less than market value. The benefit will be treated as a dividend. The amount of the dividend will be the amount of interest saved because of the favourable interest rate provided by the company. The amount treated as a dividend is the difference between the interest payable if the loan was taken with a commercial bank and the interest payable to the company ie Afs 8,000.*

If a shareholder is entitled to use company property on terms more favourable than available to the general public ie free of charge or at a discounted rate, then the use of the company property will be treated as a dividend to the extent of that favourable treatment.

<u>Example 4:</u> *Aref is a shareholder of Avid Car Rental Company. The company conducts the business of hiring cars to customers. Cars are available for hire at the rate of Afs 2,000 per day. Aref takes a car for five days to travel from Kabul to Jalalabad to visit his family. Because Aref is a shareholder, he pays Afs 1,000 per day for the hire of the car. Aref has received a benefit from the company in his capacity as shareholder of the company. The benefit is treated as a dividend. The value of the benefit is the difference between market value and the amount Aref paid ie Afs 2,000 less Afs 1,000 equals Afs 1,000.a day. The value of the benefit for 5 days is Afs 5,000.*

13.8 When a non-resident person owns a branch in Afghanistan, and that branch pays or incurs an amount to the non-resident person or to a person that is "connected" (within the meaning of Article 97 of the Income Tax Law) to that non-resident person, the payment will be considered a distribution from the branch to that non-resident person. In making the determination of whether a payment has been made, due regard shall be given to the books and records of the branch. If a branch operation generates profits during the year, and those profits are not reflected as earnings on the balance sheet at the end of the tax year, a dividend will be deemed to have been distributed. This deemed dividend will be subject to all applicable withholding taxes.

<u>Example 1</u>. *Kashif is an individual resident of Pakistan that operates an import-export business within Afghanistan. Kashif has chosen to operate his import-export business as a branch, not a corporation. At the beginning of the year, the balance sheet for the branch is as follows:*

| | | | |
|---|---|---|---|
| ***Assets:*** | | ***Liabilities:*** | |
| *Cash* | *1,000,000* | *Accounts Payable* | *1,000,000* |
| *Receivables* | *8,000,000* | | |
| *Inventory* | *10,000,000* | ***Equity:*** | |
| *Office Furniture* | *50,000* | *Equity Investment* | *10,000* |
| | | *Earnings* | *18,040,000* |

*During the year, the corporation does not generate any earnings. The balance sheet for the branch at the end of the year is as follows:*

| | | | |
|---|---|---|---|
| ***Assets:*** | | ***Liabilities:*** | |
| *Cash* | *2,000,000* | *Accounts Payable* | *1,000,000* |
| *Receivables* | *7,000,000* | | |
| *Inventory* | *10,000,000* | ***Equity:*** | |
| *Office Furniture* | *50,000* | *Equity Investment* | *10,000* |
| | | *Earnings* | *18,040,000* |

*Under these facts there has not been a deemed dividend from the branch. Instead, the books and records merely indicate that the branch has collected 1,000,000 of its accounts receivable. All of that cash is still on the books of the branch, however. Any interest on that cash will be taxed in Afghanistan. Hence, there has not been a distribution.*

*Example 2*. *Kashif is a resident of Pakistan that operates an import-export business within Afghanistan. Kashif has chosen to operate his import-export business as a branch, not a corporation. At the beginning of the year, the balance sheet for the branch is as follows:*

| | | | |
|---|---|---|---|
| ***Assets:*** | | ***Liabilities:*** | |
| *Cash* | *1,000,000* | *Accounts Payable* | *1,000,000* |
| *Receivables* | *8,000,000* | | |
| *Inventory* | *10,000,000* | ***Equity:*** | |
| *Office Furniture* | *50,000* | *Equity Investment* | *10,000* |
| | | *Earnings* | *18,040,000* |

*During the year, the corporation generates Afs. 1,000,000 earnings. The balance sheet for the branch at the end of the year is as follows:*

| | | | |
|---|---|---|---|
| ***Assets:*** | | ***Liabilities:*** | |
| *Cash* | *2,000,000* | *Accounts Payable* | *1,000,000* |
| *Receivables* | *8,000,000* | | |
| *Inventory* | *10,000,000* | ***Equity:*** | |
| *Office Furniture* | *50,000* | *Equity Investment* | *10,000* |
| | | *Earnings* | *19,040,000* |

*Under these facts there has not been any constructive dividend distribution. Although the branch generated an additional Afs. 1,000,000 of earnings during the year, the earnings continued to be reflected on the branch's balance sheet. As such, any interest accrued on the additional Afs. 1,000,000 held by the branch will be subject to tax in Afghanistan.*

*Example 3*. *Kashif is a resident of Pakistan that operates an import-export business within Afghanistan. Kashif has chosen to operate his import-export business as a branch, not a corporation. At the beginning of the year, the balance sheet for the branch is as follows:*

| | | | |
|---|---|---|---|
| ***Assets:*** | | ***Liabilities:*** | |
| *Cash* | *1,000,000* | *Accounts Payable* | *1,000,000* |
| *Receivables* | *8,000,000* | | |
| *Inventory* | *10,000,000* | ***Equity:*** | |
| *Office Furniture* | *50,000* | *Equity Investment* | *10,000* |
| | | *Earnings* | *18,040,000* |

*During the year, the corporation generates Afs. 1,000,000 earnings. The balance sheet for the branch at the end of the year is as follows:*

| | | | |
|---|---|---|---|
| ***Assets:*** | | ***Liabilities:*** | |
| *Cash* | *2,000,000* | *Accounts Payable* | *1,000,000* |
| *Receivables* | *7,000,000* | | |
| *Inventory* | *10,000,000* | ***Equity:*** | |
| *Office Furniture* | *50,000* | *Equity Investment* | *10,000* |
| | | *Earnings* | *18,040,000* |

*Under these facts there has been a constructive dividend distribution of Afs. 1,000,000. The branch generated an additional Afs. 1,000,000 of earnings during the year. The earnings were reflected in a Afs. 1,000,000 increase in the branch's cash balance. But the receivables decreased by a like amount. In the end, no amount was added to the branch's equity. Because Afs. 1,000,000 was earned by the branch, but the extra Afs. 1,000,000 were not reflected in the branch's equity, the branch is deemed to have distributed Afs. 1,000,000 to Kashif. As such, the dividend is subject to 20 percent income tax.*

*Remark: Because the purpose of the tax on the deemed dividends of a branch is to equalize the tax treatment of Afghan branches and corporations, the deemed dividends paid by the branch shall be deductible by the branch in computing the branch's taxable income.*

13.9 The tax on the deemed dividends of a branch shall apply equally to non-residents that invest in Afghanistan through a partnership. It does not matter whether the partnership is domestic or foreign.

*Example.* *USCO is a United States corporation. CANCO is a Canadian corporation. USCO and CANCO are partners in an Afghan partnership. USCO owns 60% of the partnership and CANCO owns 40% of the partnership. The opening balance sheet for the partnership at the beginning of the year is as follows:*

| | | | |
|---|---|---|---|
| ***Assets:*** | | ***Liabilities:*** | |
| *Cash* | *1,000,000* | *Accounts Payable* | *1,000,000* |
| *Receivables* | *8,000,000* | | |
| *Inventory* | *10,000,000* | ***Equity:*** | |
| *Office Furniture* | *50,000* | *Capital* | *10,000* |
| | | *Earnings* | *18,040,000* |

*During the year, the corporation generates Afs. 1,000,000 earnings. The balance sheet for the branch at the end of the year is as follows:*

| | | | |
|---|---|---|---|
| ***Assets:*** | | ***Liabilities:*** | |
| *Cash* | *2,000,000* | *Accounts Payable* | *1,000,000* |
| *Receivables* | *7,000,000* | | |
| *Inventory* | *10,000,000* | ***Equity:*** | |
| *Office Furniture* | *50,000* | *Capital* | *10,000* |
| | | *Earnings* | *18,040,000* |

*The additional 1,000,000 Afghanis of profit should have caused the partnership's earnings to increase by 1,000,000. Because the earnings did not increase by 1,000,000 Afghanis, there has been a constructive distribution of 1,000,000 Afghanis under these facts. There is a presumption that USCO received 600,000 of the distribution and CANCO received 400,000 of the distribution. The parties may rebut this presumption if they can prove that the distribution was shared in a different ratio.*

13.10 “Receipts” in the case of taxpayers who account on an accrual basis (See Chapter 5 of the Income Tax Law), also means accrued sales, accrued interest income, accrued rental income, etc.

*Example:* *A limited liability company has cash sales in 1384 of Afs. 8,700,000. If Afs. 300,000 of the sales which were made in the last month of 1384, were not paid until the first month of the following year, 1385, the sales of Afs. 300,000 are included and accrued to the sales for 1384. Under the accrual system of accounting, sales are considered to be income at the time the sale is made rather than when the payment is received; therefore, the income for the taxable year for this company, which is required to use the accrual system, is Afs. 9,000,000 (the amount of sales) rather than Afs. 8,700,000 (the amount of payments actually received).*

| | |
|---|---|
| Article 14 | <u>Non-taxable income</u> The following receipts are not subject to income tax and not included in tax returns of natural and legal persons:<br><br>1. grants, gifts, and awards of the State;<br><br>2. grants, gifts, and awards of foreign governments, international organizations, or nonprofit organizations for contributions to science, art, literature, social progress, and international understanding;<br><br>3. all scholarships, fellowships, and other grants for professional and technical training;<br><br>4. health, accident, and unemployment insurance benefits;<br><br>5. life insurance paid on death;<br><br>6. compensation or damages for personal injuries or sickness or restitution of reputation;<br><br>7. proceeds of borrowing;<br><br>8. proceeds of issues of stocks and bonds by companies;<br><br>9. acquisition of assets in connection with mergers of domestic corporations and other legal persons;<br><br>10. acquisition of movable or immovable property through expropriation of property of debtors by creditors;<br><br>11. payments on principal received from debtors;<br><br>12. interest on bonds issued by the State and by municipalities; and<br><br>13. any other receipts according to the provisions of this Law. |

14.1 Article 14 of the Income Tax Law covers receipts which are excluded from gross income. Receipts, unless specifically listed as excluded from income, are included in income.

14.2 "Grants, gifts, and awards of State" do not include payments made to employees for services performed in the ordinary course of duty. Grants, gifts, and awards are given in special circumstances or in recognition of issued or unusual service or accomplishment. They are associated with hardship, or recognition of accomplishment. Annual bonuses, overtime, back pay and other benefits given on a nonselective basis are part of the taxable income of the recipient.

*<u>Example 1</u>: A family is struck by a calamity. This family receives Afs. 5,000 as a gift from the State. This Afs. 5,000 is not taxable income of any of the members of the family.*

*<u>Remark</u>: Amounts donated or granted by foreign and/or domestic*

*institutions are also not taxable.*

*Example 2:* *A medical doctor devotes his life to building up medical clinics, facilities, and staff in several communities. The State honors him with an intangible recognition, and also with tangible material award. Such material gain is exempt from taxation.*

*Example 3:* *The receipt of a Nobel prize is an award of an international, nonprofit organization that is exempt from taxation.*

14.3 All of the money received in connection with a scholarship, fellowship, or grant for professional and technical training is exempt. This includes travel funds and living expense funds, as well as reimbursement for tuition, fees, cost of books and supplies, and other expenses.

*Example:* *A student receives a scholarship which covers his travel, hotel bills, lodging, tuition, fees, books, medical costs, etc., plus an allowance for clothing, food, and personal expenses of Afs. 5,000 per month. All of this is exempt from taxation.*

*If the student receives a supplement from the State, this supplement is also exempt from taxation. If, however, as an employee of the State, he receives all or part of his salary from the State, this salary is subject to taxation.*

14.4 Payment received from an insurance company as a result of loss, misfortune, sickness, etc. against which the recipient was insured is not taxable.

*Example 1:* *An individual insured himself against sickness and injury with an insurance company to which he paid monthly premiums. He was injured in an accident which resulted in lost income and medical expenses, and caused a disability. Under terms of his insurance policy he was paid Afs. 10,000,000 in settlement of his claim. This receipt is not taxable.*

*Example 2:* *An individual is injured while working at his job. His employer carries an insurance policy which covers all his employees. The insurance company pays the injured employee Afs. 10,000,000 in settlement of his claim. This receipt is exempt from taxation, though the injured employee did not even pay the premium for the insurance coverage.*

14.5 Payment received by a beneficiary from insurance upon the death of the insured person is not taxable income of the beneficiary.

*Example 1:* *An individual has purchased an insurance policy which provides, among other things, that his beneficiary shall be paid Afs. 2,000 per month upon death of the insured. This income is not taxable.*

*Remark:* *Regardless of whom the beneficiary is or how the insurance benefit is paid, the money paid by the insurance company is not subject to income tax.*

*Example 2:* *An individual is killed in an accident while working on his job. His employer carries an insurance policy which covers all of his*

*employees. The insurance company pays the amount of the death benefit specified by the policy to the beneficiary of the deceased. This receipt is exempt from taxation even though the deceased did not pay the premium for the insurance coverage.*

14.6 Compensation paid for personal injuries, sickness, or other harm inflicted on a person is not taxable.

*Example 1:* *A person struck and injured by an automobile receives Afs. 10,000 as compensation for the harm done. This receipt is not taxable.*

*Example 2:* *A person develops a disabling disease from his employment by a firm in an occupation exposing him to harmful chemicals. Upon order of a court, the firm pays the disabled person Afs. 2,000 per month for the period of his disability. This income is not taxable.*

14.7 Receipts which are proceeds of borrowing are not taxable.

*Example:* *An individual receives Afs. 25,000 from a bank in exchange for his promissory note. This receipt is not income and is not taxable.*

14.8 Receipts from the issue of stock or sale of bonds by a corporation is not taxable income.

*Example 1:* *A corporation increases its capital by issuing shares of stock at a par value of Afs. 1,000 per share. The corporation sells 10,000 shares at Afs. 1,000 each. The Afs. 10,000,000 received is not taxable.*

*Example 2:* *A corporation sells bonds redeemable in 10 years at Afs. 5,000 each with interest payable annually at a rate of five per cent. It sells 1,000 such bonds, receiving Afs. 5,000 for each bond. The proceeds, Afs. 5,000,000 are not taxable.*

*Remark:* *If, however, these bonds bring more than face value, the excess is subject to income tax. On the other hand, if bonds are sold for less than redeemable value, the discount in value is a deductible expense. The excess, called a premium, is in fact a reduction in interest over the term of the bond, while the discount is in fact additional interest over the term of the bond. Either shall be allocated over the term (period of years from date of issue to date of redemption) of the bond.*

14.9 Assets acquired through mergers are not taxable at the corporate or shareholder level if one of the following requirements are satisfied:

(a) The transaction qualifies as a “merger” under Afghanistan’s 1955 Commercial Code or any successor law to the extent that the shareholders exchange stock of the merged corporations for stock of the surviving corporation.

*Example 1:* *Corporation A merges with Corporation B to form a new corpora-*

*tion. In the process of this merger the new corporation acquires the cash, and other assets as well as the liabilities of Corporations A and B. The shareholders of Corporation A and B surrender their shares in exchange for shares in the new corporation. Neither Corporation A nor Corporation B recognizes income in this transaction. Because the shareholders of Corporation A and Corporation B exchange their shares for shares of the surviving corporation, they do not have to recognize income.*

*Example 2:* *Naqibullah owns all of the issued stock of Corporation A. Naqibullah has an Afs. 10,000 cost basis in his shares. Naqibullah's shares are worth Afs. 500,000. Wahid owns all of the issued stock of Corporation B. Wahid has an Afs. 20,000 cost basis in his shares. Wahid's shares are also worth Afs. 500,000. Naqibullah and Wahid decide that they should merge their two corporations. In the merger, Naqibullah receives 50 shares of the surviving corporation. Wahid receives 45 shares of the surviving corporation and Afs. 50,000. To the extent that Naqibullah receives shares in the merger, the transaction is tax-free to Naqibullah. Naqibullah therefore takes the 50 shares with a carryover basis of Afs. 10,000. Wahid's consideration consists of shares (90%) and cash (10%). The shares can be received tax-free. Wahid takes the shares with a carryover basis of Afs. 18,000. Wahid's receipt of cash is taxable. Wahid must recognize gain of Afs. 30,000 (Afs. 50,000 – Afs. 20,000 cost basis in 10% of shares). Neither Corporation A nor Corporation B recognizes gain or loss on the transaction.*

(b) An Afghan resident may transfer stock or other property to an Afghan corporation or limited liability company provided that, after the exchange, the Afghan resident owns 5% or more of the stock of the transferee. For this purpose, stock shall be measured by both voting power and value.

*Example 1:* *Naqibullah and Wahid are Afghan residents that want to form a corporation which will operate a clothing store in Kabul City. Naqibullah contributes Afs. 500,000 to the corporation in exchange for 50% of its shares. Wahid contributes clothing inventory that he has acquired to the corporation in exchange for 50% of its shares. Wahid had a cost basis of 200,000 Afghanis in the clothes that he contributed. Naqibullah cannot recognize gain or loss on the transfer of Afghan currency to the corporation. Because Wahid received shares representing more than 5% of the corporation, the transfer is considered tax-free. Wahid receives the shares of the corporation with a Afs. 200,000 cost basis. The corporation takes the clothing with a Afs. 200,000 cost basis.*

*Example 2:* *Naqibullah and Wahid are Afghan residents that together own all of the stock of an Afghan limited liability company. Naqibullah's cousin, Adib, has some useful equipment which he would like to contribute to the business in exchange for stock ownership in the business. Adib has a cost basis of Afs. 100,000 in the equipment. Naqibullah and Wahid agree to cause their corporation to issue stock to Adib in exchange for the equipment. The stock issued to Adib represents 7% of the value of the entire corporation, but does*

*not possess any voting rights. The stock is worth approximately Afs. 175,000. Because Adib does not hold any voting rights in the corporation after the transfer, the transfer is not tax-free to Adib. Adib must therefore recognize gain of Afs. 75,000. The corporation takes the equipment with a fair market value cost basis of Afs. 175,000.*

*Example 3:* *Naqibullah and Wahid are Afghan residents that together own all of the stock of an Afghan limited liability company. Naqibullah and Wahid decide that Naqibullah should transfer some appreciated land to the limited liability company. The two shareholders agree that Naqibullah should be entitled to receive an additional 2% interest in the voting power and value of the corporation in exchange for the contributed land. Thus, Naqibullah transfers the land to the limited liability company. After the transfer, Naqibullah owns 52% of the entity and Wahid owns 48% of the entity. Even though Naqibullah did not receive a 5% or greater interest in the limited liability company (measured by vote and value) in exchange for the transferred land, the transfer is considered tax-free because Naqibullah owns 5% or more of the voting power and value of the entity immediately after the transfer.*

14.10 Money received by the lender from the borrower in repayment of a loan is not income and is therefore not subject to income tax. Finance lease payments made by the lessee to the lessor representing the principal amount of investment in the cost of the leased asset is also not income of the lessor chargeable to income tax.

14.11 Interest on bonds issued by the State or by municipalities of Afghanistan is exempt, whether received by an individual (Afghan or alien), a corporation, or a limited liability company, (Afghan or foreign).

*Example:* *A limited liability company buys government bonds totaling Afs. 500,000. Every year the Treasury Department of the Ministry of Finance makes an interest payment to the company. Since this receipt is an interest on government bonds, it is not subject to the income tax, and is not reported by the company its income tax return.*

14.12 Interest received by partnerships is deemed to be received by the partners of the partnership for purposes of applying the rules in Article 14(12).

14.13 The value of an asset acquired by gift, bequest, devise, finance lease or inheritance is excluded from income, but the income from such asset is taxable income.

| | |
|---|---|
| Article 15 | Food and fuel tax exemption Income represented by the value of food, fuel, and goods consumed or used by the producer of the same or by members of their household shall be exempted from income tax. |

15.1 The “producer” is the person who made the item or article used by himself or his dependants.

*Example: An artisan owns a small carpentry shop where he makes furniture. During the year he makes a table and six chairs which he uses in his own home. He does not have to include the value of these items on this return.*

*Remark: In most cases, the producer will pay the fixed tax under Chapter 11 of the Income Tax Law, which is in lieu of income taxes. In applying the provisions of Chapter11, the amount of goods normally consumed by the taxpayer and his dependants is taken into account in arriving at the net income potential of his establishment.*

| | |
|---|---|
| Article 16 | Taxes on rent or lease of immovable properties Rent received in money or otherwise from renting or leasing of immovable property used for commercial, industrial and other economic purposes is subject to income tax. Taxation of agricultural lands, gardens, and livestock together with their income are taxed by separate laws. |

16.1 Taxation of the yield from agriculture and animal husbandry is not subject to the Income Tax Law. The income of the farmer, the landowner, the herdsmen, or owner of livestock derived from agricultural or livestock production is not subject to income taxes.

a. The following examples are types of income excluded from income taxes by Article 16 of the Income Tax Law:

1. money received from the sale of grain by the person who produced the grain or by the person on whose land it was grown;

2. rent in money received by the landowner for land devoted to production of crops, fruit, timber, or used for pasture and grazing of animals;

3. money received from the sale of wool, skins, dairy products, meat, live animals, and other products of animal husbandry by the owner of the animals or by the person caring for the animals; and

4. money received by the owner of herds of livestock as his share of the income from such herds.

b. The following examples are types of income not excluded from taxation under the Income Tax Law:

1. income from industrial and commercial processing of agricultural or animal products;

2. income from trade in agricultural or animal products;

3. income from rental of land not devoted to agricultural production; and

4. income from sale of supplies, fertilizer, equipment, chemicals, etc. to landowners, farmers, and herdsmen, even if used in agricultural and livestock production.

*Example 1:* *Naqibullah owns and operates a farm on which he produces wheat. Naqibullah sells the wheat to Azziz who is in the business of purchasing wheat from farmers and reselling it to flour mills. Azziz sells the wheat that he purchased from Naqibullah to a flour mill in Kabul that is owned by Wahid. The flour mill grinds the wheat into flour and sells the flour to merchants in Kabul. Naqibullah is not subject to income tax. Azziz, Wahid, and the merchants that sell the flour are all subject to the Income Tax Law.*

*Example 2:* *Adib owns a farm. Adib uses a tractor on his farm. He also rents the tractor to other farmers when he is not using it. The rental income that Adib receives will be subject to income tax, even if Adib rents the tractor to other farmers.*

16.2 The owners of tangible property, primarily used for commercial, industrial, or other economic purposes, are subject to income tax on income received from renting and leasing such property.

*Example 1:* *The owners of commercial shops and sarais are subject to income tax on income received from the renting or leasing of such property.*

*Example 2:* *The owners of factories and compounds used for industrial purposes are subject to income tax on income received from renting and leasing such property.*

*Example 3:* *Adib owns a farm and uses a tractor on that farm. When he is not using the tractor for farming, Adib rents the tractor to contractors in the nearest city who use the tractor to haul bricks and mortar. The income that Adib earns from renting the tractor is included in taxable income, even though the tractor is used during a portion of the year in his farming operations.*

| | |
|---|---|
| Article 17 | Liability to withholding tax from salary and wages (1) Ministries, agencies and other government organizations, enterprises, companies and charitable organizations shall be required to withhold tax from the salary and wages of its employees when they are being paid and transfer the withheld amount to the government account.<br><br>(2) Pensions of government employees are exempt from income tax. |

17.1 The process and procedure for complying with the wage withholding tax provisions are set forth in Ministry of Finance publications Guide 5 'Wage Withholding Tax' and Public Ruling titled 'Salary or Wages in Afghanistan'. Both publications are available at the Ministry of Finance's website at www.mof.gov.af/tax.

17.2 Only payments to "employees" are subject to withholding. Payments made to natural persons who are "independent contractors" are not subject to withholding. Instead, the independent contractor is responsible for paying annual income tax.

17.3 The following factors shall be considered in determining whether a person is an "employee" or an "independent contractor" under this Article 17 and Article 46. For this purpose, the "principal" shall be the person for whom services are performed and the "service provider" is the person that is performing the services for consideration.

(a) The degree of control that the principal has over the manner in which the service provider performs the services. In this regard, due consideration will be given to whether the principal controls the hours that the service provider must perform and the manner in which the work is done.

Remark: The foregoing factor will typically be the most significant factor in making the determination as to whether someone is an employee or an independent contractor.

(b) The degree to which the principal provides the service provider with the tools that the service provider uses to perform his or her services.

(c) Whether the principal engages a specific individual to perform services.

(d) The manner of payment (*e.g.*, pay by the hour versus payment upon completion).

(e) Whether payment is fixed or contingent upon the occurrence of events.

(f) The typical arrangement in the marketplace – *i.e.*, are the providers of this particular type of service usually treated as employees or independent contractors?

(g) The manner in which the service providers are treated by the principal. Due consideration will be given to whether the service providers are referred to as “employees” by the principal.

*<u>Example 1</u>:* *The Ministry of Communications pays five individuals to fix transmission towers. The individuals earn a fixed amount of Afs. 20,500 per month. The Ministry instructs the individuals when the towers are to be fixed. The Ministry provides very detailed rules that have to be followed in terms of safety. The Ministry provides the individuals with trucks and tools. The individuals do not have to purchase their own equipment, but they do purchase their own uniforms for the job. Under these facts, the Ministry will be considered the “employer” and the five individuals will be considered “employees”. The Ministry will have to withhold Afs. 950 per month (ie Afs. 20,500 taxed at the rates specified in paragraph 3 of Article 4).*

Article 18 Deductible expenses (1) Deduction of all ordinary and necessary expenses of production, collection, and preservation of income of natural and legal persons shall be allowed in accordance with the provisions of this Law as follows provided that these expenses have been incurred during the tax year or one of three previous years.

1. any expense related to the cost of production or trade and business, such as insurance and freight expenses, etc.;

2. the cost of supplies, materials, fuel, electricity, water, and other necessary expenses incurred in the production of income, or in a trade or business;

3. wages, salaries, commission, and fees paid for services rendered by employees in trade or business;

4. interest paid on loans utilized for business and trade ;

5. rent paid on property necessary to and used for the purposes of trade or business;

6. cost of repairs and maintenance of properties and equipment necessary to and used for purposes of the business or trade;

7. depreciation of movable and immovable property (except agricultural land) used in trade or business, or held by the producer for the production of income, in accordance with the Income Tax Manual. The total of deductions for depreciation of the property shall not exceed its cost to the taxpayer. However, a natural or legal person will not be entitled to claim depreciation for that part of the cost of an asset which the person does not withhold tax from payment for that asset in accordance with Article 72 of this Law;

8. any tax or charge that is a necessary expense of doing business, holding property and equipment for earning income or producing income, if paid or accrued during the tax year. Taxes imposed by this Law and taxes not qualifying as necessary business expense shall not be deductible except as otherwise provided by this Law;

9. damages to movable or immovable property caused by fire, earthquake, and by disaster of any kind, over a period of three years, to the extent that the cost is determined and substantiated by records and the loss was not covered by insurance;

10. losses in business or trade from bad debts according to the Income Tax Manual;

11. dividends paid in money by a legal person established under

the laws of Afghanistan; and

12. other expenses of doing business and of holding movable or immovable property for the production of income under relevant legislative documents.

(2) No deductions shall be allowed for the following expenses:

1. Expenses incurred to provide entertainment or advertising that are not connected to economical or commercial activities;

2. Dividends, interest, royalties, rent, commissions, wages, salaries, payments which are the subject of Article 72 of this Law, and other similar income from which legal and natural persons are required to withhold and pay tax under the provisions of this Law, but have failed to do so; and

3. in the case of a branch in Afghanistan of a non-resident person, any expenses paid or incurred to the non-resident person or any person connected to the non-resident person.

18.1 Expenses incurred in the production of income are deducted from profit or net income from that activity to determine the amount of taxable income. Article 18 of the Income Tax Law lists the ordinary and necessary costs and expenses that are deductible from receipts in determination of taxable income of any business activity of natural or legal persons. Expenses and costs may be incurred which are not deductible for purposes of income taxation. Thus, the profit or net income of a business may be different according to the records of the owner than net income determined in accordance with the Law.

Examples of non-deductible expenditures are:

a. gifts;

b. illegal expenditures;

c. donations;

d. income taxes;

e. additions to reserves that are not required by law (See Article 19(2)2 of the Income Tax Law);

f. any excessive amount added to a reserve required by law (See Article 19(2)2 and Article 56 of the Income Tax Law);

g. cost of goods purchased but used by the owners or employees for personal or household purposes and not sold;

h. cost of goods purchased but subsequently returned to supplier or manufacturer; and

i. cost and expense of providing benefits for the owners, officers, and management that are not necessary for the conduct of business.

*Example 1*: *An individual owns a factory. Out of the income from the factory, the factory purchases an automobile for the individual's family. Such expenditures are not deductible in determining the taxable income of the individual.*

*Example 2*: *An automobile dealer purchases 10 automobiles for resale at a cost of Afs. 160,000 each. He keeps two of these for his family's use and sells eight at an average price of Afs. 200,000. If all purchases were allowed as a deduction, profit would be understated:*

| | |
|---|---|
| *a. Sales receipt (8 x Afs. 200,000)* | *Afs. 1,600,000* |
| *b. Cost of purchase (l0 x Afs. l60,000)* | *1,600.000* |
| *c. Gross profit* | *none* |

*Whereas the correct statement would be:*

| | |
|---|---|
| *a. Sales receipt (8 x Afs. 200,000)* | *Afs. 1,600,000* |
| *b. Cost of purchase – less 2 automobiles for personal use (8 x Afs. 160,000)* | *1,280.000* |
| *c. Gross profit* | *Afs. 320,000* |

18.2 Interest paid on business debts and the interest portion of lease rentals paid by the lessee is deductible expense but interest paid on personal debts is not. A personal debt is one incurred for purchase of goods and services or property for personal consumption and use. A business debt is one incurred in purchase of land, buildings, equipment, goods, etc., for leasing or under a finance lease arrangement, resale, production of goods and services, and other business purposes.

*Example:* *Azziz borrows money from his brother, Wahid, to purchase a computer. Wahid charges Azziz 2% interest per year. Azziz cannot deduct the interest that Azziz pays to Wahid.*

18.3 Depreciation and recovery of cost basis shall not be allowed unless the taxpayer has clearly established the cost of the property being depreciated or recovered. Any cost established for purposes of claiming depreciation expense is binding on the taxpayer for purposes of determining gain from sale of the same property.

*Example 1:* *Adib purchased a motorcycle for use in his business three years ago. Adib never kept the receipt from the purchase. Adib now sells the motorcycle for Afs. 30,000. Adib does not present any evidence about what the cost of the motorcycle was to him. Adib must recognize gain of Afs. 30,000.*

*Example 2:* *Adib purchased a motorcycle for use in his business three years ago. Adib never kept the receipt from the purchase. Adib now sells the motorcycle for Afs. 30,000. Adib is able to demonstrate that motorcycles of this type normally cost Afs. 50,000. The man who sold him the motorcycle confirms this. Adib will be permitted to deduct Afs.*

*20,000.*

18.4 If an owner of a building is not able to clearly establish his cost basis and depreciation, the Ministry of Finance may not allow any deductions. If the owner provides acceptable documents regarding his cost basis and depreciation, then in this case, the deduction for depreciation will be allowed.

18.5 a) A leasing arrangement whereby the lessee acquires the right to possess and use the asset for a certain period in return for a series of payments and the following conditions are satisfied, is classified as a finance lease:

1. The lease term is for a period of more than 12 months;
2. The asset is used by the lessee for business purposes;
3. The risks and rewards incidental to ownership are transferred to the lessee while ownership of the leased asset is transferred to the lessee at the end of the Lease Term;
4. The lease arrangement includes an option for the lessee to purchase the asset prior to or at the end of the lease term at a predetermined price;
5. The lease term is not 80% of the Useful Life of the leased asset;
6. The present value of the lease payments agreed upon in the lease agreement is not less than 90% of the value of the asset measured on the date the lease is entered into; and
7. The “residual value “of the leased asset is clearly stated leaving no ambiguity regarding the amount to be paid to the lessor for the purchase of asset when the Lease Term is over.

b) The fair value of the asset which includes cost plus incremental profit to the lessor is recognized in the lease agreement and assets and liabilities are recognized in the balance sheet of the lessee.

c) The terms used in the above definition of finance lease, are defined as under:

1. Lease Term: For the purpose of finance lease means the period during which the leased asset remains in the possession and use of the lessee.

2. Useful Life: For the purpose of finance lease means the productive life of the asset as defined by the depreciation rates stated in the Income Tax Law.

3. Residual Value: For the purpose of finance lease means the net book value of the asset in accordance with the depreciation rates stated in the Income Tax Law or the “residual value” as stated in the lease agreement.

d) In a Finance Lease the lessee may depreciate the leased asset and in line with the principle stated in Article 13.2 the lessee will be required to

separate each payment into its principal component (which is not deductable) and its interest component (which is deductable).

*Example:* *Wahid "leases" equipment to Azziz under a lease agreement. During term of the lease Aziz will make 5 annual payments of Afs. 20,000 each on Hamal 1, starting on the first day of the lease (incremental borrowing rate is 10%). The equipment has a useful life of 10 years. The lease term is for a period of 5 years. The legal ownership of the equipment will transfer at the end of the lease term from Wahid to Aziz.*

*The first step is to determine whether this lease agreement is an ordinary lease or a finance lease. The lease agreement satisfies the above conditions of a finance lease viz;*

*i) Legal ownership of the leased equipment during and completion of the finance lease;*

*ii) The matter subject of the finance leaseis transferred to Aziz (the lessee) at the end of the lease term;*

*iii) The equipment is for the purpose of business use; and*

*iv) The present value of the lease payments agreed is more than 90% of the value of the equipment (in fact it is 100%).*

*So the lease arrangement is a finance lease agreement.*

*As such, Wahid should treat the transaction as business debt and record the interest as income. To recognize the generated income in the light of paragraph 13.2, the payments are amortized as follows:*

| *Year* | *Payment* | *Interest* | *Principal* | *Balance* |
|---|---|---|---|---|
| *Year 1* | *20,000* | | *(20,000)* | *63,398* |
| *Year 2* | *20,000* | *6,340* | *(13,660)* | *49,738* |
| *Year 3* | *20,000* | *4,974* | *(15,026)* | *34,712* |
| *Year 4* | *20,000* | *3,471* | *(16,529)* | *18,183* |
| *Year 5* | *20,000* | *1,818* | *(18,183)* | - |
| *Total* | *100,000* | *16,602* | *83,183* | - |

*If Wahid has a cost basis of Afs. 80,000 in the equipment, he reports Afs. 13,183 of gain with respect to the equipment in the year one. In addition Wahid has to recognize interest as shown in the above table, assuming the payments are made promptly each year.*

*Aziz on the other hand will record the asset in his books of accounts and depreciate it according to the depreciation policy of legally owned asset.*

18.6 When the cost of depreciable business assets is determined from documentary evidence, the depreciation expense that may be deducted each year is subject to the following provisions:

a. All institutions and agencies are required to observe the following percentages and standards with respect to the depreciation of their buildings, machinery, and other supplies.

b. The percentage shall be based on the cost.

c. The percentages and standards shall be established by the Ministry of Finance in consultation with the Ministry of Mines and Industries at appropriate times and brought to the attention of institutions and agencies.

d. Depreciation is an annual allowance. If a taxpayer fails to deduct or deducts an understated amount for one taxable year, he may not deduct the depreciation omitted or the amount understated in another year.

| No. | Kind of asset | Period of Useful Life (in years) | Percentage Allowed Each Year |
|---|---|---|---|
| I. | Brick or stone structures | 50 | 2 |
| 2. | Loam structures | 20 | 5 |
| 3. | Wooden structure | 10 | 10 |
| 4. | Machinery and equipment not otherwise specified below | 10 | 10 |
| 5. | Mining equipment | 6.5 | 15 |
| 6. | Tools | 4 | 25 |
| 7. | Printing equipment and machines | 2 | 50 |
| 8. | Handicraft machines | 3 | 33 |
| 9 | Metallurgical machines | 10 | 10 |
| I0. | Carpets | 10 | 10 |
| II. | Rugs and other furnishings | 4 | 25 |
| I2. | Chairs, seats, and sofas | 4 | 25 |
| I3. | Desks, tables, and cabinets | 10 | 10 |
| I4. | Office equipment (calculators, typewriters, telephones, etc.) | 6.5 | 15 |
| I5. | Bicycles | 5 | 20 |
| I6. | Trucks | 2 | 50 |
| I7. | Cars | 4 | 25 |
| I8. | Tires and tubes | 2 | 50 |
| I9. | Sacks | 2 | 50 |
| 20. | Impure iron stoves and pipes | 10 | 10 |
| 2I. | Iron stoves | 2 | 50 |
| 22. | Carriages, animal carts, and handcarts | 3 | 33 |
| 23. | Construction machines, rollers, and mixers | 5 | 20 |
| 24. | Computers and computer related equipment | 3 | 33 |
| 25. | Televisions, radios, cellular phones | 3 | 33 |
| 26. | Telecommunications equipment / cell towers | 7 | 14 |

*<u>Remark:</u> The cost of moveable and immovable property (except agricultural land) used in trade or business by a person for the production of income shall be deducted in accordance with Income Tax Manual and based on above mentioned percentages provided that the deductible amount does not exceed the cost of depreciable assets.*

18.7 Depreciation is not allowable for the cost of an asset to the extent to which payment for the asset has not been subject to withholding tax as required by the provisions of Article 72 and has not been paid to the government account.

*Example:* *Adel Communications contracts with Behan Construction to build a telecommunications tower for Afs 1,000,000 payable in two instalments of Afs 500,000. When the tower is complete, Adel Communications will be entitled to claim depreciation on the cost of the tower as an asset used in its business.*

*When Adel Communications makes its first payment of Afs 500,000, Behan Construction asks it not to withhold the tax because Behan Construction says that it has not budgeted for this tax. Adel Communications makes the payment and does not withhold any tax. When Adel Communications makes its second payment of Afs 500,000, it withholds tax of Afs 10,000 and pays the amount to the government account in accordance with Article 72.*

*Adel Communications will be entitled to claim depreciation of the telecommunications tower on the basis of a cost of Afs 500,000 only.*

18.8 "Wages" and "salaries" include such items as regular pay, bonuses, over time pay, retroactive increases, and other valuable considerations paid by the employer in money or other forms.

*Example:* *An employee works for a company for a monthly salary of Afs. 20,000. In the month of Qaus, he receives a promotion and his salary is increased to Afs. 24,000, effective as of Meezon 1. At the end of the year, the company pays each employee a bonus of five per cent of his salary. In reporting the salary paid to the employee, the company must include all of these items, and the employee must report them on his income tax return as follows:*

| | | |
|---|---|---|
| *a.* | *Salary (first 6 months) (6 x Afs. 20,000)* | *Afs. 120,000* |
| *b.* | *Salary (second 6 months) (6 x Afs. 24,000)* | *144,000* |
| *c.* | *Total 12 months' salary* | *Afs. 264,000* |
| *d.* | *Five per cent of yearly salary at the end of the year (5% of Afs. 264,000)* | *13,200* |
| *e.* | *Total salary paid by the company* | *Afs. 277,200* |

*The company is entitled to claim a deduction for the amount of the salary paid.*

18.9 Payment by the employer of the personal income tax of his employee is payment of additional salary or wages to the employee and as such is subject to taxation.

18.10 The municipal tax on leased property is deductible from rental income.

*Example:* *A tax of Afs. 20,000 is paid to a municipality on commercial property leased to a tenant for Afs. 240,000 per year. This tax is deductible from rental income. If depreciation was Afs 20,000 and repairs were Afs 4,000 and no other deductible expenses were incurred, the net income from this property would be:*

| | | | |
|---|---|---|---|
| *a.* | *Gross rent* | | *Afs. 240,000* |
| *b.* | *Municipal tax* | *Afs. 20,000* | |
| | *Depreciation and repairs (see Regulation 18.4)* | *24,000* | *- 44,000* |
| *c.* | *Net income* | | *196,000* |

18.11 Net income taxes are not deductible in computing net income.

*Example:* *A corporation has a net income in the taxable year of Afs. 800,000. During the taxable year it paid income taxes of Afs. 120,000 on income received during the previous year. This amount is not deductible nor is the income tax for the current year deductible.*

18.12 An employer can deduct certain non-cash benefits that it provides to its employees, provided that the provision of the benefits is directly related to the employer's business.

*Example:* *A construction company which is building a dam some distance from any town finds that it must provide transportation between the nearest town and the construction site each day to induce laborers to work at the project site. This is a legitimate expense of doing business and the company may deduct the cost of providing such transportation.*

*Remark:* *If some of the employees drive their own cars to the project site, they cannot deduct the cost of traveling to and from work from their income when filing their individual income tax returns.*

18.13 Loss of property used for production, collection, or preservation of income caused by fire, wind, earthquake, casualty, or disaster of any kind may be deducted to the extent that such loss was not reimbursed by insurance. To claim such a deduction, the owner must have kept records which clearly show the value or cost of the property lost. One third of the loss may be claimed in the current year and each of the succeeding two years.

18.14 Premiums paid for insurance of property used for the production, collection, and preservation of income are a legitimate cost of doing business and are fully deductible. Receipts from an insurance company as the result of a loss are not taxable unless the amount of reimbursement exceeds the cost or depreciated value of the property lost. If the amount of reimbursement received exceeds the depreciated value of the property, the excess must be reported as income by the owner.

*Example.* *An individual operates a car dealership in Kabul. Due to a severe storm, two of the cars on the individual's lot are damaged. One car is a Toyota. The other car is a Mercedes. All of the cars are fully insured. The individual purchased the Mercedes for Afs. 1,000,000. The individual purchased the Toyota for Afs. 800,000. After filing an insurance claim for the damage, the individual receives Afs. 700,000 for the Mercedes and Afs. 850,000 for the Toyota. The individual is entitled to recognize a loss of Afs. 300,000 with respect to the Mercedes, but must recognize income of*

*Afs. 50,000 with respect to the Toyota. The loss of Afs. 300,000 may be claimed over the course of three years. The first Afs. 100,000 loss may be claimed in the current year. An addition Afs. 100,000 may be deducted in each of the subsequent two years.*

18.15 A taxpayer will be allowed a deduction in a tax year for a bad debt if the following conditions are satisfied:

(a) the amount of the debt was previously included in the taxable income of the taxpayer;

(b) the debt is written off in the accounts of the taxpayer during the tax year; and

(c) the taxpayer has reasonable grounds for believing that the debt will not be recovered.

This requirement will not apply to a bank entitled to a deduction for additions to reserves against losses in accordance with Article 56 of this Law.

*Example:* *Ahmad Advertising Company provides advertising services for newspapers and radio. Ahmad Advertising Company has an arrangement with Shiraz Restaurant where Ahmad Advertising Company places advertisements each month in the newspaper and on the radio and then sends an invoice for Afs 5,000 to Shiraz Restaurant for payment. One month, Shiraz does not make the payment. Ahmad Advertising Company cancels the arrangement. Ahmad Advertising Company, being required to account on the accruals basis and having provided the advertising services, has already included the amount of Afs 5,000 in its income. Ahmad Advertising Company makes attempts to collect the money. It makes phone calls and sends a letter to Shiraz Restaurant but no payment is received. Eventually, Shiraz Restaurant closes its business.*

*Ahmad Advertising Company has reasonable grounds for believing that the debt will not be recovered. It may treat the amount as a bad debt and claim an income tax deduction for the amount not received.*

*Remark:* *If an amount is written off as a bad debt, but the debtor subsequently pays some or all of the amount written off, then this amount will be treated as income.*

18.16 No deduction is allowable for any payment which has not been subject to withholding tax as required by the law. Tax is required to be withheld from the payment of dividends, interest, royalties, rent, commissions, wages and salaries and similar income. Tax is also required to be withheld from payments made to contractors in accordance with Article 72. Where tax is not withheld from the payment to a contractor, the payer will not be entitled to a tax deduction for the payment made.

*Example:* *Ferozkoh Construction and Road Building Company has a contract to buy asphalt and cement from Hendekosh Trade Company for Afs 5,000,000. The contract requires that payment be made in two instalments of Afs 2,500,000. Ferozkoh Construction Company makes the first payment to Hendekosh Trade Company and, because Hendekosh Trade Company has a business license, Ferozkoh Construction and Road Building Company withholds tax of Afs 50,000 from the payment. The withheld tax is paid to the government account. When Ferozkoh Construction Company makes the second payment, Hendekosh Trade Company says to Ferozkoh Construction and Road Building Company not to withhold the tax because Hendekosh Trade Company is having cash flow problems. Ferozkoh Construction and Road Building Company pays the amount of Afs 2,500,000 to Hendekosh Trade Company and does not withhold any amount of tax.*

*Ferozkoh Construction and Road Building Company will be entitled to claim a deduction against income for the amount of the first payment ie Afs 2,500,000 but not for the second amount.*

Article 19 Non-deductible expenses (1) Personal expenses including the following expenses shall not be deductible:

1. payments made to persons for their or their family's benefit and enjoyment;

2. expenses and costs of maintenance, repair, construction, improvement, furnishing, and other expenses of the taxpayer's family house or residence or any property devoted to the taxpayer's own personal or family use;

3. interest on personal loans;

4. costs of commuting to and from work and cost of travel for personal purposes;

5. cost of life, accident, health, and liability insurance for the protection of the taxpayer and their family; and

6. cost of insurance of any kind for the protection of property used for personal purposes.

(2) The following expenses shall not be deductible:

1. The cost of acquiring land, buildings, durable items (such as machinery, equipment, fixtures, and furniture, or costs of additions or improvements to the same). Depreciation expense allowable under sub-paragraph 7 of paragraph (1) of Article 18 and the provisions of Chapter 3 of this Law shall be excluded from the provisions of this paragraph.

2. Additions to reserves for contingencies, bad debts, and other similar purposes; and

3. Taxes paid to foreign countries by non-resident persons on income from sources within Afghanistan, except as provided by an existing treaty.

19.1 The expenses listed under Article 19(1) of the Income Tax Law are typical living expenses of an individual and his family that are specifically listed as not deductible to remove any uncertainty that could otherwise arise. No personal expenses are deductible. Examples of personal expenses are:

a. cost of food, supplies, clothing and shelter for taxpayer and his dependants;

b. costs of entertainment, recreation, books, and education for taxpayer and dependants;

c. medical and dental expenses of taxpayer and dependants;

d. contributions, gifts, and support given to unfortunates;

e. expenses of repair and maintenance of automobile used for personal and family purposes;

f. personal income taxes paid;

g. tax on a residence occupied by the owner, or taxes of any kind except those that are expenses of a business from which income is taxable;

h. fines paid for violations of law by the taxpayer or members of his family;

i. losses (except losses covered by Article 18(1)9 of the Income Tax Law) of property through misfortune, theft, carelessness, etc.; and

j. other costs and expenses that are not costs of doing business, producing income, etc.

19.2 Land is a fixed asset that is not depreciable for purposes of taxation. Unless destroyed by flood, landslide, etc., the land does not lose utility and value. Therefore, the cost of acquiring land is not deductible either at the time the land is purchased or as it is used. The cost of land is deducted from the price or value realized only when the land is sold or transferred (except by inheritance).

*Example 1:* *A corporation purchases a large tract of land as a site for a new factory. The cost of the land is not deductible from income nor can depreciation expense be claimed on the investment in land. The purchase price paid remains unchanged on the financial statement of the corporation until the land is sold in whole or in part.*

*Example 2:* *A corporation purchases a tract of land with an office building situated on the tract. The price paid for the entire property is Afs. 30,000,000. A division of this sum must be made on the books of the corporation between the cost of land and cost of improvements (buildings etc.). The cost allocated to land cannot be depreciated, but the cost allocated to improvements can be deducted in annual depreciation expense over the period of expected useful life of the improvements.*

19.3 An addition to a reserve is part of income set aside but not expended. If an amount is added to an already established reserve or is set aside to provide a new reserve which may be deemed necessary by the management, it is deductible if required by law.

*Example l:* *If the law requires a bank to maintain a reserve for losses on loans equal to 25 percent of loans issued and the reserve is less than that amount, any amount needed to bring the reserve up to 25 percent of*

*loans outstanding, and not exceeding that, may be added to that reserve and deducted from income before taxes are calculated.*

*Thus, if loans outstanding were Afs. 2,000,000,000 at the end of the year, and the reserve for losses on loans was Afs. 475,000,000, the maximum amount that can be added to this reserve, in addition to the Afs. 475,000,000, can be found as follows:*

| | | |
|---|---|---|
| a. | 25% of loans outstanding (25% of Afs. 2,000,000,000) | Afs. 500,000,000 |
| b. | the amount of the existing reserve | - 475,000,000 |
| c. | the amount by which the reserve is less than the legal reserve | Afs. 25,000,000 |

*So, this reserve is thus Afs. 25,000,000 less than the amount required by law. Therefore, an amount up to Afs. 25,000,000 may be set aside and deducted from income before taxes are assessed. If net income were Afs. 25,000,000 or less, the entire income could be set aside, leaving no income subject to income tax.*

*Remark:* *The business receipts tax would not be affected by reserve additions.*

*Example 2:* *If the bank had reserve of Afs. 500,000,000 and outstanding loans of Afs. 2,000,000 at the end of the year, an addition to this reserve would not be deductible because the amount of the reserve already equaled 25 per cent of the amount of loans outstanding. Thus, if net income was Afs. l00,000,000, and Afs. 25,000,000 of this was added to the reserve for losses on loans, increasing the reserve to Afs. 525,000,000, the taxable income (Afs. 100,000,000) would not be reduced. The amount added to the reserve cannot be deducted from income, because the reserve was already at the amount required by law (.25 x Afs. 2,000,000,000 = Afs. 500,000,000).*

*Example 3:* *Reserves for depreciation are not affected by Article 19 of the Income Tax Law. Allowable depreciation expenses may be deducted from the cost of the assets depreciated. (See Regulation l8.6 for allowable depreciation rates.)*

19.4 An expense that is not deductible may not be paid from a reserve built up out of tax-free income.

*Example:* *Since income taxes are not deductible from taxable income, charging income tax payments against tax-free reserves is essentially the same as deducting those taxes from income. If, on the other hand, the reserve for contingencies is not required by law and the reserve had been built up from income after taxes, the payment of income taxes may be charged against the reserve.*

19.5 Tax payments by non-resident persons to foreign countries do not affect the taxes due to the State on income from sources in Afghanistan.

<u>*Example*</u>*:* *A non-resident person may be subject to income taxes imposed by his own country on his income from sources in Afghanistan. The income from sources within Afghanistan is taxable by the Government of Afghanistan. Afghanistan has priority over taxation of such income and does not allow the taxes paid by the non-resident to his own country to affect (reduce) the tax due to the State. Therefore, such foreign tax paid cannot be deducted from taxable income or credited in computing the tax due under the Law. Thus, if a non-resident person earns Afs. 500,000 from services performed by him in Afghanistan and in his country, regardless of how the tax due in his own country is calculated, the tax due in Afghanistan is unaffected.*

Article 20 Income from sources within Afghanistan (1) Income from sources within Afghanistan shall be as follows:

1. Interest from loans, profit on deposits, and income from investments;

2. Dividends received from resident companies operating in Afghanistan;

3. Salaries, wages, and income from self-employment;

4. Rental income and royalties from any movable and immovable property;

5. Gains from sale of immovable and movable property;

6. Commissions on sales including insurance of any type;

7. Income from commercial activities within Afghanistan;

8. Gains from the sale or transfer of any movable property used in commercial or employment activities;

9. Royalties, fees and commissions paid by a resident of Afghanistan;

10. Income from discovery and extraction of any minerals, petroleum, or any other resources;

11. Income from other sources within Afghanistan which is subject to tax according to the provisions of this Law.

(2) For the purposes of this Law, apart from Articles 29 and 30, the term "immovable property" mentioned in subparagraph 5 of paragraph (1) of this Article includes any benefit in a company or other entity where the value of the assets of the company or entity results principally from ownership either directly or indirectly through other persons of –

1 immovable property in Afghanistan; or

2 benefits in immovable property in Afghanistan, including hydrocarbon contracts and mining licenses and mining authorizations as defined in Chapter 12.

(3) For the purposes of this Law, apart from Articles 29 and 30, exploitation of an interest described in subparagraph 10 of paragraph (1) of this Article includes any sale of or other dealing with an interest.

20.1 Interest on loans, deposits, investments, etc., within Afghanistan includes:

a. interest on deposits by natural or legal persons in banks in Afghanistan; and

b. interest on loans and finance leases to individuals, companies, permanent establishments, and subsidiaries in Afghanistan.

20.2 Dividends paid by an Afghan corporation or limited liability company will be considered to have an Afghan source and therefore subject to Afghan withholding tax.

<u>Example:</u> *A foreign investor owns all of the issued stock of an Afghan corporation. The Afghan corporation has accumulated Afs. 1,000,000 of earnings. The Afghan corporation distributes Afs. 1,200,000 to its shareholder. Of the Afs. 1,200,000 distribution, only Afs. 1,000,000 is considered a dividend that has an Afghan source. The remainder of the distribution is considered a return of invested capital or a gain with respect to the investor's stock. Neither the return of capital nor the gain with respect to the stock is considered to have an Afghan source.*

20.3 Salaries, wages, self-employment income, etc. for services performed in Afghanistan are considered to have an Afghan source.

<u>Example:</u> *A non-resident individual is employed by a UK company to perform services inside and outside of Afghanistan. The non-resident employee spends approximately 80% of his time during the year in Afghanistan. Thus, 80% of the individual's salary during the year shall be considered to have an Afghan source. This income will be subject to Afghan income tax unless exempted by a treaty or an agreement with the State.*

20.4 Rentals and royalties from any property (moveable and immovable) used within Afghanistan shall be considered to have an Afghan source.

<u>Example 1:</u> *A Chinese company leases trucks to an Afghan corporation. The Afghan corporation, in turn, uses the trucks to make deliveries throughout Afghanistan. The lease payment from the Afghan corporation to the Chinese company is considered to have an Afghan source.*

<u>Example 2:</u> *A Chinese company leases trucks to an Afghan corporation. The Afghan corporation, in turn, uses the trucks to make deliveries throughout Afghanistan and Pakistan. The lease payment from the Afghan corporation to the Chinese company is considered to have an Afghan source only to the extent it relates to the use of trucks in Afghanistan. Thus, the lease payment from the Afghan corporation to the Chinese company must be allocated between payments for use of trucks within Afghanistan and the use of trucks in Pakistan based on a reasonable measure. Examples of reasonable measures would include*

*the number of miles driven in each country, or a comparison of revenues from deliveries in each country.*

20.5 Gain from the sale of immovable and movable property that is physically situated in Afghanistan shall be considered to have an Afghan source. Such gains shall include:

a. income from the ownership or interest in any immovable property, mineral deposit, or natural resources in Afghanistan;

b. income from the ownership or interest in any franchise to do business in Afghanistan;

c. gain from the sale of an interest in a domestic or foreign partnership, to the extent the partnership owns assets in Afghanistan;

<u>*Example 1:*</u> *A foreign investor owns a 10% interest in the capital and profits of an Afghan partnership. The Afghan partnership owns real property in Afghanistan. If the investor sells his 10% interest in the Afghan partnership, the gain (if any) will be considered to have an Afghan source. The sale of the partnership interest will have the same source as the sale of the underlying property.*

<u>*Example 2:*</u> *A foreign investor owns a 10% interest in the capital and profits of a UK limited liability partnership. The partnership owns mining properties in Afghanistan. If the investor sells the UK partnership interest, the gain (if any) will be considered to have an Afghan source.*

<u>*Example 3:*</u> *A foreign investor owns a 10% interest in the capital and profits of an Afghan partnership. The Afghan partnership owns real property in India. The Afghan partnership does not own any Afghan assets. If the foreign investor sells his 10% interest in the partnership, the gain (if any) will not be considered to have an Afghan source.*

b) gain from the sale of stock of a corporation or limited liability company if the value of the assets of the company results principally from ownership either directly or indirectly through other persons of: (a) immovable property in Afghanistan; or (b) interest in immovable property in Afghanistan, including hydrocarbon contracts and mining licenses and mining authorizations as defined in Chapter 12.

<u>Remark</u>: For this purpose, the term “principally” shall mean more than fifty percent, measured by value.

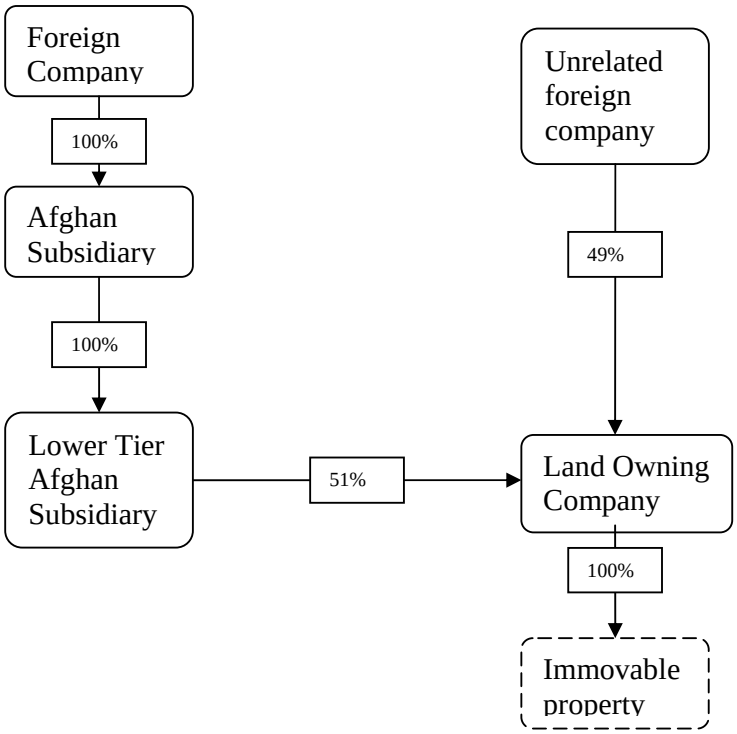
<u>Remark</u>: A corporation or limited liability company shall be considered to indirectly own those assets that are owned through lower-tier entities based on the value of the interest that the upper-tier entity owns in the lower-tier entity.

<u>*Example 1:*</u> *A foreign investor owns an interest in the stock of an Afghan corporation. The Afghan corporation leases some real property and owns equipment situated in Afghanistan. The Afghan corporation entered into the real property lease three years ago and the lease payments are somewhat below market. Thus, the leasehold interest is worth Afs. 300,000 to the Afghan corporation. The equipment is worth approximately Afs. 1,000,000. If the foreign investor sells the stock of the Afghan corporation at a gain, the gain will not be considered to have an Afghan source.*

<u>*Example 2:*</u> *A foreign investor owns an interest in an Afghan corporation ("A1"). A1 owns all of the issued stock of a second Afghan corporation ("A2"). A1's sole asset is the stock of A2. A2's sole asset consists of real property located in Bamiyan province. If the foreign investor sells the stock of A1, the gain will be considered to have an Afghan source, because A1's assets (owned indirectly) principally consist of real property located in Afghanistan.*

<u>*Example 3:*</u> *A foreign investor owns all of the issued stock of an Afghan corporation ("A1"). A1 owns stock of a lower-tier Afghan corporation ("A2") which represents 70% of the value of A2. A1 owns Afs. 1,000,000 that it has on deposit with Da Afghanistan Bank. A2 owns real property located in Afghanistan that is worth Afs. 2,000,000. The value of A1's property results principally from the indirect ownership of real property located in Afghanistan. This is because A1's assets consist of Afs. 1,000,000 of cash and Afs. 1,400,000 of real property (70% x Afs. 2,000,000). Thus, if the foreign investor sells the stock of A1 at a gain, the gain will be considered to have an Afghan source.*

*<u>Example 4</u>:*




*The only assets owned by Afghan Subsidiary are shares in Lower Tier Afghan Subsidiary and the only assets owned by Lower Tier Afghan Subsidiary are shares in Land Owning Company and the only asset owned by Land Owning Company is immovable property eg a mining license for a site in Afghanistan.*

*If Foreign Company were to sell its shares in Afghan Subsidiary, Foreign Company would be treated as having sold immovable property in Afghanistan and the gain realised on the sale of shares in Afghan Subsidiary would be subject to income tax. This is because 100% of the value of Afghan Subsidiary is attributable to the immovable property further down the chain.*

*The same result would follow if Lower Tier Afghan Subsidiary owned 49% of Land Owning Company and Unrelated Foreign Company owned 51% of Land Owning Company. While Foreign Company now has an indirect interest in the immovable property of less than 50%, it is still the case that 100% of the value of Afghan Subsidiary is attributable to the ownership of immovable property. A sale of shares in Afghan Subsidiary in this case would be treated as a sale of immovable property.*

> *<u>Remark:</u> The tracing mechanism through interposed entities will apply in the same manner to immovable property or to benefits in immovable property in Afghanistan, including hydrocarbon contracts and mining licenses and mining authorizations as defined in Chapter 12.*

20.6 Commissions on sales of any kind including insurance shall be considered to have an Afghan source to the extent the sales activities take place in Afghanistan. For this purpose, consideration will be given to all of the relevant facts and circumstances. The physical location where the contract is executed will be persuasive, but not definitive evidence of where the sales activities took place.

*Example:* *An insurance salesman from a foreign country is in Afghanistan 30 days selling insurance to aliens in Afghanistan, some of whom belong to the foreign diplomatic corps. All commissions earned by this salesman on sales made while in Afghanistan, including those received from sales of insurance to aliens exempt from taxes in Afghanistan, are subject to income tax. The foregoing is true even if the contracts (if any) happen to be signed outside of Afghanistan. The fact that the solicitation and negotiation occurred in Afghanistan is sufficient to subject the commissions to income tax within Afghanistan.*

20.7 Gains from the sale or transfer of any movable property used in commercial or employment activities within Afghanistan is considered to have an Afghan source. Whether property is "used" within Afghanistan is determined based on a facts and circumstances test with due regard for the amount of time the property was used in Afghanistan compared with the amount of time that it was used elsewhere, during the period that the owner used the property.

*Example 1:* *A Pakistani corporation owns a number of trucks that it uses to transport goods throughout Afghanistan. The Pakistani corporation has used one truck for three years within Afghanistan. At the beginning of the fourth year, the Pakistani corporation sells the truck to a third party at a gain. The gain is considered to have an Afghan source regardless whether the sale actually occurs in Afghanistan or not.*

*Example 2:* *A Pakistani corporation owns a number of trucks that it uses to transport goods between Pakistan and Afghanistan. The Pakistani corporation has used one truck for three years. More than half of the time the truck was owned, it was physically used within Pakistan, not Afghanistan. At the beginning of the fourth year, the Pakistani corporation sells the truck to a third party at a gain. The gain is not considered to have an Afghan source, because the truck was predominantly used outside of Afghanistan.*

20.8 A management fee, annuity, or commission paid by a resident of Afghanistan is considered to have an Afghan source.

*Example 1:* *A UK corporation owns all of the issued stock of an Afghan corporation. Certain executives from the UK corporation provide ongoing management advice to the Afghan corporation. In exchange for this advice, the Afghan corporation pays the UK corporation a management fee. The management fee is considered to have an*

*Afghan source whether or not the advisory services are actually performed in Afghanistan.*

20.9 Income from the exploitation of any interest in a right to explore for, or exploit, any mineral, petroleum, or any other resources physically situated in Afghanistan shall be considered income from Afghan sources. To the extent that any natural or legal person generates any income (including but not limited to exploration, extraction, and/or refining) with respect to the exploitation of Afghan minerals, petroleum or other resources, the income shall be considered to have an Afghan source.

# CHAPTER 3

# GAIN OR LOSS FROM THE SALE, EXCHANGE, OR TRANSFER OF ASSETS

## Article 21 – Article 30

| | |
|---|---|
| Article 21 | Gains subject to income tax The gain from the sale or exchange of capital assets or investment in trade or business shall be subject to income tax. |

21.1 Gain from a sale or exchange of capital assets is income and the difference between the amount realized and the taxpayer's cost (or cost after depreciation and related expenses of sale) of the property is income to be reported by all persons, corporations, limited liability companies and other entities.

*Example 1:* *Ten shares of stock that cost the owner Afs. 10,000 are sold five years later for Afs. 10,000. There is no gain and no taxable income from the transaction.*

*Example 2:* *Ten shares of stock in an Afghan corporation are gifted to an Afghan resident. The Afghan resident takes a zero cost basis in the shares. If the Afghan resident sells the shares for Afs. 50,000 but has to pay fees of Afs. 5,000 to effect the sale, the Afghan resident will recognize gain of Afs. 45,000.*

*Example 3:* *On Hoot 29, 1386, a corporation sells its office building for Afs. 13,000,000. The building was purchased on Hamal 1, 1382 for Afs. 10,000,000. The annual depreciation claimed each year was Afs. 200,000 and the total deducted for the five years is Afs. 1,000,000. The expenses of sale were Afs. 50,000. The gain is computed as follows:*

| | | |
|---|---|---|
| Sales price | | Afs. 13,000,000 |
| Original cost | Afs. 10,000,000 | |
| Less: Depreciation | 1,000,000 | 9,000,000 |
| | | 4,000,000 |
| Less: Expense of sale | | 50,000 |
| Gain on sale | | Afs. 3,950,000 |

21.2 For purposes of this Income Tax Law, the term "capital assets" means property held by the taxpayer, whether or not connected with his trade or business, but does not include stock in trade of the taxpayer or other property of a kind which would be included in the inventory if on hand at the close of a taxable year, or property held by the taxpayer for sale to customers in the ordinary course of trade or business.

| | | |
|---|---|---|
| Article 22 | Taxable gain of tax year | The gain from the sale or exchange of any asset of a corporation or a limited liability company shall be taxable income in the tax year in which the asset was transferred. |

22.1 Gain from ***any*** transfer of ***any*** asset of a corporation or limited liability company is taxable income.

22.2 In a finance lease (as described in Regulation 18.5), the transfer of the leased asset from the lessor to the lessee which occurs at the end of the lease term is considered as completion of the original sale ( lease-to-own) that took place at the commencement of the finance lease. No gain would therefore accrue to the lessor at the time of actual transfer of the title to the asset to the lessee.

22.3 The gain realized at the time an asset is sold is taxable income in the year of sale even though the gain in value may have accumulated gradually over a period of years.

*Example:* *A limited liability company has owned an apartment building 10 years during which period the value of the property has continued to increase. In 1385 the company sold the property, realizing a gain Afs. 1,000,000. The gain reflects the total increase in value during the entire 10 year period. The Afs. 1,000,000 gain is, however, taxable income in the tax year 1385, the year that the apartment is sold.*

Article 23 Tax on transfer of property (1) Gain from the sale, exchange, or transfer of the following assets shall be taxable income:

1. a trade or business, including goodwill;

2. a factory including equipment, machinery, buildings and land, or any part of such assets;

3 equipment used in the business of transporting persons and goods; and

4. shares of stock in corporations or limited liability companies.

(2) Gain from the sale or transfer of movable or immovable property acquired by inheritance shall be excluded from the provisions of paragraph (1) of this Article.

23.1 Gain from the sale of assets of legal persons will be taxable income of the legal person in accordance with Article 22. Article 23 applies principally to natural persons ie individuals. The exclusion of immovable property (except factories) owned by an individual from the assets listed in Article 23 of the Income Tax Law applies only to individuals who own and hold such property for personal use. It does not exempt from taxation, for example, a profit derived from the construction and sale of buildings by individuals in the business of constructing and selling buildings. Nor does it exempt from taxation commissions received by agents or brokers who handle the sale of immovable property.

*Example:* *Wahid builds houses for a living. He and his family currently live in Kabul. During 1387, he builds three houses in Herat. Wahid sells his existing house in Kabul and moves his family into one of the houses that he built in Herat. He uses the house for his private dwelling. He sells the other two houses. The gain on the two Herat houses that are sold is subject to income tax under this Article. The gain on his Kabul home is not subject to income tax.*

23.2 Gain from sale of assets belonging to individuals and not covered by Article 23 of the Income Tax Law will not be subject to annual income tax. However, the sale of immovable and immovable property by an individual may be subject to the fixed tax imposed by Article 30(1).

*Example:* *Gain from sale or exchange of a generator used for personal use is not subject to income tax but if used in connection with a trade or business, the gain is reportable as taxable income.*

| | | |
|---|---|---|
| a. | Cost when purchased | Afs. 125,000 |
| b. | Plus expense of sale | 1,000 |
| c. | Cost when sold | Afs. 126,000 |

| | | |
|---|---|---|
| d. | Sale price | Afs. 150,000 |
| | minus cost when sold | - 126,000 |
| e. | Gain | Afs. 24,000 |

*The gain realized by the individual is Afs. 24,000 and is not taxable because the asset sold was not used in trade or business.*

*Remark: If the sales price is less than the cost price, a loss is incurred from the transaction. As the loss is not a loss incurred in the course of business (ie it is a personal loss), the amount of the loss is not allowed as a deductible expense.*

Article 24 Deduction of expenses from taxable income Proceeds from sale, exchange and transfer of assets (except by inheritance), shall be reported in full. The following deductions are allowed in determination of taxable gain:

1. Cost to the taxpayer of the asset and investment sold, less the total amount allowable for its depreciation since it was acquired.

2. Sale expenses including commission, advertising, documents and other expenses of transferring the asset.

24.1 Gain realized from the sale, exchange, or transfer of assets (except by inheritance or pursuant to a reorganization governed by Article 14) is determined as follows. The costs and expenses deductible by law are subtracted from the price or market value of the consideration received for the asset sold, exchanged, or transferred. The difference so obtained is the gain realized. The costs that are deductible are the price paid for the asset when it was acquired and the cost of permanent additions or improvements to the asset, less depreciation allowable. The expenses deductible are all the expenses incurred in selling, exchanging, or transferring the asset.

The depreciation allowable is:

a. the amount that has been allowed as depreciation expense for income tax purposes; or

b. the amount of depreciation that would have been allowed had depreciation expense been calculated for income tax purposes.

*Example:* *A car owned by a company is sold in 1385 for Afs. 350,000. This car was purchased in 1382 at a total cost of Afs. 420,000, and prior to its sale a new set of tires costing Afs. 60,000 had been installed on the car. If the company selling the car had charged depreciation expense at the rate of 25 per cent in each of the years 1382, 1383, and 1384, and the expense of sale and transfer was Afs. 600, the taxable gain will be computed as follows:*

| | | |
|---|---|---|
| a. | cost when purchased | Afs. 420,000 |
| b. | total depreciation for three years (3 x Afs. 105,000) | 315,000 |
| c. | depreciation value (cost – total depreciation) | Afs. 105,000 |
| d. | plus cost of tires | 60,000 |
| e. | plus expense of sale | 600 |
| f. | adjusted cost when sold | 165,600 |
| g. | sale price | Afs. 350,000 |
| h. | minus adjusted basis | - 165,600 |
| i. | gain realized | Afs. 184,400 |

| | |
|---|---|
| Article 25 | Tax determination based on market value The market value of the movable or immovable asset at the time it was transferred or exchanged (except inheritance), shall be the basis for computing the gain. |

25.1 An exchange which is a trade of assets of equal value or in which money is only part of the consideration received may result in realization of taxable gain. Such gain is determined by subtracting the depreciated cost of the assets exchanged and the expenses of transfer from the market value of the items received in the exchange.

*Example:* *An individual exchanges 1,000 shares of stock in a corporation for a residence owned by an individual. Although the shares have been paying dividends regularly, there is no regular trading in these shares and no market price is available. The shares were purchased 10 years earlier at Afs. 200 per share. If the residential property is worth more than Afs. 200,000, it is clear that the shares are worth more than Afs. 200 each on the date they were exchanged for that property. If an appraisal by the Ministry of Finance shows that the property is worth Afs. 1,000,000 and could be sold for this amount, and if the expenses of transferring the stocks are Afs. 2,000, then the gain realized by the owner of the shares will be determined in the following manner:*

| | | |
|---|---|---|
| a. | Market value of the consideration (house) | Afs. 1,000,000 |
| b. | Less cost of shares transferred (1,000 x Afs. 200) | 200,000 |
| c. | Gain received from the transfer of stocks | Afs. 800,000 |
| d. | Minus expense of transfer | 2,000 |
| e. | Net gain realized from the exchange of shares | Afs. 798,000 |

*Therefore, the amount Afs. 798,000 is the net profit from the exchange of stocks realized by the person acquiring the residential property (former owner of the stocks) and he must pay income tax on it as per the provisions of Article 29.*

| | |
|---|---|
| Article 26 | Form of transfer not to affect tax liability The form of transfer of movable or immovable assets (except by inheritance) shall not affect taxability of the gain from the transfer. |

26.1 Gain derived from the transfer of an asset is taxable, regardless of the nature of the transfer, unless the transfer is made by way of inheritance or pursuant to a transaction that qualifies as a partially or completely tax-free corporate reorganization under Article 14. For this purpose, the phrase "nature of transfer" means:

a. transfer by sale for money;

b. transfer by trade for other assets;

c. transfer by trade for other assets and money;

d. transfer as a gift to close relatives or friends in consideration of friendship; and

e. transfer in consideration of past services or expected future services of the person to whom the "gift" is made.

26.2 The Income Tax Law exempts from taxation any gain from the transfer of assets by inheritance. This exemption applies both to any gain by the estate of the deceased which transfers the asset and to any gain by the heir who receives the asset. It exempts from taxation any gain that would otherwise be treated as taxable income and subject to the income tax under the Income Tax Law. The exemption also applies to transfer of land or buildings by inheritance. Notwithstanding the foregoing, the recipient of the inherited property shall take the property with a zero cost basis.

*Example 1:* *The property of the estate of a deceased father is divided according to law among his sons and daughters. A natural right to this property was vested in these heirs from the date of their birth. In this case, the income tax calculated according to Article 4 of the Income Tax Law, and the one percent transfer tax under Article 30(1) of the Income Tax Law do not apply.*

*Example 2:* *The last will and testament of a property owner is carried out and his natural heirs inherit property accordingly. The will, however, provides a rather unequal distribution of property among the heirs. One heir receives land worth considerably more than the property received by the other heirs. The property received by the heirs is, nevertheless, an inheritance. The land owner exercised his legal right to have his property divided as he wished and as stated in his will. Therefore, the property received through inheritance is not subject to taxation under*

*the Income Tax Law, even though distribution may be unequal among the heirs.*

*Example 3*: *If the property owner in Example 2 had willed all or a portion of his estate to an individual who was not a natural heir, (for example, to faithful employee or a close friend), this transfer of assets would be subject to the provisions of the Income Tax Law. Any assets so transferred would be taxable income of the recipient. The estate of the deceased would also have to pay the one per cent transfer tax on the market value of any land or buildings transferred.*

| | |
|---|---|
| Article 27 | Deduction of loss incurred from taxable income Losses from the sale or exchange of capital assets used in trade or business shall be deductible from the taxable income of the taxpayer in the tax year in which the sale or exchange took place, provided that a gain from such sale or exchange would have been taxable. |

27.1 Under certain conditions, a taxpayer may recover a portion of a loss from the sale or transfer of a capital asset used in trade or business. To do so, he must have income which is subject to taxation under Article 4 of the Income Tax Law, in the year in which the loss occurred. If he has such income, he may deduct the amount of the loss, along with other allowable deductions, in computing his taxable income. If he has no income for the year which is taxable under Article 4, he cannot deduct the loss.

Remark: An artisan whose commercial activity is taxed under Chapter 11 of the Income Tax Law, and who pays the fixed tax in compliance with the Income Tax Law, cannot recover a loss from the sale or transfer of an asset used in his commercial activity.

27.2 When an individual suffers loss from a sale of immovable property not used in trade or business, he cannot deduct this loss even though he has taxable income in the same year as this sale took place.

*Example:* *An individual has taxable income from sale of shares of stock of Afs. 200,000 in 1385. He also has other taxable income from dividends, wages, etc., in the same year.*

*In 1385, he sold a residential property at a loss of Afs. 100,000. He cannot deduct this loss from other income, because gain from sale of this asset would not have been subject to income tax. Instead, the sale is subject to the fixed tax provisions of Article 30 of the Income Tax Law.*

27.3 The loss referred to in this Article is separate and distinct from the loss referred to Article 18(1)9. Losses from the sale or exchange of property may be claimed in the year incurred. Losses described in Article 18(1)9 must be claimed over a three-year period.

| | |
|---|---|
| Article 28 | <u>Non-deduction of additional loss from taxable income</u> Loss from sale or exchange of shares of stock shall not be deductible except from the gain from sale or exchange of shares of stock in the same year. For any such gain, if in excess of loss from such transactions, the excess is taxable, but if any such loss is in excess of gain, the excess loss shall not be deductible. |

28.1 When a person suffers loss from sale or exchange of shares of stock, the person cannot deduct such loss from taxable income, except from that portion, if any, which is the gain from sale or exchange of shares of stock realized in the same year.

*<u>Example 1</u>:* *An individual sells 100 shares at a price of Afs. 1,600 per share. The shares had cost him Afs. 2,000 per share two years before. His loss on this sale is Afs. 40,000 (100 x (2,000 – 1,600)). If this is the only sale or transfer of shares of stock in this tax year, he cannot deduct any of this loss from his other taxable income. This is the case even though this person may have other taxable income from salary, dividends, etc.*

*<u>Example 2</u>:* *An individual sells 10 shares which had cost him Afs. 2,000 each, at a loss of Afs. 500 each, for a total loss of Afs. 5,000. In the same year, he sold 20 shares in another company at a profit of Afs. 400 each for a total profit from this sale of Afs. 8,000. This person can deduct his loss of Afs. 5,000 from his gain of Afs. 8,000, because the loss and the gain occurred in the same year. The remaining Afs. 3,000 of gain is taxable income.*

*<u>Example 3</u>:* *If the individual in Example 2 above would have had a gain of only Afs. 4,000, he would have been allowed to deduct only Afs. 4,000 of his Afs. 5,000 loss. In this case, there would have been no taxable income and no further deduction of his loss. Because this loss is subject to the special rule in Article 28, it cannot be carried forward under the provisions of Article 42.*

*<u>Example 4</u>:* *If the loss of Afs. 5,000 in Example 2 above had been suffered in one tax year and the gain of Afs. 8,000 realized in a different year, none of the loss would be deductible and all of the gain would have been taxable.*

28.2 Gain or loss from sale or exchange of shares of stock is determined as follows:

a. The amount for which the stock was sold, or the value of the assets received in exchange for the stock, or the market value of the stock on the date it was transferred, is recorded.

b. The owner's cost of the stock is added to the expense of transfer.

c . The figure obtained in (b) is subtracted from the figure obtained in (a). The difference shows the gain or loss from the sale or exchange of the shares of stock.

If the figure in (b) is less than the figure in (a), the difference shows the gain realized. If (b) is greater than (a), the loss from the transaction is shown.

Remark: 1. The average cost per share shall be the total amount paid for all shares of the same kind of stock divided by the number of such shares owned at the time of transfer.

2. The average cost per share multiplied by the number of shares transferred is the owner's cost of his stock.

*Example 1:* *An individual in 1385 sold 100 shares of stock in Logar Mining Company at a price of Afs. 900 per share for a total sale of Afs. 90,000 with a gain of Afs. 40,000. He had no expense of sale. This was all common stock, one share worth exactly the same as any other in the same company, and all with the same voting and income rights. The owner had, however, acquired this stock at different times, and still had 20 shares left after he had sold 100.*

| | Cost | Sale | Gain | Expense of Sale | Net Profit |
|---|---|---|---|---|---|
| Purchased | | | | | |
| 1379 20 shares @ Afs. 1,000 | 20,000 | | | | |
| 1381 40 shares @ Afs. 1,000 | 40,000 | | | | |
| 1383 60 shares stock dividend | 0 | | | | |
| 120 shares @ Afs. 500 average price per share | 60,000 | | | | |
| Sold | | | | | |
| 1385 100 shares @ Afs. 900 | - 50,000 | 90,000 | 40,000 | | 40,000 |
| Balance 20 shares @ Afs. 500 average price per share | 10,000 | | | | |

*Example 2:* *In 1386 the same individual purchases 50 additional shares in the same company at a cost of Afs. 800 per share. With this purchase and the 20 shares he had left after the 1385 sale, he now has 70 shares in Logar Mining Company. In 1387 he sells 75 shares for Afs. 1,000 each. His expense of sale is Afs. 3,000 and his taxable gain of Afs. 24,000 is calculated as follows:*

| | Cost | Sale | Gain | Expense of Sale | Net Profit |
|---|---|---|---|---|---|
| Balance from Example 1 20 shares | 10,000 | | | | |
| Purchased | | | | | |
| 1386 50 shares @ Afs. 800 | 40,000 | | | | |
| Balance 70 shares @ Afs. 714 | 50,000 | | | | |
| average share price | | | | | |
| Sold | | | | | |
| 1387 40 shares @ Afs. 1,000 | | | | | |
| Total | 28,560 | 40,000 | 11,440 | 3,000 | 8,440 |
| Balance | | | | | |
| 30 shares @ Afs. 714 | 21,440 | | | | |

Article 29 <u>Calculation of tax on capital gains</u> The method of determining and computing tax on capital gains shall be as follows:

(1) Gain, taxable under Article 23 of this Law, from the sale or transfer of an asset owned by a person eighteen months or more shall be subject to the provisions of this Article if one or more of the following conditions are met:

- the transfer of property (except by inheritance) was not a sale;
- the asset transferred was a capital asset;
- the asset was transferred on sale or liquidation of a business.

(2) The income tax of any person in any tax year where assets were transferred under any of the circumstances described in paragraph 1 of this Article will be the product of the person's taxable income from all sources multiplied by the special rate imposed by paragraph (3) of this Article.

(3) The special rate imposed by this Article shall be determined as follows:

- the gain from transfer of any asset (except by inheritance) is divided by the number of years it was owned;
- the average annual gain or gains so determined are added to all other taxable income and income tax is computed according to the rate schedule in Article 4 of this Law.
- the tax so computed, divided by the amount of taxable income for which it was computed is the special rate. If the resulting rate is less than two percent, the applicable rate shall be two percent.

29.1 The purpose of Article 29 of the Income Tax Law is equitable taxation of the income of an individual whose gain on sale or exchange of an asset may have been earned over a period of years but which becomes taxable in one year. Without this provision, the taxable income so realized would usually be taxed at higher rates (under the rate schedule in Article 4 of the Income Tax Law). Since the income received is not taxed year by year (which, for practical reasons, can not be done), all of the gain would be taxed in one year, and since the amount of income is greater, a higher rate would also be applied. Under Article 29, the accumulated gain realized is divided by the number of years it was accumulated. The average thus found is used in determining the rate to be applied to the total accumulation.

Method of Determining and Computing Tax on Capital Gains

*Example:* *Gain from sale of stock by an individual in 1388 is Afs. 1,000,000. The shares of this stock owned by the seller have been owned on average 4 years. Thus, average gain per year is 1,000,000/4 = Afs. 250,000.*

*The person selling this stock has taxable income from other sources of Afs. 1,300,000 (after deductions), and his tax for 1388 will be calculated as follows:*

| | | |
|---|---|---|
| a. | 1388 taxable income from other sources | Afs. 1,300,000 |
| b. | Average gain per year during period stock was held | 250,000 |
| c. | Total | Afs.1,550,000 |
| d. | Tentative tax from Article 4 of the Law | 176,800 |
| e. | Special rate is 176,800/1,550,000 | 11.40% |
| f. | 1388 taxable income other sources | 1,300,000 |
| g. | Taxable income from sale of shares | 1,000,000 |
| h. | Total taxable income | 2,300,000 |
| i. | Tax (2,300,000 x 11.40%*) | Afs.262,200 |

* *As the special rate of 11.40% is more than the 2% minimum percentage prescribed, the rate of 11.40% applies.*

*Remark:* *If the special concession rate above had not been applied, the tax on Afs. 2,300,000 would have been Afs. 326,800.*

29.2 Corporations and limited liability companies may not use this method. There is no tax advantage in using Article 29 for corporations and limited liability companies, because they are taxed at a uniform rate of 20 percent. Thus, the averaging of gain would not change the rate of their tax.

29.3 The gains from assets owned less than 18 months do not qualify for concessional treatment under this Article.

| | |
|---|---|
| Article 30 | Tax on sale of movable or immovable property (1) According to the provisions of Article 23 of this Law, the price receivable from the sale or transfer of movable or immovable property by a natural person shall be subject to one percent tax at the time of transfer of ownership of the property in lieu of income tax.<br><br>(2) According to the provisions of Article 23 of this Law, the price receivable from the sale or transfer of movable or immovable property by a legal person shall be subject to one percent tax at the time of transfer of ownership of the property. The tax paid will be allowed as a credit against tax payable when the tax return is filed. |

30.1 The tax imposed by paragraph 1 of Article 30 of Income Tax Law applies to sale or transfer of any movable and immoveable property such as vehicles and land owned by an individual person, individual persons in ordinary partnerships, or by families. Leases renewed from one year to another year or for terms of ten years or less are not considered to be transfers of land rights for the purposes of this tax. Leases with a term in excess of ten years are considered transfers subject to this tax.

*Example 1:* *A landowner leases his agricultural land to a farmer who pays a specified part of the produce of the land each year as rent. The tax provided in Article 30 of the Law does not apply.*

*Example 2:* *A tract of land in a city is owned by an individual who leases the tract in a 99 year renewable lease to a company that builds an industrial plant on the land. This transfer of land rights is taxable. The tax will be one percent of the market value of the land.*

*Example 3:* *Feroz owns a motor vehicle. He purchased the motor vehicle two years ago for Afs 130,000. Feroz agrees to sell the motor vehicle to Najib for Afs 150,000. Feroz will be required to pay fixed tax of 1 percent of Afs 150,000 ie Afs 1500 at the time that the motor vehicle is sold.*

*Remark: Becuase Feroz sells the property as a natural person (ie an individual) and not as a legal person (company or other form of organization), Feroz is not required to account for the sale in his annual income tax return. The fixed tax of 1% of the sale price payable at the time of sale is a final tax and applies instead of annual income tax.*

30.2 Whenever two individuals exchange properties, each property is taxed as a separate transaction.

*Example:* *Azziz owns a parcel of land in Kabul Province that he does not use in his trade or business. Wahid owns a parcel of land in Herat Province that he does not use in his trade or business. Azziz and Wahid agree to*

*exchange their parcels of land. Both Azziz and Wahid must pay a tax equal to 1% of the value of the land transferred.*

30.3 A transfer of a partnership interest is treated as a transfer of the underlying property owned by the partnership.

*Example:* *Azziz is an Afghan resident who owns a 10% interest in an Afghan partnership. The remaining 90% of the partnership is owned by Azziz's brother, Wahid. Wahid is also an Afghan resident. The Afghan partnership owns real property located in Kandahar Province that is not used in a trade or business. If Azziz sells his 10% interest, Azziz is deemed to have sold the underlying real property owned by the partnership. Azziz is therefore subject to the 1% transfer tax in Article 30(1) of the Income Tax Law.*

30.4 According to paragraph 2 of Article 30 for Income Tax Law, legal persons are required to pay 1 percent tax on the sale or transfer of movable and immovable properties. The tax paid will be treated as a prepayment of tax and shall be credited against annual income tax at the time of lodgement of the annual income tax.

*Example:* *Hokhosth Company sells a truck for Afs. 200,000 during the 1388 tax year. The company is required to pay 1 percent tax ie Afs. 2,000 to the government bank account at the time of sale. This tax is treated as a prepayment by Hokhosth Company of annual income tax and will be allowed as a credit at the time of filing the company's income tax return.*

*If Hokhosth Company has net income of Afs. 200,000 for the 1388 tax year, then its tax payable at the time of lodgement of its 1388 tax return will be as follows:*

| | | |
|---|---|---|
| *Net income* | *Afs 200,000* | |
| *Income tax liability* | *(20% of 200,000)* | *Afs 20,000* |
| *Less: Income tax paid* | *(fixed tax on sale of asset)* | *2,000* |
| *Income tax payable* | | *18,000* |

*Remark: Article 30 does not apply to trading stock of a business.*

# CHAPTER 4

# PARTNERSHIPS

## Article 31 – Article 35

Article 31 Definitions

1. A partnership is an association of two or more persons carrying on business and sharing profit or loss in accordance with the partnership agreement.

2. A partner is a person who has a share in the partnership.

3. The partnership agreement is the body of provisions agreed to by the partners under which they operate the partnership.

4. A general partnership (Sherkat-Tazamoni) is one in which the partners are liable for payment of all debts of the partnership individually and collectively.

5. A special partnership (Sherkat-Tazamoni-Mekhtalet) is one in which one or more partners have unlimited liability for debts of the partnership and the rest of the partners have liability limited to their shares of capital in the partnership.

6 A limited liability company (Sherkat-Mahdudul Masseliat) is a company in which the partners (shareholders) are not individually liable for debts of the company but each partner (shareholder) has liability limited to their shares of capital in the company.

7 A corporation (Sherkat-Sahami) is a company which has its capital determined and divided by shares and liability of each partner (shareholder) is limited to their shares.

31.1 Corporation shares are negotiable. They may be sold by the owner without the consent of the remaining shareholders. A limited liability company is different. Shares of the partners (shareholders) in a limited liability company are not negotiable. The company determines whether a partner (shareholder) can sell his shares or not, and to whom his share may be sold. A limited liability company is taxed like a corporation. Please refer to Article 32 of the Income Tax Law and the regulations issued pursuant thereto with respect to the taxation of limited liability companies.

31.2 To have a partnership, two or more persons must join together pursuant to an agreement to carry on a business and share the profits thereof.

(a) The parties are not required to formalize their agreement in writing. The partnership "agreement" can be created through the course of conduct of the parties.

*Example:* *Adib and Wahid operate a series of fruit stands in Kabul City. They never formalize their agreement in writing. Nevertheless, every day, Adib provides the carts that are necessary to display the fruit and he provides the services of various vendors. Wahid provides the fruit to*

*the vendors. Adib takes 60% of the profits (after expenses) from the venture and Wahid takes 40% of the profits (after expenses). Adib and Wahid are joined together in a partnership, even though they do not have a formal written agreement.*

(b) Mere co-ownership of property is usually not sufficient, in itself, to create a partnership. Instead, there must also be a sharing of profits and losses.

*Example:* *Adib and Wahid are brothers. They inherited a parcel of land in Zabul Province from their father. Adib and Wahid jointly own the property, but the property is undeveloped. Neither Adib nor Wahid have any intention of developing the land. Instead, they intend to hold it for a period of time and eventually sell it. They may sell it separately or they may sell it jointly. Under these facts, Adib and Wahid are not joined together in a partnership.*

31.3 The partnership income (or loss) is reportable by the individual partners at the end of the taxable year whether the income is distributed or not. Each partner must recognize his or her distributive share of partnership income or loss.

*Example 1:* *Adib is an Afghan resident. Adib owns 15% of an Afghan partnership. Wahid is an Afghan resident. Wahid owns 85% of an Afghan partnership. The partnership generates Afs. 1,000,000 of profit during the year. The partnership does not make any distribution of profits during the year. Adib must recognize Afs. 150,000 of profit on his tax return. Wahid must recognize Afs. 850,000 of profit on his tax return.*

*Example 2:* *Adib is an Afghan resident. Adib owns 15% of an Afghan partnership. Wahid is an Afghan resident. Wahid owns 85% of an Afghan partnership. The partnership generates Afs. 1,000,000 of loss during the year. The partnership does not make any distributions during the year. Adib must recognize Afs. 150,000 of loss on his tax return. Wahid must recognize Afs. 850,000 of loss on his tax return.*

| | |
|---|---|
| Article 32 | Limited liability companies and special partnerships.<br><br>(1) A limited liability company shall be subject to the same provisions of this Law as corporations (Sherkat-Sahami). Partners in such companies shall be considered shareholders and distribution of profits as dividends for the purposes of this Law.<br><br>(2) A special partnership shall be subject to the same provisions of this Law as a general partnership. |

32.1 The provisions of the Income Tax Law relating to shareholders of corporations apply to partners in limited liability companies. Similarly, provisions relating to dividends paid to shareholders by a corporation also apply to distributions of earnings to the partners in a limited liability company.

*Example: A limited liability company has earnings of Afs. 1,000,000 in a taxable year. Afs. 900,000 in cash is distributed to the partners and Afs. 100,000 is retained by the company. The net income tax of the company will be 20 percent of Afs. 100,000, that is, Afs. 20,000; and the tax withheld from dividends will be 20 percent of Afs. 900,000, that is, Afs. 180,000.*

32.2 The partners who have limited liability in a special partnership will also have a limited liability with respect to fixed taxes under Chapter 11 of the Income Tax Law. The fixed tax can be paid from any share of such partners to the extent of their earnings (undistributed or distributed) or assets, or from the partners who have an unlimited liability.

*Example: After audit, it is determined that a special partnership owes an additional tax of Afs. 100,000 for the taxable year 1385. The special partnership made no profit in 1385 nor did it make any distribution of earnings in that year. There are no assets available for payment of this additional tax. In this situation the partners with limited liability cannot be assessed for any part of the tax, but the partners with unlimited liability are themselves liable for the entire tax.*

Remark: If the partnership had assets available for the payment of the tax, or if it had distributed assets (earnings) in the same year (1385), the assessment of additional tax would be made first against the remaining assets and assets distributed that same year. If the tax liability were, nevertheless, not fully satisfied, the balance unpaid would be the liability of the partners having unlimited liability.

| | |
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| Article 33 | General partnerships A general partnership as a legal entity shall not be subject to the income tax imposed by this Law. Partners as natural persons shall be liable for income tax only in their separate and individual capacities. The income of the general partnership shall be taxable as income of the partners individually, each of whom shall be required to include their share of the partnership income in their taxable income. |

33.1 Income of a general partnership is exempt from income tax if both of the following conditions are met:

a. its income is from commercial activity subject to a fixed tax;

b. such fixed tax is in lieu of tax on income according to Chapter 11 of the Income Tax Law.

Such income of a general partnership is exempt whether distributed to the partners or not distributed.

Remark: A business establishment is taxed under provisions of Chapter 11 of the Income Tax Law and is owned and operated by a general partnership which pays the fixed tax. In some years profit from commercial activity of this establishment is distributed to the partners, and in some years it is not. The partnership's income is exempt from taxation.

33.2 An Afghan resident partner can receive a distribution of money from a partnership without tax to the extent of the partner's share of his basis in the partnership.

*Example 1:* *Azziz and Wahid are equal partners in an Afghan partnership. They each contributed Afs. 500,000 to the partnership upon the formation of the partnership. During the year, the partnership generated Afs. 200,000 of profit. At the end of the year, before considering distributions, Azziz and Wahid's share in their partnership interests increased from Afs. 500,000 to Afs. 600,000. During the year, the partnership distributed Afs. 50,000 to each partner. Azziz and Wahid must each recognize Afs. 100,000 as their distributable share of partnership profit. Azziz and Wahid do not have to recognize the Afs. 50,000 that is distributed to them during the year. After the distribution, Azziz and Wahid's share in the partnership will each be reduced to Afs. 550,000.*

*Example 2:* *Azziz and Wahid are equal partners in an Afghan partnership. They each contributed Afs. 500,000 to the partnership upon the formation of the partnership. During the year, the partnership generated Afs. 200,000 of profit. Azziz and Wahid must each recognize Afs. 100,000 as their distributable share of partnership profit. At the end of the year, Azziz and Wahid's basis in their partnership interests increased from Afs. 500,000 to Afs. 600,000. The partnership did not make a profit or*

*a loss during its second year of operation, but it did distribute Afs. 60,000 to each partner. After the distribution, Azziz and Wahid's basis in the partnership was reduced to Afs. 540,000.*

33.3 If a partner in a partnership receives money in excess of the partner's basis in the partnership, the partner must recognize a gain with respect to his or her partnership interest.

*Example:* *Azziz and Wahid are equal partners in an Afghan partnership. They each have a basis of Afs. 200,000 in the Afghan partnership. Due to accelerated depreciation deductions, the partnership generates a significant amount of cash without generating any significant taxable income. The partnership distributes Afs. 210,000 to each of Azziz and Wahid during the first year of operation. Azziz and Wahid must each recognize a gain of Afs. 10,000 (Afs. 210,000 – 200,000).*

| | |
|---|---|
| Article 34 | <u>Determination of net income</u> Every general partnership shall be required to make an annual report of all its receipts, expenses, and disbursements, and to determine its net income in the same manner as an individual. The partnership shall be required to report separately the share of the following items for each partner:<br><br>1. the net income or net loss;<br><br>2. the gain or loss from sale or exchange of movable and immovable property; and<br><br>3. salary, interest, dividends, advances, etc. |

34.1 All partnerships (general and special) must file an annual report whether engaged in activities covered by fixed taxes in lieu of income tax or not. A copy of the report of the partnership must be filed by each partner at the tax office of the district in which he is required to file his income tax return.

34.2 An individual engaged in business activities subject to fixed taxes in two or more locations which are taxed through different tax offices shall pay the fixed tax of each establishment at the tax office of the district in which such establishment is located. Such individual, if required to file an income tax return, shall file such return at the tax office in the district of either his permanent residence or at the office from which he received his commercial license. This rule shall also govern the filing of the income tax return of an individual who is a partner in a partnership.

34.3 A partnership annual report is required even though the firm has no taxable income for the taxable year. Each partner of the partnership must report his or her respective shares of partnership profit at the end of the taxable year whether the profit has been distributed or not.

| | |
|---|---|
| Article 35 | Distribution of receipts The income, expenses, and net profit of a general partnership shall be deemed to have been shared by the partners according to the terms and conditions of the general partnership agreement. |

35.1 Where the partnership agreement is verbal (or the partnership agreement is unclear) and the partners disagree about the division of income, the Ministry of Finance will apportion the assets, liabilities, and undistributed income equally unless facts and circumstances indicate otherwise. Factors that the Ministry may look to include, but are not limited to, the following:

(a) The fair market value of the relative contributions of the partners.

(b) The method in which profits and losses were shared in prior years.

(c) The manner in which distributions were shared between the partners.

*Example:* *Jamal and his brother Wahid agree to begin selling vases and artistic crafts in Kabul. Jamal allows the business to use his store located on Shar-e-Now street and Wahid transfers various vases that he created to the store. The brothers never document their agreement. The store is worth Afs. 4,000,000 and Wahid's vases are worth Afs. 1,000,000. At the end of the first year of operation, the store is very successful. The brothers begin to argue about how much of the business they own and how much income each partner is entitled to. In this case, the Ministry of Finance may, for example, look at the relative contributions of the two brothers and conclude that Jamal owns 80% of the partnership and Wahid owns 20% of the partnership.*

# CHAPTER 5

# RULES FOR ACCOUNTING

## Article 36 – Article 41

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| Article 36 | Maintenance and preservation of records All natural and legal persons with taxable income in a tax year shall prepare, keep and maintain records of all transactions, all movable and immovable property, and of all income. Such records shall be made available to the Ministry of Finance upon request. |

36.1 All corporations, limited liability companies, and partnerships are required to keep records whether they have taxable income or not.

36.2 Individuals who have no taxable income are not required to keep records under any provision of the Income Tax Law. This includes:

a. individuals whose only income is from commercial activities taxed under fixed taxes that are in lieu of income tax;

Remark: Small shopkeepers who pay taxes under Chapter 11 of the Income Tax Law.

b. individuals whose income is solely from agriculture;

c. individuals with income less than their own personal exemption of Afs. 5,000 per month (Afs 60,000 per year); and

d. individuals with income from any source exempt from taxation, or individuals who, in addition to exempt income, also have income subject to taxation but in amounts less than Afs. 5,000 per month (Afs 60,000 per year).

*Example: An individual receives Afs. 12,000 from sale of wheat and Afs. 25,000 from sale of grapes produced on his own land. He also has income from a fruit shop which is taxed under Chapter 11 of the Income Tax Law. A third source of income is salary from an employer in the amount of Afs. 4,000 per month.*

*Since the only income subject to income taxation is his salary and since his salary of Afs. 48,000 per year is less than the minimum amount required to be subject to income tax, this individual is not required by this Law to keep records.*

36.3 Although an individual has no taxable income from his usual business, he is required to keep records and documents covering any other transaction that may result in taxable gain.

*Example: A shopkeeper pays a fixed tax under provisions of Chapter 11 of the Income Tax Law. But he also receives a large dividend with respect to shares of stock that he owns. The dividend is subject to income tax. Although the individual does not have to keep records with respect to the*

*activities of his shop, he has to keep records with respect to the dividend that he receives.*

36.4 Records and documents must be maintained but need not be surrendered. Instead, the person or entity required to keep records and documents must produce these for inspection, examination, copying, etc., whenever the Ministry of Finance asks for them.

*Example:* *A company taxed on its net income is asked to deliver its business records to the Ministry of Finance. This company may refuse to deliver originals of its records to the Ministry, but it must make all its records and documents available at its own office for inspection, audit, reproduction, etc., by auditors of the Ministry of Finance.*

36.5 Records and documents must be kept for a period of 5 years after the end of the tax year to which the records and documents relate i.e. the period for which law provides limitation for amendment of assessment.

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| Article 37 | Accrual method of accounting Corporations and limited liability companies shall compute their income using the accrual method of accounting which recognizes income and expenses when due. |

37.1 The "accrual method of accounting" means any recognized double-entry system of accounting which includes a procedure for adjustments that will show income separately for a given period and financial position precisely for a given date.

37.2 Corporations and limited liability companies must use the accrual method of accounting in accordance with accepted accounting principles. An accurate and well-documented accounting method is indispensable for efficient management.

*Example:* *A company loans Afs. 1,000,000 at eight percent interest. Principal and interest are due one year after date of loan. The taxable year ends before the borrower repays the loan with interest. Under the accrual method, the interest earned by the end of the solar year will be reflected in the total income for that taxable year. Thus, if in the year 1385 this loan was made at the end of Saur, accrued interest income for the period between the end of Saur and the end of Hoot of the year 1385 (that is, the income for the ten months of the year 1385) will be included with 1385 income, even though it was not received in 1385. The interest income is computed as follows:*

*a. Since the interest rate is eight percent per year, the interest for one year from the end of Saur, 1385, to the end of Saur, 1386, will be equal to the product of Afs. 1,000,000 and eight percent, namely:*

*Afs. 1,000,000 x 8/100 = Afs. 80,000*

*b. Because only 10 months of interest are recognized in the year 1385, only 10/12 of the interest is attributable to 1385 and this is equal to:*

*Afs. 80,000 x 10/12 = Afs. 66,667.*

37.3 An accrual basis taxpayer recognizes income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy.

(a) Prepayments for goods or services in the form of a deposit are generally not included in income until the good is sold or the service is delivered. For this purpose, a deposit is an amount of money that is paid in advance, but which may have to be refunded if the recipient fails to provide the required goods or perform the required services.

<u>Example:</u> *An Afghan corporation provides painting services to various businesses and home owners in Mazar-e-Sharif. The Afghan corporation typically receives Afs. 200,000 as a deposit to paint a large building. The corporation expects to receive an additional Afs. 1,000,000 in six months once it has completed painting the building. The Afghan corporation does not have to accrue the income until after the building has been painted.*

(b) If the taxpayer is required to perform services over a period longer than one year, then the taxpayer is required to use the percentage of completion method to determine the amount of income associated with the project that must be recognized each year. Under the percentage of completion method, the taxpayer makes a reasonable estimate of the total costs that it expects to incur over the course of the contract. The taxpayer determines the amount of costs that the taxpayer incurred during the tax year. The taxpayer divides the amount of costs incurred by the taxpayer during the year by the total estimated costs for the project. This fraction is then multiplied by the revenue that is expected to be generated from the project.

<u>Example 1:</u> *An Afghan corporation enters into a contract to construct a building in Herat. It will take three years to complete the building. The Afghan corporation estimates that it will incur Afs. 30,000,000 to construct the building. The contract provides that the Afghan corporation will be paid in periodic installments over the life of the contract. The total amount that the Afghan corporation will be paid over the contract term is Afs. 40,000,000. Because the contract calls for the corporation to provide construction services over a period exceeding one year, the corporation must use the percentage of completion method in accruing its income under this contract.*

*If, in the first year, the corporation incurs Afs. 6,000,000 of costs, then the corporation must accrue 1/5 (6,000,000 / 30,000,000) of the revenue associated with the contract or Afs. 8,000,000. The profit recognized in the first years is thus Afs. 2,000,000 (Afs 8,000,000 – 6,000,000)*

<u>Example 2:</u> *The facts are the same as in Example 1, except that in the second year, the Afghan corporation revises its cost estimates. It now believes the total cost to complete the project will be Afs. 35,000,000. In the second year, the Afghan corporation incurs Afs. 5,000,000 of expenses. The Afghan corporation must accrue 1/7 of the revenue (5,000,000/35,000,000) or approximately Afs. 5,714,000. The profit is thus Afs. 714,000 in the second year.*

<u>Remark</u>: Small contracts need not be subject to the percentage of completion method. For this purpose, a small contract is a contract for which the total consideration to be received is less than Afs. 15,000,000.

37.4 An accrual basis taxpayer recognizes an item of expense when: (i) the liability becomes fixed; and (ii) all the events have occurred that establish both the nature and amount of the liability.

a) A liability is fixed when it is certain to arise.

<u>Example 1:</u> *An Afghan corporation operates a computer supply store in Herat. The Afghan corporation sells 10 computers to a business operating in Herat for Afs. 1,000,000 during 1386. On the last day of Hoot in 1386, the purchaser informs the Afghan corporation that one of the computers is defective. The purchaser asks for a refund of Afs. 2,000. The Afghan corporation disputes the liability. The Afghan corporation cannot claim a deduction for the Afs. 2,000 liability on its 1386 income tax return, because the liability is not fixed.*

<u>Example 2:</u> *The facts are the same as in Example 1, except that on the 10th day of Saur, 1387, the Afghan corporation and the purchaser agree that the purchaser is entitled to a Afs. 1,000 refund. Even though the settlement is reached before the Afghan corporation files its tax return for 1386, the Afghan corporation cannot deduct the expense, because the liability did not become fixed during the 1386 taxable year.*

b) All events required to establish the nature and amount of the liability will be satisfied when all of the events that give rise to the liability have occurred.

<u>Example 1:</u> *An Afghan corporation operates a shop in Herat. The corporation employs an Afghan resident individual to wash its windows once a month. The Afghan corporation hires the individual in the middle of Hoot in 1386. The first washing isn't due to occur until the 10th day of Hamal, in 1387. The Afghan corporation cannot deduct the expense of the first washing in 1386, even if the corporation pays the window washer in advance, because all of the events that generate the liability (i.e., the washing of the windows) will not occur until the following year. Until the windows are actually washed, the corporation's liability will not arise.*

<u>Example 2:</u> *An Afghan corporation operates a shop in Kabul. The shop sells cars and trucks to the public. The Afghan corporation hires an Afghan resident individual to install air conditioning units in its showroom. The corporation and the individual agree that the air conditioning units will be installed no later than the last day of Hoot, 1385. The corporation and the individual agree that the corporation does not have to pay the individual until 45 days after the date the work is completed. The individual installs the air conditioning units as requested, but does not complete the job until the last day of Hoot, 1385. Even though the corporation does not have to pay the individual until 1386, the corporation is entitled to deduct the expense associated*

*with the installation of the air conditioning units because the liability is "fixed" and the "all events" test has been satisfied by the end of 1385.*

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| Article 38 | Cash method of accounting A person shall compute their taxable income using the cash method of accounting at the time of receipt of income and payment of expense. The Ministry of Finance may permit a taxpayer to compute their taxable income using the accrual method of accounting. This provision shall not apply to corporations and limited liability companies.<br><br>Deductions for depreciation shall be allowed in accordance with the Income Tax Manual. |

38.1 According to the cash method of accounting, all deductible expenses and costs paid during the taxable year are subtracted from the total amount received in cash (or its equivalent) during the taxable year, and income is computed including (1) the change in inventory from the beginning of the year to the end of the year, and (2) the depreciation taken during the year.

*Example 1:* *If a trader keeps his records on the cash basis, the following steps are to be taken to find the net cash income of his business:*

*a. all cash receipts are recorded when received, and sales totaled for the taxable year; Afs. 1,572,000*

*b. the value of the inventory at the beginning of the year is recorded; Afs.11,000*

*c. all purchases of goods for resale are recorded when paid for and totaled for the taxable year; Afs. 460,000;*

*d. the amounts from (b) and (c) above are added; Afs. 471,000*

*e. the value of the inventory at the end of the year (closing inventory), Afs. 87,000, is determined, to take into account the increase (or decrease) during the year (as required by Article 40 of the Income Tax Law).*

*Remark: The closing inventory for one year becomes the beginning inventory for the next year.*

*f. from the total amount obtained in (d) above, the amount obtained in (e) above is subtracted to obtain the value of goods sold during the year; Afs. 384,000*

*g. the amount obtained in (f) is subtracted from the amount in (a) to get the gross cash profit; Afs. 1,188,000*

*h. all cash business expenses are recorded when paid and totaled for the year; Afs. 66,000*

*i. the total of depreciation expenses of fixtures, equipment, buildings, etc., used in business (even though not cash expenditures) is computed (but only to the extent specifically allowed during the year); Afs. 1,800*

*j. the amounts obtained in (h) and (i) are added; Afs. 67,800; and*

*k. the amount obtained in (j), Afs. 67,800, is subtracted from the gross profit (the amount obtained in (g)) to obtain the net cash income; Afs. 1,120,200.*

*The following is a summary of the previous example:*

| | | | |
|---|---|---|---|
| a. | Total cash receipts from sales | | Afs. 1,572,000 |
| b. | Beginning Inventory | Afs. 11,000 | |
| c. | Cash paid for purchases | 460,000 | |
| d. | Sum of (b) and (c) | Afs. 471,000 | |
| e. | Ending inventory | 87,000 | |
| f. | Cost of goods sold during the year (d-e) | | 384,000 |
| g. | Cash gross profit (a-f) | | Afs. 1,188,000 |
| h. | Total business cash expenses | Afs. 66,000 | |
| i. | Depreciation (non-cash expense) | Afs. 1,800 | |
| j. | Sum of (h + i) | | 67,800 |
| k. | Cash net income (g - j) | | Afs. 1,120,200 |

38.2 Use of the accrual method of accounting by a taxpayer is to be preferred. Any individual willing and able to use this method should be given permission to compute his income this way.

38.3 Where income is derived from a business which does not require an inventory of goods, products, or materials, etc. nor use of equipment, fixtures, buildings, etc. owned by the individual, net income under the cash method of accounting is cash received in the business minus cash paid out for business expenses.

*Example: A broker selling real property for the owners receives commissions based on prices received for the properties. He has business expenses such as newspaper advertising, taxi fares in contacting owners and prospective buyers, cost of printed materials, office rent, telephone and electricity costs, wages of an office boy, and other similar expenses. If all commissions received during the taxable year total Afs. 300,000 and all expenses paid during the taxable year total Afs. 25,000, his cash income is Afs. 275,000, which is also his net income computed under the cash method of accounting. Although part of the Afs. 300,000 may have been earned during a previous year, under the cash method the income is reported when received.*

38.4 A taxpayer may request that it be permitted to change to an accrual method of accounting by filing a request for permission with the Ministry of Finance. If a change to an accrual method of accounting is approved by the Ministry of Finance, the income of the taxpayer earned in prior years but not received must be added, and the expenses incurred in prior years but not paid must be

deducted. These adjustments are reported for the last year in which the cash method of accounting was used.

*Example:* *An importer who, in the year 1385, has taxable income of Afs. 150,000 computed under the cash method of accounting has obtained permission to report his income for the next taxable year (1386) as computed by using accrual method of accounting. Before he files his 1386 return on the accrual basis he will have to file an amended 1385 return to adjust and account for transactions up to the beginning of 1386.*

*Assuming that at the time of setting up his new accounting system at the beginning of the year 1386, his beginning balance sheet shows the following assets and liabilities:*

| **Assets:** | | **Liabilities:** | |
|---|---|---|---|
| Accounts Receivable | 60,000 | Unpaid Purchase | 32,000 |
| Accrued Interest on Notes Receivable | 6,000 | Accrued Interest Expense | 3,000 |
| Prepaid Insurance | 7,000 | Accrued Rental Expense | 1,500 |
| | | Unpaid Wages of Employees | 7,500 |

*The amended return that will have to be filed is as follows:*

| | | | | | |
|---|---|---|---|---|---|
| *a.* | *Taxable income for 1385 year* | | | *Afs.* | *150,000* |
| *b.* | *Add Income earned but not received:* | | | | |
| | *1. Accounts receivable* | *Afs.* | *60,000* | | |
| | *2. Accrued interest receivable* | | *6,000* | | |
| | *Total income not received* | | | | *66,000* |
| *c.* | *Total income earned and receivable ((a) + (b) above)* | | | | *216,000* |
| *d.* | *Add Expenses paid and deducted but not yet incurred:* | | | | |
| | *Prepaid insurance* | | | *Afs.* | *7,000* |
| *e.* | *Total items (c) and (d) above* | | | *Afs.* | *223,000* |
| *f.* | *Less Accounts payable:* | | | | |
| | *1. Purchase not paid for* | *32,000* | | | |
| | *2. Accrued interest expense* | *3,000* | | | |
| | *3. Accrued rental expense* | *1,500* | | | |
| | *4. Unpaid wages of employees* | *7,500* | | | |
| | *Total accounts payable* | | | | *44,000* |
| *g.* | *Taxable income, as amended ((e) less (f) above)* | | | | *179,000* |
| *h.* | *Total tax per amended return (at 20%)* | | | *35,800* | |
| *i.* | *Income tax paid per original return* | | | *30,000* | |
| *j.* | *Additional tax due* | | | *5,800* | |

38.5 Any additional tax due to the change in the accounting period or methods shall be paid with the amended return. Any reduction in tax computed according to an amended return filed in connection with the same changeover shall be subtracted from any income tax owing on income of a subsequent year.

*Example: An amended return for the year 1385 is filed together with the first return on accrual method for the year 1386 in Sonbula 1387. Any additional tax computed in the amended return is due at that time, and no interest or penalty is charged if this tax is paid before the end of the third month of 1387. Any reduction in tax indicated by the amended return may be subtracted from the 1386 tax or, if no tax is due from 1386, or if the tax due is less than the reduction, it can be deducted from the taxes for subsequent years.*

38.6 In order to make a change in the accounting method, all taxpayers must make a written request to the Ministry of Finance no later than 30 days before the end of the taxable year.

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| Article 39 | Form and content of records For better management of income tax, identifying the actual income and presenting accurate reports, Ministry of Finance shall prescribe the form and content of taxpayers books and records. |

39.1 The Ministry of Finance is authorized by Article 39 of the Income Tax Law to prescribe the records to be kept and the reports required of any taxpayer or class of taxpayers. The Ministry is authorized to insist on the completeness of records and verifiability of entries in order to audit a taxpayer's records. In general any double-entry system of accounting recognized and accepted by societies of professional accountants is prescribed for all corporations and limited liability companies. The accounting records must be kept current at all times, with transactions being recorded as they occur. The accounts shall be such that detailed financial statements may be readily prepared showing the financial position of the company as of a given date (balance sheet), and the operations of the company over a given period (profit and loss statement).

39.2 The Ministry of Finance requires that all corporations, limited liability companies and other entities liable to pay annual income tax maintain the following accounting records:

a. journals
b. ledgers
c. inventory and stocktake records
d. asset register
e. banking and financial transaction information
f. legal documents, including contracts
g. statements, invoices and receipts
h. income statements
i. balance sheets.

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| Article 40 | <u>Inventory at the close of year</u> Inventories of goods, products, and materials used in business shall be taken at the close of each tax year and priced at cost or market value, whichever is lower. All taxpayers engaged in manufacturing, trade, or other businesses shall be required to take inventories on such basis as the Ministry of Finance may prescribe. |

40.1 An inventory is a listing of all items and quantities of goods, products, and materials on hand at a given time. For purposes of accounting, inventories are expressed in terms of money value. Article 40 of the Income Tax Law requires that an inventory be "priced at cost or market value, whichever is lower." By market value it is meant the price that the owner can reasonably expect to sell the item for in the usual course of business. As a general rule, most items or quantities included in an inventory will be priced at cost, which is the total of invoice price, freight, insurance, duties, etc., paid by the owner. Market value will ordinarily be higher than cost and therefore cannot be used. The following examples where cost is higher than market value are exceptions to this:

a. where a very similar item can now be purchased at a greatly reduced cost;

b. where an improved item is available at a cost that reduces the market value of the older item on hand;

c. where an item cannot be sold, even at cost, as happens when the businessman misjudges the wants of the customers;

d. where the item has been damaged, has deteriorated, or has gone out of fashion;

e. where a tax paid by the owner on the item has been discontinued or reduced—such as customs duties;

f. where circumstances are such that they clearly reduce the prices to be expected to less than cost.

Inventories accurately detailed and realistically priced are essential to any determination of net income.

40.2 The taxpayer shall take an inventory at the close of the taxable year and retain the inventory record as substantiation of the value reported in his income tax return. Each item or kind of material shall be described together with the quantity or weight. The unit cost or cost per item shall be noted and the value of all units of given kind extended on the record. The sum of all extensions is the value of the inventory at the end of the year.

*Example:*

| Number of Units | Description of Item | Unit cost | Market value if lower | Total Value (Afs) |
|---|---|---|---|---|
| 6 | No. 1506 6 Phillips Radios | 1,200 | | 7,200 |
| 22 | No. 215412 Condensers | 12 | | 264 |
| 1 | No. 168 2 Phillips Tape Recorders | 10,400 | | 10,400 |
| 1 | 1955 obsolete phonograph | 7,500 | 2,500 | 2,500 |
| 112 | CDs RCA | 180 | | 20,160 |
| 231 | CDs Vivendi | 60 | | 13,860 |
| ... | …….. | …. | …… | …… |
| | Total Carried Forward | | | 54,384 |

40.3 The inventory shall be taken at the close of each taxable year. At the end of the last business day of the taxable year stocktake of the items and quantities on hand shall begin and continue until all items have been listed and counted, all materials measured and the quantities on hand noted. The inventory is to be taken after the final transactions of the year are completed and before selling or buying in the new year begins. Nothing should move out of or into the stock of merchandise while the stocktake takes place.

*Example: A shop is open for business through Hoot 30, 1385. The next two days the shop is closed and no business is conducted. During that time all goods on hand are counted and listed on inventory record sheets. Before business resumes on the third day after closing, every item of merchandise on hand has been recoded. In this way the cost of goods sold during the taxable year can be determined. No sales recorded for the new year will have been taken out of the stock before the stocktake.*

*Remark: There is no requirement that a taxpayer physically close its business if the taxpayer can establish what the inventory at the end of the year is.*

40.4 Purchases of goods may be recorded as the system of accounting observed requires. The cost of goods sold, however, must not include purchases not yet received and included in inventory, unless adjustment is made for such purchases.

*Example: An Afghan resident individual operates an import business and has the following situation at the close of 1385. Because the business is operated by an individual, the business uses the cash basis of accounting.*

*His cash purchases for the year total Afs. 600,000. This total includes cash paid in advance in the amount of Afs. 40,000 for goods that have not yet arrived and are not a part of his stock of goods on hand. This amount should be added to his closing inventory as follows:*

| | | |
|---|---|---|
| a. | Total value of inventory at the end of 1385 | Afs. 67,500 |
| b. | Advance payment on shipment ordered in 1385 not received by end of year | 40,000 |
| c. | Total inventory plus advances at the end of 1384 | Afs.107,500 |

*By adding his closing inventory for 1384 to his purchases of Afs. 600,000 and subtracting Afs. 107,500, he will have his cost of goods sold in 1385. At the end of the next year 1386 he can use Afs. 107,500 as his beginning inventory. Additional expenses on the shipment, such as import duties, trucking charges, etc., will be recorded for 1386 as payments are made.*

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| Article 41 | Determination of taxable income of two or more businesses Where two or more organizations or businesses are owned or controlled, directly or indirectly, by the same natural or legal person, the Ministry of Finance may apportion or allocate receipts, deductions or credits between or among such organizations or businesses to accurately reflect taxable income and prevent evasion of taxes. |

41.1 The authority provided by Article 41 of the Income Tax Law makes it lawful for the Ministry of Finance to adjust the tax position of entities or businesses controlled by the same person when such action is necessary to prevent tax evasion. However, this course of action should be exercised with restraint. Unless there is an evasion of tax, separate organizations are allowable and there is no need for the allocation and distribution authorized in Article 41 of the Income Tax Law.

*Example 1: The shareholders of Company A own the issued stock of Company B. Control is identical and the majority of each Board of Directors is comprised of the same individuals. Separate management and function for each company exist, however, and no tax saving is noted. If the profits of both were combined, the tax rate would be the same. There is no exemption in either case, so taxes are the same with separated organizations as they would be if the activities of both were carried on by one company. In this case, there is no need for the Ministry to reallocate income between Company A and Company B.*

*Example 2: Azziz is an Afghan resident individual that owns all of the issued stock of two Afghan corporations, Corporation A and Corporation B. Both corporations are engaged in the business of harvesting and processing timber. Corporation A is more efficient in production than Corporation B. Corporation A has historically always generated a profit. Corporation B, however, has a net operating loss that it is carrying forward. Corporation A decides to sell some unprocessed timber to Corporation B at price that is lower than Corporation A's cost so that Corporation B can process the timber, generate a profit, and utilize some of its net operating loss. The Ministry has the right under these facts to reallocate income away from Corporation B and to Corporation A.*

41.2 When tax saving is being realized by an owner or owners because of division of business activities between separate organizations owned, controlled, or directed by the same owner or owners, the Ministry of Finance is authorized to prevent tax evasion by allocating the income of the organization to their owners.

Before any allocations are made, thorough investigation must determine the following facts:

a. the identity of shareholders or partners in each entity;

b. the number of shares (or the amount of capital) held by each shareholder (or partner) in each entity;

c. the identity of the members of the Boards of Directors of each entity;

d. the identity of management personnel of each entity;

e. the nature of the business activity of each entity (i.e., how does the activity of one differ from that of the other; is the activity of each entity continuous from year to year?);

f. in case of limited liability companies, the extent to which individual partners participate in the management and regular activities of the company;

g. the amount of capital invested in each entity; and

h. the economic justification for separate organization.

The allocation of income is made after an investigation shows that:

a. there is little or no justification economically for separate organization and that capital was also available without separate organization, the risks of each organization are similar, business activities are similar, markets and sources of raw materials are the same, etc., for this and the parent organization;

b. the control and direction of one organization is identical to that of the others;

c. the management is the same, or overlaps, or follows the same policies;

d. in the case of a limited liability company, one individual (or entity) dominates, and other partners are silent, inactive, or without power in the affairs of the company.

41.3 Where a domestic corporation is a subsidiary of a foreign corporation and is, in effect, a permanent establishment of that foreign corporation selling its products in Afghanistan, the Ministry may allocate a part of the profits of the foreign corporation to the domestic corporation for taxation.

*Example: A domestic corporation sells manufactured products of the foreign corporation which controls and directs its operations. The domestic corporation shows a net profit of Afs. 1,000,000, and pays tax of Afs. 200,000. Investigation shows that most of its sales were products of the foreign corporation. Investigation furthermore proves that purchases were not "arms length" at competitive prices when made from the foreign corporation. Therefore, the Ministry of Finance can allocate a part of the profit of the foreign corporation to the domestic corporation and assess the domestic corporation on this additional income. Thus, if sales by the*

*foreign corporation to its subsidiary (domestic corporation) were Afs. 40,000,000 in the taxable year, and the world-wide profits of the foreign corporation were six percent of sales, the domestic corporation could reasonably be assessed on an additional Afs. 2,400,000 of taxable income (Afs. 40,000,000 x 6% =Afs. 2,400,000). An additional tax of Afs. 480,000 (Afs. 2,400,000 x 20%) would be due to the State.*

Remark: Where a transaction between connected persons results in an amount paid or payable that is different to the amount paid or payable had the transaction been between unconnected persons, Article 97 allows the Ministry of Finance to adjust the amount paid or payable between the connected persons. Reference should be made to the procedures discussed at Article 97 in this Manual.

# CHAPTER 6

# SPECIAL PROVISIONS FOR CORPORATIONS AND LIMITED LIABILITY COMPANIES

## Article 42 – Article 47

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| Article 42 | Deduction of operating loss (1) A corporation or limited liability company incurring a net operating loss in a tax year shall be entitled to deduct the loss from its taxable income of the three succeeding years, deducting each year one-third of the loss. Paragraph 4 of Article 47 of this Law shall be an exception to this provision.<br><br>(2) Where a resident company carries on activities to generate income from a source outside Afghanistan, the company shall separately compute its taxable income as defined in Article 12 of this Law or its net operating loss as defined in paragraph (1) of this Article in respect of the activities to generate income from a source in Afghanistan and its activities to generate income from a source outside Afghanistan. A net operating loss from activities to generate income from a source outside Afghanistan may only be carried forward and deducted from taxable income from such activities and may not be deducted from taxable income from a source in Afghanistan. |

42.1 A net operating loss is the amount that exceeds operating income of a tax year after allowing operating deductions under the Income Tax Law and can only be offset if there is profit in the tax year the loss is to be offset. An operating loss for a tax year incurred by a corporation or limited liability company which is not an approved enterprise (and subject to the loss carry forward provisions of Article 47) is offset equally against taxable income of the three succeeding years.

*Example: A corporation incurred a net operating loss of Afs. 120,000 in 1385. As provided by Article 42(1) of the Income Tax Law, this loss may be deducted from the taxable income of the company in three following years. One-third of the loss may be deducted in each of the three years. This loss is deductible Afs. 40,000 in 1386, Afs. 40,000 in 1387, and Afs. 40,000 in 1388. But in none of these three years may any of these amounts be made to appear as part of a loss of that year. Thus, if in 1386 the corporation had no profit, there could be no deduction of the Afs. 40,000 allowed to be carried forward. If no taxable profit was made in the three succeeding years (1386, 1387, and 1388) none of the Afs. 120,000 loss could be deducted. If no profit was made in 1386 and 1387 but a large profit was made in 1388, the most that could be deducted in 1388 would be Afs. 40,000. The amounts that could have been claimed as deductions in 1386 and 1387 will be lost.*

42.2 A corporation or limited liability company may generate losses in successive years. To the extent that the carry forward of those losses overlap, they may be added to one another.

*Example 1: A corporation had the following losses:*

| Year of Loss | Total Loss | Years of Carry-Over Losses | | | | |
|---|---|---|---|---|---|---|
| | | 1385 | 1386 | 1387 | 1388 | 1389 |
| Loss 1384 | 120,000 | 40,000 | 40,000 | 40,000 | None | None |
| Loss 1385 | 150,000 | None | 50,000 | 50,000 | 50,000 | None |
| Loss 1386 | 600,000 | None | None | 200,000 | 200,000 | 200,000 |
| Maximum Loss Allowable in Each Year | | 40,000 | 90,000 | 290,000 | 250,000 | 200,000 |

The taxpayer in this example is permitted to add the losses in 1386, 1387 and 1388 in accordance with the table above to determine the amount of loss that may be deducted against profits in a particular year.

*Example 2:* *Assume that the corporation in Example 1 has profit of Afs. 2,500,000 in 1388. Since the year 1388 is the fourth year after the year 1384, the loss for the 1384 year cannot be deducted from the profit of the year 1388. The maximum carry-over loss allowable is Afs. 250,000.*

*Remark:* *Even though only Afs. 50,000 of the 1385 loss of Afs. 150,000 has been claimed as a deduction, the remaining Afs. 100,000 cannot be recovered. The Law does not allow any loss to be carried forward for more than three years from the year of the loss.*

*Example 3:* *Assume that the corporation from Example 1 has a loss of Afs. 400,000 in 1389. Even though the 1386 carry forward loss of Afs. 200,000 is not utilized in 1389, it cannot be recovered or offset in any subsequent year. Even if there is a profit in 1390, any remaining balance of the 1386 loss not previously deducted may not be applied since 1390 is the fourth year after the 1386 loss. The Law does not allow any loss to be carried forward for more than three years from the year of the loss.*

42.3 A non-Afghan sourced loss cannot be used to offset or reduce Afghan sourced taxable income. An Afghan sourced loss cannot be used to offset or reduce non-Afghan sourced taxable income. The income or loss of a resident company from sources in Afghanistan and outside Afghanistan are required to be computed separately.

*Example 1:* *An Afghan corporation operates a carpet store in Afghanistan and another in Pakistan. The Afghan store is located in Jalalabad. The Pakistani store is located in Lahore. The Afghan corporation purchases carpets that are manufactured in Afghanistan and then sells them to customers in Afghanistan and Pakistan through the two stores. During 1386, the store in Jalalabad generates taxable income of Afs. 1,000,000. The store in Lahore generates a loss of Afs. 300,000. The Afghan corporation must pay income tax of Afs. 200,000 (20% x Afs.*

*1,000,000 on the taxable income from Afghan sources). The Afghan corporation will not be entitled to deduct its loss of Afs. 300,000 from the store in Lahore against its profits from the sales through the Jalalabad store.*

*Example 2:* *The facts are the same as in Example 1. In 1387, the Afghan corporation's Jalalabad store generates a loss of Afs. 700,000 and the Lahore store generates a profit of Afs. 800,000. The Lahore store's profits are subject to Afs. 320,000 of Pakistani tax. The 1386 loss from the Lahore store may be carried forward and offset against the profits from the Lahore store in 1387. The net profit, after the loss is carried forward, is Afs. 500,000.*

*Remark: Under Article 5 of the Income Tax Law, the Afghan corporation is entitled to claim a foreign tax credit for the Pakistani taxes that are paid, subject to a limit. The limit equals the amount of the Afghan tax that would be due on the Afs. 500,000 income that was generated in Pakistan, or Afs. 100,000. The excess of the Afs. 320,000 Pakistani taxes over the Afs. 100,000 that can be claimed as a credit, cannot be carried forward and used in future years.*

| | |
|---|---|
| Article 43 | Distribution of assets to shareholders The distribution of the assets of a corporation or limited liability company to its shareholders or partners shall be treated as a reduction in the cost of stocks or capital. The payment of dividends or distribution by a corporation or a limited liability company on liquidation shall be excluded from the provisions of this Article. |

43.1 A distribution of assets of a corporation or limited liability company shall be deemed to be a payment of dividends unless the taxpayer can establish that the company did not have any accumulated earnings or surplus during the tax year in which the distribution was distributed.

*Example 1:* *Adib is an Afghan resident that owns all of the issued stock of an Afghan corporation. The corporation began operations in 1384. During 1385, the corporation distributes Afs. 100,000 to Adib with respect to Adib's stock. The Afs. 100,000 is deemed to be a taxable dividend to Adib unless Adib can demonstrate using the corporation's books and records that the corporation has not generated profit during 1384 and 1385.*

*Example 2:* *Adib is an Afghan resident that owns all of the issued stock of an Afghan corporation. The first year of operation is 1385. The Afghan corporation does not generate any profits in the months of Hamal and Saur. On the last day of Saur, the corporation distributes Afs. 10,000 to Adib. During the remaining months of 1385, the corporation generates Afs. 1,000,000 of profit. The Afs. 10,000 distribution to Adib is considered a dividend. Although the corporation did not have any earnings on the date that the distribution was made, the corporation generated earnings during the year in which the distribution was made that exceeded the distribution.*

*Example 3:* *Adib is an Afghan resident that owns all of the issued stock of an Afghan corporation. The first year of operation is 1385. The Afghan corporation does not generate any profits during 1385. On the last day of Saur, the corporation distributes Afs. 10,000 to Adib. The corporation generates Afs. 1,000,000 profit in 1386. The distribution of the Afs. 10,000 to Adib in 1385 is not considered a dividend. Although the corporation generated earnings in the year after the dividend, ie 1386, those earnings are not considered in determining whether or not the distribution in 1385 is a dividend.*

43.2 The value of the property distributed is its fair market value.

*Example 1:* *Adib owns all of the issued stock of an Afghan corporation. The Afghan corporation has Afs. 1,000,000 of accumulated earnings. Adib causes the Afghan corporation to distribute equipment to him. The equipment has a cost basis of Afs. 100,000, but is worth Afs. 150,000. The distribution of the equipment is considered a dividend of Afs.*

*150,000 to Adib. Adib takes the equipment with a cost basis of Afs. 150,000.*

<u>*Example 2:*</u> *Adib owns all of the issued stock of an Afghan corporation. The Afghan corporation has no accumulated earnings. Adib invested Afs. 200,000 in the stock of the Afghan corporation. Adib causes the Afghan corporation to distribute equipment to him. The equipment has a cost basis of Afs. 100,000, but is worth Afs. 150,000. The distribution of the equipment is considered a return of Afs. 150,000 investment capital to Adib. Adib takes the equipment with a cost basis of Afs. 150,000.*

43.3 A distribution of assets to shareholders reduces (but not below zero) the cost of shares owned by each shareholder by an amount equal to the distribution received. Such receipt is not taxable income of the shareholder because it is a return of capital he invested at the time he purchased his shares. A record of this return (refund) of capital must be kept to show the reduced cost to the shareholders of his shares. If the shareholder subsequently transfers his shares, the reduced cost will determine gain or loss from such transfer. If the value of a distribution exceeds the shareholder's cost basis in the shares, then the shareholder will realise a gain with respect to the distribution equal to the amount of the excess.

| | |
|---|---|
| Article 44 | Distribution of assets on liquidation of a company A distribution of assets among shareholders or partners on liquidation of a corporation or a limited liability company shall be treated by the shareholders or partners as proceeds from sale or exchange of assets as provided in Chapter 3 of this Law. The amount distributed in money plus the market value of any other assets distributed less the shareholder's cost of the stock or the amount of partner's capital on which distribution is made shall be taxable income of the shareholder or partner. No gain or loss shall be recognized to the corporation or limited liability company on the distribution of its assets in partial or total liquidation. |

44.1 A liquidating distribution by a corporation to its shareholders is considered first a return of earnings and then a return of invested capital. To the extent the distribution is a return to the shareholder of capital invested by him, it is not income. To the extent the distribution exceeds the shareholder's invested capital, the distribution gives rise to a taxable gain to the shareholder.

*Example:* *Adib owns all of the issued stock of an Afghan corporation. Adib purchased the stock in a prior year for Afs. 1,000,000. After selling all of its assets, the corporation has Afs. 500,000 of earnings and Afs. 2,000,000 of cash. Adib causes the corporation to liquidate, distributing all of its cash to Adib. Adib recognizes Afs. 500,000 as a taxable dividend. The next Afs. 1,000,000 is considered a return of capital that is not income to Adib. The remaining Afs. 500,000 of the distribution is considered a taxable gain to Adib, because it exceeds Adib's cost basis in his shares of stock.*

| | |
|---|---|
| Article 45 | <u>Distribution of money or other assets</u> A dividend is any distribution of money or assets made by a corporation or a limited liability company to its shareholders or partners out of its earnings and shall be subject to the following:<br><br>1. Dividends paid in cash by a corporation or limited liability company established under the laws of Afghanistan shall be deductible from the income of the company which makes the payment except where sub-paragraph 2 of paragraph (2) of Article 18 applies.<br><br>2. Dividends paid in the form of securities for shares or loan or of similar nature shall not be deductible from income of the corporation or limited liability company.<br><br>3. Dividends paid in cash shall be taxable income of the recipient at the time of receipt, but dividends in the form of securities for shares or loan or of similar nature shall not be considered as taxable income of the recipient at the time received. |

45.1 If a corporation or limited liability company makes dividend payments that are non-deductible under Article 18(2)2 because withholding tax has not been paid, the payments will continue to be treated as “dividends” under this Law. Shareholders will be liable to income tax on the dividends received.

45.2 A corporation or limited liability company may not deduct the value of its securities that it issues in the form of dividends.

<u>*Example 1:*</u> *Adib and Wahid each own 50 shares of the issued stock of an Afghan corporation. The corporation has 100 shares issued. The corporation has Afs. 1,000,000 of accumulated profits. The corporation issues an extra share of its stock to Adib and Wahid. Each share is worth Afs. 9,000. The corporation cannot deduct any amount.*

<u>*Example 2:*</u> *Adib and Wahid each own 50 shares of the issued stock of an Afghan corporation. The corporation has 100 shares issued. The corporation has Afs. 1,000,000 accumulated earnings. The corporation distributes a promissory note to each of Adib and Wahid. The promissory notes each have a principal amount of Afs. 10,000. The corporation cannot deduct the value of the notes from its taxable income.*

<u>*Example 3:*</u> *Adib and Wahid each own 50 shares of the issued stock of an Afghan corporation called Company A. Company A has 100 shares issued. Company A has Afs. 1,000,000 accumulated earnings. Company A owns 200 shares of another corporation called Company B. Company A distributes the 200 shares of Company B stock to Adib and Wahid. Each share of Company B stock is worth Afs. 10. Company A can deduct the value of the Company B shares that it distributes from its taxable income. The Company B shares are treated just like any other item of property.*

*Example 4:* *Adib and Wahid each own 50 shares of the issued stock of an Afghan corporation called Company A. Company A has 100 shares issued. Company A has Afs. 1,000,000 accumulated earnings. Company A owns notes that were issued by another corporation called Company B. The notes have a value of Afs. 200,000. Company A distributes the Afs. 200,000 notes to Adib and Wahid. Company A can deduct the value of the Company B notes that it distributes from its taxable income. The Company B notes are treated just like any other item of property.*

45.3 If securities are received as dividends they are not considered taxable income in the year they are received. The proceeds of the sale, exchange, repayment or transfer of such securities are, however, taxable income. In this case, because the recipient did not pay anything for these securities the entire proceeds are considered taxable gain. The expense of sale may be deducted.

*Example 1:* *In 1384 a shareholder receives stock dividends in the form of ten shares. In 1385 the shareholder sells his ten shares for Afs. 6,000. He had no expense in selling these shares and therefore the entire Afs. 6,000 is income subject to taxation in 1385.*

*Example 2:* *In 1384 a shareholder of a corporation receives notes issued by that corporation. The notes have a face value of Afs. 100,000. The shareholder does not have to include the notes in his income when they are received. The notes have a cost basis to the shareholder of zero. If the corporation makes a Afs. 10,000 payment on the notes, the payment is considered income to the shareholder at that time. The shareholder has to include the Afs. 10,000 payment in his income. The shareholder is entitled to increase its basis in the notes by Afs. 10,000. The corporation is entitled to deduct the Afs. 10,000 payment as if it were a dividend.*

Article 46 Withholding tax (1) Profit or non-profit legal persons formed under the laws of Afghanistan shall be required to withhold income tax as follows:

1. in the case of wages and salaries, in accordance with the provisions of this Law;

2. twenty percent tax from interest, dividends, royalties, prizes, rewards, lotteries, bakhshishis (gratuities), bonuses, and service charges according to the provisions of this Law.

(2) Tax withheld under this Article shall be paid to the State not later than 10 days after the end of the month in which the tax was withheld.

(3 Legal persons withholding tax from payments of salaries and wages under the provisions of this Law shall provide to each person receiving such payment details of payments and tax withheld, in the manner prescribed by the Ministry of Finance, within one month of the end of the tax year in which tax was withheld.

(4) A person making payments subject to withholding tax shall report details of payments and withholding tax to the Ministry of Finance in the prescribed manner not later than ten days after the end of each month.

(5) Where the correct amount of tax has been withheld from an amount in accordance with the provisions of this Law, it shall be deemed that the income tax on this source of income has been fully satisfied.

(6) Natural persons who have more than one source of income shall be required to file a tax return and income tax shall be computed under the provisions of this Law. Any amount of tax which has been withheld on payment of the income will be allowed as a credit against income tax payable.

46.1 Profit and non-profit legal persons organized under the Laws of Afghanistan are required to withhold tax from the payment of salary or wages to employees according to the provisions of the law. Article 58 specifically applies to the withholding of tax from salary or wages of employees. Reference should be made to the regulations of Article 58.

46.2 Profit and non-profit legal persons organized under the Laws of Afghanistan are required to withhold tax from the payment of dividends, interest, royalties, prizes, rewards, lotteries and bonuses. Whenever such payments are made , the payer is required to withhold tax at the rate of 20 percent and pay it to the government account.

*Example 1: Azizullah deposits an amount of Afs. 200,000 in a savings account of the National Bank. The National Bank pays interest at the of 5 percent per annum. At the end of the tax year, the National Bank pays an amount of Afs. 10,000 as interest to Azizullah. The National Bank is required to withhold 20% tax ie Afs. 2,000 and pay it to the*

*government account within 10 days after the month in which the tax was withheld.*

46.3 Where banks make interest payments on loans or deposits from other banks, withholding of tax from the interest payment is required.

*Example:* *Afghan Bank is a company created in Afghanistan which provides banking services. During the year, Afghan Bank provided a loan to Herat Bank. Herat Bank repays the loan with interest. Herat Bank is required to withhold tax from the payment of interest to Afghan Bank.*

Banks with interest income are required to declare that interest income for annual income tax purposes and pay income tax accordingly. Credit will be allowable for tax withheld from the interest which is subjected to annual income tax.

46.4 Although there is an obligation on the person who pays interest to withhold tax, where the person who receives interest would not otherwise liable to income tax, the obligation to withhold tax shall be waived. This shall apply where financial institutions make interest payments on loans or deposits to:

a) organisations that are not subject to income tax under Article 10 as an exempt organization,
b) agencies and departments of the State and of municipalities in accordance with Article 11.

Where interest is paid in such cases, banks should confirm the tax exempt status of the organisation concerned with officials of the Afghanistan Revenue Department and keep written evidence of such confirmation available upon request by Ministry of Finance officers.

46.5 The taxes withheld from dividends shall be paid to the State within 10 days after the end of the month in which the tax was withheld. The entire dividend declared by the company must be paid out, with the State receiving the amount withheld and the shareholders receiving the balance.

*Example:* *A company subject to tax withholding from dividends declares a dividend of Afs. 100 per share on its 50,000 shares of stock, or a total dividend of Afs. 5,000,000 which is reportable as income by the shareholders. Of this amount, Afs. 4,000,000 (80 percent of 5,000,000) will be paid to the shareholders and Afs, 1,000,000 (20 percent of Afs. 5,000,000) will be withheld for taxes.*

*Remark: Taxes withheld from any payments subject to withholding tax according to this Article are required to be transferred to the State account within 10 days after the end of the month in which the taxes were withheld.*

46.6 The withholding of tax applies to payments from lotteries and prizes.

*Example:* *Afghan Bank distributes prize-winning cash amounts for its Lucky Draw account in the month of Mizan to the winners. The bank is required to withhold tax according to sub paragraph 2, paragraph 1 of Article 46 of Income Tax Law and transfer the withheld tax by 10 Aqrab of that year to the government account.*

46.7 At the same time as the taxes withheld from dividends are paid to the State the company shall file with the tax office a report listing the names of all shareholders, the amount of dividend withheld and the amount paid each shareholder or partner. This report shall be made on the prescribed form.

46.8 A corporation that makes a dividend distribution to its shareholders must issue a statement. The statement issued to the shareholder with his dividend shall be prepared in three copies. The three copies shall be distributed as follows:..

- Two copies shall be issued to the shareholder. The shareholder shall attach the original to his income tax return to get credit for the tax withheld and retain one copy.

- The third copy shall be attached to the report filed with the bank at the time the taxes withheld are remitted by the company.

*Remark: The requirement to issue statements on the payment of dividends applies equally to the withholding of tax and payment of balance for other income subject to withholding tax in accordance with Article 46(1)2 of Income Tax Law*

46.9 Tax withheld from a dividend, though paid by the corporation, is a tax on earnings of shareholders. The tax withheld may be credited by the shareholder against his total income tax liability. In order to receive credit for overpayment of tax due to tax withheld, the taxpayer must file an income tax return.

*Example: Consider the following case:*

| | | | |
|---|---|---|---|
| a. | A shareholder has taxable income of | | Afs. 500,000 |
| b. | In addition, he receives cash in amount of Afs. 100,000 which resulted from a dividend of Afs. 125,000 from which 20%, or Afs. 25,000, has been withheld | | Afs. 125,000 |
| c. | Total taxable income | | Afs. 625,000 |
| d. | Income tax based on the rate schedule of Article 4 of the Income Tax Law: | | |
| | Tax on Afs. 60,000 | Afs. 0 | |
| | Tax on Afs. 90,000 | 1,800 | |
| | Tax on Afs. 475,000 | 47,500 | Afs. 49,300 |
| e. | Deduct taxes withheld | | - Afs. 25,000 |
| f. | Tax Due | | Afs. 24,300 |

Article 47 Deduction of depreciation and losses (1) Enterprises registered under the Law on Domestic and Foreign Private Investment in Afghanistan shall, from June 21 2004 and as an exception to sub-paragraph 7 of paragraph (1) of Article 18, be entitled to a deduction for the depreciation of buildings and other depreciable assets as follows:

- four years for buildings; and
- two years for other depreciable assets.

(2) The allowable depreciation deduction for buildings and other depreciable assets shall be an equal deduction for each tax year of depreciation. If a depreciable asset is held by the enterprise for less than half of the year, depreciation shall be calculated and deducted for half of the year. If a depreciable asset is held for more than half of the year, depreciation shall be calculated and allowed for one year.

(3) Approved enterprises incurring a net operating loss in a tax year based on legal and accounting records may, from June 21 2004 and as an exception to Article 42, carry forward this loss as a deduction from taxable income in each subsequent year until the loss is fully set off. The loss incurred by such approved enterprises shall be calculated in accordance with Article 42 of this Law. Depreciation and expenditure which relate to a period covered by a tax exemption or to a period before an enterprise first became an approved enterprise shall not be allowable in the calculation of a net operating loss.

47.1 Taxpayers must use the “straight line” method in computing their depreciation deductions under this Article. Under the “straight line” method of depreciation, an equal amount of depreciation is taken each year.

*Example:* *An Afghan corporation purchases equipment for Afs. 10,000,000 at the beginning of 1385. The corporation is entitled to claim Afs. 5,000,000 of depreciation in 1385 and Afs. 5,000,000 depreciation in 1386.*

47.2 A taxpayer that owns property at any time during the year may claim a depreciation deduction for that property in that year. If, however, the taxpayer owns the property for less than one half of the year the taxpayer will be entitled to claim one-half of the annual depreciation for that property in that year. If, as a result of this rule, the taxpayer has not fully depreciated the property in the two (2) fiscal year or four (4) fiscal year period, then the remaining depreciation shall be claimed in the immediately following year.

*Example:* *An Afghan corporation purchases equipment for Afs. 10,000,000 in thelast month in 1386. The corporation continues to hold the property throughout 1387 and 1388. The corporation can claim the following deductions in the following years:*

| | *Deduction* |
|---|---|
| *Year 1386* | *Afs. 2,500,000* |
| *Year 1387* | *Afs. 5,000,000* |
| *Year 1388* | *Afs. 2,500,000* |

Remark: For further information on the interpretation and application of this Article, reference should be made to the Ministry of Finance Public Ruling 1384/4 titled 'Tax Holidays, Exemptions and Concessions for Investment'.

47.3 Taxpayers who have had a tax exemption or tax holiday need to calculate the written down value of depreciable assets as at 1 Saratan 1383 (21st June 2004). Registered and Approved Enterprises under the Law on Domestic and Foreign Private Investment will be allowed depreciation on their depreciable assets under accelerated depreciation rules from the date of registration or 21st June 2004 whichever is later. For the period between 1 Saratan, 1383 (21st June 2004) and the date of registration only standard depreciation is allowable on depreciable assets. Similarly, if an enterprise is not registered it will be allowed depreciation on its depreciable assets under the normal depreciation rules.

47.4 The carry forward and offset of a net operating loss according to Article 47 is only available to a taxpayer that is an enterprise approved under the Law on Domestic and Foreign Private Investment in Afghanistan 2005 and registered with Afghanistan Investment Support Agency (AISA). If the enterprise is not registered with AISA, the loss may only be carried forward and allowed for a maximum of three years according to the standard loss carry-forward method as provided by Article 42.

47.5 All approved and registered enterprises are entitled to carry-forward of net operating loss for offset against profits of the succeeding years until that loss has been offset in full. However, Article 47 imposes the following restrictions:

- the net operating loss shall be allowed and balance carried-forward for deduction against the income of the following year(s) with effect from 1 Saratan 1383 (21st June 2004) or the date of registration with AISA, whichever is later;

- operating losses incurred during tax holiday or tax exemption are not allowed to be carried forward.

The following examples clarify the carry-forward of operating losses against operating profits for registered and approved enterprises:

*Example 1:* *Istiqlal Corporation was registered in 1382. It was exempt from tax until 1 Saratan 1383. For 1383, it made an operating loss of 100,000 Afs. In 1384, it made an operating profit of Afs. 175,000. Istiqlal Corporation can offset the proportionate loss for the period from 1 Saratan to 29 Hoot ie nine months amounting to three-quarters of the operating loss for the year ie Afs. 75,000 against operating profit of the tax year 1384, leaving taxable income of Afs. 100,000 in the tax year 1384.*

*<u>Example 2</u>:* *Asman Company commenced business on 1 Hamal 1383 and was registered on 1 Aqrab 1383 i.e. 6th month of the tax year 1383. It made an operating loss of Afs. 100,000 in the tax year 1383. In 1384, it made an operating profit of Afs. 175,000. Asman Company can offset the proportionate loss for the period Aqrab to Hoot ie six months equal to one-half of the operating loss for the year 1383 amounting to Afs. 50,000 against the operating profit of the tax year 1384, leaving a net profit of Afs 125,000 in the year 1384.*

*<u>Example 3:</u>* *Chaman Corporation, a registered enterprise since 1383, made an operating loss of Afs 100,000 in 1384. In 1385 it made an operating profit of Afs 150,000. In its 1385 income tax return, Chaman Corporation can deduct the loss of Afs 100,000 for the previous year from the taxable income for 1385 tax year leaving taxable income of Afs 50,000.*

*<u>Example 4:</u>* *Same details as Example 3 except Chaman Corporation made an operating loss of Afs 50,000 in 1385. Chaman Corporation is entitled to claim the loss of 1384 as a deduction in the year 1385. The loss for the tax year 1385 is Afs 150,000 (ie 100,000+50,000) and will be allowed as a deduction in the 1386 tax year.*

*If Chaman Corporation makes an operating profit greater than Afs 150,000 in 1386, the loss from the previous year will be fully recouped. If Chaman Corporation does not make an operating profit greater than Afs 150,000, the loss which is incurred having allowed a deduction for the previous year's loss may be carried forward as a deduction for the 1387 year. A deduction for the previous year's loss shall continue until such time as Chaman Corporation makes operating profits which exceed the loss from the previous year.*

*<u>Example 5</u>:* *Arman Company made an operating loss of Afs 100,000 in 1384. In 1385 it made an operating profit of Afs 50,000. In the income tax return for the tax year 1385, Arman Company can claim a deduction for the operating loss of Afs 100,000 for 1384 thereby creating a loss for the 1385 year of Afs 50,000.*

*In tax year 1386, Arman Company made an operating profit of Afs 150,000. It may claim a deduction for the 1385 loss of Afs 50,000 in the income tax return of 1386 resulting in taxable income for the 1386 year of Afs 100,000.*

*If Arman Company made an operating loss in the tax year 1386 the loss attributed to tax year 1384 will not be fully deducted in the tax year 1386. The loss attributed to tax year 1384 will therefore be carried-forward indefinitely in following years until such time when there is operating profit to offset this loss.*

# CHAPTER 7

# TAXATION OF INSURANCE COMPANIES

## Article 48 – Article 53

| | |
|---|---|
| Article 48 | Provisions applicable to insurance companies The Articles of this Chapter shall apply to an insurance company provided it meets the following conditions:<br><br>1. It has been established as a corporation under the laws of Afghanistan;<br><br>2. The company is engaged in more than one field of insurance, such as casualty-risk insurance, life insurance, or any other type of insurance activity; and<br><br>3 The company must have separate accounting and reserves for each of its fields of insurance and other activities. |

48.1 Insurance companies require large reserves to pay claims made by their policy holders. Chapter 7 of the Income Tax Law allows insurance companies to use receipts for creating such reserves and, in turn, requires separate accounting for each field of insurance with basically different reserve requirements.

a. One field of insurance is "insurance against fire, theft, accident, sickness, casualty, or risk of any kind in which insurance is for a specified term."

Ordinarily, claims for losses suffered by policy holders will equal premiums received, plus expense and profit. However, in some years of unusual combinations of disasters, ample reserves will be necessary if the company is to pay all losses. For this field of insurance, reserves (for claims) equal 100 percent of premiums for transport insurance plus 50 per cent of premiums for other risk insurance received in the year are allowed.

*Example:* *If premium income for transport insurance in 1385 is Afs. 1,000,000, and premium income for other risk insurance in 1385 is Afs. 10,000,000, the company is allowed to transfer its profits to this reserve until the reserve is Afs. 6,000,000 - that is, Afs. 1,000,000 for transport insurance plus Afs. 5,000,000. for other risk insurance.*

In addition to this reserve, a reserve for losses equal to twice the paid in capital is allowed. In any year at the beginning of which both these reserves are at their maximum and the premium income is not increased, no income-tax-free transfer to reserves can be allowed.

*Thus, based on the facts in the foregoing example, the following reserves would be permissible:*

| Insurance | Premium Income | Reserve Allowed | | Reserve Allowed |
|---|---|---|---|---|
| Transport | 1,000,000 | 100% | 1,000,000 | 200% of the paid |
| Other | 10,000,000 | 50% | 5,000,000 | up capital |

b. The other field of insurance is "written contracts that require ultimate payment of specified benefits to the policy-holder or his beneficiaries."

Ordinary and paid-up life insurance, endowment plans, annuity contracts, and other savings plans which may be offered by insurance companies are examples of this kind of insurance. Accumulation of reserves that will meet the ultimate payments specified in policies is necessary. The purchaser of an annuity expects to get his money plus interest back in the form of monthly income at some future specified date. The insurance company must invest all of this premium income to meet this contractual obligation. Similarly, as life insurance will be paid eventually upon the death of the insured, premiums must be accumulated so that this obligation which cannot be avoided unilaterally by the company can be paid and so an entirely different basis for building reserves is permitted for this field of insurance. All premium income is exempt (just as bank deposits are not subject to tax). Since premium income is exempt, expenses that are ordinarily paid directly out of premium income <u>are not</u> deductible. Nor are benefits (claims) paid to policy-holders deductible, for the simple reason that they are paid out of reserves built by "income-tax-free" premium income. This distinction between reserves for the two fields of insurance must be clearly understood and accounting must be completely separated. Otherwise, taxable income cannot be determined accurately.

<u>Example:</u> *An insurance company with a paid-in capital of Afs. 500,000 writes transport and other risk insurance exclusively. In 1386 it began the year with a reserve for claims of Afs. 2,000,000 and for losses (in operations) of Afs. 1,000,000. During 1386 its premium income is Afs. 400,000 for transport insurance and Afs.4,100,000 for other risk (loss and accident) insurance. Its net profit is Afs. 540,000* ***before*** *any additions to reserves have been made.*

*This company can increase its reserves as follows:*

*a. Reserves permissible at end of year:**

| | |
|---|---|
| 1. For losses: Afs. 500,000 x 2 | Afs. 1,000,000 |
| 2. For claims: Afs. 400,000 (transport) x 100% | 400,000 |
| Afs. 4,100,000 (other risk) x 50% | 2,050,000 |
| Total Reserves permissible at the end of year | Afs. 3,450,000 |

* <u>Remark:</u> *The company may add to its reserve any amount available. If, however, the reserve is increased to more than the permissible amounts, the excess added may not be deducted in computing taxable income.*

*b. The company began the year with Afs. 3,000,000 of reserves. Hence, only Afs. 450,000 can be deducted.*

*This amount <u>if added to reserves</u> in 1386 may be deducted from the net profit of Afs. 540,000, leaving a taxable income of Afs. 90,000 (that is, the difference between Afs. 540,000 and Afs. 450,000).*

48.2 An insurance company engaged in more than one field of insurance as described in Regulation 48.1 must maintain separate accounting for each field of insurance. That means that premium income, expenses, reserves set up, income from investment of reserves, etc., must be recorded in separate accounts for each field of insurance. Some administrative expenses may be allocated but only on a consistent and reasonable basis. Thus, premiums for risk insurance, commissions paid for writing risk insurance, risk insurance claims paid, reserves for claim of risk insured, income from such reserves, paid-in capital allocated to risk insurance, etc., must be recorded in a distinct and separate set of accounts, and must not be intermingled with similar income and disbursements, reserves, and capital belonging to other fields of insurance.

In this way, the profit or loss from each field of insurance can be determined. The reserve for each field of insurance will be increased exclusively from its own receipts or profit. Separate profit and loss statements and balance sheets must be prepared for each field of insurance and must be submitted to the Ministry of Finance. Taxable income of the company will, however, be determined on the basis of the total business of the company.

<u>*Example:*</u> *A company engaged in both risk insurance and life and annuity insurance keeps completely separate accounting and reserves for both fields of insurance. In 1386 its net profit from its operations in risk insurance is transferred to reserves for claims which are below the maximums which may be provided income-tax-free.*

*If in the same year the company has a net profit of Afs. 250,000 from its life and annuity insurance business, no part of this net profit is deductible from taxable income even though added to lawful reserves. The entire amount is taxable income either of the company if not distributed in dividends or of the shareholders subject to tax withholding.*

| | |
|---|---|
| Article 49 | Taxable income of insurance companies The following receipts of insurance companies shall be subject to income tax:<br><br>1. interest, dividends, rent, and other income from investments and property;<br><br>2. receipts from activities other than insurance;<br><br>3. premiums for insurance against fire, theft, accident, sickness, casualty, or risk, the insurance of which is for a specified term, and the insured person has no money claim after the term has expired; and<br><br>4. income from capital transactions. |

49.1 Premiums received for risk insurance are generally included in income and subject to taxation, while premiums for the insurance described in Article 50 of the Income Tax Law are not.

*Example:* *A company writing risk insurance includes all premiums received and deducts all claims paid, commissions, other expenses of selling insurance, and administrative expenses in determining its net profit.*

*A simplified statement of income and expense (operating statement) of this company would appear as follows:*

*a. Receipts:*

| | |
|---|---|
| 1. Premium income | Afs. 2,500,000 |
| 2. Less claims paid | 1,600,000 |
| Gross gain (difference of two items above) | Afs. 900,000 |
| 3. Other receipts - (interest, dividend, etc.) | 75,000 |
| 4. Income before expenses | Afs. 975,000 |

*b. Expenses:*

| | |
|---|---|
| 1. Fees and commissions of salesmen | 300,000 |
| 2. Adjusting claims expense | 75,000 |
| 4.Other administrative expense | 175,000 |
| 5. Allowable additions to reserves made | 175,000 |
| Total expenses deductible | 725,000 |

| | |
|---|---|
| *c. Net taxable income* | *Afs. 250,000* |

49.2 Group life insurance shall be considered to be risk insurance in either of the following cases:

a. if premiums are changeable as individuals increase in age or

b. if individuals leaving the group cannot continue insurance at the same rate as those in the group and in the same age bracket.

<u>*Example:*</u> *Insurance at a low rate is offered to all employees of a corporation provided at least a given percentage of the employees are insured. Rates are lowest for the youngest employees and highest for the oldest and are set for the age bracket, not the individual. Thus, if the rate is higher for the 41 to 50 age bracket than for the 31 to 40 age bracket, and a person upon reaching 41 must pay a higher premium, the increased risk is reflected in the premium. Also, employees who leave the group are dropped from the group insurance policy but are allowed to become insured under a separate policy at higher rates. Both of these conditions point out that this is term insurance against the risk of death of an employee while a member of the group. Reserve requirements here typify those of the casualty-risk field of insurance. Therefore, premium income from this group insurance is taxable and claims paid are deductible.*

49.3 Since all gain from sale or exchange of any capital asset of a corporation or limited liability company is subject to taxation, any gain from the sale or exchange of investments and property owned by insurance companies is likewise subject to taxation.

| | |
|---|---|
| Article 50 | Exemption of certain policy holders All insurance premiums received for written contracts that require ultimate payment of specified benefits to the policyholder or their beneficiaries are exempt from income tax. |

50.1. Although ordinary and paid-up life insurance, endowment plans, annuity contracts, and various combinations of life insurance with savings plans are insurance for which premiums received by the insurance company are exempt from taxation, each kind of insurance policy issued should be examined before it is so classified. Premiums are exempt only if the insurance policy meets the following tests:

a. The policy cannot be terminated by the insurance company without payment of benefits or except upon failure of policyholder to pay the premiums as provided in the policy;

b. The insurance premiums specified in a policy cannot be increased by the insurance company;

c. The policy remains in effect regardless of whether or not the insured continues to be a member of any particular group, occupation, etc,

d. The premiums for the insurance are added to the reserve for policyholders and invested. Only specified sales commissions on premiums may be paid out of the premiums received;

e. The reserve for policyholder shall also be supported by income from investments of funds from a lawful reserve;

f. No transfers out of the reserve for policyholders are permitted except in payment of benefits to policyholders or their beneficiaries.

| | |
|---|---|
| Article 51 | Non-deductible expenses of insurance companies The following expenses and payments made in connection with insurance for which premium income is tax exempt under Article 50 shall not be deductible:<br><br>1. Commission expense and other costs of writing insurance; and<br><br>2. Payments of benefits to the policyholders or their beneficiaries. |

51.1 Commission expense and other costs of writing insurance for which premiums are exempt from taxation, and payments of benefits of such insurance are not deductible expenses. They are paid either out of premium receipts (in the case of sales commissions) or out of tax-free reserves.

Although premium income is exempt and the above expenses and disbursements are not deductible, the insurance company must include complete information about these items and the reserves in its reports to the Ministry of Finance.

*Example:* *A simplified statement covering the reserve and operations would appear as follows:*

Statement on Policyholder's Reserve:

| | | |
|---|---|---|
| a. | Reserves at beginning of year | Afs. 10,000,000 |
| b. | Addition to reserves during year: | |
| | 1. premiums received during year | Afs. 2,000,000 |
| | 2. expenses: | |
| | commissions paid | Afs. 100,000 |
| | Added to reserve during year (2,000,000 — 100,000) | 1,900,000 |
| c. | Sum of items (a) and (b). | 11,900,000 |
| d. | Claims and benefits paid during year | 1,500,000 |
| e. | Difference of items (c) and (d). | 10,400,000 |
| f. | *Additions to reserve from investment income | 260,000 |
| g. | Reserve at end of year | Afs. 10,660,000 |

**Remark:* *This reserve addition is made after taxes on income*.

Income and Expense Statement:

| | | | |
|---|---|---|---|
| a. | Income subject to income tax, including: interest, dividends, capital gains during year | Afs. | 600,000 |
| b. | Deductible expenses: | | |
| | 1. Business receipts tax | Afs. | 2,000 |
| | 2. Administrative expenses | | 200,000 |
| | Total deductible expenses | | 202,000 |
| c. | Taxable income (difference between (a) and (b)) | Afs. | 398,000 |

| | |
|---|---|
| Article 52 | <u>Deductible expenses of insurance companies</u> (1) The following expenses and payments of insurance companies are deductible from their income:<br><br>1. amounts paid (claims) on insurance for which premium income is taxable;<br><br>2. commission and other expenses incurred on writing insurance for which premium income is taxable;<br><br>3. reinsurance expenses incurred on insurance for which premium income is taxable;<br><br>4. additions to reserves for compensation of claims, provided such reserves do not exceed 100 percent of premiums for transport insurance and 50 percent of premiums for any other risk insurance received during the tax year;<br><br>5. additions to reserves for losses in operations in the field of insurance for which premium income is taxable, provided such reserves do not exceed twice the amount of invested capital for such field of insurance;<br><br>6. other necessary expenses of doing business as provided in Chapter II of this Law except those stated in Article 51.<br><br>(2) Any transfers or payments from reserves referred to in sub-paragraphs (4) and (5) of paragraph 1 of this Article, except for actual claims and losses or for dividend payments in money, are taxable income in the tax year during which the transfer or payment was made. |

52.1 “Insurance for which premium income is taxable” mentioned in sub-paragraph 1 of Article 52(1) refers only to casualty-risk insurance. It will be noted that receipts and expenditures of casualty-risk insurance are treated the same as in other lines of business. Thus, all receipts including premiums are subject to income tax and all disbursements, including claims paid, that are legitimate and necessary expenses of business are deductible in computing taxable income. The significant provision of Chapter 7 with respect to casualty-risk insurance is deductibility of additions to reserves is provided in sub-paragraphs 4 and 5 of Article 52(1).

52.2 Though additions to reserves described in sub-paragraphs 4 and 5 of Article 52(1) of the Income Tax Law are deductible, any transfers out of these reserves for purposes other than payment of claims and losses are subject to income tax. If dividends are paid to shareholders, taxes must be withheld and remitted to the State in accordance with Article 46 of the Income Tax Law. If funds are used for purposes other than prudent investments which have reasonable liquidity, such uses shall also be deemed transfers out of the reserves subject to income tax.

In the absence of law governing the investment of insurance company reserves, the Ministry of Finance will have to consider the purpose of the reserve and the nature of each investment of reserve funds. Reserves against claims and losses of casualty-risk insurance need to be reasonably "liquid" if unexpected and unusual losses are to be covered (which is the purpose of these reserves).Therefore, salability or convertibility of the investment to money within a period of time reasonable from the viewpoint of time allowable in fair settlement of claims should guide the Ministry in determination of the status of an investment. If the investment meets the requirement of liquidity it does not constitute a transfer from the reserve, but if it does not meet this requirement it is deemed a transfer from the reserve and taxed.

<u>*Example:*</u> *A casualty-risk insurance company erects an office building to house its own office and other offices and shops to be leased. A substantial part of the funds in the reserve for claims is invested in this property. The remaining cost is borne by a mortgage loan from an investment bank. The mortgage loan is approximately the maximum that can be borrowed on this office building. Therefore, the funds used in completing this investment must be deemed a transfer from the reserve subject to tax. This investment in the building on "top" of the mortgage is highly "non liquid," and cannot serve the purposes of the reserve. If on the other hand, the entire cost of the property had been paid with funds from the reserve for claims, and the insurance company can furnish a mortgage loan commitment from an investment bank, the amount of the commitment may be deemed to meet the requirement of the reserve, and only the difference between the total cost and the commitment would be deemed to have been transferred and, therefore, taxable.*

52.3 The reserve for policyholders' claims and benefits built from exempt premiums described in Article 50 of the Income Tax Law is ordinarily supported by premiums and income from investment of funds in the reserve. Although the law does not allow deduction of additions out of investment income to this reserve without payment of tax, the premium income going into this reserve is tax-free (exempt) income. The reason for this difference is that since the benefits received by the policyholders or their beneficiaries are not subject to income tax, such benefits have, theoretically, been bought and paid for by the policyholder. Since part of these benefits originated from investment income there is, however, an element of income in such benefits, and taxing the recipient directly is obviously impracticable. Therefore, the insurance company is taxed on investment income added to this reserve and subsequently transferred to the recipient. As a result, the recipient is taxed indirectly on any part of benefits arising out of investment income.

| | |
|---|---|
| Article 53 | Determination of taxable income of foreign insurance companies Any foreign insurance company or reinsurance company receiving premium income of any kind from within Afghanistan is subject to income tax as follows:<br><br>1. the premiums received by the company from within Afghanistan in the tax year shall be determined;<br><br>2. the total premiums received world-wide by the company in the same period shall be determined;<br><br>3. the net income before income tax and dividend payments by the company from its world-wide business shall be determined;<br><br>4. the amount determined in sub-paragraph (1) divided by the amount determined in sub-paragraph (2) multiplied by the amount determined in sub-paragraph (3) of this Article shall be taxable income. |

53.1 Premiums paid by a natural person who is an Afghan resident or a legal person created under the laws of Afghanistan to a foreign insurance company are considered income from sources within Afghanistan and are subject to income tax. This includes reinsurance premiums paid by a domestic insurance company to a foreign insurance company. Taxable income of a foreign company from sources within Afghanistan is determined as follows:

a. The total world-wide premium income, which is the total of all premium income received by the foreign company from all countries during the relevant fiscal year, is determined.

b. The total gross receipts of the foreign company from all sources is determined.

c. The total of disbursements paid to policyholders is determined.

d. The increase in reserves for policyholders is determined. (By “increase in reserves” is meant the net increase in the reserve from the beginning of the year to the end of the year.)

e. The total of necessary expenses of doing business, (except income taxes, dividends paid to shareholders, and addition to reserves), is determined.

f. The amounts determined in (c), (d), and (e) are totaled.

g. The worldwide net income of the foreign company from all countries is determined by subtracting the total obtained in (f) from the total receipts from all sources in all countries during the latest fiscal year, obtained in (b).

h. The total of the premium income from Afghanistan in the relevant fiscal year is determined.

i. The world-wide net income of the foreign company from all countries (g) is divided by the total of the world-wide premium income of the foreign company from all countries (a).

The above quotient shows the average ratio of premium income from all countries that is net income.

j. The total premium income from Afghanistan is multiplied by the ratio found in (i) above.

The product so obtained is taxable income from sources within Afghanistan and is taxed at the rate of 20 per cent.

Remark: It should be remembered that no deductions are allowed from the taxable income computed in (j) above, as the formula itself provides all deductions on an average basis.

*Example: An agency of a foreign insurance company in Afghanistan remits premiums amounting to Afs. 600,000 to the account of the foreign company in 1384. Taxable income of the foreign company from sources within Afghanistan is computed as follows:*

*a. The total world-wide premium income of the foreign company in the year 2005 (the period which corresponds to 1384) is found to be US$25,000,000;*

*b. The total gross receipts of the foreign company from all sources is determined to be US$30,000,000.*

*c. The total of disbursements paid to policyholders (such as claims and benefits) is found to be US$19,000,000.*

*d. The increase in reserves for policyholders is found to be US$7,000,000.*

*e. The total of necessary expenses of doing business is determined to be US$1,500,000.*

*f. The total of figures from (c), (d), and (e) is determined:*

| | | |
|---|---|---|
| | *US $19,000,000* | *(c)* |
| | *7,000,000* | *(d)* |
| | *1,500,000* | *(e)* |
| *Total* | *US $27,500,000* | |

*g. The world-wide net income of the foreign company from all countries is determined. For this purpose, the total figure obtained in (f), that is, $27,500,000, should be subtracted from the figure in (b).*

*Namely:*

*US$30,000,000 - US$27,500,000 = US$2,500,000*

*h. The total of the premium income from Afghanistan in 1384 is determined. In this example, the amount is Afs.600,000.*

*i. The figure obtained from (g) should be divided by the figure in (a):*

*US$2,500,000 ÷ US$25,000,000 = 1/10*

*Therefore, the average ratio of premium income from all countries to net income is 1/10, that is 1/10 of the premium income from all countries is net income.*

*j. From the computation in (i), it is seen that 1/10 of the premium income from Afghanistan should be considered as net income, and therefore the net taxable income of the foreign company from sources within Afghanistan is:*

*1/10 x Afs. 600,000 = Afs. 60,000*

*The tax to be paid to Afghanistan on Afs. 60,000 net income by the foreign company, would be 20 per cent of Afs. 60,000, or Afs. 12,000.*

*<u>Remark:</u> The agency itself is also subject to income taxes on its own profit from the sale of insurance.*

# CHAPTER 8

# TAXATION OF BANKS, LOAN AND INVESTMENT CORPORATIONS

## Article 54 — Article 57

| | |
|---|---|
| Article 54 | Profits and gains subject to tax Income of banks, loan and investment corporations shall be subject to income tax on all income from dividends, interest, discounts, rents, service charges, fees, commissions, and on gains from capital transactions. |

54.1 Deposits and investments received by a bank, loan or investment company are not subject to income tax or the business receipts tax.

*Example:* *During a taxable year a bank receives a total of Afs. 20,000,000 from customers for deposit in savings accounts and/or demand accounts. During the same year the bank earns a total interest income of Afs. 5,000,000 on loans made to borrowers. Here, the Afs. 20,000,000 received is not subject to income tax or the business receipts tax. The Afs. 5,000,000 is subject to both taxes. Taxable income under the Income Tax Law is, however, the amount remaining after deductible expenses have been subtracted from the Afs. 5,000,000.*

54.2 Interest income from bonds of the State or municipalities of Afghanistan is exempt from income tax under paragraph 12 of Article 14 of the Income Tax Law. This also applies to income from such bonds owned by banks, loan and investment companies.

*Example:* *A commercial bank has interest income of Afs. 5,000,000 during a taxable year. Afs. 400,000 is from bonds of the State which are owned by the commercial bank. This Afs. 400,000 is exempt from the income tax. The total interest income of Afs. 5,000,000 should be reported as income received, and Afs. 400,000 deducted to determine the taxable income of the bank.*

| | |
|---|---|
| Article 55 | Deduction of necessary expenses Necessary business expenses shall be deductible from the income described in Article 54 of this Law. Losses from capital transactions, dividends paid in money and additions to a reserve against losses on loans shall also be deductible. |

55.1 Withdrawals by depositors or investors from a bank or loan and investment company are not deductible from income. Since the deposits and investments were not income of the bank or company when received, they are not expenditures when returned to the depositors or investors by the bank or loan and investment company.

*Example:* *A bank's statement shows the following record of deposits:*

| | | |
|---|---|---|
| *a.* | *Deposits at beginning of year* | *Afs. 60,000,000* |
| *b.* | *Deposits during year:* | |
| | *1. Deposits received during year* | *Afs. 20,000,000* |
| | *2. Withdrawal during year* | *15,000,000* |
| | *3. Net deposits during the year (difference of items 1 and 2)* | *5,000,000* |
| *c.* | *Deposits at end of year* | *Afs. 65,000,000* |

*None of this increase is income or expense. This statement merely shows the bank's liability to depositors. Neither income tax nor the business receipts tax applies here.*

55.2 Interest paid to depositors or investors by a bank or investment company is deductible from income of the bank or company. Paragraph 4 of Article 18 of the Income Tax Law provides that "interest on business loans" is deductible. The bank or investment company is in the business of accepting money for deposit and safekeeping and placing such money on loan to borrowers for the purpose of earning interest income. The interest paid by the bank or investment company is a necessary expense of such business, and is an inducement to those with surplus funds to deposit them with the bank or investment company.

*Example:* *During a taxable year a bank earns a total of Afs. 5,000,000 from interest, dividends, and gains realized from its business of loaning and investing funds in its possession. During the same year the bank has paid or owes Afs. 3,500,000 interest to depositors who have placed their money in savings accounts. This amount of Afs. 3,500,000 is deductible from income as are other necessary expenses of doing business.*

55.3 By "losses from capital transactions" is meant losses realized at the time of sale of securities owned by the bank or investment company. Loss is the difference between the amount received on the sale of shares, loans, and capital, etc. and the amount paid for the security by the bank or investment company.

*<u>Example</u>:* *A bank purchased bonds of the State issued in 1385 at interest of four per cent per year. The bank paid Afs. 1,000 per bond, which was the face value at the time of issue and purchase. The bank carried these bonds on its books at Afs. 1,000 per bond. In 1387 the State issued bonds at interest of 4½ per cent per year. This caused a reduction in market value of four per cent bonds issued in 1385.*

*The bank sold 100 of its 1385 bonds in 1387 at a total price of Afs. 90,000. These bonds being carried on the books at Afs. 1,000 each, or Afs. 100,000 for 100 shares, were therefore sold at a loss of Afs. 10,000. This loss is a deductible expense of the bank for taxable year 1387.*

| | |
|---|---|
| Article 56 | Additions to reserves Additions to reserves against losses on loans shall be deductible only if such reserve does not exceed 25 percent of loans outstanding at the end of the tax year. Any transfers or payments from such reserve, except in accordance with the purpose of the reserve, shall be taxable income in the year the transfer or payment was made. |

56.1 If, at the end of the taxable year, the reserve for losses on loans exceeds 25 per cent of the loans outstanding, and additions to such reserves have been made during the taxable year, there shall be allowed as deduction for additions to such reserve only the amount necessary to make the reserve 25 per cent of loans outstanding at the end of the year.

*Example 1:* *In the middle of the year 1385 a bank increased its reserve for losses on loans by Afs. 200,000. By the end of the year its outstanding loans had diminished so that its reserve for losses on loans was more than 25 per cent of loans outstanding. Part of the additions made earlier in that year is therefore not deductible. If the reserve for losses at the beginning of the year 1385 is Afs. 6,000,000, and the loans outstanding at the end of 1385 are Afs. 24,500,000, the following computation shows how deduction is determined:*

| | | |
|---|---|---|
| a. Reserve for losses at beginning of 1385 | Afs. | 6,000,000 |
| b. Added to reserve midyear 1385 | | 200,000 |
| c. Reserve at end of 1385 | | 6,200,000 |
| d. Outstanding loans end of 1385 | | 24,500,000 |
| e. 25% of outstanding loans | | 6,125,000 |
| f. Excess in reserve (Afs. 6,200,000 — Afs. 6,125,000) | | 75,000 |
| g. Amount of 1385 additions which were deductible (Afs. 200,000 — Afs. 75,000) | Afs. | 125,000 |

*Therefore, only Afs.125,000 may be allowed as a deduction in computing taxable income, though Afs.200,000 was added to the reserve during the taxable year.*

*Example 2:* *If the same bank had the same beginning reserve, addition to reserve, and ending reserve, but had loans outstanding at end of year of Afs. 24,000,000 or less, none of the Afs. 200,000 addition made at midyear would be deductible. This is true because the allowable reserve (25 per cent) on loans outstanding (Afs. 24,000,000) is Afs. 6,000,000, the amount which was already in the reserve before the addition was made.*

56.2 If a reserve for losses on loans exceeds the reserve required by law, the bank or investment company might transfer excess funds and use them for some purpose other than to cover losses on loans. Such transfers are not taxable if they do not exceed nondeductible additions previously made to the reserve. When made out of non-taxable funds in the reserve (additions that were deducted from income before taxes), the transfers are, however, taxable.

Such transfers are taxed as income in the year they were taken out of the reserve.

<u>*Example 1*</u>*:* *The reserve of a bank for losses on loans is greater than the reserve required by law or by the charter of the bank. The reserve is Afs. 10,000,000, of which only Afs. 8,000,000 came from additions deducted from income in computing income taxes. The bank transfers Afs. 2,000,000 from this reserve to build a new bank building. This transfer is not subject to income tax since the reserve contained Afs. 2,000,000 that was taxed before being added to the reserve.*

<u>*Example 2*</u>*:* *The reserve of a bank for losses on loans is greater than the reserve required by law or by the charter of the bank. This reserve was built entirely by additions deducted from income. In other words, all funds in this reserve were added to it free of income tax. This bank transfers Afs. 250,000 from this reserve and uses this amount to purchase equipment. Since this transfer is not in accordance with the purpose of the reserve, it is taxable in the year in which it takes place. Therefore, Afs. 250,000 is added to other taxable income and a tax of 20 per cent is assessed.*

| | |
|---|---|
| Article 57 | Increase or decrease in value of securities An increase or decrease in value of securities owned, loans and similar items shall not be recognized for the purposes of this Law until realized through sale or exchange of the securities. When gain or loss is realized through sale or exchange of the securities, such gain or loss shall be income or loss in the year in which the sale or exchange took place. |

57.1 Securities owned by a bank or investment company may be revalued as good banking practice and law may require. Losses or gains shown from such revaluation are not considered in computing taxable income, however. Only when a security is sold or otherwise exchanged is the gain or loss reported in taxable income.

*Example 1:* *A bank owns stock in a corporation for which it paid Afs. 5,000,000. Over a period of 10 years these securities diminished in value and the corporation went bankrupt. These stocks were finally redeemed by a receivership for the bankrupt corporation that issued the securities. The bank receives Afs. 1,000,000 in the liquidation of the assets of the corporation in the tenth year. The loss of Afs. 4,000,000 is deductible by the bank in the year the stocks were returned, not before.*

*Example 2:* *A bank purchases securities for Afs. 5,000,000, which gradually increase in value. Five years after purchase, the bank sells these securities for Afs. 7,500,000. The gain of Afs. 2,500,000 is taxable in the year the securities are sold.*

# CHAPTER 9

# WITHHOLDING TAXES ON SOURCES OF INCOME

## Article 58 - Article 63

| | |
|---|---|
| Article 58 | Withholding and payment of tax All natural or legal profit and non profit persons, ministries, state enterprises, municipalities and other State departments employing two or more employees in any month of a year shall be required to withhold taxes as provided in Article 4 of this Law from payment of salaries and wages and pay the amount withheld to the Government account. |

58.1 Individuals and legal persons who employ other persons are required to withhold taxes from salaries and wages paid.

*Example 1:* *An individual is in the business of building houses. He has from five to twenty workmen in his employ who earn taxable income. This individual is required to withhold taxes from salaries and wages paid to his employees.*

*Example 2:* *The same individual enters into a partnership with another person in order to raise capital and take on bigger construction projects. The partnership is required to withhold taxes from the wages of any workman whose wages are high enough to be taxable.*

58.2 Persons who are not on the payroll, but are hired to perform some service for remuneration that is not wages or salary, are not employees. The remuneration of such persons is not subject to tax withholding.

*Example 1:* *A company hires an electrician to repair the electric wiring in its warehouse. The electrician agrees to do the work for Afs. 2,000 plus cost of materials used. Since this workman is not an employee on the payroll of the company but an independent contractor, the company is not required to withhold taxes from the amount paid to him.*

*Example 2:* *A company hires a plumber to install plumbing in its offices. This plumber is hired with the understanding that he will be paid the retail price for all fixtures, fittings, and pipe installed, plus labor costs, and a specified percentage of profit. The company pays the plumber on this basis as billed by the plumber. The company is not required to withhold taxes since the plumber is an independent contractor.*

*Example 3:* *A company hires a workman to build a brick wall around its storage yard. The workmen and their supervisors are paid daily wages by the company. Even though these workmen are only temporarily on its payroll, the company is required to withhold taxes.*

Article 59 Rent withholding tax on buildings and houses (1) Payments of rent for buildings and houses which are rented to legal or natural persons and are used for business purposes or offices are subject to withholding tax as follows:

1. Where the monthly rent is from Afs 10,000 to Afs.100,000 - ten (10) percent.

2. Where the monthly rent is more than Afs.100,000 – fifteen (15) percent.

(2) Tenants of buildings and houses mentioned in paragraph (1) of this Article shall be required to pay taxes according to the rulings issued by the Ministry of Finance.

(3) Tax collected under paragraph (1) of this Article shall be paid by the tenant in respect of the income tax liability of the landlord under this Law. This tax shall be treated as a prepayment of the tax liability of the landlord and shall be credited at the time of annual tax payment. In the event of a dispute about the amount of rent owed by a tenant, the tenant will be treated as having paid to the landlord as rent any tax that was paid to the relevant authorities under this Article.

(4) Payments of rent include:

- any money, goods or services or any other benefit received by a person or persons as rent; and

- the cost of any repairs, renovations or improvements to the property carried out by the tenant.

(5) If the rental payment of a property is less than the actual rental value of the property, the Ministry of Finance by an authorized panel shall determine the rent according to the market value.

(6) Property dealers shall be required to send a copy of the agreement to the Ministry of Finance as soon as it is signed. If a property dealer makes a false agreement or delays the sending of the agreement, the Ministry of Finance will officially notify the Ministry of Justice to take necessary action.

(7) Where it is established that the rent in a rent agreement is more than 20 percent lower than the market value of rent, paragraph (5) of this Article shall apply. In the case of a dispute regarding the market value of the rent, the onus is on the landlord to prove that the rate fixed by the Ministry of Finance is not correct. This provision applies where the Ministry of Finance finds evidence and documents which show that the rent specified in the rent agreement is less than that which is paid. In this case, the Ministry of Finance may require the landlord to pay penalty of twice the amount of the understatement of the tax amount.

(8) If the tax has not been paid within 15 days of the due date, the following action shall be taken:

1. Subject to a notice in writing by the Ministry of Finance, the right of the landlord in a rent agreement or similar contract to receive payment for rental services shall be treated as if it has been temporarily transferred to the Ministry of Finance as representative of the Government of Afghanistan;

2. If the tenant has not paid the tax due within 30 days after receiving notice from the Ministry of Finance for the amount overdue, the right of the landlord in a rent agreement or similar contract to evict tenants for non-payment of rent shall be treated as if it has been transferred to the Ministry of Finance as representative of the Government of Afghanistan;

   This arrangement will remain in place until the Ministry of Finance receives the rental tax due and any additional income tax payable in accordance with Chapter 16 of this law.

59.1 Legal or natural persons that pay rent for the use of buildings or other properties for business purposes, office space or accommodation for their staff must withhold tax at the rates provided in Article 59 if the total rental payment exceeds 10,000 Afghanis per month. Where the total rental payment is less than 10,000 Afghanis per month, then withholding tax under Article 59 is not payable. The rental income will be subject to annual income tax under Article 4 of the Income Tax Law regardless whether it is subject to withholding tax or not.

*Example 1:* *Najibullah rents office space in the Wazir Akbar Khan area of Kabul. Najibullah pays Afs. 20,000 per month. Najibullah must withhold 10% from total rent ie is Afs. 2,000 per month and transfer that amount to an account specified by the Ministry of Finance*

*Example 2:* *Accar Organization rents a house in Wazir Akbar Khan area for US $5,000 per month. The exchange rate per US dollar is 50 Afghani and total rent amount is Afs 250,000. Therefore rent withholding tax is calculated as follows:*

*Total withholding taxable income = Afs 250,000*
*Rent withholding tax rate= 15%*
*Withholding tax = 250,000×15% =37,500*

*Example 3:* *Azziz rents an apartment in the Shar-e-naw area of Kabul. Azziz pays Afs. 30,000 per month. Because the payments are made for personal accommodation that is not used in a business, Azziz is not required to withhold any tax from the rental payment.*

*Remark:* *While Azziz is not required to withhold tax from the payments, the owner of the apartment is liable to pay income tax on the rental income that the owner receives and he shall file his tax return*

*and pay his due tax for rental income and any other income in accordance with Income Tax Law*

59.2 Natural and legal persons required to withhold tax from their rental payments must pay the tax to an account in an authorized bank determined by Ministry of Finance within 15 days of the month following the month in which the rental payment is made.

<u>*Example:*</u> *Najibullah rents office space for use in a business. The rent is Afs. 20,000 per month. The first payment is due on the first of Jawza. Najibullah will pay Afs. 18,000 to the landlord and will withhold Afs. 2,000. The Afs. 2,000 should be remitted to the bank by the 15$^{th}$ day of Saratan.*

59.3 The amount withheld by the tenant is treated as a prepayment of the landlord's income tax liability with respect to the rental income. To claim the withheld amount as a credit, the landlord must file an income tax return.

<u>*Example:*</u> *An Afghan corporation rents office space from Wais, an Afghan resident and landlord. The Afghan corporation is obligated to pay Afs. 300,000 of rent during the year. Of this amount, only Afs. 255,000 is actually paid by the Afghan corporation to Wais. The remaining Afs. 45,000 is withheld and paid over to the government. Wais files his income tax return for the year and declares Afs. 300,000 of rental income. Wais does not have any other income. Wais has Afs. 30,000 of deductible expenses. Thus, Wais's taxable income is Afs. 270,000. According to Article 4, the tax payable on taxable income of Afs 270,000 is Afs 13,800. Because Wais has already had Afs. 40,000 withheld from his rental income, Wais is entitled to a refund of Afs. 26,200. To obtain this refund, Wais must file an income tax return.*

<u>*Remark:*</u> *If a landlord has other income beside rental income, he is required to declare it in his annual return and the total tax liability for all income will be determined. From the total tax liability, the total of withheld taxes will be deducted.*

59.4 Payments for rental services and any benefit that the tenant confers on the landlord's property including repairs paid for by the tenant are considered as landlord's income and shall be included in his return.

<u>*Example:*</u> *An Afghan corporation rents warehouse space from Wais. The Afghan corporation makes monthly rental payments to Wais. Each month's rent is Afs. 200,000. The corporation pays to have the heating system repaired in the warehouse for Afs. 500,000 in the month of Saratan. The cost is not reimbursed by Wais. The Afs. 500,000 payment is considered additional rent paid from the corporation to Wais and is therefore subject to withholding tax. Withholding tax on the amount of Afs 500,000 is Afs 100,000. Withholding tax on the usual rent payment of Afs 200,000 is Afs 40,000. Therefore, the Afghan corporation shall*

*withhold Afs 140,000 from its payment of rent as withholding tax and transfer the tax to the government account .*

59.5 If the Ministry of Finance determines that the rent for property has been determined at less than market value rates, the Ministry of Finance has the power under Article 97 to increase the rental value of the property and can change the previous rent in accordance with market value rates.

*Example:* *Azziz rents some office space to his son Najibullah for Afs. 12,000 per month. Azziz rents similar space in the same area to unrelated parties for Afs. 20,000 per month. The Ministry of Finance has the right to cause Najibullah to withhold the same Afs. 2,000 per month as tax on rental for unrelated parties even though Najibullah is only paying Afs. 12,000 per month. This is because the rents that were charged were not arm's length and so the Ministry of Finance has the right to increase the rental payments.*

59.6 If Ministry of Finance is of the opinion that rent payments for a property are more than 20 percent lower than market value, the Ministry shall act according to Article 59 (5) of Income Tax Law. If the landlord disputes the market value of rent determined by the Ministry of Finance, the landlord is required to prove that the valuation of the Ministry of Finance is not correct. If the landlord cannot present reliable proof to rebut the valuation determined by the Ministry of Finance, the Ministry of Finance shall charge the landlord additional tax equal to double the amount of tax understated.

*Example:* *Nesar Ahmad rents out his house located in Karte 4, Kabul to Save Children Institute for Afs 80,000 per month. In order to evade tax, both parties made a second contract showing that the rent to be Afs 40,000 and presented it to the Ministry of Finance for withholding tax purposes. Withholding tax of Afs 4000 ie 10% from Afs 40,000 is withheld and paid to the government account. During an audit, the Ministry of Finance finds out about the legitimate contract. Nesar Ahmad cannot provide any reason to rebut the Ministry of Finance's allegation that rent payments have been understated. Therefore, Nesar Ahmad must pay Afs 8,000 as double the understated tax amount of Afs 4,000 as additional tax.*

59.7 Legal or natural persons that are in the business of renting land and buildings for profit are required to forward each rental agreement they execute to the Ministry of Finance (attention Afghanistan Revenue Department) or the tax office in the district in which the landlord resides or is based.

59.8 In the event that the rent withholding tax is not paid within 15 days of the day it is due, the following events may occur:

1) The Ministry of Finance may, at its discretion, provide a notice in writing to the tenant that the landlord's right to receive payment has been transferred to the Ministry of Finance, as representative for the Government of Afghanistan.

2) The tenant has 30 days from the date that it receives the notice referred to in paragraph (1) to pay over the appropriate amount of tax. If the tenant fails to pay over the correct amount of tax, the landlord's right to evict tenants for non-payment of tax shall be transferred to the Ministry of Finance as representative of the Government of Afghanistan.

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| Article 60 | Remittance of tax payments Any employer required to withhold tax under Article 58 of this Law shall remit to the State the amount withheld not later than ten days after the end of the month in which the amounts were withheld. The employer shall be required to submit with this remittance a Tax Withholding Report to the relevant tax office in the format prescribed in the Income Tax Manual. |

60.1 An employer must withhold tax from the wages paid to its employees. An employer does not need to withhold tax from the payments made to independent contractors.

Remark: In order to determine whether a person is an employee or an independent contractor, reference should be made to Public Ruling 1385/5 titled 'Employee or Independent Contractor for the Purposes of Wage Withholding Tax'.

60.2 An employer who, according to Article 59, is required to withhold tax shall calculate the amount of tax to be withheld according to the following tables.

Monthly Payroll

| Income from | Income up to | Tax |
|---|---|---|
| Afs. 0 | Afs. 5,000 | Afs. 0 |
| Afs. 5,001 | Afs. 12,500 | 2% of the amount over Afs 5,000 |
| Afs. 12,501 | Afs. 100,000 | Afs. 150 + 10% of the amount over Afs. 12,500 |
| Afs. 100,001 | | Afs. 8,900 + 20% of the amount over Afs. 100,000 |

Semi-Monthly Payroll

| Income from | Income up to | Tax |
|---|---|---|
| Afs. 0 | Afs. 2,500 | Afs. 0 |
| Afs. 2,501 | Afs. 6,250 | 2% of amount over Afs 2,500 |
| Afs. 6,251 | Afs. 50,000 | Afs. 75 + 10% of the amount over Afs. 6,250 |
| Afs. 50,001 | | Afs. 4,450 + 20% of the amount over 50,000 |

Bi- Weekly Payroll

| Income from | Income up to | Tax |
|---|---|---|
| Afs. 0 | Afs. 2,308 | Afs. 0 |
| Afs. 2,309 | Afs. 5,769 | 2% of amount over Afs 2,308 |
| Afs. 5,770 | Afs. 46,154 | Afs. 69 + 10% of the amount over Afs. 5,769 |
| Afs. 46,155 | | Afs. 4,108 + 20% of the amount over 46,154 |

Weekly Payroll

| Income from | Income up to | Tax |
|---|---|---|
| Afs. 0 | Afs. 1,154 | Afs. 0 |
| Afs. 1,155 | Afs. 2,885 | 2% of amount over Afs. 1,154 |
| Afs. 2,886 | Afs. 23,077 | Afs. 35 + 10% of the amount over Afs. 2,885 |
| Afs. 23,078 | | Afs. 2,054 + 20% of the amount over Afs. 23,077 |

Daily payroll

| Income from | Income up to | Tax |
|---|---|---|
| Afs. 0 | Afs. 164 | Afs. 0 |
| Afs 165 | Afs 411 | 2% of amount over Afs 164 |
| Afs. 412 | Afs. 3,288 | 10% of amount over Afs. 411 |
| Afs. 3,289 | | Afs. 288 + 20% of the amount over Afs. 3,288 |

<u>*Example:*</u> *Aziz employs two individuals, Najib and Wahid, in his construction business. Najib and Wahid are employees and not independent contractors. Najib earns Afs. 3,600 per day. Wahid earns Afs. 24,000 per week. Aziz must withhold Afs. 350 from Najib's pay every day. Aziz must withhold Afs. 2,239 from Wahid's pay every week.*

60.3 The employer must transfer the withheld amounts into an account determined by Ministry of Finance no later than 10 days after the end of the month in which the amounts were withheld. Each deposit should be accompanied by a "Report of Tax Withholding and Bank Deposit Form for Employers." This form can be obtained from the Ministry of Finance.

An electronic funds transfer option is also available. Please refer to Guide 06 which can be found on the Ministry of Finance website.

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| Article 61 | <u>Preparation of statements</u> (1) As prescribed by the Ministry of Finance, each employer required to withhold tax from salaries or wages shall prepare a salary and tax statement for each employee and submit the statement to the Ministry of Finance or relevant tax office and employees concerned not later than the end of the first month of the following year.<br><br>(2) Every employer prescribed in paragraph (1) of this Article shall be required to file an annual consolidated report of taxes withheld from salaries and wages in the format prescribed by the Ministry of Finance. |

61.1 The employer and employee have certain reporting obligations with respect to wage withholding that have to be complied with.

a) Every year, the employer must prepare an Annual Salary and Tax Statement for each employee subject to wage withholding. At any time that an employee ceases employment, the employer should provide the Annual Salary and Tax Statement at the time of cessation of employment.

b) In addition, the employer must prepare an Annual Summary Report of Taxes Withheld and Wage and Tax Statement Transmittal Form. The purpose of this form is to provide the Ministry of Finance with a summary of all of the amounts that the employer has withheld from all of its employees during the year.

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|---|---|
| Article 62 | <u>Time for submission of statements</u> (1) Every taxpayer shall be required to submit their annual salary and tax statement to the relevant tax office within one and half months after the end of the tax year.<br><br>(2) The income tax liability for a tax year shall be discharged by a taxpayer by filing their salary and tax statement, certified by their employer, within one and half months after the end of the tax year, provided the taxpayer meets the following conditions:<br><br>1. The taxpayer has no taxable income in the tax year other than the salary or wage from which taxes were withheld;<br><br>2. The taxpayer was not employed during the tax year by more than one employer; and<br><br>3. The taxes withheld were in accordance with income tax rates prescribed in paragraph (3) of Article 4 of this Law. |

62.1 Every taxpayer that is an employee subject to wage withholding should receive a white copy and a green copy of a wage withholding statement from his or her employer.

62.2 If the following requirements are met, the taxpayer does not have to file a tax return. Instead, the taxpayer must simply file the white copy of his or her wage withholding statement with the local tax office.

a) The taxpayer has no taxable income in the taxable year other than the salary or wage from which taxes were withheld.

b) The taxpayer was not employed during the taxable year by more than one employer.

c) The taxes withheld were in accordance with income tax rates prescribed in paragraph 3 of Article 4 of the Income Tax Law.

62.3 If any of the requirements set forth in Article 62.2 are not satisfied, then the taxpayer must file a return in accordance with Article 63.

62.4 If all of the requirements set forth in Article 62.2 are satisfied, but the taxpayer has deductions to claim (e.g., the losses described in Article 18(1)9), the taxpayer may, at its option, file a tax return in accordance with Article 63.

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|---|---|---|
| Article 63 | Filing of returns | (1) Any taxpayer with income from salaries or wages subject to tax withholding from more than one employer or has income from sources other than salaries or wages shall file an income tax return as required by the provisions of this Law. The taxes withheld shall be allowed as a credit against the taxpayer's tax liability. |

63.1 A person meeting the conditions of Article 62 of the Income Tax Law, who has paid his income tax through the withholding of taxes from his salary, is not required to file an income tax return. He must, however, file a copy of the Annual Salary and Tax Statement received from his employer. He must also be prepared to show that he has met the conditions of Article 62 of the Income Tax Law.

63.2 The amount of withholding tax shown on the wage withholding form is an advance payment of tax due, not the employee's final tax liability. The taxpayer's income tax return shows the taxpayer's final tax liability. If the amount withheld exceeds the amount shown as due on the taxpayer's tax return, the taxpayer is entitled to a refund. If the amount withheld is less than the amount shown as due on the taxpayer's return, the taxpayer must remit additional funds to pay those taxes.

*Example:* *An Afghan corporation employs Wahid. The Afghan corporation pays Wahid Afs. 150,000 per month, or Afs. 1,800,000 per year. The Afghan corporation withholds Afs. 226,800 of tax. In addition to his wages, Wahid receives investment income from a note receivable of Afs. 20,000. Wahid's tax liability is as follows:*

| | |
|---|---|
| *Wages* | *Afs. 1,800,000* |
| *Investment Income* | *Afs. 20,000* |
| *SubTotal* | *Afs. 1,820,000* |
| *Income Tax Payable* | *Afs. 230,800* |
| *Taxes Withheld* | *(Afs. 226,800)* |
| *Net Tax Payable* | *Afs. 4,000* |

# CHAPTER 10

# BUSINESS RECEIPTS TAX

## Article 64 - Article 67

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| Article 64 | Business receipts tax Business receipts tax is a tax which is imposed on total gross income (sales) before any deduction according to the rates prescribed by Article 66 of this Law.<br><br>(1) A legal person who provides goods or services in exchange for consideration shall be required to pay business receipts tax.<br><br>(2) A natural person who provides goods or services in exchange for consideration and whose revenue from such sales is Afs. 750,000 or more per quarter of the year shall be required to pay business receipts tax. Persons referred to in paragraphs (2), (3), (4), and (5) of Article 66 shall be excluded from the threshold amount in this provision.<br><br>(3) Persons who import goods shall be subject to two percent business receipts tax on the cost price of the imported goods including custom duty. The business receipts tax will be treated as an advance payment for business receipts tax payable.<br><br>(4) The business receipts tax provided in paragraph 3 of this Article shall be collected by the Customs Office where the custom duty is paid.<br><br>(5) Total gross income of a business entity shall not be severable.<br><br>(6) If the consideration for provision of goods or services includes cash, goods or services, the value of goods or services shall be calculated according to market value of the goods or services received. |

64.1 Generally, the business receipts tax applies to limited liability companies, corporations, general partnerships and organizations. The business receipts tax does not apply to individuals except in the case outlined in Article 64(2).

*Example 1:* *Mansur Trading Ltd Company is a trading company. It exports and imports goods. It earns income from these activities, thus it is subject to business receipts tax based on the rates provided in Article 66.*

*Example 2:* *Mili Bus Enterprise is a State agency. It provides transportation services and generates income from that source. The income of Mili Bus Enterprise is subject to business receipts tax based on the rates provided in Article 66.*

*Example 3:* *An Indian family in Kabul operates a corporate business organization in India and in Afghanistan. The income of the Indian corporation from activities in Afghanistan is subject to business receipts tax based on the rate provided in Article 66.*

*Example 4:* *Sabz Group Agriculture Cooperative generates income from sale of fertilizer and enriched seeds to farmers. It is subject to business receipts tax based on the rate provided in Article 66.*

64. 2 Natural persons (individual traders, persons who are subject to fixed tax, and other natural persons who generate taxable income) who earn Afs 750,000 or more per quarter are subject to business receipts tax based on rates provided in Article 66.

*Example 1:* *Ahmad Gull is an individual who has a business license and is engaged in the business of providing legal services. Ahmad Gull generates Afs 3,250,000 income annually. Ahmad Gull income is subject to business receipts tax based on rates provided in Article 66.*

*Example 2:* *Aziz Ahmad operates a clothes shop in Kabul Mandawi. He earns income in four quarters of year 1387 as follows:*

*First Quarter: Afs 850,000 Second Quarter: Afs 900,000*
*Third Quarter: Afs 820,000 Fourth Quarter: Afs 790,000*

*Aziz Ahmad is subject to business receipts tax based on rates provided in Article 66 of Income Tax Law.*

*Example 3:* *Farzana is a famous artist in drawing and painting. She works as an official employee for Ministry of Information and Culture and earns Afs 60,000 per year as a government employee. Farzana provides drawing and painting services in a shop after official hours. She earns Afs 4,000,000 from sales of artwork annually. As Farzana's income from artwork is more than Afs 750,000 per quarter, her income is subject to business receipts tax based on the rate provided in Article 66.*

*Remark: Under Article 65(8), the income from an individual's salary is not subject to business receipts tax. Tax is withheld from salary paid to an employee and shall be transferred to the government account.*

*Example 4:* *Shugofa is an artist in drawing and painting. Shugofa provides drawing and painting services in a shop. She earns Afs 1,000,000 from sales of artwork annually. As Shugofa's income from artwork is less than Afs 750,000 per quarter, her income is not subject to business receipts tax.*

*Remark: Shugofa will be liable to pay fixed tax on the operation of her business according to Articles 74 and 75.*

64. 3 According to the Article 64 (3), business receipts tax applies to imports and is calculated on the value of the imports including customs duty. Business receipts tax paid on imports is recognized as prepaid tax and is allowed as a credit when paying quarterly business receipts tax.

*Example 1:* *Qari Khalil Trading Company is engaged in the import of vehicles. It imports different types of vehicles from popular companies of the world each year. In Jadi 1388, it imported 10 new model Corolla cars. The purchase price plus transportation expenses*

*to custom's border are Afs 30,000,000. Custom duty at the notional rate of 5% is therefore Afs 150,000. The costs of the cars including customs duties are Afs 30,150,000.*

*The company, as well as paying custom duties, is subject to business receipts tax as follows:*

*Cost subject to BRT at Customs Office - Afs 30,150,000*

*BRT Rate - 2%*

*BRT payable at Custom Office = Afs 30,150,000×2% = Afs 603,000,*

*Remark 1: Afs 603,000 BRT paid on import is recognized as the company's prepaid business receipts tax, and is creditable when filing the quarterly business receipts tax return.*

*Remark 2: As the company is carrying on a business of selling imported cars, the Afs 603,000 BRT paid on import is a deductible expense of the business when calculating its net taxable income for annual income tax purposes in accordance with Article 67(2).*

64.4 Charging business receipts tax on imports means that business receipts tax shall be charged by the custom's office where imported goods are brought into the country. Every border post or custom's office which charges and collects custom duties shall also collect the business receipts tax applicable to imports.

*Example 1: Salazor Company imports electronic and technology instruments through Kabul International Airport. Salazor Company is required to pay custom duties to Kabul Airport Customs Office. Business receipts tax on the cost of the imports including custom duties is also to be collected by the employees of the Kabul Airport Customs Office.*

64.5 The total income of a business is not severable and cannot be divided. This means that a business cannot artificially divide a single entity into different separate branches in order to reduce the income of the branches below the taxable income threshold.

*Example: Daoud and his brother Waheed operate a business of painting houses. Their quarterly income is Afs.850,000, with a little less than half of this amount generated from sale of paint and the remaining amount generated from the labour of painting. Daoud and Waheed decide to split their activity into two parts; Daoud provides customers with the paint and Waheed does the painting. They claim that they are both exempt from business receipts tax because their quarterly incomes are less than Afs.750,000 that is less than the taxable income threshold, and they are natural persons.*

*While Daoud and Waheed claim they are operating separate businesses from a commercial point of view, both activities form a single business. Customers cannot differentiate the two parts despite the invoice for the paint supply and the invoice for painting labour being different. Customers view the supply of paint and the painting as the one service. Ministry of Finance will apply Article 64 (5) to combine the incomes and treat it as the business income of the party who has higher income.*

64.6 Where the income of a business is received in the form of goods or services, income will be assessed based on market value of the goods or services.

*Example:* *Aryana Food Stuff Production Company earned Afs. 500,000 in 1388 from sale of food stuff which was produced in its factory. In the same year the company purchased a Corolla car from Pamir Car Bargain in exchange for 500kg of food stuff. The market value of Corolla is Afs. 250,000, so the income subject to tax is cash sales plus market value of the car and is calculated as follows:*

*Total Income = Afs 500,000+250,000= 750,000*

*The total income of Afs 750,000 is subject to business receipts tax at the rate provided by Article 66.*

Article 65 Business receipts tax exemptions The following income shall be exempt from the business receipts tax.

1- Income received from interest;

2- Fees earned from exchange of currency, operation of savings or other bank accounts, deposits and withdrawal transactions, issuance of cheques or letters of credit, internet banking, provision of mortgages or loans, and provision of lines of credit;

3- Issuance of cash settled futures contracts;

4- Issuance of futures contracts settled by physical delivery of the goods of the contract;

5- Premiums from the provision of any insurance or re- insurance;

6- Distributions received by a shareholder from a corporation, limited liability company or partnership with respect to shareholder's stocks or partnership interest;

7- Income from export of goods and services;

8- Income from provision of services specified in the Articles 17 or 46 of this Law.

9- Income received from rent or lease of residential property to a natural person provided that the tenant uses the property for residential purposes for more than six months of the tax year; and

10- Income from sale of property by a natural person outside the ordinary course of the natural person's business. A sale shall be considered to be outside the course of the natural person's business when such sales are not regular and continuous.

65.1 The income of some sources are exempt from business receipts tax for the purpose of encouraging investments, supporting banking, facilitating investment, supporting exports of domestic products and encouraging investment in insurance sector.

65.2 Interest income, whether earned from saving accounts or investments in banks or financial institutions or anyone else, is exempt from business receipts tax.

*Example 1*: *Najeebullah is a United Nations employee in Kabul and receives Afs.200,000 monthly salary. He invests his salary in an Afghanistan National Bank saving account. ANB gives 8% interest to Najeebullah annually. His income from bank interest is exempt from business receipts tax.*

*Example 2:* *A bank receives Afs. 2,400,000,000 from deposits in a tax year. These deposits are not considered taxable business receipts. Interest received by the bank from the investment of these deposited sums is also not taxable business receipts.*

*Remark: Interest received by the bank will be considered taxable income for income tax purposes.*

*Example 3:* *A bank receives Afs. 1,300,000,000 from borrowers during a tax year as return of the principal from loans. None of these receipts are taxable. Interest received on the loans is not a taxable business receipt in accordance with Article 65 and is exempt.*

*Remark: Interest received by the bank will be considered taxable income for income tax purposes.*

65.3 Income received from exchange of currency, bank operations (saving accounts, fixed deposits, other deposits and bank investment through giving loans to other investment and economic sections), issuance of chequebooks and guarantee letters, internet banking, mortgage transactions, loans and letters of credit is exempt from business receipts tax.

*Example 1:* *Jamshid is engaged in the exchange of money in Shahzada Market. Annually, he earns Afs.4,000,000 from this source. His income is exempt from business receipt tax.*

*Example 2:* *Pashtani Bank, besides other services, provides money exchange services. Annually, it earns a large amount from this source. Based on Article 65, the income earned from this source is exempt from business receipts tax.*

*Example 3:* *Gulistan Trading Company is an import/export business and has money held in a savings account with a bank. It receives annual interest on the amount invested. The interest received by the company is not subject to business receipts tax.*

*Example 4:* *Bahar Construction Company receives Afs 35,000,000 loan from a private lender at the interest rate of 15% per annum for the purpose of constructing Bahar shoping centre. The interest received by the private lender is exempt from business receipt tax.*

65.4 Income received from the issuance of cash settled futures contracts and the issuance of futures contracts settled by physical delivery of the goods under contract is exempt from business receipts tax.

A ‘futures contract’ is an agreement to buy or sell a specified amount of a product at an agreed price on or before a given date in the future. Futures contracts are generally concerned with ‘commodities’ i.e. certain foods (e.g. sugar, corn, coffee etc), fuels, precious metals, treasury bonds, currencies etc particularly where supply, demand and price varies over time.

<u>Example 1</u>: *A jeweller uses gold in producing jewellery. The jeweller is aware that the price of gold changes regularly and supply can be variable. So that the jeweller can be assured of obtaining gold at a fixed price next year, the jeweller may enter into a contract with a gold supplier for the supply of 1 kilogram of gold next year for the price of US $500 per ounce. The price of gold next year may be more or it may be less than the agreed rate but payment will be made according to the agreed terms.*

Futures contracts can be traded in futures exchanges in a similar manner to the trading of shares. The contracts can be bought and sold before their settlement date with the market price reflecting the value of that contract based on the expectation of the value of gold at the time of settlement of the contract compared to the value of gold at that time.

The exemption from business receipts tax does not apply to the income derived from the settlement of the futures contract. Rather it applies to income derived from the issuance and trading of futures contracts. Contract trading is done through 'brokers' or financial institutions usually for a fixed fee (commission) per contract. The fees charged by such brokers and financial institutions will be exempt from business receipts tax.

<u>Example 2</u>: *ABC Bank attends to the issuance of the jeweller's gold contract on the futures exchange. ABC Bank charges a fee for that service. That fee is exempt from business receipts tax. ABC Bank will be required to pay income tax on this fee as it is income from carrying on a business.*

65.5 Under the provision of Article 65, income received for insurance and re-insurance services are exempt from business receipts tax. For the purposes of this Article re-insurance means insurance provided to an insurance company by another insurance company.

<u>Example 1</u>: *Afghan National Insurance Company receives Afs 250,000,000 from its customers for its fire and accident insurance services. According to this Article, the company is exempt from business receipts tax on this income.*

<u>Example 2</u>: *The facts are the same as Example 1 except that Afghan National Insurance Company, besides providing insurance services to its customers, is insured by London International Insurance Company. London International Insurance Company receives Afs 1,500,000 from Afghan National Insurance Company in exchange for its insurance services. London International Insurance Company is exempt from business receipts tax on the income its receives from Afghan National Insurance Company.*

65.6 According to Article 65 (1) 6, dividends received from a share in a corporation, limited liability company or partnership are exempt from business receipt tax.

*Example 1:* *Afghan Production Corporation is a company which has 50 shareholders. After paying its taxes, the company has Afs 500,000 for distribution to the shareholders. Afghan Production Corporation deducts dividend withholding tax and distributes the balance to its shareholders. The dividend received by the shareholders is exempt from business receipt tax.*

*Remark:* *If a shareholder of a company is itself a company, business receipts tax will not apply to the dividend income which it receives.*

65.7 Under paragraph 7 of Article 65, income derived from export is exempt from business receipts tax.

*Example:* *Sher Mohammad Trading Company is engaged in exporting fruit and vegetables. In tax year 1388, the company earned Afs 450,000,000 from exporting fruit and vegetables. Sher Mohammad Company is required to file an annual income tax return and pay its income tax liabilities but it will be exempt from paying business receipts tax on this income.*

65.8 Under paragraph 8 of Article 65, income specified in Articles 17 and 46 such as wages, salary, dividend, interest, royalty, lottery and bonus sources is exempt from business receipts tax.

*Example 1:* *Zekrya is employed by Akbar Corporation. He earns monthly income of US$ 4000 (equivalent to Afs 200,000). According to this provision, he is exempt from business receipts tax.*

*Example 2:* *In the above example Zekrya is not an employee of Akbar Corporation which is a construction business. Zekrya manufactures doors and kitchens for houses. Akbar Corporation contracts with Zekrya to supply doors and kitchen for one of their under- construction houses for the amount of Afs 3,000,000. Payments are made in equal installments on monthly basis and doors and kitchen supplied on bimonthly basis during contract period of six months. Zekrya is an independent contractor, his contract receipts from Akbar Corporation include cost of material incurred by him besides his labour and skills, and he is responsible for all the risks involved. Zekrya's gross income of Afs 3,000,000 is subject to business receipts tax.*

*Example 3:* *Miss Palwasha is a famous history author. She has published many books. Khawaran Printing Press publishes and distributes Miss Palwasha's books to market. She earns 1% royalty for publishing of each book by Khawaran Printing Press. Miss Palwasha's income from royalties is exempt from business receipts tax.*

65.9 Income received from rent or lease of residential property to a natural person is exempt from business receipts tax provided that the tenant uses the property for residential purposes for more than six months of the tax year.

*Example:* *Ahmad Gull lets his house located in Shahr-e-Now, Kabul to Ulfat Khan for Afs.1000 per month for 12 months. Ulfat Khan uses the house for residential purposes. Based on this Article, Ahmad Gull would not be liable to business receipts tax on the rental income received.*

*Remark: If the tenant is a legal person, then the exemption from business receipts tax for the landlord will not apply. If the landlord is an individual, the income from the rent payments received from a tenant who is a legal person will be subject to business receipts tax if the requirements of Article 64 are met.*

65.10 Income from sale of the property by a natural person outside of the ordinary course of the natural person's business is exempt from business receipts tax. A sale is considered to be outside the course of the natural person's business when it is not regular and continuous.

*Example 1:* *Shafiq Ahmad, due to his need for cash, sells his apartment in Macrorayan which he inherited from his father for Afs 2,500,000. As he has not sold the apartment in the course of business and he is not engaged with apartment dealings, he is exempt from business receipts tax on the receipt from this sale.*

*Example 2:* *Hussain Ali has a taxi which he had purchased in 1382. As it is an old model car, he sold it in 1388. As his main business is not purchase/sales of cars and this transaction took place several years after purchase, therefore under the Article 65 Hussain Ali is exempt from business receipts tax.*

Article 66 Business receipts tax rates

(1) Two percent of income received (before any deductions) from any profit activities of the persons mentioned in Article 64 (1) and (2), excluding the persons mentioned in paragraph (2) to (5) of this Article.

(2) Two percent of income received (before any deductions) from hotels or guest houses and restaurants the monthly income of which is less than the threshold amount in Article 64 (2).

(3) Five percent of income received (before any deductions) from hotels or guest houses and restaurants income of which is more than the threshold amount in Article 64 (2).

(4) Five percent of income received (before any deductions) from services provided by clubs and halls where events are held.

(5) Ten percent of income received (before any deductions) from telecommunication, airline services, and hotel and restaurants providing superior services.

(6) A taxpayer referred to in paragraphs (3), (4) and (5) of this Article who claims not to have income from the provision of taxable services according to these paragraphs for one or more months shall be required to inform the Ministry of Finance in writing and attach a completed tax return. If the claim is confirmed, the taxpayer will not be subject to tax under the above mentioned paragraphs. If the claim is proved to be incorrect, besides the payment of tax according to paragraphs (3), (4) and (5), the taxpayer shall be required to pay additional tax according to the provisions of Article 98 (2) of this Law.

(7) The Ministry of Finance may specify criteria and procedures for the better application of this Article.

Definitions:

*Hotel or Guest House Services*: For the purpose of this Law means the provision of sleeping accommodation and related services (including meals, beverages, laundry, and telecommunication services) to persons who occupy such accommodation temporarily as a traveler;

*Restaurant services*: For the purpose of this Law means the provision of food or beverages by an establishment that provides facilities for immediate consumption at that establishment, or catering services of prepared food, or sale of cooked foods that were prepared on the premises.

*Telecommunication Services*: For the purpose of this Law means the provision of any type of telephone, internet and fax service; and,

*Airline Services*: For the purpose of this Law means passenger air services where the origin of the flight is in Afghanistan.

66.1 Unless otherwise provided by Article 66, the income (before deductions) from sale of goods and services by legal persons or natural persons whose

business income is Afs 750,000 or more per quarter will be subject to 2% business receipts tax.

<u>Example 1</u>: *An Afghan corporation purchases electric generators from an unrelated corporation in China. The Afghan corporation sells the generators to customers in Afghanistan. The revenue from the sale of the generators is considered a "business receipt" and is subject to business receipts tax.*

<u>Example 2</u>: *An Afghan corporation purchases electric generators from an unrelated corporation in China. The Afghan corporation sells the generators to unrelated parties in Iran. The revenue from the sale of generators is considered a business receipt and is subject to the business receipts tax even though the sales are made to customers in Iran.*

<u>Example 3</u>: *An Afghan corporation purchases spare automotive parts from an unrelated manufacturer in China. The Afghan corporation's cost for mufflers is Afs. 35,000 per unit. The Afghan corporation sells the mufflers for Afs. 40,000 per unit. The entire Afs.40,000 is considered a business receipt and is subject to 2% business receipts tax. No deduction is permitted for cost of goods sold.*

<u>Example 4</u>: *An Afghan Company agrees to provide construction services to the owner of a plot of land in Wazir Akbar Khan area of Kabul. The company agrees with the owner to construct a four-storey building on the owner's land. The owner and the company never put the contract in writing. The revenue generated by the company in constructing the building is considered a business receipt and is subject to business receipts tax at a 2% rate. The fact that the contract was not put in writing is not relevant.*

<u>Example 5</u>: *Khalid is an individual trader and is engaged in the import and export of goods. In tax year 1388 he earned Afs 25,000,000 from the sale of imported goods. He is subject to 2% business receipts tax on the income of Afs 25,000,000.*

<u>Example 6</u>: *Abdul Saboor owns a mobile phone store situated in Herat. His earnings in the four quarter of year 1388 were as follows:*

| | |
|---|---|
| *First quarter: Afs 850,000* | *Second quarter: Afs 900,000* |
| *Third quarter: Afs 880,000* | *Fourth quarter: Afs 920,000* |

*According to the provisions of Article 64 and 66, his gross income is subject to 2% business receipts tax.*

<u>Example 7</u>: *According to the provisions of Article 65, a bank's income received from the sources of interest on loan, currency conversion charges, operating bank accounts, issuance of cheques and granting of credit is exempt from business receipts tax. However, income received from*

*other sources which are not exempt according to Article 65 such as the provision of book keeping services, investment advice or use of security boxes is subject to 2% business receipts tax.*

66.2 Income of retailing companies that sell goods "on commission" and companies that purchase goods for resale is subject to 2 per cent business receipts tax.

*Example:* *A travel agency sells tickets for a number of different airlines. It receives a commission on each ticket it sells. It also sells different types of souvenirs which it orders on consignment, receiving a commission on any sales which it makes. It further sells other merchandise which it has purchased for resale. The travel agency is subject to 2% business receipts tax on all its income.*

*Considering the above explanation, the travel agency earned the following income in the first quarter of tax year 1388 and is liable to pay business receipts tax:*

*Afs 250,000 – Income received from commission on tickets sold*

*Afs 100,000 – Income received from commission on souvenirs*

*Afs 120,000 – Income from resale of goods*

*BRT payable = Afs 470,000×2% = 9,400.*

*Remark: While the travel agency is liable to 2% business receipts tax on the commissions it makes from airline ticket sales, the airlines themselves are also liable to 10% business receipts tax in the respect of the income received from ticket sales for those flights which originate in Afghanistan in accordance with Article 66(5).*

66.3 Revenues from the sale of admission to public entertainment including cinema shows, plays, concerts, exhibitions, sports and similar events are considered business receipts that are subject to tax at a 2% rate.

*Example:* *An Afghan company owns a movie theatre in Shar-e-naw. The movie theater charges Afs.150 per ticket. The revenue from ticket sales is considered a business receipt and is subject to business receipts tax. It does not matter whether the attendees are Afghan residents or not.*

66.4 A person will be liable to pay 2 percent business receipts tax on all receipts from sales of merchandise less any "returns." Merchandise returned by customers is not considered an expense but instead is considered sales that are returned. The refunds made for such returns may be subtracted from total receipts before applying the two percent tax.

*Example:* *A tour bus company is subject to business receipts tax on income from passenger fares. The total receipts from fares in a tax year is Afs.*

*2,500,000. However, because of a cancellation by a tour group, income from tickets valued at Afs. 200,000 was returned. Total income less returns is subject to business receipts tax.*

| | | |
|---|---|---|
| *Total income from passengers' fares* | *Afs.* | *2,500,000* |
| *less Amount returned* | *Afs.* | *200,000* |
| *Income subject to BRT* | *Afs* | *2,300,000* |

66.5 According to the Article 66 (2), hotels and restaurants that earn less than Afs. 750,000 (before any deduction) per quarter are required to pay 2% business receipts tax.

*Example 1:* *Rozi Khan is the owner of a restaurant in Maiwand Avenue, Kabul. In the first quarter of 1388 he earned from sales of food cooked in his restaurant:*

*Hamal: Afs. 145.000 Sawr: Afs. 220,000 Jawza: Afs. 200,000*

*Based on restaurant's monthly income, tax is calculated as follows:*

*Total income for the quarter = 145,000+220,000+200,000= 565,000*
*BRT Payable = Afs 565,000×2%= Afs 11,300*

*Example 2:* *In the second quarter of 1388, Kabul Guest House and Hotel located in Kabul city earned Afs. 225,000 in Saratan, 243,000 in Asad, and 250,000 in Sonbula from the sale of foods and rent of rooms. According to the Article 66 (2) the owner of the hotel is required to calculate 2% business receipts tax on total income before any deduction and pay it according to the provisions of Article 88(5).*

*Quarter total income = Afs. 225,000+243,000+250,000 = 718,000*
*Quarter BRT liability =Afs 718,000×2% = Afs 14,360*

*Remark: In example 1, the owner of Maiwand Avenue, Kabul is a natural person and his income from the restaurant is below Afs 750,000 for each of the four quarters of the year. If he opts for fixed tax regime under Article 74 and 75 he will not pay business receipts tax on income from restaurant but instead will pay fixed tax in lieu of income tax and business receipts tax as provided by Article 68.*

66.6 According to Article 66 (3), hotels, guest houses and restaurants that earn more than Afs.750,000 (before any deduction) are subject to 5% business receipts tax.

*Example 1:* *Shandiz Resturant located in Kabul city earned Afs.265,000 in Hamal, 285,000 in Sawr and 251,000 in Jawza respectively. According to Article 66 (3), business receipts tax is calculated as follows:*

*265,000+285,000+251,000 = 801,000 =Total Income of First Quarter in Afs.*

*801,000×5% = 40,050 =First Quarter's BRT*

<u>*Example 2*</u>*:* *Maiwand Hotel and Guest House situated in Herat besides provision of foods and rental rooms, provides telephone and laundry services and serves beverages as well. Maiwand Hotel earned in third quarter of the tax year1388 Afs.387,500 in Mizan, 398,500 in Aqrab, and 375,600 in Qaws respectively. Its income is taxed as follows:*

*Total income subject to Tax in third quarter = Afs387,500 + 398,500 + 375,600 = Afs 1,161,600*
*BRT payable in third quarter= Afs 1,161,600×5% = 58,080*

<u>*Example 3*</u>*:* *Maiwand Restaurant located in Shahr-e-Now provides burgers, shiryakh and zhala (Afghan ice-cream), and other types of food to its customers. Its first quarter income is as follows:*

*Hamal: Afs 295,000 Sawr: Afs. 325,000 Jawza: Afs. 350,000*

*The above income is taxed as follows:*

*Total taxable income Hamal+Sawr+Jawza = 295,000 + 325,000 + 350,000 = Afs 970,000–*

*BRT payable = Afs 970,000×5% = Afs 48,500*

66.7 According to Article 66(4), the total income of clubs and halls (wedding halls) before any deduction and without considering any particular threshold, are subject to 5% business receipts tax.

<u>*Example*</u>*:* *In fourth quarter of tax year 1387, Sham-e-Paris Wedding Hall located in Kabul city earned Afs.5,000,000 in Jadi, 5,545,000 in Dalwa, 4,800,000 in Hoot respectively. According to above provision, the owner of the wedding hall is required to calculate 5% business receipts tax on total income before any deduction, which is calculated as follows:*

*Total Taxable Income = Income of Jadi+Dalwa+Hoot*

*5,000,000+5,545,000+4,800,000= 15,345,000*

*BRT payable = Afs 15,345,000× 5% = Afs 767,250*

*For the fourth quarter, Sham-e-Paris Wedding Hall is liable to pay Afs. 787,250 business receipts tax.*

66.8 According to provision of Article 66 (5), income from communication, air transport, hotels and restaurants with premium services are subject to 10%

business receipts tax. No threshold amount applies, so total income of the mentioned services is subject to 10% business receipts tax before any deduction.

To determine whether hotels and restaurants provide premium services and are therefore subject to 10% business receipts tax, the following characteristics and standards should be considered:

1. hotels and restaurants meet the standard and requirements of three star and above;
2. hotels and restaurants have facilities such as air conditioning, telephone service, internet, laundry service, two or more food variety in terms of quality;
3. customers of these hotels and restaurants are people with high income such as foreigners, tourists, merchants and other high-income people.

*Example 1:* *Afghan Airways earned Afs.856,586,000 in 1388 from national and international passenger flights originating in Afghanistan. This income is subject to 10% business receipts tax. The business receipts tax is calculated quarterly and payable to the government account.*

*Example 2:* *City Hotel is a prominent hotel in Kabul which provides high quality services mainly to foreigners. City Hotel earned Afs.4,525,000 in Hamal, 5,600,000 in Sawr, 5,500,00 in Jawza in the first quarter of 1388. According to Article 66 (5), this income is subject to 10% business receipts tax and is calculated as follows:*

*Total Income subject to BRT = Incomes of Hamal+Sawr+Jawza=*

*Afs 15,625,000+5,600,000+5,500,000=Afs 15,625,000*

*BRT payable = Afs 15,625,000×10%= Afs 1,562,500*

*Example 3:* *Hindokush Telecommunication Company earned Afs.500,000,000 from sales of top up cards, telephone and internet services, and Afs.25,000,000 from sale of SIM cards and mobile phones. The company is subject to 10% business receipts tax on income earned from sales of top up cards, telephone and internet services, and 2% on income received from sales of SIM cards and mobile phones. Hindokush Company is required to calculate business receipts tax quarterly and transfer the amount to the government account.*

66.9 If, according to Article 66 (6), the income of persons is less than the prescribed threshold in one or several months of the year, then those persons are required to inform the relevant administration for the purpose of verification and approval.

| | |
|---|---|
| Article 67 | Application of business receipts tax (1) Business receipts tax shall be payable on total receipts and shall not be affected by whether the taxpayer has a profit or loss during the current or previous years.<br><br>(2) Business receipts tax paid shall be a deductible expense in computing taxable income for the same tax year.<br><br>(3) The tax imposed under Article 64 (3) of this Law is allowable as a credit in calculation of business receipts tax liabilities. If the amount paid is more than the business receipts tax payable for that year, the excess amount is not allowable as a credit in subsequent periods. |

67.1 The amount of business receipts tax payable is not affected whether the taxpayer has a profit or loss during the year. The amount of business receipts tax payable is based on the total receipts of the business.

*Example:* *During one tax year, Company A earns Afs.500,000 subject to business receipts tax but suffers Afs.150,000 loss. In the next tax year, Company A earns the same amount but, instead of a loss, it makes Afs.150,000 profit. For both years, Company A must pay the same amount of business receipts tax on its earnings of Afs 500,000. The amount of income tax liability does not change the amount of business receipts tax.*

67.2 According to Article 67(2), business receipts tax is recognized as an ordinary and necessary expense of business and is deductible from taxable income when computing income tax liability.

*Example:* *An Afghan Corporation paints houses and earned Afs.1,000,000 during a tax year. The corporation has wage expenses of Afs.400,000 and other operating expenses of Afs.250,000. The Afghan corporation computes its taxable incomes as follows:*

| | | |
|---|---|---|
| *Total income:* | | *1,000,000* |
| *Administrative expenses* | *400,000* | |
| *Operating expenses* | *250,000* | |
| *Business Receipts Tax paid* | *20,000* | |
| *Total deductible costs* | | *(670,000)* |
| *Taxable Income* | | *330,000* |

67.3 Business receipts tax on imports, which is collected at customs offices, is creditable against business receipts tax liability computed for the same tax year. If the business receipts tax on imports exceeds the business receipts tax liability for the tax year, the extra amount is not transferred as a tax credit to the next tax year. However, the total business receipts tax paid is a deductible expense in computation of taxable income for income tax purposes.

*<u>Example</u>:* *Omid Trading Company imported clothes valued at Afs.500,000 in the 1388 tax year. It is liable to pay Afs. 40,000 custom duties on the imported clothes. Omid Trading Company's business receipts tax on imports is computed as follows:*

| | |
|---|---|
| *Imports* | *Afs 500,000* |
| *Customs duties* | *40,000* |
| *Import value for BRT purposes* | *Afs 540,000* |

*BRT payable on import* $540{,}000 \times 2\% = 10{,}800$

*Omid Trading Company has sales of Afs. 800,000 from its imports. Business receipts tax liability is calculated as follows:*

*Afs.* $800{,}000 \times 2\% =$ *Afs 16,000*

*According to Article 67 (3), Afs 10,800 paid is taken as a credit against the business receipts tax due of Afs.16,000. Omid Trading Company would be required to pay the balance ie Afs. 5,200 at the time of the lodgement of its business receipts tax form.*

*<u>Remark</u>: Omid Trading Company would be entitled to an income tax deduction for the amount of business receipts tax paid. The company is therefore entitled to claim a deduction of Afs. 16,000 in calculating its net taxable income for income tax purposes.*

# CHAPTER 11

# FIXED TAXES

## Article 68 - Article 76

| | |
|---|---|
| Article 68 | Business activities subject to fixed tax Persons engaged in commercial activities specified by the provisions of this Chapter shall be subject to fixed tax in lieu of income tax and business receipts tax. |

68.1 In general, fixed taxes are imposed in lieu of income tax and business receipts tax. However, not all Articles of this Chapter impose fixed tax in lieu of income tax and business receipts tax. Further, not all fixed taxes are final taxes. Some fixed taxes are allowable as a credit in the payment of annual income tax or business receipts tax. The specific Articles of this chapter will determine the nature and extent of the particular fixed tax.

68.2 Fixed taxes can apply to individuals, partnerships, limited liability companies and corporations.

| | |
|---|---|
| Article 69 | Payment of fixed tax Fixed taxes shall be payable during the tax year unless otherwise provided in this Law. |

69.1 For details regarding when each of the fixed taxes prescribed in this Chapter are due and payable, reference should be made in the first instance to the relevant Article prescribing the fixed tax. In the case where the Article does not state when the fixed tax is due and payable, reference should be made to Article 88.

| | |
|---|---|
| Article 70 | Fixed tax on imports (1) Persons who import goods and have a business license shall be subject to two percent fixed tax on the total cost, including custom duties, of the goods imported. The tax paid shall be allowed as a credit in the calculation of the person's annual income tax assessment in accordance with the provisions of this Law.<br><br>(2) Persons who import goods without having a business license shall be subject to three percent fixed tax on the total cost, including customs duties, of the goods imported in lieu of income tax.<br><br>(3) Persons who import goods and have an interim business license but do not file their returns of income to the Ministry of Finance shall be subject to three percent fixed tax on the total cost, including customs duties, of goods imported in lieu of income tax.<br><br>(4) The tax mentioned in this Article shall be paid at the customs house where customs duties on the goods are paid. |

70.1 Taxpayers that have a business license are subject to a tax on their imports. The tax equals 2% of the value of the goods imported. The 2% tax is an advance payment of income tax due and payable. The 2% tax may be larger or smaller than the taxpayer's actual net income tax liability. The taxpayer's payment of the 2% advance tax does not excuse the taxpayer from his obligation to file an income tax return.

*Example 1:* *An Afghan corporation imports goods worth Afs. 20,000,000 during the year 1385. The Afs. 20,000,000 value includes customs duties applied. The corporation must pay Afs. 400,000 in addition to the customs duties that it has to pay. After the end of 1385, the Afghan corporation is required to file a tax return. The tax return shows the following results:*

| | | |
|---|---|---|
| Revenue | | 100,000,000 |
| BRT | (2,000,000) | |
| Operating Expenses | (40,000,000) | |
| Interest Expense | (18,000,000) | (60,000,000) |
| Taxable Income | | 40,000,000 |
| Tentative Tax Liability (20%) | | 8,000,000 |
| Advance Tax Payment | | (400,000) |
| Tax Due | | 7,600,000 |

*Example 2:* *An Afghan corporation imports goods worth Afs. 40,000,000 during the year 1385. The Afs. 40,000,000 includes the customs duties that are due. The corporation must pay Afs. 800,000 in addition to the customs duties that it has to pay. After the end of 1385, the Afghan corporation is required to file a tax return. The tax return shows the following results:*

| | | |
|---|---|---|
| Revenue | | 100,000,000 |
| BRT | (2,000,000) | |
| Operating Expenses | (84,000,000) | |
| Interest Expense | (11,000,000) | (97,000,000) |
| Taxable Income | | 3,000,000 |
| Tentative Tax Liability (20%) | | 600,000 |
| Advance Tax Payment | | (800,000) |
| Tax Refunded | | (200,000) |

*Remark: It is important to note that if the Afghan corporation fails to file an income tax return, the corporation will not be entitled to receive its Afs. 200,000 tax refund.*

70.2 Taxpayers who do not have a business license (or who have an interim business license but have not provided a business declaration form to the Ministry of Finance) are also subject to a tax on their imports. The tax equals 3% of the value of the goods imported including customs duties. The 3% tax is payable in lieu of income tax.

Article 71 Fixed tax on transport Persons who transport passengers or goods for business purposes shall be required to pay an annual tax before renewal of their vehicle registration as follows:

| No | TYPE OF VEHICLE | TAX |
|---|---|---|
| ***1*** | ***Vehicles based on tonnes*** | |
| 1 | From 1 up to 2 tonnes | 2600 afs |
| 2 | Over 2 up to 3 tonnes | 3400 afs |
| 3 | Over 3 up to 4 tonnes | 4200 afs |
| 4 | Over 4 up to 5 tonnes | 5000 afs |
| 5 | Over 5 up to 6 tonnes | 6000 afs |
| 6 | Over 6 up to 8 tonnes | 7500 afs |
| 7 | Over 8 up to 10 tonnes | 9000 afs |
| 8 | Over 10 up to 12 tonnes | 10500 afs |
| 9 | Over 12 up to 14 tonnes | 12000 afs |
| 10 | Over 14 up to 16 tonnes | 13500 afs |
| 11 | Over 16 up to 18 tonnes | 15000 afs |
| 12 | Over 18 up to 20 tonnes | 16500 afs |
| 13 | Over 20 up to 25 tonnes | 18500 afs |
| 14 | More than 25 tonnes | 18500 afs and 500 afs per additional tonne |
| 15 | More than the total allowable tons on the axle of a trailer | Over 500kg then 200 afs per tonne |
| ***2*** | ***Passenger vehicles*** | |
| 1 | Taxi with capacity of 3 to 5 passengers | 2000 afs |
| 2 | Taxi with capacity of more than 5 passengers | 2000 afs and 200 afs per additional seat |
| 3 | Microbus with up to 14 seats | 2600 afs |
| 4 | Other buses from 15 up to 21 seats | 4000 afs |
| 5 | Other buses from 22 up to 29 seats | 6000 afs |
| 6 | Other buses from 30 up to 39 seats | 7000 afs |
| 7 | Other buses from 40 up to 49 seats | 7500 afs |
| 8 | Other buses from 50 up to 60 seats | 8000 afs |
| 9 | Other buses with more than 60 seats | 8000 afs and 200afs per additional seat |
| ***3*** | ***Vehicles according to their cylinders*** | |
| 1 | 4 cylinders | 1500 afs per vehicle |
| 2 | 6 cylinders | 2000 afs per vehicle |
| 3 | 8 cylinders | 3000 afs per vehicle |
| 4 | More than 8 cylinders | 3000 afs and 500afs per additional cylinder |
| ***4*** | ***Rickshaw*** | |
| 1 | Motorbike rickshaw | 500 afs |
| 2 | Rickshaw | 1000 afs |

71.1 The tax specified in Article 71 of the Income Tax Law is collected from the owners of vehicles used in the business of transporting persons or property as listed in this Article.

*Example 1:* *From a person owning two taxis Afs. 4,000 per year is received as fixed tax on the operation of his taxi as provided for in Article 71 of the Income Tax Law.*

*Example 2:* *A man has a truck which has a capacity of two tons. This man must pay Afs. 2,600 per year as fixed tax on his truck.*

*Example 3:* *The fixed tax of a vehicle is not limited to a category or class solely because of its description but may be assigned another category because of its use.*

*A one-ton truck ordinarily rated at the 2,600 afghani rate is used as a taxi carrying passengers equivalent to a bus. The fixed tax imposed will be the bus rate of 4,000 Afs.*

*Example 4:* *A man who has an animal-drawn carriage (used to transport persons or goods for money) operates a "rickshaw" and must pay Afs. 1,000 per year as fixed tax on his carriage.*

71.2 The fixed tax of Article 71 of the Income Tax Law is in lieu of an income tax on income from such vehicles. In case the owner has other income subject to income tax, the income received from the operation of a vehicle listed in Article 71 should be noted but not included in his income return.

71.3 The fixed tax provided in Article 71 of the Income Tax Law is paid at the tax office of the district in which the owner resides. If the place of residence of the owner and the place where the highway-use license is issued are not the same, then the fixed tax is paid in the tax office of the place where the highway-use license is issued.

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| Article 72 | Withholding tax on contractors (1) Persons who, without a business license or contrary to approved by- law, provide supplies, materials, construction and services under contract to government agencies, municipalities, state entities, private entities and other persons shall be subject to 7 percent fixed tax in lieu of income tax. This tax is withheld from the gross amount payable to the contractor.<br><br>(2) Persons who have a business license and provide the services and other activities mentioned in paragraph (1) of this Article to the specified entities shall be subject to 2 percent contractor tax. The tax levied by this paragraph is creditable against subsequent tax liabilities.<br><br>(3) The tax mentioned in paragraph (1) and (2) of this Article shall be withheld by the payer from payment and shall be transferred to the relevant account within ten days. Contractors subject to this Article shall be required to, upon signing the contract, send a copy thereof to the relevant tax administration. Natural persons who, according to provision of paragraph (1) of Article 17 of this Law, earn taxable salaries shall be excluded from this provision. |

72.1 For the withholding tax to apply, there must be payment made under a contract. No definition of "contract" is provided in the Law. The following definition given in the Contract Law is, therefore, the accepted basis for withholding income tax:

*"A contract is an agreement between two or more parties, which is enforceable by the law. A business transaction to buy and sell goods or services is a contract between the buyer and the seller."*

An offer and acceptance of business transactions or sale and supply of goods and services constitute a contractual arrangement. Such arrangement may be in writing or verbal and the mode of payment may be in cash or on credit. The transaction is a contract and withholding provisions under Article 72 will apply.

72.2 Fixed tax at the rate of 7% provided by Article 72 is to be withheld from the payments to natural and legal persons who furnish supplies, materials, or provide construction or other services to the State or private entities without a business license or contrary to by-laws. Such persons are required to pay, in lieu of the income tax of such activities, a tax at the time payment is received. In such cases the contracting party is required to withhold the tax at the time of payment to contractor and pay the amount to the government bank account.

*Example 1*: *A Chinese corporation supplies communications equipment directly to the Ministry of Communications pursuant to a contract. The Chinese corporation ships the equipment directly from its manufacturing facility to the Ministry of Communications, which then uses the equipment to build communications facilities in Afghanistan. The sales price in the first year is Afs. 100,000,000. The Chinese corporation does not obtain a business license in Afghanistan, because it does not have any substantial physical presence in Afghanistan. The Chinese*

*corporation is subject to the fixed tax in Article 72. When the Treasury Department within the Ministry of Finance issues the payment to the Chinese corporation, it will withhold 7% of the amount due in satisfaction of the Chinese corporation's liability.*

*Remark: If a foreign company contracts the provision of goods or services to persons in Afghanistan through its registered branch in Afghanistan, the branch shall be liable to withholding tax. The foreign company which exports to its branch for the purpose of sale shall not be subject to withholding tax under this Article.*

*Example 2: Global Construction Company, based on approved by-law, has a license to provide construction services and furnish/import construction materials sufficient for its use. The company imports more construction materials than its needs and sells them to Sitara Construction Company. It sold materials valued Afs.2,000,000 to Sitara Construction Company. The payment to Global Construction Company is subject to 7% withholding tax, and according to the Article 72 (3) Sitara Construction Company is required to withhold 7% tax when paying to Global Construction Company and transfer the amount to the government account.*

*Remark: Where a person has two or more income sources, one of which is selling property or services under contract and is subject to seven percent fixed tax in lieu of income tax, that person is not required to include that part of their income in their annual tax return. The person shall record his other incomes in his annual tax return and pay this tax according to Income Tax Law.*

72.3 Persons holding a current business license and entering into a contract with government agencies, enterprises, entities and non-governmental persons to furnish them with supplies, construction services and perform other activities, are subject to 2% withholding tax. The contracting agencies are required to withhold tax while making payments to contractors and transfer it to the government back account.

*Example 1: Ministry of Education rents 30 buses for Afs. 5,000 per day from Bakhtar Transportation Company to transport its employees. The company has a license to operate this business. Bakhtar Company is subject to 2% withholding tax from rental income. Ministry of Education is required to withhold tax from the rent that pays to Bakhtar Company and transfer it to the proper account.*

*Example 2: Stanford Trading Company enters into a contract with Telco to provide technical and communication equipments worth Afs.5,500,000. Stanford Trading Company's has a business license and therefore the payment is subject to 2% withholding tax. Telco is required to withhold the tax from payment to Stanford Trading Company and transfer it to the government account.*

*Remark: A distinction is made for the purpose of applying the appropriate withholding tax rate between those persons having a business license or acting according to by-laws and those person who do not. No definition of license or by-law is provided in the Law. However, for the purposes of Article 72, all licenses issued for the purpose of allowing commercial and economic activities by the government and official agencies to natural and legal persons are acceptable.*

72.4 Article 72 does not provide a threshold amount below which no withholding of tax is required. To reduce the compliance burden on taxpayers, a minimum threshold of Afs. 500,000 has been set for contract withholding tax purposes. Transactions below Afs. 500,000 are not subject to withholding income tax. Payments for purchases of daily household consumption are usually below this minimum threshold and are not liable for withholding income tax. Payments on account of purchases or supplies made or services rendered to a legal or natural person aggregating below Afs. 500,000 in a tax year shall not be subject to withholding tax. However, if the aggregate of payments to one person on this account exceed this threshold in a tax year the entire payment to that legal or natural person shall be liable to contract withholding income tax under Article 72.

72.5 According to the paragraph 3 of Article 72, tax that is withheld from payment to a contractor is required to be transferred to the government account within 10 days. However to relieve the withholding person of the additional burden and reduce the cost of compliance, the tax withheld during a month is required to be remitted to relevant government account on 10$^{th}$ of the next following month.

*Example 1: Omid Plastic Production Company entered into a contract with Nabi Zada Trading Company to supply its required raw materials. According to the contract, Nabi Zada Trading Company is required to provide Omid Plastic Production Company with raw materials on the 7$^{th}$ day of each month and receive payment on the 14$^{th}$ day of each month. Omid Plastic Production Company makes the payment to Nabi Zada Company on the 14$^{th}$ day of the month and is required to withhold tax while making that payment. Omid Plastic Production Company must transfer the amount of tax withheld from payment to the related account within 10 days after the end of the month. All other taxes withheld by Omid Plastic Production Company from payments to contractors during the month must also be paid within 10 days of the end of the month.*

72.6 The provisions of Article 72 of Income Tax Law shall not be applicable to payments made on contracts of employment, in accordance with Article 17, where there is a requirement for wage withholding tax to apply. Payment made according to other contracts which are subject to particular withholding tax requirements under the Income Tax Law will not be subject to withholding tax according to Article 72.

*Example: Mukhtar English School enters into a contract with Ahmed to rent a building from Ahmed for use of teaching. Mukhtar English School is*

*required to pay Afs. 500,000 a month in rent. Mukhtar English School has a license to provide private education. Mukhtar English School is required to withhold tax from the payment of rent according to Article 59. Being a more specific provision for the obligation to withhold tax, Mukhtar English School will be required to withhold 15% tax from the payment of rent. The general provision of contractor withholding tax will not apply in this case.*

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| Article 73 | Fixed tax of exhibition income (1) Fixed tax shall be applied to natural persons who are residents of Afghanistan and to natural and legal persons who are non-residents of Afghanistan.<br><br>(2) Persons mentioned in paragraph (1) of this Article who provide entertainment such as theatre, exhibition of films, radio, television, music, or sports competition in Afghanistan shall be subject to a fixed tax of ten percent of receipts from sale of admission or tickets. The fixed tax shall be imposed in lieu of income tax and business receipts tax. This tax is payable in accordance with paragraph (9) of Article 88 of this Law. The tax shall be paid at the tax office of the district in which the service is provided.<br><br>Other persons who provide entertainment services shall be subject to income tax and business receipts tax according to the provisions of this Law. |

73.1 Under article 73 of Income Tax Law, natural persons being resident of Afghanistan and non resident legal and natural persons who are engaged in entertainment exhibitions such as movies, radio or TV, music, sport competitions and other similar activities are subject to 10 percent fixed tax on total income derived from such activities rather than income tax and business receipts tax. Under the Income Tax Law, legal persons resident of Afghanistan who engage in such activities are subject to annual income tax and business receipts tax, must file tax returns and pay tax according to the Law.

In the case of cinemas, theaters, exhibits, carnivals or other places of entertainment the following points shall be considered:

a. A person who only owns such a place but leases it to others, is subject to income tax according to the rate schedule of Article 4 of the Income Tax Law on their income from the lease of such property owned by them.

b. The lessee of property and places mentioned in Article 73 of the Income Tax Law is subject to taxes provided in Article 73 of the Income Tax Law. If the lease of property is equal to or more than amount provided in Article 59, the lessee is required to withhold tax and pay the amount withheld amount to the government account in accordance with relevant procedures

c. The person who is the owner of the property and places mentioned in Article 73 and who at the same time operates such places, is only subject to the fixed tax on admissions provided in Article 73.

*Example 1*: *Wahid owns a cinema in Paghman and at the same time operates it. If Wahid receives Afs. 375,000 in the month of Saraton,1385, from the sales of admission, he must pay to the State at the Paghman tax office before the 15th day of the month of Asad,1385, ten per cent of Afs.*

*375,000, that is the amount of Afs. 37,500, in lieu of income tax on income received from such ownership and activity.*

*Example 2:* *If the owner of Example 1 leases his cinema out to another person for Afs. 600,000 per year, then the owner must pay income tax according to the rate schedule of Article 4 of the Income Tax Law on his income of Afs. 600,000 from his ownership; and the lessee should pay the fixed tax on the sale of admissions according to this Article. The lessee is also required to withhold tax from rent payments under the Article 59 of Income Tax Law.*

*Example 3:* *Bollywood Movie Show Company, a foreign company, show its movie in a tent it rents from the Loyee Jorga in Kabul for two months. The company earns Afs 2,500,000 from the showing of the movies. It must pay 10 % fixed tax from its total income and pay the amount to the government account.*

*Example 4:* *MovieTime, an Afghan company, operates a cinema complex in Shar-i-now. It shows movies to the public for a fee. For the tax year, it earns Afs 5,000,000 from the sale of movie tickets. After allowing expenses of operation, MovieTime's net taxable income for the year is Afs. 2,000,000. As MovieTime is a legal person resident of Afghanistan, it will not be subject to the fixed tax under Article 73. MovieTime will be subject to annual income tax on its net taxable income and will also be subject to business receipts tax on its total business receipts.*

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| Article 74 | <u>Fixed tax on small business (all types)</u><br>(1) Natural persons who are engaged in business activities and meet the following conditions shall be subject to fixed tax in accordance with Article 75:<br><br>1. Natural persons who have income which is neither exempt nor subject to withholding tax in accordance with the provisions of this Law.<br><br>2. The total gross annual income of the natural persons is less than Afs. 3,000,000 for a tax year.<br><br>(2) Natural persons who meet the requirements of paragraph (1) of this Article shall be required to file an income tax return under paragraph (6) of Article 88 of this Law. The fixed tax payable shall be computed according to the provisions of Article 75 of this Law. |

74.1 This Article provides the conditions upon which a fixed tax will be imposed on businesses operated by natural persons ie individuals. Such persons will not be required to pay annual income tax based on net profit or business receipts tax except where a person elects to do so in accordance with Article 75(4).

74.2 The fixed tax is in lieu of income tax and business receipts tax on the sale of goods and services in the circumstances covered by Article 74. If an individual is taxable under Article 74 but also has income from sources other than the business activity covered by fixed tax, he must report such income and pay tax according to the rate schedule in Article 4 of the Law. The individual will be entitled to be taxed according to the progressive tax rates applicable to individuals for the year. The income from the business taxed under Article 75 of the Income Tax Law shall not be included with that other income.

74.3 Corporations, limited liability companies and other organizations do not qualify for fixed tax under this Article even if business is conducted in the same manner or same scale as business conducted by individuals meeting the income threshold requirements of Article 74. These entities will be subject to annual income tax and business receipts tax.

74.4 Article 74 explains the implementation of the fixed tax regime on natural persons who have business activities. For the purpose of imposing the fixed tax, the total earnings of natural persons from such business activity should not exceed Afs. 3,000,000 in a tax year. If their income for a tax year is Afs. 3,000,000 or more, then they are liable to pay income tax and business receipts tax according to the provisions of the Law.

74.5 In accordance with paragraph (6) of Article 88, persons who carry on business from fixed business establishments are required to pay their tax quarterly and the payment for each quarter must be made no later than the 15th day of the month following each quarter.

74.6 According to the provisions of the previous Income Tax Law (ie Income Tax Law 2005), owners of mills grinding grains or processing rice, cane or seed oil extracting machines; medical doctors; individuals who did not have a fixed place of business; and brokers and commissioners were taxed based on specific standards. In this Law, the mentioned individuals are now taxed based on the provisions of Article 74 and the thresholds of Article 75.

| | |
|---|---|
| Article 75 | Determining fixed tax on small business activities (All Types)<br><br>(1) Natural persons who receive income for a tax year of not more than Afs.60,000 from sources which are subject to withholding tax in accordance with the provisions of this Law and any other sources shall be exempt from tax.<br><br>(2) The persons mentioned in paragraph (1) of this Article who have income of more than Afs.60,000 and up to Afs.150,000 for a tax year, excluding exempt income and income subject to withholding tax provided under this Law, shall be required to pay a fixed tax of Afs. 500 for each quarter of the year.<br><br>(3) The persons mentioned in paragraph (1) of this Article who have income of more than Afs.150,000 and up to Afs.500,000 for a tax year, excluding exempt income and income subject to withholding tax provided under this Law, shall be required to pay a fixed tax of Afs.1,500 plus the fixed amount mentioned in paragraph (2) of this Article for each quarter of the year.<br><br>(4) The persons who have income of more than Afs.500,000 and up to Afs.3,000,000 for a tax year, excluding exempt income and income subject to withholding tax provided under this Law, shall be subject to three percent fixed tax on gross income received or the person may elect to pay business receipts tax and income tax on their taxable income in accordance with paragraph (3) of Article 4 of this Law. The election to pay income tax and business receipts tax or fixed tax shall not be for a period of less than three years. |

75.1 Article 74 of the Law provides the qualifying conditions for the application of the fixed tax on natural persons who undertake business activities. The computation of fixed tax is provided by Article 75. The amount of fixed tax is computed separately based on income from all business sources derived by an individual for each tax year.

Where a person earns income of less than Afs.60,000 in a tax year from all sources, including business activity, then no fixed tax is applicable. Where the person receives income, excluding exempt income and income subject to withholding tax provided under the Income Tax Law, of more than Afs.60,000 but not more than Afs.150,000 for a tax year , the person is required to pay a fixed tax of Afs.500 for each quarter of the tax year. Where the person receives income for a tax year of more than Afs.150,000 but not more than Afs.500,000, the person is required to pay quarterly a fixed tax of Afs.2,000 i.e. Afs. 1,500 plus Afs. 500 for income between Afs 60,000 and Afs Afs 150,000. Where the person receives income for a tax year of more than Afs.500,000 but not more than Afs.3,000,000, the person is required to pay 3 percent tax on gross income received or may choose to pay annual income tax and business receipts tax under the normal tax regime. The person who chooses to pay income tax and business receipts tax must do so for a period of at least three years.

On an annual basis, fixed tax applies as follows:

**Annual Fixed Tax Schedule**

| **Category** | **Gross Annual Income (Afs)** | **Tax Amount/ Rate in quarter** | **Total Annual Tax** |
|---|---|---|---|
| *1* | *0 – 60,000* | *0* | *0* |
| *2* | *60,001 – 150,000* | *500* | *2,000* |
| *3* | *150,001 – 500,000* | *1,500+500 afs* | *8,000* |
| *4* | *500,001 -3,000,000* | *3% of gross income or, if elected, income tax and business receipts tax.* | *3% of gross income or, if elected, income tax and business receipts tax.* |

On a quarterly basis, fixed tax applies as follows:

**Quarterly Fixed Tax Schedule**

| **Category** | **Income (Afs)** | **Quarterly Tax Amount/ Rate** |
|---|---|---|
| *1* | *0 – 15,000* | *0* |
| *2* | *15,001 – 37,500* | *500* |
| *3* | *37,501 – 125,000* | *1,500 +500 afs* |
| *4* | *125,001- 750,000* | *3% of gross income or, if elected, income tax and BRT* |

*Remark: Persons who are subject to fixed tax in accordance with Articles 74 and 75 are required to compute and pay their fixed tax on total income. The term "income" which is provided in the mentioned Articles means gross income.*

75.2 A person whose annual income is between Afs 500,000 and 3,000,000 will be subject to fixed tax at the rate of 3% of total income unless the person elects to pay annual income tax and business receipts instead. An election can only be made in writing, must be signed and presented to the relevant tax office.

*Example: Ali owns and operates a grocery store. He decides that he would prefer to pay annual income tax and business receipts tax (if applicable) rather than 3% fixed tax on total income from the grocery store. Ali would like this arrangement to apply for the 1389 tax year and subsequent years. Ali is required to notify the local tax office of his decision in writing. Ali will then be liable for business receipts tax and annual income tax from 1 Hamal 1389 and will be required to meet business receipts tax and income tax lodgement and payment obligations as provided by the Law.*

75.3 Persons are required to compute their fixed tax based on a determination of their total income from business activity. The determination should be based on business records available. If business records are not available, then the determination must be based on a reasonable estimate of total income. The person must complete their tax form, present it to the relevant tax office and pay the amount due to the government bank account.

*<u>Example 1</u>:* *Abdul Samey owns a diesel mill. It operates 26 days a month and generates Afs.1,000 on daily basis. His taxable income for a quarter is computed as follows:*

| | | | |
|---|---|---|---|
| *Monthly Income* | – | *Afs 1,000×26days* | *= Afs 26,000* |
| *Quarterly Income* | – | *Afs 26,000×3 months* | *= Afs 78,000* |

*Abdul Samey's quarterly fixed tax payable is computed as follows:*

| | |
|---|---|
| *Fixed tax on Afs. 78,000 total Quarterly Income* | *Afs 1,500* |
| *Add: Fixed tax on Quarterly Income between Afs 60,000 – Afs 150,000* | *500* |
| *Total Fixed Tax for the Quarter* | *Afs 2,000* |

*On the basis that the above tax computation applies to the first quarter of tax year, Abdul Samey is required to pay Afs.2,000 to the relevant bank account by 15th of Saratan and submit his tax return to the relevant tax office after payment to the government bank account.*

*<u>Example 2</u>:* *Sahar Gul owns a small shop in a village situated in Pacheragam district of Ningarhar Province. Based on his reasonable estimates, he earns less than Afs. 60,000 annually. Sahar Gull is not subject to fixed tax and is not liable to pay fixed tax.*

*<u>Example 3</u>:* *Najeebullah runs a shop in Butchers Market of Charikar city. He earns Afs.200,000 quarterly (ie Afs 800,000 annually). His tax liability is computed as follows:*

*Quarterly total income 200,000× 3% fixed tax =Afs 6,000*

*Najeebullah is required to pay his tax liability to the relevant bank account in accordance with the provisions of the law.*

*<u>Remark</u>: Because Najeebullah's total annual income is between Afs 500,000 and 3,000,000, he may elect to pay income tax on net income (ie total income less allowable deductions) and business receipts tax instead of paying the fixed tax.*

*<u>Example 4</u>:* *Hussain Ali owns a cloth shop in Mandawi Avenue of Kabul city. He earns gross income of Afs. 35,000,000 annually. He does not pay fixed tax, but is required to pay income tax and business receipts tax in accordance with provisions of the Law.*

75.4 The fixed tax imposed by Article 75 is computed on the basis of self-assessment. Under this method, the taxpayer is required to compute his tax liability based on adopted standards and facts. Normally, total income will be calculated on the basis of business records and other documentary evidence regarding business transactions. However, where business records are not available, the following factors must be taken into account when determining

the amount of income earned by a business and calculating the amount of fixed tax payable:

1. Type of good/services provided by the business
2. Estimated quantity of work or volume of sales
3. Rental value, extent and capacity of the business location
4. Location and economical advantages of business location in relation to the population
5. Demand for goods/services offered
6. Estimation of capital, cost of goods/services and sales prices
7. Extent of domestic or foreign products
8. Extent of consumable and non-consumable goods
9. Estimation of daily, monthly, quarterly and annual gross income of the business.

Tax offices have the responsibility of ensuring the payment of all taxes due and payable according to the Law and will monitor and examine the accuracy of tax returns presented by the taxpayer. Relevant tax offices examine the mentioned tax returns, and may audit the return based on specified tax computation factors. If tax officers discover that the tax paid is understated, they may issue amended assessments. In that case, additional tax and other penalties will be imposed.

75.5 If a person who is subject to fixed tax elects to pay income tax and business receipts tax (if applicable) in lieu of fixed tax, he is then required to keep business records and supporting documents based on which income tax and business receipts tax can be computed. The person is also required to complete the required tax returns, pay the amount to the government bank account and deliver his tax return to the relevant tax office. If a person elects to pay annual income tax and business receipts tax instead of fixed tax, he must do so for a period of at least three years.

*Example 1*: *Malalai is a dentist. She treats patients in a private practice. For the tax year 1388, she averages 30 patient treatments each day and she operates for 25 days in a month. She treats each patient for Afs.100. Her annual income tax is computed as follows:*

*Monthly income: Afs 100 × 30 = 3,000 × 25 days = Afs 75,000*
*Annual Income: Afs 75,000 × 12months = Afs 900,000*

*Mulalai must either pay the fixed tax or has the option to elect to pay income tax and business receipts tax instead of the fixed tax. Malalai has elected to pay income tax and business receipts tax (if applicable). Malalai's income tax is computed as follows:*

| | | |
|---|---|---|
| *Total Annual Income:* | *Afs* | *900,000* |
| *Less Operating Expenses (documented)* | *Afs* | *600,000* |
| *Taxable Income for the year:* | *Afs* | *300,000* |

*Income tax for individual according to Article 4 = Afs 16,800*

*Remark: Because Malalai's total income per quarter is less than Afs 750,000 and dental services are not one of the prescribed services for which business receipts tax applies for persons who earn less than Afs 750,000 per quarter, she is not liable to pay business receipts tax.*

*Example 2:* *Hamid owns and operates a restaurant located in Shar-e-Naw. On average, he earns total income of Afs.600,000 per quarter (ie Afs 2,400,000 per annum) for providing restaurant services for the 1388 tax year. Hamid must either pay the fixed tax or has the option to elect to pay income tax and business receipts tax instead of the fixed tax. Hamid has elected to pay income tax and business receipts tax. Hamid is required to pay business receipt tax quarterly and income tax at the end of the tax year. Taxes are assessed as below:*

*A. Business Receipts Tax (quarter):*

*Hamid is liable to pay business receipts tax in accordance with Art. 66 (2). The business receipts tax rate is 2%. Business receipts taxable income =Afs.600,000. Business receipt tax for one quarter =Afs 600,000 x 2% = Afs. 12,000. Total business receipt tax payable for the tax year = Afs 12,000 x 4=Afs 48,000*

*B. Income Tax (annual):*

*Hamid spends an amount of Afs. 2,000,000 during the tax year for the purpose of earning the above-mentioned income. Income tax is assessed as follows:*

| | | | |
|---|---|---|---|
| *Gross income* | | | *Afs 2,400,000* |
| *Less:* | *deductible expenses* | *Afs 2,000,000* | |
| | *business receipts tax paid* | *48,000* | *2,048,000* |
| *Taxable Income* | | | *Afs 352,000* |

*According to the table prescribed by Article 4 of Income Tax Law, income tax payable is assessed as Afs 22,000.*

*Total tax payable = Income tax+ business receipt tax =*
*= 22,000 + 48,000= 70,000*

*Note: If Hamid opted to pay fixed tax, the total amount payable for the year would have been Afs 2,400,000 x 3% = Afs 72,000*

75.6 Where a person does not have income tax subject to fixed tax in one of quarters of the fiscal year (ie income is less than amount of Afs. 60,000), the person is required to submit his report for this quarter together with accurate documents to the relevant tax office. The tax office may confirm or reject the report upon evaluation of the person's documents.

75.7 Where a person is subject to fixed tax for quarters of tax year according to provisions of Articles 74 and 75 of Income Tax Law and his income increases so that on an annual basis it will exceed the Afs 3,000,000 limit for fixed tax, then the person must pay annual income tax and business receipt tax.

| | |
|---|---|
| Article 76 | Amendments to exemptions (1) Amendments to exemptions and tax rates of this Law shall be proposed by the Ministry of Finance and approved by the authorized officials.<br><br>(2) Tax imposition and exemptions shall not be valid without the approval of the Ministry of Finance. |

76.1 Article 42(2) of the Constitution of Afghanistan prohibits the imposition of tax and duties, unless the tax or duty is enacted as a law.

76.2 Moreover, the imposition of any tax, and the exemption from any tax, shall be approved by the Ministry of Finance.

76.3 It is important to understand the difference between a "tax" and a "fee" charged for the provision of a good or a service. A "tax" is a levy imposed by a governmental body to raise revenue for the operation of government and the provision of goods and or services to the public at large. A "fee" is a reasonable charge for goods and services provided by the government to a specific taxpayer. A "fee" is reasonable if it is commensurate with the fee that would be charged by a private business to provide similar goods or services. The mere fact that a private business may be able to provide similar goods or services at a somewhat lower price does not automatically convert the "fee" into a tax. Nevertheless, if the "fee" charged is significantly higher than the charge that would be payable to a private firm, the excess portion of the fee may be considered a "tax". In addition, the fact that people are compelled to pay the charge does not automatically mean that the charge is a tax, but it is evidence that the charge is a tax.

*Example 1:* *The Ministry of Information, Culture and Tourism charges individuals for brochures illustrating various locations in Afghanistan. No one is compelled to purchase the brochures. The charge is therefore a "fee" and not a "tax". The Ministry may charge this fee even in the absence of a law authorizing it. Moreover, the Ministry may charge this fee without obtaining approval from the Ministry of Finance.*

*Example 2:* *The Ministry of Transportation decides to start charging every Afghan individual and business Afs. 10 per month for the use of the road. The fact that every person is compelled to pay the charge and the charge is not directly related to any good or service consumed by the people, the charge is a tax. As such, it cannot be imposed without the authority of a law. Moreover, this law should not be proposed without the permission of the Ministry of Finance.*

## CHAPTER 12

# TAXATION RULES FOR

# QUALIFYING EXTRACTIVE INDUSTRY TAXPAYERS

### Article 77 – Article 85

Article 77 Definitions (1) In this Chapter:

1. a “hydrocarbons Contract” means an Exploration Contract or Service Contract described in any applicable law affecting hydrocarbons in Afghanistan. Hydrocarbons are petroleum, gas, and other derivatives therefrom;

2. a “Mining Authorization” is a permission letter that is issued by Ministry of Mines in accordance with the Mines Law, for exploration of quarries, constant utilization of quarries, utilization of previously explored idle materials, professional utilization, business, process, transfer, and processing of minerals;

3. a “Mining License” is a document issued in accordance with the Mines Law for exploration or utilization of mines;

4. "QEIT" means a Qualifying Extractive Industries Taxpayer and refers to a person that holds a mining License or mining Authorization or is party to a hydrocarbons Contract;

5. a "QEIT asset" is an asset that –

   - has an effective life of more than 12 months; and

   - is constructed or acquired to be used directly in the business stated in the mining License, mining Authorization or hydrocarbons Contract.

(2) A well that is drilled by a QEIT for the purpose of exploring for, developing, or producing hydrocarbons shall be deemed to be a QEIT asset and all costs incurred in the course of drilling the well, contracting with another person to drill the well for the QEIT, or closing a well shall be treated as the cost of acquiring the well. Where the drilling or contracting costs for drilling are incurred over more than one tax year, the QEIT shall be treated as acquiring separate QEIT assets in each year with a cost for each asset equal to the drilling or contracting costs for drilling incurred in that year.

77.1 Chapter 12 of the Income Tax Law contains rules that apply to taxpayers known as Qualifying Extractive Industries Taxpayers. Subparagraph 4 of paragraph (1) of Article 77 defines a QEIT as a person that holds a mining License or mining Authorization or is party to a hydrocarbons Contract. The remaining Articles in Chapter 12 apply only to a taxpayer that is a QEIT.

Article 77 also defines important concepts used in later Articles in the Chapter. Subparagraphs 1, 2, and 3 of paragraph (1) of Article 77 describe the types of rights that a taxpayer can hold in order to be considered a QEIT – a mining Authorization, a mining License, or a hydrocarbons Contract. These three terms are used throughout the Chapter.

77.2 A business that is involved in the extractive industries but which is not a QEIT as defined will not be entitled to use the provisions of Chapter 12.

Example: *Mining Support Services is a company with provides accommodation and meals to contractors and employees working on a copper mining site. The copper mine site is operated by Global Copper which holds a mining Authorisation. Only Global Copper will be entitled to use the provisions of Chapter 12. Mining Support Services, not being a QEIT, will be subject to the all the provisions of the income tax law except Chapter 12. Even though Mining Support Services is a business involved in the extractive industries, its business operations will be taxable on the same basis as for any other business in any other industry.*

77.3 Subparagraph 5 of paragraph (1) of Article 77 defines a QEIT asset. This definition is used in Article 81 which provides an accelerated depreciation rule for QEIT assets.

Paragraph (2) of Article 77 expands the definition of a QEIT asset to include all costs incurred by a QEIT in the course of drilling a well for the purpose of exploring for, developing, or producing hydrocarbons. The effect of this definition is to bring the cost of drilling a well into Article 81 so the cost will be deducted by way of depreciation deductions. The definition treats each year's costs as a separate QEIT asset, to be depreciated separately.

| | |
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| Article 78 | Precedence of Chapter 12 The Articles in the Chapters of this Law apart from this Chapter apply to a QEIT in the same manner they apply to a taxpayer that is not a QEIT unless they are changed by an Article in this Chapter. |

78.1 Chapter 12 contains specific tax rules for what are known as "qualifying extractive industry taxpayers" – taxpayers that hold a mining License or mining Authorization or are party to a hydrocarbons Contract.

Chapter 12 does *not* displace the remainder of the Income Tax Law for these taxpayers. A qualifying extractive industry taxpayer (or QEIT) is subject to the remainder of the Law in the same manner as all other taxpayers. The only effect of Chapter 12 is to modify a limited number of general rules so they operate more appropriately to QEITs in recognition of some features of extractive industry investments that are not found in other commercial enterprises.

Article 78 makes it clear that all Articles of the Income Tax Law apply to QEITs in the same manner as they apply to other taxpayers unless there is an Article in Chapter 12 that prescribes a different rule. In this case, the rule in Chapter 12 takes precedence over the rule that would otherwise apply.

| | |
|---|---|
| Article 79 | Tax obligations of QEIT (1) A QEIT shall be treated as a separate taxpayer in respect of each mining Authorization, mining License, or Contract for hydrocarbons.<br><br>(2) If a QEIT is party to more than one hydrocarbon Contract or holds more than one mining License, or mining Authorization, or any combination of these, the person shall be treated as if it were a separate person in respect of the business operations related to each hydrocarbon Contract, mining License, or mining Authorization.<br><br>(3) If a hydrocarbon Contract, mining License, or mining Authorization is renewed, the renewal shall be treated as part of the original hydrocarbon Contract, mining License, or mining Authorization for the purpose of this Article.<br><br>(4) If a QEIT is party to more than one hydrocarbon Contract or holds more than one mining License, or mining Authorization, or any combination of these and incurs expenditure in relation to more than one hydrocarbon Contract, mining License, or mining Authorization, the expenditure shall be apportioned between the different parts of the business on the basis of the application of the expenditure. |

79.1 To ensure the cost of acquiring an extractive industry asset is matched with the income produced by the asset, Article 79 treats each taxpayer as a separate person for each mining License, mining Authorization, or hydrocarbons Contract held by the taxpayer. As a result of this rule, a taxpayer cannot, for example, deduct expenses from developing a mine under one mining License against income derived from selling the output of a mine under another License held by the taxpayer. Instead, the cost of developing each mine will be deducted against the income derived from exploiting the mine.

If this rule were not used, a taxpayer that embarked upon a series of separate projects could avoid paying tax on income derived from the mature projects by starting a new project and deducting the expenses incurred on starting up the new project from the income derived from the mature projects that are already in production. By treating a taxpayer as a separate person in respect of each mining License, mining Authorization, or hydrocarbons Contract held by the person, the expenses incurred for each project will be matched to the income produced from the project.

*Example: Afghan Mining holds four Mining Licenses and Authorizations that cover two contiguous areas. In 2008, the company's operations in area 1 reached the production stage. The expenses and income from operations in area 2 in afghanis are as follows:*

| ***year*** | ***costs for that year*** | ***cumulative pre-production costs to the start of that year*** | ***sales*** |
|---|---|---|---|
| *2006* | *6 m* | *0 m* | *0* |
| *2007* | *6 m* | *6 m* | *100,000* |
| *2008* | *6 m* | *12 m* | *800,000* |
| *2009* | *4 m* | | *8 m* |
| *2010* | *4 m* | | *8 m* |
| *2011* | *4 m* | | *8 m* |

*As explained below in the description of Article 83, in 2008, the taxpayer can deduct its expenses for that year of 6 m (unless the expenses were incurred to acquire depreciable QEIT assets) and also deduct a portion of the 12 m pre-production costs incurred prior to 2008. The deductions allowed in 2008 for area 2 greatly exceed the income derived from area 2 in that year. However, as a result of Article 79, Afghan Mining cannot deduct the excess expenses from its income from area 1, which is mined under a separate mining Authorization. Instead, it will have a loss in 2008 in respect of area 2 and can carry the loss forward to deduct in later years against future income from the sale of minerals from area 2.*

| | |
|---|---|
| Article 80 | Business receipts tax The business receipts tax imposed under Chapter 10 of this Law shall not apply to:<br><br>1. receipts of a QEIT from the sale of mineral substances (as defined in the Minerals Law, 2005) that are subject to a mining License or mining Authorization;<br><br>2. receipts of a QEIT from the sale of hydrocarbons that are subject to a hydrocarbons Contract; or<br><br>3. receipts of a QEIT from the sale or transfer of a mining License or mining Authorization or a hydrocarbons Contract. |

80.1 The Business Receipts Tax imposed by Chapter 10 of the Income Tax Law is a turnover tax based on gross receipts of a business. The sale of Mineral Substances (as defined in the Minerals Law, 2005) is subject to royalties charges also imposed on the gross receipts from the sale. The rate of royalties imposed on gross receipts from the sale of minerals is determined on the basis that royalties will be the only charge imposed on the gross receipts. Article 80 exempts the receipts from Business Receipts Tax imposed under Chapter 10 of the Income Tax Law to ensure the royalties provisions in the Minerals Law, 2005 operate as intended and are the only charges imposed on the gross receipts from mineral sales.

80.2 Hydrocarbons are subject to a different licensing regime from the system applied to other mineral substances. The production of hydrocarbons is subject to royalties and "production sharing" agreements. As was the case with royalties imposed under the Minerals Law, the royalties regime and production sharing formula for hydrocarbons are calculated on the basis that there will be no additional tax based on gross sales. And again, as was the case with mineral sales, Article 80 exempts receipts from the sale of hydrocarbons from the Business Receipts Tax imposed under Chapter 10 of the Income Tax Law if the seller holds a contract for the conduct of hydrocarbon operations in Afghanistan. This ensures the hydrocarbons royalties and production sharing rules will operate as intended and there will be no further costs imposed on the gross production of hydrocarbons.

80.3 Article 80 also exempts the gross receipts from the sale or transfer of a mining License or mining Authorization or a hydrocarbons Contract from Business Receipts Tax.

80.4 Article 80 exempts three types of receipts from Business Receipts Tax but the exemption has no application to the income tax imposed on taxable income under Article 4. The taxable income of a taxpayer is a measurement of net profits after deductions as allowed under the Income Tax Law.

Article 81 Depreciation deductions

(1) Contrary to sub-paragraph (7) of paragraph (1) of Article 18 of this Law, a person that is a QEIT and that incurs an expense to acquire a QEIT asset other than a building or rights to occupy a building may deduct the cost of acquiring the asset for a year on a straight-line basis over the lesser of:

1. the effective life of the asset; and

2. five years

commencing with a deduction in the year in which the asset is acquired.

(2) Contrary to sub-paragraph (7) of paragraph (1) of Article 18 of this Law, a person that is a QEIT and that incurs an expense other than annual rent to construct or acquire a QEIT asset that is a building or to acquire rights to occupy a building may deduct the expense on a straight-line basis over 15 years, commencing with a deduction in the year in which the expense is incurred.

(3) A person that is a QEIT that incurs an expense to acquire a mining Authorization or mining License or hydrocarbons Contract may deduct the cost of acquiring the Authorization, License or Contract on a straight-line basis over the period to which the Authorization, License or Contract applies.

(4) The depreciated value of a QEIT asset at any time shall be the original cost less any deductions for the cost of constructing or acquiring the asset that were allowed under this Article. Where a person that is a QEIT disposes of a QEIT asset for more than its depreciated value, the excess of sale proceeds over depreciated value shall be included in the person's income for tax purposes. Where a person that is a QEIT disposes of a QEIT asset for less than its depreciated value, the excess of depreciated value over sale proceeds shall be deductible in the year of sale.

81.1 Where a taxpayer incurs a capital expense to acquire an asset with a life that lasts longer than the end of the fiscal year, no deduction is allowed for the cost of acquisition. By itself, the acquisition of an asset by a taxpayer does not result in any change in the net economic position of the taxpayer. Rather, it is merely a conversion of property from one form (most often money) to another form (tangible or intangible moveable property). As the property depreciates in value due to use or the passage of time, the taxpayer is allowed a deduction for the depreciation under paragraph 7 of subsection (1) of Article 18.

81.2 *Machinery and property other than buildings*

The rate of depreciation allowed under paragraph 7 of subsection (1) of Article 18 is set out in this Income Tax Manual and is based on the estimated life of the property. In the case of intangible property such as a contract or patent, the life of the property is known from the outset. In the case of tangible property such as machinery or buildings, an estimate must be made of the life of the property. However, subsection (1) of Article 81 provides an "accelerated depreciation" rule that sets the maximum depreciation deduction period for all capital assets other

than buildings or rights to occupy buildings at five years. The depreciation rate set out in subsection (1) of Article 81 is the *lesser* of five years and the effective life of the asset. If the asset has a life less than five years, the ordinary life is used. This could be the case, for example, with some quickly used small machinery or a contract for a few years. The cost is depreciated on a "straight-line" basis, meaning it is recognized in equal deductions over the life of the asset or the five year period if that applies.

Article 81 sets a maximum depreciation period for the cost of the asset and provides for straight-line depreciation. It does not replace paragraph 7 of subsection (1) of Article 18 and apart from the time period specified in Article 81, actual depreciation is calculated using the procedures set out in the Income Tax Manual for paragraph 7 of subsection (1) of Article 18. Thus, if a QEIT asset is acquired part way through a fiscal year, the procedures set out in the Income Tax Manual for paragraph 7 of subsection (1) of Article 18 will apply in the same manner as they would for other assets.

The accelerated depreciation deduction rules in paragraph (1) of Article 81 only apply to QEIT assets, which are defined in subparagraph 5 of paragraph (1) of Article 77 as assets constructed or acquired to be used directly in the business subject to a mining License or mining Authorization or a hydrocarbons Contract. Thus, if a company that had a quarry license to extract limestone also manufactured cement, the accelerated depreciation deduction rule would only apply to machines used in the quarry operation and not to machines used in the cement factory.

The phrase "used directly in the business subject to a mining License or mining Authorization or a hydrocarbons Contract" indicates that that a QEIT asset must actually be used in the process of carrying out the activity specified in a mining Authorization or License or a hydrocarbons Contract. This will be actual mining exploration or minerals extraction or actual hydrocarbon exploration or extraction.

It is assumed that assets used at a mining or hydrocarbons exploration or extraction site are applied directly to the activity specified in a mining Authorization or License or a hydrocarbons Contract. Assets used elsewhere will not be considered to be used in the process of carrying out the activity specified in a mining Authorization or License or a hydrocarbons Contract. Thus, assets used in an office of the taxpayer located in a city away from the mining or hydrocarbons operations will not be QEIT assets and the ordinary depreciation rules in paragraph 7 of subsection (1) of Article 18 will apply to these assets.

81.3 *Hydrocarbons Well*

Paragraph (2) of Article 77 deems a well that is drilled by a QEIT for the purpose of exploring for, developing, or producing hydrocarbons to be a QEIT asset and further treats all costs incurred in the course of drilling the well, contracting with another person to drill the well for the QEIT, or closing a well as the cost of acquiring the well. As a result, the cost of drilling a well will be the

cost of a QEIT asset and can be deducted over the lesser of the expected life of the well and five years.

Only costs incurred in the actual drilling of a well, contracting with another person to drill a well for the QEIT, closing a well or acquiring a well are costs of a QEIT asset. Preparatory costs such as surveying or site preparation are not costs incurred in drilling a well and thus would not be costs incurred to acquire a QEIT asset. Those costs would not be recognized under Article 81, dealing with QEIT asset costs, and instead would be recognized under Article 83, dealing with pre-production costs.

81.4 *Buildings*

Assets that are subject to the depreciation rule in paragraph (1) of Article 81 do *not* include the cost of acquiring buildings or the right to occupy buildings that are QEIT assets. These are subject to the rule in paragraph 2 of Article 81. A QEIT asset is defined in paragraph 5 of subsection (1) of Article 77. A QEIT asset has two identifiable characteristics: it will have an effective life greater than 12 months; and it will have been constructed or acquired to be used directly in the business subject to a mining License or mining Authorization or a hydrocarbons Contract. If the QEIT asset is a building or a right to occupy a building, Article 81 rather than Article 18 will govern the maximum period for depreciation of the cost of acquisition or construction.

As is the case with assets other than buildings, it is assumed that buildings used at a mining or hydrocarbons exploration or extraction site are applied directly to the activity specified in a mining Authorization or License or a hydrocarbons Contract. Buildings used elsewhere will not be considered to be used in the process of carrying out the activity specified in a mining Authorization or License or a hydrocarbons Contract. Thus, an office building of the taxpayer located in a city away from the mining or hydrocarbons operations will not be a QEIT asset and the ordinary depreciation rules in paragraph 7 of subsection (1) of Article 18 will apply to the building.

Paragraph 2 of Article 81 applies to the cost of constructing or acquiring a building and the cost of acquiring a right to occupy a building other than the cost of annual rent. Ordinary rent is deductible as it is incurred. However, "pre-paid" rent for or a lump sum payment for a long-term lease would be treated as the equivalent as the cost of acquiring a building and subject to paragraph (2).

A single depreciation rule applies to the cost of constructing or acquiring buildings that are QEIT assets. These costs are depreciated on a straight-line basis (in equal annual deductions) over 15 years, subject to special rules for partial year depreciation in the year of acquisition. These are described in the Income Tax Manual for Article 18.

81.5 *Mining Authorization, Mining License, or Hydrocarbons Contract*

The cost of acquiring a mining Authorization, mining License, or hydrocarbons Contract (as these terms are defined in Article 77) is depreciable on a straight

line basis (in equal annual deductions) over the life of the rights acquired. The cost of acquiring a mining Authorization, mining License, or hydrocarbons Contract includes all incidental costs such as legal fees and other indirect expenses that led to the acquisition of the mining Authorization, mining License, or hydrocarbons Contract. As these expenses are part of the cost of acquisition, under subparagraph 1 of paragraph (2) of Article 19 they may not be deducted under another provision but must be recognized under the depreciation rules.

81.6 *Balancing adjustment on disposal of QEIT asset*

When a QEIT sells an asset that is depreciated under Article 81, there will be a balancing adjustment if the sale proceeds are greater or lesser than the asset's "depreciated value" at that time. The depreciated value is the original cost less any depreciation deductions that were previously taken. If the sale proceeds exceed the depreciated value, previous deductions proved to be excessive and the excess deductions are "recaptured" by way of an income inclusion. The excess of sale proceeds over depreciated value is included in income. If the sale proceeds are less than the depreciated value, previous deductions proved to be insufficient and the shortfall is recognized by way of a further deduction. The excess of depreciated value over the sale proceeds is allowed as a deduction.

If a QEIT sells all its rights in a project, including its rights to the original license and all its equipment and buildings, the seller and the buyer will be required to allocate the sale price between the different types of property transferred so the provisions of Article 81 can be applied by the seller and the purchaser. The price must be allocated on the basis of the market value of the different assets sold.

Article 82 Cost of constructing roads

(1) This Article applies to a person that is a QEIT and that incurs an expense to construct a road that will be used to carry on a business that is subject to a mining License or mining Authorization or a hydrocarbons Contract.

(2) A person described in paragraph (1) of this Article may deduct the cost of constructing the road described in paragraph (1) of this Article over a period of fifteen years commencing with a deduction in the year in which the road is completed.

(3) This paragraph applies where a person that is a QEIT sells its rights under a mining License or mining Authorization or hydrocarbons Contract to another person and as a result of that transfer the person making the sale will no longer use a road described in paragraph (1) of this Article and the person acquiring the mining License, mining Authorization or hydrocarbons Contract will use the road. In this situation, the person acquiring the mining License, mining Authorization or hydrocarbons Contract asset shall be entitled to deduct the undeducted cost of constructing the road over the remaining deduction years. For this purpose, the remaining deduction years for the road shall be calculated as 15 minus the number of years during which the previous owner or owners were entitled to deductions under this Article.

(4) Where paragraph (3) of this Article applies to a road described in paragraph (1) of this Article, the person who sells its rights under a mining License, mining Authorization or hydrocarbons Contract shall not entitled to any deductions under this Article for the cost of constructing the road the year in which the rights under the mining License, mining Authorization or hydrocarbons Contract are sold or in any later year.

82.1 It is common for mining or hydrocarbon projects to be located in areas that are not accessible using existing roads. In this case, the QEIT with a hydrocarbons Contract, mining Authorization or mining License will have to construct roads to gain access to the site. The QEIT has rights to use immovable property and to extract minerals or hydrocarbons from the property, but does not have any ownership of the underlying property. The roads, therefore, will revert to the owner of the immovable property at the end of the contract or license. Normally it is the owner of property that is allowed depreciation deductions under Article 18. However, Article 82 extends depreciation rights to the QEIT that has incurred costs to construct a road used for a QEIT project.

82.2 Subsection (2) of Article 82 sets out a 15 year depreciation period. Depreciation is allowed on a straight-line basis and the ordinary depreciation rules in paragraph 7 of subsection (1) of Article 18 apply. However, since Article 82 provides for deductions "over a period of fifteen years commencing with a deduction in the year in which the road is completed" the rule in Article 18 that applies to acquisitions part way through a tax year does not apply. An eligible QEIT can deduct 1/15 of the cost of constructing a road in the year in which the road is completed. Apart from the time period specified in Article 82, depreciation is calculated using the procedures set out in the Income Tax Manual for paragraph 7 of subsection (1) of Article 18.

82.3 The depreciation period is fixed from the year in which the road is completed. If one QEIT sells its rights in a natural resource exploitation project to another QEIT, under subsection (3) of Article 82, the original period continues and the new owner is entitled to depreciation deductions for the remaining period of the original 15 years.

82.4 Subsection (4) makes it clear that following the sale of a natural resource project, including rights to use any road constructed for the project, the seller is not entitled to further deductions for the construction of the road and only the purchaser is entitled to those deductions.

*Example:* *Afghan Minerals is a foreign-owned company. It applied for permission under Article 3 of this Law to use a substituted fiscal year based on the European calendar running from 1 January to 31 December. Permission was granted.*

*In November 2006, Afghan Minerals commenced work on a copper mine, including an access road from the Kabul-Herat Road to the mining site. The road cost 300,000 afghanis to construct. It was completed at the end of June 2007. In 2007 and in each of the following 14 years, Afghan Minerals is allowed to deduct 1/15 x 300,000 = 20,000 afghanis.*

*In 2012, Afghan Minerals sold its mining operations to New Mining Company for 5 million afghanis. At that time, Afghan Minerals had deducted 100,000 in years 2007-2011. Of the 5 million that New Mining Company paid for the entire operation of Afghan Minerals, (300,000 – 100,000) = 200,000 afghanis is presumed to have been paid for all rights related to the road. The cost of all the other assets and rights acquired is thus 4,800,000 afghanis. New Mining Company is able to deduct 20,000 afghanis in 2012 and in each of the following 9 years.*

Article 83 Pre-production costs

(1) Notwithstanding Article 18 of this Law, a person that is a QEIT may only deduct an expenditure that is a pre-production cost on a straight-line basis over the pre-production cost recovery period where –

1. a "pre-production cost" is any expenditure that is incurred by a QEIT prior to commencing commercial production of minerals in the course of business related to a mining License or mining Authorization or a hydrocarbons Contract. However, a pre-production cost does not include the cost of acquiring a QEIT asset or the cost of constructing a road;

2. the "pre-production cost recovery period" for a mining business carried on by a QEIT in an area defined in a mining License or mining Authorization shall be the lesser of –

   - 15 years; and

   - the number of years remaining in the License or Authorization

3. the "pre-production cost recovery period" for a hydrocarbon business is the number of years remaining in the Contract.

(2) A QEIT shall be treated as commencing commercial production of minerals or hydrocarbons in the earlier of:

1. the year in which the Ministry of Finance and the Ministry of Mines and Industries issue to the QEIT a written notification that the Ministries jointly accept a written submission by a QEIT that it has commenced commercial production, and

2. in the case of a QEIT that holds a mining Authorization, the year in which the proceeds from the sale of minerals exceeds 6 percent of the pre-production costs incurred by the QEIT prior to that year, or

3. in the case of a QEIT that holds a hydrocarbons Contract, the year in which the proceeds from the sale of hydrocarbons exceeds the threshold percentage of the pre-production costs incurred by the QEIT prior to that year where the number in the threshold percentage is determined by dividing 100 by the number of years of the hydrocarbons Contract.

(3) Where a person that is a QEIT sells its rights in a mining License or mining Authorization or hydrocarbon Contract to another QEIT, the first QEIT may add to the cost of acquiring its rights in the License, Authorization or Contract any pre-production expenses it incurred that have not been previously deducted under paragraph (1).

83.1 Article 83 explains how a QEIT can recognize pre-production costs for tax purposes. Pre-production costs are defined in paragraph 1 of subsection (1) of Article 83. These are any expenses incurred by a QEIT prior to commencing commercial production of minerals related to a mining License or mining

Authorization or a hydrocarbons Contract other than the cost of acquiring QEIT assets (which are depreciated under Article 81) or constructing a road (which are depreciated under Article 82).

83.2 Pre-production costs are considered to be a type of "capital expense" incurred by a QEIT in the acquisition of an asset, namely an operative mine or hydrocarbon well. Article 83 requires the QEIT to keep record of all pre-production costs and then allows the QEIT to depreciate the costs over what is known as the "pre-production cost recovery period". This is defined in paragraph 2 of subsection (1) of Article 83 as the lesser of 15 years and the number of years remaining in the License or Authorization for a mining project and in paragraph 3 of subsection (1) of Article 83 as the number of years remaining in a hydrocarbon Contract in the case of a hydrocarbon project. The number of years remaining in a mining License, mining Authorization or hydrocarbons Contract is calculated from the beginning of the year in which commercial production commences.

*Example:* *Afghan Mining commences operations in 2006. It has a 20 year mining Authorization. Afghan Mining incurs substantial pre-production expenses from 2006 to 2008. In 2009, it commences commercial production (according to the formula in paragraph 2 of subsection (2) of Article 83). There are 17 years remaining in the mining Authorization. The deduction period in paragraph 2 of subsection (1) of Article 83 is thus 15 years. Afghan Mining may deduct 1/15 of its pre-production costs in 2009 and for each of the following 14 years.*

83.3 The rule in Article 83 only applies to "pre-production costs" which are defined in paragraph 1 of subsection (1) of Article 83 as expenses incurred prior to commencing commercial production. The time at which a QEIT will be considered to have commenced commercial production is defined in subsection (2) of Article 83. It is the earlier of the year in which the Ministry of Finance and the Ministry of Mines and Industries issue to the QEIT a written notification that the Ministries jointly accept a written submission by a QEIT that it has commenced commercial production and a production threshold. Different production thresholds apply to hydrocarbon and mineral QEITs. In the case of a minerals QEIT, the production threshold is set out in paragraph 2 of subsection (2) of Article 83. A minerals QEIT will be treated as meeting the production threshold in the year in which the proceeds from the sale of minerals exceeds 6 percent of the pre-production costs incurred by the QEIT prior to that year.

*Example:* *Afghan Minerals has a mining Authorisation and commences to establish a coal mine in 2006. Afghan Minerals incurs annual expenses of 6 million afghanis over three years and 4 million afghanis in subsequent years. In 2009 it began limited sales and started full production in 2011. Its sales and expenses in afghanis are as follows:*

| *year* | *costs for that year* | *cumulative pre-production costs to the start of that year* | *sales* |
|---|---|---|---|
| *2006* | *6 m* | *0 m* | *0* |
| *2007* | *6 m* | *6 m* | *100,000* |
| *2008* | *6 m* | *12 m* | *800,000* |
| *2009* | *4 m* | | *8 m* |
| *2010* | *4 m* | | *8 m* |
| *2011* | *4 m* | | *8 m* |

*In 2007, sales amounted to 100,000/6,000,000 = 1.6% of prior cumulative pre-production costs.*

*In 2008, sales amounted to 800,000/12,000,000 = 6.6% of prior cumulative pre-production costs. As a result, the QEIT can begin depreciating the $12 m of pre-production costs in 2008. Expenses incurred in 2008 will not be pre-production costs. Their treatment will depend on the nature of the costs. If they are costs incurred to acquire QEIT assets, the QEIT asset depreciation rules will apply to them. If they are production costs that do not involve the acquisition of QEIT assets they can be deducted in that year.*

83.4 In the case of a hydrocarbons QEIT, the year in which the production threshold will have been met is described in paragraph 3 of subsection (2) of Article 83. For a QEIT that holds a hydrocarbons Contract, this is defined as the year in which the proceeds from the sale of hydrocarbons exceeds the threshold percentage of pre-production costs where the threshold percentage is determined by dividing 100 by the number of years of the hydrocarbons Contract.

*Example: PetroAfghan has a 10 year production license under a hydrocarbons contract. It incurs drilling costs and operating costs in afghanis as follows:*

| *year* | *costs for that year* | *cumulative pre-production costs to the start of that year* | *sales* |
|---|---|---|---|
| *2006* | *6 m* | *0 m* | *0* |
| *2007* | *6 m* | *6 m* | *100,000* |
| *2008* | *9 m* | *12 m* | *800,000* |
| *2009* | *1 m* | *21 m* | *4 m* |
| *2010* | *1 m* | | *4 m* |
| *2011* | *1 m* | | *4 m* |

*The production threshold for PetroAfghan is determined as 10/100 = 10%. The year in which sales exceed 10% of pre-production costs incurred prior*

*to that year, the QEIT may commence to depreciate the pre-production costs.*

*In 2007, sales amounted to 100,000/6,000,000 = 1.6% of prior cumulative pre-production costs.*

*In 2008, sales amounted to 800,000/12,000,000 = 6.6% of prior cumulative pre-production costs.*

*In 2009, sales amounted to 4,000,000/21,000,000 = 19% of prior cumulative pre-production costs. The remaining time on the contract (including the year of qualification) is 7 years. The taxpayer can therefore depreciate $21,000,000 over 7 years which equals $3,000,000 per year. The treatment of the $1 million incurred in 2009 will depend on whether the expenses were for QEIT assets (and therefore depreciable) or for expenses that were consumed in the year (and therefore deductible).*

83.5 Subsection (3) of Article 83 explains what happens if a QEIT sells its rights in a mining License or mining Authorization or hydrocarbon Contract to another QEIT. At the time it sells its rights, it may have deducted all the pre-production costs incurred. It can add the undeducted costs to the cost of its rights when calculating the gain or loss on the sale of the rights.

*Example:* *Consider the example of PetroAfghan immediately above if PetroAfghan had sold its rights under its hydrocarbons Contract to NewCo in 2010 for 25 million afghanis. At that point, PetroAfghan will have deducted 3,000,000 of its 21,000,000 afghanis pre-production costs. It has not deducted 18,000,000 afghanis of the pre-production costs. Under subsection (3) of Article 83, PetroAfghan can treat the excess of its pre-production costs over the portion previously deducted as costs of acquiring the Contract rights. When it sells its rights to NewCo, it will have a gain of 25,000,000 minus 18,000,000 = 7,000,000 afghanis profit on the sale.*

*The first QEIT may add to the cost of acquiring its rights in the License, Authorization or Contract any pre-production expenses it incurred that have not been previously deducted under paragraph (1).*

Article 84 Deduction for contributions to a fund for environmental and social obligations

A person that is a QEIT may deduct any amount that is required to be paid in respect of environmental and social obligations under Article 82 of the Minerals Law, 2005 or pursuant to a plan required by any applicable law affecting hydrocarbons provided –

1. the amount is paid to an entity that has no direct or indirect connection to the person claiming a deduction under this Article; and

2. the person provides, through a financial institution approved for this purpose by the Da Afghanistan Bank, a bank guarantee for payment to the Ministry of Finance of the deductible amount in the event the entity holding the amount deposited does not apply the funds as specified in the governing Minerals Regulations or pursuant to a plan required by any applicable law affecting hydrocarbons.

84.1 Under normal circumstances, payments to a fund for future environmental or social obligations would not give rise to a deduction as the payment would be treated as a provision or reserve (in effect, an amount set aside for future expenditure) with a deduction available only when amounts are spent on actual environmental or social purposes related to the original QEIT operations. However, Article 84 allows a deduction for contributions to a fund for environmental and social obligations of a QEIT where the QEIT has completely severed its power to control the use of the money paid to the fund.

The subsection contains two conditions that must be met to ensure the QEIT has truly given up all control over the money and further that the money is guaranteed to be available for the intended purpose. The first condition is that the environmental or social fund must be under the control of another entity that has no direct or indirect connection to the person claiming a deduction under Article 84. Second, the QEIT making the contribution must provide the Ministry of Finance with a bank guarantee for payment of the amount deducted in the event the entity holding the amount deposited does not apply the funds as specified in the governing Minerals Regulations or pursuant to a plan required by any applicable law affecting hydrocarbons.

84.2 A bank guarantee imposes an obligation on the financial institution that issues the guarantee to make a payment of the amount that should have been applied by the fund for environmental or social purposes. It is an absolute promise by a financial institution to make a payment upon presentation by the Ministry of Finance of evidence showing the entity holding funds to be used for environmental or social purposes did not apply the funds as specified in the governing Minerals Regulations or pursuant to a plan required by any applicable law affecting hydrocarbons. A bank guarantee will only satisfy the requirements of Article 84 if the financial institution issuing the bank guarantee has been approved for this purpose by the Da Afghanistan Bank.

84.3 It is a requirement for the deduction that the environmental or social fund to which money is contributed must be under the control of another entity that has no direct or indirect connection to the QEIT claiming the deduction. This

requirement is intended to ensure that the QEIT that claimed a deduction cannot later access the funds for its own purposes. It may be the case, however, that despite the assurances given, the QEIT claiming the deduction has a connection with the entity controlling the fund or has influence over that entity and as a result amounts from the fund are later passed directly or indirectly back to the QEIT that claimed the deduction or to an entity connected with the QEIT that claimed the deduction. Amounts would be considered to be passed indirectly back to the QEIT where the money is spent for the benefit of the QEIT that claimed the deduction or for the benefit of another entity that is connected to the QEIT who claimed the deduction. In these cases, the amount that passed directly or indirectly back to the QEIT who claimed the deduction would be treated for tax purposes as income of the QEIT.

84.4 In the ordinary course of events where a QEIT pays an amount into a social or environmental fund and the money is later applied by the fund for the purposes specified in the Mining Regulations or pursuant to a plan required by any applicable law affecting hydrocarbons, the money in the fund will have been completely severed from the company that contributed it. The use of the money by the fund will have no connection to the QEIT that originally contributed it and the spending of the money has no effect on the tax liability of the QEIT.

Article 85 Loss carry-forward and stability agreements

(1) Article 42 of this Law, which imposes a limit on the recognition of net operating losses, shall not apply to a QEIT. Where a QEIT incurs a net operating loss as defined in Article 47, the loss may be treated as a deductible expense in the following year.

(2) Subject to paragraph (3) of this Article, the Ministry of Finance shall apply to a QEIT the provisions of this Law as they stood at the time the QEIT became party to a mining Authorization, mining License, or hydrocarbons Contract for a period of:

1. 5 years, in the case of a QEIT holding a mining Authorization, commencing with the year in which the QEIT begins to hold the Authorization;

2. 8 years, in the case of a QEIT holding a mining License, commencing in the year with the year in which the QEIT begins to hold the License; or

3. the period of the hydrocarbons Contract, in the case of a QEIT that is party to a hydrocarbons Contract.

(3) The Ministry of Finance shall only apply the provisions of this Law to a QEIT as set out in paragraph (2) where the QEIT has agreed in writing that taxable income of the QEIT shall be subject to an income tax rate of 30 per cent for the years in which the provisions of this Law are applied by the Ministry of Finance on the basis of this Article without regard to subsequent changes.

*85.1 Loss carry forward*

Article 42 provides a loss carry-forward rule for taxpayers incurring a net operating loss. As a result of subsection (1) of Article 85, the rule in Article 42 will not apply to a taxpayer that is a QEIT. The loss carry-forward rule in Article 42 allows taxpayers that incur a net operating loss in a year to deduct one-third of the loss in each of the following three years. The rule in subsection (1) of Article 85 allows a QEIT that has incurred a loss to deduct the entire loss in the following fiscal year. If the deduction in a later year leads to a loss in that later year, that loss, too, may be carried forward to the next year. The effect is to allow indefinite carry-forward for net operating losses.

*85.2 Stability*

Subsection (2) of Article 85 provides entities that hold a mining Authorization, mining License, or hydrocarbons Contract with a "tax stability" guarantee. This is an assurance that the tax law in effect at the time they became a party to the mining Authorization, mining License, or hydrocarbons Contract will continue to apply to them for the time set out in the subsection. This stability guarantee allows entities in long-term natural resource extraction projects to invest on the basis of certainty as to all the tax rules and tax rates that will apply to profits from the project for the period set out in the subsection. In other words, the entire Income Tax Law, including all administrative, rate and other provisions, in effect at the time the QEIT became a party to the mining Authorization, mining License, or hydrocarbons Contract will continue to apply to them for the time set

out in the subsection. The tax stability period is 5 years, in the case of a QEIT holding a mining Authorization, 8 years, in the case of a QEIT holding a mining License, and the period of the hydrocarbons Contract, in the case of a QEIT that is party to a hydrocarbons Contract. The stability period runs from the year in which the QEIT begins to hold the mining License, mining Authorization or hydrocarbons contract, as the case may be.

To qualify for application of the tax stability rule in subsection (2), the QEIT must agree in writing that the tax rate applied to the taxpayer will be 30% instead of the rate that would otherwise apply. The tax stability agreement must be entered into at the same time as the mining Authorization, mining License, or hydrocarbons Contract to which it relates.

As a tax stability agreement is entered into at same time as the mining Authorization, mining License, or hydrocarbons Contract to which it relates, a QEIT who has more than one Authorization, License or Contract will have more than one stability agreement, assuming the QEIT has signed stability agreements for the different Authorizations, Licenses or Contracts. As a result of Article 79, a QEIT that holds more than one Authorization, License or Contract will be treated as a separate taxpayer in respect of each Authorization, License or Contract it holds.

A QEIT that holds more than one Authorization, License or Contract may have some expenses common to two or more Authorizations, Licenses or Contracts. For example, a QEIT may have a head office in Kabul and hold Contracts for two separate drilling areas in other provinces. The assets in Kabul cannot be QEIT assets as they are not used directly in the drilling and hydrocarbon extraction process. Similarly, expenses incurred for operations in Kabul cannot be pre-production expenses. The costs of assets in the Kabul office and other expenses are subject to the ordinary provisions of the Income Tax Law, not Chapter 12. As a separate stability agreement will apply to each Contract, the agreements will have no effect on the separate application of the Income Tax Law to the operations in Kabul.

# CHAPTER 13

# ASSESSMENTS, RETURNS, OBJECTIONS AND PAYMENT OF TAX

## Article 86 - Article 91

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| Article 86 | Taxpayer Identification Numbers (1) Individuals, companies and organizations which are, according to the Income Tax Law or the Customs Law, required to pay taxes or customs duties; social, non-profit and welfare organizations which are required to withhold taxes from the salaries or wages of their employees; persons who have an account or open an account with a bank or other financial institution; and employees whose income is subject to income tax withholding under provisions of this Law shall be required to have a Taxpayer Identification Number.<br><br>(2) Procedures for the issue and use of Taxpayer Identification Numbers shall be prescribed by the Ministry of Finance.<br><br>(3) Ministries, government agencies and other government organizations shall not issue or renew business licenses for natural or legal persons who are required to have a Taxpayer Identification Number but fail to provide it. |

86.1 Individuals, companies and organizations that are required to pay taxes or customs duties are required to have a taxpayer identification number.

*Example 1*: *Wahid is an employee of a Non-Governmental Organization. Wahid earns Afs. 4,000 per month. Wahid does not have any other income. Wahid is not subject to income tax under Article 4. Wahid does not have to obtain a taxpayer identification number.*

*Example 2*: *Wahid is an employee of a Non-Governmental Organization. Wahid earns Afs. 30,000 per month. Wahid is subject to tax under Article 4. Wahid must obtain a taxpayer identification number because he is subject to tax. The Non-Governmental Organization must also obtain a taxpayer identification number because it is obliged to withhold tax from Wahid's wages.*

*Example 3*: *Company A is an Afghan corporation that has generated losses every year that it has operated. Although Company A has generated losses, it is still required to pay Business Receipts Tax. Hence, Company A is required to obtain a taxpayer identification number.*

*Example 4*: *Company B is an Afghan corporation that is engaged in construction work in Herat. During its first year of operation, Company B imported goods that were subject to customs duty. Company B did not have any revenue in its first year of operation. Company B did not have any profit during its first year of operation. Even though Company B does not have to pay income tax or Business Receipts Tax during its first year of operation, it must obtain a taxpayer identification number, because it paid customs duties.*

86.2 Non-profit and welfare organizations that withhold taxes from the salaries or wages of their employees must obtain taxpayer identification numbers.

*Example 1:* *A non-governmental organization employs a single Afghan individual. The organization pays the employee Afs. 10,000 per month. The organization does not have any other employees. The organization does not have to withhold any portion of the employee's wages under Article 46(1). Thus, the organization does not have to obtain a taxpayer identification number.*

*Example 2:* *A non-governmental organization employs two Afghan citizens. One Afghan citizen earns Afs. 20,000 per month. The other Afghan citizen earns Afs. 10,000 per month. The non-governmental organization is required to file an application to obtain a taxpayer identification number.*

86.3 Individuals who have an account with a bank must obtain a taxpayer identification number.

*Example:* *Najibullah opens a bank account in the name of his child, Azziz. Azziz is only 10 years old, but Najibullah wants Azziz to learn how to save money. Najibullah deposits Afs. 100 in the account. Azziz must obtain a taxpayer identification number.*

86.4 To obtain a taxpayer identification number, the taxpayer should request a Tax Identification Number application form from the Ministry of Finance or at a mustofiat office which has a TIN office co-located on the premises. The Ministry of Finance's Tax Information Page at www.mof.gov.af/tax has application forms that can be downloaded, completed and submitted to the Ministry of Finance.

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| Article 87 | Assessments and amended assessments (1) Legal persons who have a license and natural persons who are subject to income tax under the provisions of this Law shall be required to file a detailed tax return and balance sheet to report income, tax withholding, and other necessary information required by the provisions of this Law and the Income Tax Manual and submit it to the relevant tax office.<br><br>(2) An individual who derives wage income that is subject to income tax withholding in accordance with the provisions of this Law shall not file a tax return unless the person receives wages from two or more employers or has other income in addition to their wage income. The tax withheld from wages or salaries under the provisions of the Law shall not be refundable.<br><br>(3) Where a person has filed a tax return required under the provisions of this Law, the tax due according to the tax return shall be treated as an assessment of tax payable and the tax return shall be treated as a notice of assessment.<br><br>(4) Where the Ministry of Finance believes that the information provided on a tax return does not correctly disclose the tax due, the Ministry of Finance may determine the amount of the tax due and issue to the person liable for payment of the tax an amended assessment notice for the amount due. This notice may also be amended if the Ministry of Finance believes it does not correctly show the tax due. The amended notice shall be treated as a notice of assessment.<br><br>(5) Where a person has not prepared and filed a tax return required under the provisions of this Law, the Ministry of Finance may determine the amount of tax due and issue the person a notice of assessment for the amount due. This notice may be amended if the Ministry of Finance believes it does not correctly show the tax due. The amended notice shall be treated as a notice of assessment.<br><br>(6) The Ministry of Finance may issue an assessment notice or amend an assessment notice only within five years of the date on which the tax return to which the notice relates was due. However, the Ministry of Finance may make or amend an assessment at any time where a person failed to file a tax return or filed an incorrect tax return (with the intent of evading tax).<br><br>(7) Where the Ministry of Finance believes that the collection of tax that will become due is in jeopardy because a person is about to depart from Afghanistan, to cease business, or to transfer property, or for other reasons, the Ministry of Finance may at any time issue an assessment notice for any period in the current or preceding tax year. |

87.1 Legal persons formed under the laws of Afghanistan are required to file an income tax return whether or not they have income during the year.

*Example 1:* *Company A is an Afghan corporation that generated Afs. 10,000 of profit during the year 1385. Company A must file an income tax return for the year 1385.*

*Example 2:* *Company B is an Afghan corporation that generated a Afs. 10,000 loss during the year 1385. Company B must file an income tax return for the year 1385 even though it does not have a tax liability in that year.*

*Example 3:* *Company C is a partnership formed under the laws of Afghanistan. Company C must file an information return every year, regardless whether the partnership generates profit or loss.*

87.2 Natural persons are required to file an income tax return. There are two exceptions, however.

(a) The first exception applies if a natural person meets the following requirements:

1. The individual is employed by a single employer.

2. The employer properly withholds tax from the individual's wages.

3. The individual does not have any other source of income.

*Example:* *Naim is employed by the Ministry of Finance. Naim earns Afs. 20,000 per month in salary. Naim has no other source of income. Naim is subject to tax under Article 4, but the Ministry of Finance withholds tax from Naim's wages. Naim does not have to file an income tax return.*

(b) The second exception applies if the natural person is not subject to income tax.

*Example:* *Baz is employed by the Ministry of Finance. Baz earns Afs. 4,500 per month in salary. Baz has no other source of income. Because Baz is not subject to tax under Article 4, Baz does not have to file an income tax return under this Article.*

87.3 Taxpayers that are subject to income tax under the Income Tax Law, but are exempt from tax due to an international agreement or treaty, must file an income tax return. The income tax return should reflect the effect of the exemption. The relevant agreement or portion of the treaty should be attached to the tax return with an explanation as to why the agreement or treaty applies.

*Example:* *Company A is an Afghan corporation that provides construction services to the Ministry of Education. Company A operates under an agreement that the Government of Afghanistan has with a foreign sovereign government. The agreement was duly entered into by the Government of Afghanistan. The agreement exempts the Contractor's activities from Afghan taxation. The contractor must file an income tax return in Afghanistan. The tax return should reflect the fact that the contractor does not owe any tax. The relevant portions of the agreement should be attached to the taxpayer's tax return.*

87.4 Taxpayers can obtain tax forms from Ministry of Finance tax offices (including mustufiats) and from authorized banks. Guides to help with the completion of tax forms can be downloaded from the Ministry of Finance website at www.mof.gov.af/tax. Instructions on the form will direct the taxpayer where the form should be filed.

87.5 If a taxpayer completes and files a tax return on a timely basis, the tax return shall constitute a notice of assessment. There are then three possibilities:

(a) If the Afghanistan Revenue Department believes that the tax return was properly filed, and the tax due was properly remitted, no further action is necessary.

(b) If the taxpayer properly completed and filed its return, but the taxpayer did not remit sufficient funds to the Ministry of Finance to satisfy the amount due, the Ministry of Finance may, at its option, seek to collect from the taxpayer the amount shown as due on the tax return.

*Example:* *Company A is an Afghan corporation that properly completes and files a tax return. The return shows that Company A owes Afs. 100,000. Company A does not remit any money with the return. The Afghanistan Revenue Department, upon examining the return and discussing the matter with the taxpayer, believes that the return was properly completed and that it is accurate. The Ministry of Finance may immediately begin collection procedures under Chapter 14 of this Income Tax Law.*

(c) If the Afghanistan Revenue Department believes, after due examination and investigation, that the tax return was improperly completed, then the Afghanistan Revenue Department has five years from the date on which the tax return was due (except where the Afghanistan Revenue Department considers the return was filed with the intent of evading tax) to issue an amended notice of assessment to the taxpayer. The amended notice should indicate the amount that the Afghanistan Revenue Department believes the taxpayer owes.

87.6 If the taxpayer has not filed a tax return that is due, the Afghanistan Revenue Department has the authority to issue a tax assessment for the taxpayer following these steps:

(a) The Afghanistan Revenue Department should request, in writing, that the taxpayer file its tax return within a reasonable time.

(b) If the taxpayer requests additional time to file its tax return, the Afghanistan Revenue Department may grant additional time in its sole discretion. If the tax return is subsequently filed, the Afghanistan Revenue Department should consider whether any potential penalties should be assessed under its authority in Chapter 16.

(c) The Afghanistan Revenue Department should prepare an assessment after it has made reasonable inquiries. In particular, the Afghanistan Revenue Department should attempt to obtain any information that would be relevant to determining the appropriate amount of tax due. For example, to determine the amount of business receipts tax due, the Afghanistan Revenue Department may request that the taxpayer provide all of its sales receipts for the past year. If inadequate information is available, the Afghanistan Revenue Department should seek to estimate the taxpayer's liability by looking at the tax liability owed by similar taxpayers under similar conditions or arrive at an estimated assessment for the taxpayer in question by other means appropriate to the situation.

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(d) Once the assessment is complete, the Afghanistan Revenue Department should deliver a completed notice of assessment to the taxpayer. If the taxpayer does not pay the tax immediately, enforcement actions may be taken in accord with Chapter 14.

87.7 If the taxpayer filed its tax return on time, but the Afghanistan Revenue Department believes that it should issue an amended assessment to the taxpayer, the Afghanistan Revenue Department must send the assessment notice to the taxpayer within 5 years of the date that the tax return was due (except where the Afghanistan Revenue Department considers the return was filed with the intent of evading tax). An assessment will be considered "sent" on the day that it is delivered to the taxpayer or to a reliable document delivery service. A document delivery service will be deemed to be "reliable" if it requires the signature of the recipient and the Afghanistan Revenue Department can establish that the signature was actually obtained. In all other cases, whether a document delivery service is considered "reliable" will depend on the relevant facts and circumstances.

87.8 If a taxpayer files a tax return, but does not file the return on time, the Afghanistan Revenue Department may (if it chooses to) issue a notice of assessment within five (5) years of the date the tax return was due to be submitted to the relevant tax office (except where the Afghanistan Revenue Department considers the return was filed with the intent of evading tax).

87.9 If a taxpayer does not file a tax return, the Afghanistan Revenue Department may (if it chooses to) issue a notice of assessment when it chooses to do so. The Afghanistan Revenue Department is not bound by the five year time limit in the case of taxpayers that do not file a tax return.

87.10 Despite the foregoing rules, the Afghanistan Revenue Department may issue an assessment to a taxpayer before the tax return is due or without giving reasonable time for a taxpayer to submit a tax return (a "jeopardy assessment") if all three of the following conditions are satisfied:

(a) The Afghanistan Revenue Department has collected evidence that suggests that it is more likely than not that the taxpayer has an unpaid tax liability.

(b) The Afghanistan Revenue Department has evidence that suggests that it is more likely than not that any one of the following events will soon occur:

(i) The taxpayer will cease doing business.

(ii) Assets that could be used to pay the tax will be transferred outside of Afghanistan.

(iii) Key individuals (*e.g.*, directors or officers of a company) are about to leave the country.

(c) The Afghanistan Revenue Department has evidence which suggests that it is more likely than not that the unpaid tax liability will not be paid unless a jeopardy assessment is issued.

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| Article 88 | Filing returns and payment of tax (1) A person who is required to complete a tax return and balance sheet (other than a business receipts tax return) must file their tax return by the end of Jawza (third month) of the next year at the relevant tax office.<br><br>(2) Tax specified in an assessment notice shall be payable on the date specified in the assessment notice.<br><br>(3) Resident and non-resident persons who intend to leave Afghanistan before the due date for payment of their tax shall be required to file their tax returns and pay the tax due two weeks before leaving Afghanistan.<br><br>(4) Income tax payable by persons required to file a tax return according to the provisions of this Law that is not subject to other payment regulations under this Law must be paid when the tax return is filed.<br><br>(5) A person required to complete a business receipts tax return shall complete a tax return for each quarter of the year and file the return with evidence of the tax paid for the quarter not later than the fifteenth day of the next month after each quarter of the year.<br><br>(6) Unless a different time is provided in this Law, persons who carry on business from fixed business establishments shall be required to pay their due tax quarterly and the payment for each quarter shall be made not later than the fifteenth day of the month following each quarter.<br><br>(7) Persons who own moveable and immovable property shall pay tax due at the time of transfer of ownership of such property.<br><br>(8) Tax on contracts signed with government agencies shall, according to Article 72 of this Law, be withheld at the time payment is made by the relevant government agency.<br><br>(9) Income tax on shows, exhibitions, theaters, cinemas, concerts, sports and similar events shall be paid not later than the fifteenth day of the next month. If activities of the mentioned shows are not continuous, tax thereon shall be paid after the end of each show. |

88.1 Article 3 (1) provides that the tax year begins on the first day of Hamal and ends on the last day of Hoot. The tax return for the year ending on the last day of Hoot is not due until the last day of Jawza.

If according to the tax return no tax is payable (e.g. the taxpayer has a tax loss, has no income, or all his income is exempt from tax), the tax return should be submitted to the nearest tax office (or given to a reliable mail delivery service or courier for delivery to a tax office) by the last day of Jawza.

If however, the tax return indicates that tax is payable, the taxpayer should pay that tax and deliver their tax return to an authorized bank by the last day of Jawza. In such cases, the Afghanistan Revenue Department will arrange to

collect the tax return from the authorized bank and will treat those tax returns as having been filed at the tax office.

88.2 Tax specified in an assessment notice must be paid on the date specified in the assessment notice. A tax return submitted by a taxpayer will be treated as a notice of assessment and must be paid when the return is submitted. Unless the assessment notice is a jeopardy assessment, an assessment notice issued by the Afghanistan Revenue Department will require payment on a date which will usually be 30 days from the date the notice is mailed or sent by the Afghanistan Revenue Department to the taxpayer.

*Example:* *Company A is an Afghan corporation. It filed its return for 1385 on the fourth day of Jawza, 1386. Two years later, during 1388, the Afghanistan Revenue Department reviews the tax return and determines that Company A understated the amount of tax that is due. The Afghanistan Revenue Department issues an assessment notice for the additional tax. The assessment notice is not a jeopardy assessment. The assessment was given to a reliable courier service on the first day of Aqrab. The assessment will specify a date that is usually 30 days later. The payment must be received by this date.*

88.3 Residents and non-residents who leave the country, and who will be out of the country when their tax return is due, must prepare and file their tax return two weeks before departing the country.

*Example:* *Jane Smith is an English citizen, but is also considered a resident of Afghanistan. Jane knows that she will be leaving Afghanistan during the month of Saur and that she will remain outside of Afghanistan for the next three months. Jane must prepare and file her tax return two weeks before departing Afghanistan.*

88.4 The business receipts tax form must be filed quarterly. Every person that derives income that is subject to business receipts tax must file a business receipts tax form, even though no business receipts tax may be due.

*Example 1:* *An individual operates an electrical supply store in Kabul. The business is not operated as a corporation, limited liability company, or partnership. The individual is not required to file a business receipts tax form, because individuals are only subject to business receipts tax if they provide either certain specific types of services (ie hotel or restaurant services) or receive gross income above a certain threshold (ie Afs 750,000 per quarter).*

*Example 2:* *An individual operates a restaurant in Mazar-e-Sharif. The restaurant is not formed as a corporation, limited liability company or partnership. The individual generates Afs. 80,000 in the first month of operation, Afs. 70,000 in the second month, and Afs. 95,000 in the third month. The individual must file a business receipts tax form every quarter, even though the individual generated less than Afs. 750,000 Afs. during the quarter.*

88.5 Taxpayers subject to "fixed tax" under Articles 74 and 75 are required to pay their tax quarterly on the 15th day of the month following the end of each quarter.

88.6 To the extent that a taxpayer is subject to tax under Article 30, the tax is due on the date that the property is transferred.

*Example:* *Najibullah sells his truck for Afs. 50,000 on the 15th day of Hamal. The sale is subject to a fixed tax of 1% of Afs. 50,000, or Afs. 500. Najibullah should remit Afs. 500 to the government on the 15th day of Hamal.*

88.7 The income tax (or tax in lieu of an income tax) on shows, exhibitions, theaters, cinemas, concerts and sports shall be paid no later than the fifteenth day of the next month. If the shows are not continuous, tax shall be paid after the end of each show.

*Example 1:* *Azziz operates a cinema in Kabul. He shows movies every night except for Friday. Azziz is subject to the tax in lieu of income tax in Article 74 of the Income Tax Law. Azziz receives Afs. 50,000 of revenue in the month of Hamal. Azziz must remit Afs. 5,000 of tax to the government by the 15th day of Saur.*

*Example 2:* *Wahid occasionally produces folk music shows in Herat. The music consists of classic Afghan music performed by Afghan musicians. The shows are not regular. Instead, Wahid will organize a show when he believes that there will be a significant number of tourists in the Herat area. During the month of Saur, Wahid organizes a show that attracts a number of tourists. Wahid generates Afs. 100,000 from the show. Wahid must remit Afs. 10,000 to the government on the day after the show ends.*

88.8 In the event that the due date for filing a tax return or making a tax payment falls on a Friday or a legal holiday, the return or payment may be filed, without late filing penalties, on the next business day following the Friday or legal holiday.

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| Article 89 | Objections and appeals (1) Where a taxpayer has filed a tax return required under this Law or has received an assessment notice and that taxpayer believes that the tax return or assessment is incorrect, the taxpayer may request an amendment of the assessment notice within five years of the date on which the tax return was due to be filed.<br><br>(2) The Ministry of Finance may amend or affirm the assessment notice mentioned in paragraph (1) of this Article within 60 days after the date on which the taxpayer lodged the request for amendment and shall advise the taxpayer of its decision. If the Ministry of Finance has not amended an assessment notice as requested within this period, the earlier assessment notice will be treated as affirmed.<br><br>If the taxpayer liable to pay the tax assessed in the amended assessment notice or affirmed assessment notice believes that the amended assessment notice or affirmed assessment notice is incorrect, the taxpayer may submit to the Ministry of Finance an objection within 30 days after receiving the amended assessment notice or the assessment notice being otherwise affirmed.<br><br>The objection will be considered by the Objection Review Panel which may affirm or amend the assessment notice in whole or in part.<br><br>Where a taxpayer does not accept the decision of the Objection Review Panel or the Objection Review Panel has not made a decision within 60 days after receiving the objection, the taxpayer may appeal to a court within 30 days after receiving the decision or the assessment notice being otherwise affirmed.<br><br>The decision of the court will be final. |

89.1 A taxpayer may only request an amendment to his tax return or challenge an assessment within five years from the date on which the tax return was due. Notwithstanding the foregoing, if an assessment is not received by the taxpayer at least 30 days before the five year period expires, the taxpayer shall have 30 days from the date that he receives the assessment to respond to the assessment.

*Example 1:* *Company A is an Afghan corporation that filed its return for the year 1385 on the last day of Jawza, 1386. During the year 1388, Company A realizes that it failed to deduct certain interest expenses from its taxable income during its 1385 year. Company A may request an amendment to its tax return, but only if Company A does so before the last day of Jawza, 1391.*

*Example 2:* *Company A filed its income tax return for the year 1385 on the 15th day of Jawza, 1386. On the 2nd day of Hamal, 1391, the Afghanistan Revenue Department examines Company A's tax return and realizes that Company A understated its income. The Afghanistan Revenue Department sends an assessment notice to Company A on 20th day of Jawza, 1391. Company A does not receive the assessment until the last*

*day of Jawza, 1391. Company A has 30 days to either accept the notice of assessment or request an amendment under Article 94(1).*

89.2 If a taxpayer makes a request to amend a notice of assessment, the Ministry of Finance has 60 days to determine whether or not to agree to the amendment. The 60 day period begins on the date that the taxpayer delivers the request to a tax office or to a reliable mail delivery or courier service. Taxpayers who are not making delivery to a tax office are encouraged to send their request for amendment through a courier that requires the recipient to acknowledge receipt with a signature. Taxpayers are also encouraged to clearly indicate the date on which the request for amendment was sent on their letter requesting the amendment.

*Example:* *Company A filed its tax return for the tax year 1385 on the last day of Jawza, 1386. During 1388, the Afghanistan Revenue Department determined that Company A understated its taxable income by Afs. 1,000,000. The Afghanistan Revenue Department issued an assessment notice on the first day of Hamal, 1389. Company filed a request that the assessment be amended on the first day of Jawza, 1389. The request clearly stated the date on which the request was made. The request for amendment was given to a reliable courier that requests confirmation of receipt via signature. The Afghanistan Revenue Department has 60 days from the first day of Jawza to respond. If the Afghanistan Revenue Department fails to respond, the Afghanistan Revenue Department will be deemed to have rejected the request for amendment.*

89.3 In making a decision on a taxpayer's request for amendment, the Afghanistan Revenue Department should carefully review the taxpayer's file to ensure that the assessment is proper.

89.4 Once the Ministry of Finance has reviewed the taxpayer's request for amendment, and advised the taxpayer of its decision, the taxpayer may file a notice of objection with the Ministry of Finance if he/she wishes to dispute that decision. If the taxpayer chooses to raise an objection, the taxpayer must do so within 30 days of receiving the Ministry of Finance's response to the taxpayer's request for amendment. In the event that the Afghanistan Revenue Department did not respond to the taxpayer's request, the Afghanistan Revenue Department will be deemed to have given a negative answer on the 60th day after the taxpayer filed its request for amendment. Taxpayers will be deemed to have provided their objection to the Ministry of Finance on the day that they submit their objection notice to a tax office or to a reliable mail delivery service or courier.

*Example:* *Adib filed his tax return for the tax year 1385 on the last day of Jawza, 1386. During 1389, the Afghanistan Revenue Department examined Adib's return and determined that Adib made a number of errors in his return. On the first day of Hamal, 1390, the Afghanistan Revenue Department issued a notice of assessment to Adib. Adib mailed a request that the assessment be amended on the last day of Hamal to the*

*Ministry of Finance. Adib used a reliable courier service. The Afghanistan Revenue Department failed to respond within 60 days of the date that Adib mailed the request. Adib can consider the failure to respond a denial of his request. If Adib wants to pursue the matter, he must file a notice of objection within 30 days of the date that his request is deemed to be denied. This is the same as the date that is 90 days after the date that Adib filed his request for amendment.*

89.5 The taxpayer's objection will be determined by an "objection review panel." There is no permanent sitting objection review panel within the Afghanistan Revenue Department. Instead, an objection review panel must be assembled from independent Afghanistan Revenue Department employees. Each objection review panel must consist of 3 individuals. All of the foregoing individuals must be unrelated to the taxpayer at issue. None of the foregoing individuals should have participated in the taxpayer's case or file before the objection review panel was assembled.

89.6 Once the objection review panel receives the case, they should review all of the facts contained in the taxpayer's file. In addition, the panel should consider whether oral or written statements from the taxpayer or the responsible Afghanistan Revenue Department officials would assist in the determination of the case. If additional statements would be warranted, the panel may hold meetings with the taxpayer and/or the Afghanistan Revenue Department officer. If the panel believes additional documents would be helpful for resolving the case, it should request them, in writing, from the taxpayer or the Afghanistan Revenue Department official which shall be provided by the due date given in the requisition memo.

89.7 In reaching its decision, the objection review panel should recognize that if the taxpayer does not accept the panel's finding, the taxpayer has the right to challenge the determination in court. Thus, the panel should make its decision based on its understanding of the likelihood that the Afghanistan Revenue Department's position will be upheld or sustained if the taxpayer's case was tried before a court.

89.8 The objection review panel will make its decision by majority vote. The panel should communicate its decision in writing to the taxpayer as well as the relevant tax office. The panel is encouraged to also inform the taxpayer by telephone. The decision of the panel will be implemented by the relevant tax office within 60 days of its receipt and the taxpayer informed accordingly.

89.9 If a settlement is reached, the objection review panel and the taxpayer should enter into a definitive agreement setting forth the relevant facts and the settlement that was reached for each of the years at issue.

| | | |
|---|---|---|
| Article 90 | Refunds | If the Ministry of Finance finds, upon examination of a tax return, claim, or judgment of the Court, that the tax paid is in excess of the amount due, it shall first apply the overpayment against any other taxes or custom duties of the person then due and, with the person's agreement, to another person's tax liability and then refund the excess following procedures set out in the Income Tax Manual. |

90.1 The Ministry of Finance cannot release funds to a taxpayer until the taxpayer's case has been finally adjudicated. A final adjudication includes:

(a) The Afghanistan Revenue Department's acceptance of a taxpayer's refund claim or request for amended assessment.

(b) A definitive settlement between the taxpayer and the Ministry of Finance pursuant to the Ministry of Finance's authority under Article 89 of the Income Tax Law.

(c) A final judgment of a court. A final judgment means a decision by a court that cannot be appealed.

90.2 Once there has been a final adjudication of a taxpayer's claim, the Afghanistan Revenue Department official in charge of the taxpayer's file shall check the taxpayer's file to ensure there are no other outstanding tax liabilities against which any credit balance should be applied. If this checking shows that there are no other outstanding tax liabilities, or that there is still a credit balance remaining after offsetting other outstanding tax liabilities, the Afghanistan Revenue Department official shall then check that the taxpayer does not have any outstanding customs duty liability.

90.3 If the taxpayer has outstanding liability for customs duty, the Afghanistan Revenue Department official should contact the Treasury Department and the Customs Department to ensure that the taxpayer's customs liability is credited by the amounts owed to the taxpayer.

90.4 Any amounts that are still owed to the taxpayer after making appropriate credits for other outstanding taxes and customs duty should, in the following order, be:

(a) offset against the tax liabilities of another taxpayer, where the taxpayer has requested this action,
(b) refunded to the taxpayer via the Treasury Department, where the taxpayer has requested this action, or
(c) held as a credit against future tax liabilities of the taxpayer.

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| Article 91 | Collection of information (1) For the purpose of proper application of this Law, the Ministry of Finance is authorized to review a taxpayer's documents and may obtain financial and trade information from the taxpayer or other persons.<br><br>(2) Information received regarding an income tax return and information obtained according to paragraph (1) of this Article is confidential and shall not be disclosed by the officials of the Ministry of Finance unless authorized by law.<br><br>(3) The procedure for examination of a taxpayer's documents shall be provided in the Income Tax Manual.<br><br>(4) Any person who, without reasonable cause, fails to provide documents or information to officials of the Ministry of Finance within twenty days of such request shall pay the following additional tax for each day from the date the documents or information was requested:<br><br>1- Natural Person Afs 100<br><br>2- Legal Person Afs 200<br><br>Holidays are excluded from this provision. |

91.1 The Afghanistan Revenue Department's procedures for auditing taxpayers are contained in the Audit Manual.

91.2 Any information that a Ministry of Finance employee receives with respect to a taxpayer must remain confidential.

91.3 If a Ministry of Finance employee knowingly discloses confidential information to a person outside of the Ministry of Finance or a person within the Ministry of Finance who in carrying out their duties does not have a right to know of the confidential information, the employee may be subject to disciplinary action, including termination of employment. Disciplinary action will not be taken without the approval of the Deputy Minister of Revenue and Customs and the Minister of Finance. If the Deputy Minister is suspected of disclosing confidential information, disciplinary action may be taken by the Minister of Finance. If the Minister of Finance has disclosed confidential information, disciplinary action may be taken by the Council of Ministers.

91.4 If a Ministry of Finance employee knowingly discloses confidential information to a person in order to achieve a personal benefit, the Ministry of Finance may seek to have the employee prosecuted under Article 106(1) of the Income Tax Law.

# CHAPTER 14

# ENFORCEMENT PROVISIONS

## Article 92 – Article 96

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| Article 92 | Collection of unpaid tax from third parties (1) For the purpose of recovering any tax due from a taxpayer, the Ministry of Finance may, without the consent of the taxpayer, by notice in writing, require payment from any person: –<br><br>1. owing money to the taxpayer; or<br><br>2. holding money for the taxpayer; or<br><br>3. holding money on behalf of some other person for payment to the taxpayer; or<br><br>4. having authority of some other person to pay money to the taxpayer, or<br><br>5. who is liable to make payments of salary or wages or other similar payments to a taxpayer. |

92.1 Collection may be from anyone who owes money to the taxpayer. While it is impossible to comprehensively identify everyone who might owe a taxpayer money, one example is shown here and others follow in 92.2 through 92.5. Debt owing to a taxpayer may take many and varied forms but includes, beyond these examples, uncollected business accounts receivable, estate proceeds, amounts for any contracts completed, installment loans, promised advances or deposits, royalties due, commission payments, copyright payments, franchise payments, return on investments, stocks and bonds, safe deposits, rents, leases, etc.

*Example:* *There exists a contract showing that the taxpayer loaned money to a friend. The due date for repayment has passed. The taxpayer will not voluntarily pay the tax or can't be located.*

| | |
|---|---|
| Loan amount | Afs. 100,000 |
| Tax due | Afs. 50,000 |
| Amount collectable from friend | Afs. 50,000 |
| Remaining tax due | -0- |

92.2 Collection may be from anyone who is holding money for the taxpayer.

*Example:* *The taxpayer has a bank account.*

| | |
|---|---|
| Amount in bank account | Afs. 200,000 |
| Tax due | Afs. 50,000 |
| Amount collectable from bank | Afs. 50,000 |
| Remaining tax due | -0- |
| or--- | |
| Amount in bank account | Afs. 40,000 |
| Tax due | Afs. 50,000 |
| Amount collectable from bank | Afs. 40,000 |

| | |
|---|---|
| Remaining tax due | Afs. 10,000 |

92.3 Collection of unpaid tax may be from anyone who is holding money in an account for payment to the taxpayer.

*Example:* *An insurance company is holding money for the taxpayer to satisfy a lump sum policy pay-off.*

| | |
|---|---|
| Policy pay-off to taxpayer | Afs. 533,000 |
| Tax due | Afs. 196,000 |
| Amount collectable from insurance | Afs. 196,000 |
| Remaining Tax Due | Afs. -0- |

92.4 Collection may be from anyone who has the authority and obligation to pay money to the taxpayer.

*Example:* *The taxpayer's occupation is painting houses. The taxpayer has not been paid for two completed houses.*

| | |
|---|---|
| Money due from house owner #1 | Afs. 10,000 |
| Money due from house owner #2 | Afs. 12,000 |
| Tax due | Afs. 298,000 |
| Amount collectable from owners | Afs. 22,000 |
| Remaining tax due | Afs. 276,000 |

92.5 Collection may be from any natural or legal person who is liable for paying salary, wages or similar payments to the taxpayer.

*Example:* Weekly salary from company to taxpayer *(after deducting wage withholding tax)* Afs. 5,000

| | |
|---|---|
| Tax due | Afs. 21,000 |
| Amount collectable from company | Afs. 5,000 |
| Remaining tax due | Afs. 16,000 |

*Remark: Normal practice would be to leave the taxpayer an amount to cover reasonable living expenses. The documented decision, therefore, might be to only take 3,000 Afs. each week until the tax liability is fully paid (3,000 x 7 weeks for 21,000 in tax).*

| | |
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| Article 93 | Liability of directors, shareholders and other persons Where a company has failed to pay income tax as required under this Law, the Ministry of Finance may collect the tax due from the following persons: –<br><br>(1) any or all of the directors of the company who has failed to exercise care in ensuring the company met its tax liability;<br><br>(2) a shareholder of the company with ten percent or greater ownership interest in the company, but only to the extent that the shareholder received dividends from the company.<br><br>(3) a person who has obtained one or more assets from the company for less than market value in the course of a transaction that took place within the three years preceding the date on which the unpaid tax was due. |

93.1 Income tax liability can be collected from any or all of the directors of the company who have failed to exercise care in assuring that the company met its tax liability.

*Example:* *Nine directors of Company X agreed to delay payment of taxes in order to purchase earth moving equipment. Board of directors meeting minutes documented this decision. The tax liability may be collected from the personal assets of any single director or divided among them in any way. Judgments about collection efficiency and fairness will be made by the Afghanistan Revenue Department.*

93.2 Income tax liability can be collected from any shareholder who owns ten percent or more of the company, but only to the extent that the shareholder receives company dividends.

*Example:* *Afco has income tax owing of Afs. 1,000,000. Afco's shareholding and dividend payments are as follows.*

| *Name of Shareholder* | *Shares Owned* | *Dividends Received* | *Percentage Ownership* | *Tax Collected* |
|---|---|---|---|---|
| *W* | *20,000* | *200,000* | *20%* | *200,000* |
| *X* | *20,000* | *200,000* | *20%* | *200,000* |
| *Y* | *30,000* | *300,000* | *30%* | *300,000* |
| *Z* | *30,000* | *300,000* | *30%* | *300,000* |

*Total collected = Afs. 1,000,000.* *Balance due -0-*

*In this example the shareholders owned at least 20%, however collection can be sought from any shareholders who own 10% or more. Shareholders who own less than 10% are not liable under this provision. Also, it is important to remember that collection liability depends on dividends received. If there has been no payment of dividends, there can be no collection of the company's*

*income tax from shareholders. If a shareholder owns 40% of the company shares but only receives 10% of the dividends then collection from that person may not exceed the amount of dividends received.*

93.3 Income tax liability can be collected from any person who has obtained assets of the company for less than fair market value in a transaction within three years before the due date of the tax liability.

*Example 1:* *A company owns thirty buildings. Three of these buildings were sold within one year before the date the company was due to pay its income tax liability. The three buildings were sold to the brothers of the company president for less than their market value. The company's income tax may be collected from the purchasers of the buildings on the following basis.*

| Building | Market Value | Sale Price | Tax Collectable New Owner |
|---|---|---|---|
| A | 20,000,000 | 5,000,000 | 15,000,000 |
| B | 38,000,000 | 5,000,000 | 33,000,000 |
| C | 39,000,000 | 5,000,000 | 34,000,000 |

*Example 2:* *A company owned Mercedes car has a market value of Afs. 1,000,000. It was sold two days before an unpaid tax debt was due. The debt was for Afs. 3,332,000. The sale price of the car was Afs. 100,000. The new owner of the car is liable for Afs. 900,000.*

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| Article 94 | Persons not allowed to leave Afghanistan (1) A person who has tax due of more than Afs. 20,000 may be prevented from departing Afghanistan if the tax due has not been paid to the relevant tax offices. An authorized officer of the Ministry of Finance may issue a written notice to the relevant security authorities requesting them to prevent the person from departing Afghanistan. |

94.1 Taxpayers who owe more than 20,000 Afs. in tax liability can be prevented from leaving the country unless they:

a. pay the overdue tax to the bank and present a receipt for proof of payment to the Afghanistan Revenue Department; or

b. make satisfactory arrangements with the Afghanistan Revenue Department before leaving (for example, collateral or a binding agreement, and proof of return)

94.2 Authorized staff of the Afghanistan Revenue Department, on learning that a taxpayer is seeking to leave Afghanistan before paying or making arrangements (where more than 20,000 Afs. is owed), may issue a Departure Prohibition Order. The Order will reference this Article of the Law (requirement to stop taxpayers from leaving Afghanistan) and include details of the tax due. The Departure Prohibition Order should be personally delivered by the Afghanistan Revenue Department to:

a. The Ministry of Interior,

b. The Ministry of Transport, and to

c. Any other government authority obligated to assist.

94.3 A Departure Prohibition Order can be issued to a person who has tax due. A person in this case can only be a natural person. A Departure Prohibition Order cannot be issued to a legal person ie a company or any other organisation.

94.4 The requirement that a person has ‘tax due’ means that the person must have been assessed tax and has not paid the tax due. An assessment to tax can arise either on the person submitting a tax form or the issue of a ‘default assessment’ by the Ministry of Finance. An amended assessment issued by the Ministry of Finance may also result in tax being due and payable. A person will not be considered to have ‘tax due’ where they have not submitted a tax form to the Ministry of Finance or the Ministry of Finance has not issued a default assessment.

94.5 A person will be considered to have ‘tax due’ where that person has been assessed to tax but has not paid it. A person will also be considered to have ‘tax due’ where that person is required to pay the tax of a company according to Article 93. Where Article 93 applies, a person who is a director, shareholder, or the purchaser of company assets below market value will be

considered to have 'tax due' when the Ministry of Finance issues a notice to the person to that effect.

<u>Example:</u> *Company A has tax due of Afs 200,000s. Company A has not paid its tax because it has expended all its cash reserves and credit facilities on purchasing a new building for the business. A director of Company A made the decision to buy the building even though the director was aware that Company A was required to submit an income tax form and pay income tax. The director has failed to exercise reasonable care in ensuring the company met its income tax liability. The Ministry of Finance issued a notice to the director in accordance with Article 93 requiring the director to pay tax of Afs 200,000. As the director is considered to have 'tax due', the Ministry of Finance may issue a Departure Prohibition Order to the director.*

94.6 A person will not be considered to have tax due where that person holds or owes money to the person who has tax due.

<u>Example:</u> *Adib has been issued a tax assessment and has tax due of Afs 30,000. Haroon owes Adib Afs 25,000. While a Departure Prohibition Order may be issued to Adib, it cannot be issued to Haroon. Haroon is not a person who has 'tax due' in this example.*

<u>Remark</u>: *The Ministry of Finance may, however, issue a notice to Haroon requiring him to pay the money owed to Adib to the Ministry of Finance according to Article 92.*

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| Article 95 | Business closure (1) Where a person has failed to file a tax return, failed to pay tax on the due date or failed to withhold and pay tax as required under the provisions of this Law, the Ministry of Finance may notify the person in writing of its intention to close down part or the whole of the person's business. The Ministry of Finance may issue an order to close down part or the whole of the person's business seven days after the person receives the notice. The order shall be signed by an authorized person of the Ministry of Finance and will continue in effect until the person pays the tax due. The Ministry of Interior shall assist with the implementation of this order. |

95.1 Where a taxpayer does not submit a tax return within the legal timeframe and does not cooperate, the Afghanistan Revenue Department may decide to issue a final demand letter.

a. This demands that the late return(s) be submitted no later than the time specified after the taxpayer receives the final demand letter.

b. It also advises the taxpayer that if the return(s) are not submitted within the demand period the business may be seized, either entirely or in part. If a seizure is required security assistance will be used to assure safety and full compliance.

c. The Afghanistan Revenue Department will assure close coordination of all necessary (but not excessive) security assistance. The Ministry of Interior is required by this Law to provide assistance.

*Example:* *The case file documents that the taxpayer has been contacted three times and asked to submit a Business Receipts Tax form that is now sixty days late. The taxpayer said that the large grocery business has problems and more time is needed. Finally, the taxpayer is not willing to say when it will be possible to submit a balance sheet. The final demand letter and potential business closure should be considered.*

95.2 Where a taxpayer does not make payment, or withhold and pay, as required by the Income Tax Law and does not cooperate, the Afghanistan Revenue Department may decide to issue a final demand letter.

a. This demands that the late payment and/or withholding failure be brought into compliance no later than the time specified after the taxpayer receives the final demand letter.

b. It also advises the taxpayer that if all tax liability due and/or the failure to withhold are not brought into full compliance within the demand period, the business may be seized, either entirely or in part. If a seizure is required security assistance will be used to assure safety and full compliance.

c. The Afghanistan Revenue Department will assure close coordination for all necessary (but not excessive) security

assistance. The Ministry of Interior is required by this Law to provide assistance.

<u>*Example 1:*</u> *The case file documents that this taxpayer is a large construction company. A return has been submitted but without any payment. The tax, penalty and interest due total Afs. 25,000,000. At two previous meetings the taxpayer said the money is coming soon from outside of Afghanistan. Thirty days after the due date no money has been submitted to the bank. The final demand letter and potential business closure should be considered.*

<u>*Example 2:*</u> *A business has been selling electric generators for six months. It has twenty-six employees and has withheld tax from them but has neglected to pay any tax to the Ministry of Finance. The company president said that the money is needed for business expenses. "We just can't afford to pay this large withholding amount and stay in business." There is no cooperation to submit any of the money withheld. The final demand letter and potential business closure should be considered.*

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| Article 96 | <u>Restriction on disposal of property by a taxpayer</u> (1) Where a person has failed to file a tax return, failed to pay tax on the due date or failed to withhold and pay tax as required by the provisions of this Law, the Ministry of Finance may request an order of a court of competent jurisdiction imposing restrictions on disposal of the person's movable and immovable property until the person pays the tax due.<br><br>(2) Where a person does not pay the tax due within 30 days of the order of the court, the Ministry of Finance may request the court to order the sale of the person's property. Where the person pays tax due under paragraph (1) of this Article before an order of the court for sale of property is issued, the order imposing restrictions on the person's property shall be withdrawn.<br><br>(3) Where paragraph (1) of this Article applies, the court may issue an order to sell the person's property by public auction.<br><br>(4) The Ministry of Finance shall apply the proceeds of the sale of property to the payment of the tax due and excess of the proceeds, if any, shall be paid to the person. |

96.1 The Afghanistan Revenue Department may request a court order to restrict taxpayers who have failed to file tax returns, make tax payments, or to withhold tax, from making property transactions. This includes a prohibition on disposing of any property. If the taxpayer satisfies his obligations before the court issues the order, it will not be implemented.

96.2 Where a tax liability is not paid within thirty days from such a court order, the Afghanistan Revenue Department may make a referral to the court for a further authorization to sell the taxpayer's property.

The court may issue an order to the Afghanistan Revenue Department to sell the taxpayer's property through auction where all tax obligations of Article 96 are not met.

After sale of the taxpayer's property, all outstanding tax liability will be paid with any excess proceeds refunded to the taxpayer by the Ministry of Finance.

# CHAPTER 15

# ANTI-AVOIDANCE

## Article 97 - Article 98

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| Article 97 | Transactions between connected persons Where any amount paid or payable in a transaction between connected persons is different than the amount that would be paid or payable had the transaction taken place between unconnected persons, when determining the tax liabilities of the connected persons, the Ministry of Finance may substitute the amount that would be paid or payable had the transaction taken place between unconnected persons. |

97.1 The purpose of Article 97 of the Income Tax Law is to ensure that taxpayers do not engage in transactions with related persons in order to achieve a tax benefit that could not have been obtained had the transactions taken place between unrelated parties. The Ministry of Finance believes that Article 97 and this commentary is consistent with the Organization for Economic Cooperation and Development's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (1995).

*Example 1*: *Asahi owns all of the issued stock of Company A and Company B. Company A and Company B are Afghan corporations. Asahi causes Company A to sell products to Company B at a price of Afs. 1,000 per unit. Identical products are being sold in the market under the same terms at Afs. 800 per unit. Asahi wanted Company A to sell the products at a higher price in order to reduce the profit of Company B and increase the profit of Company A. Company A has a net operating loss that it can use to offset the profit from selling units to Company B. Under Article 97, the Ministry of Finance can restate the profits of Company A and Company B as if Company A sold products to Company B for Afs. 800 per unit.*

*Example 2*: *Asahi owns all of the issued stock of Company A and Company B. Company A is an Afghan corporation. Company B is an Uzbek corporation. Asahi causes Company A to sell products to Company B at a price of Afs. 800 per unit. Identical products are being sold in the market under the same terms at Afs. 1,000 per unit. Asahi wanted Company A to sell the products at a lower price in order to reduce the profit of Company A and increase the profit of Company B. The result will be that Company A pays less tax in Afghanistan. Under Article 97, the Ministry of Finance can restate the profits of Company A as if Company A sold products to Company B for Afs. 1,000 per unit.*

97.2 Taxpayers are "connected" with each other if their actions are controlled by the same person or entity. For this purpose, a taxpayer's spouse, brothers, sisters, children and parents will all be considered connected to each other. Whether or not other taxpayers are under the control of the same person will be determined based on the facts and circumstances. Nevertheless, the Afghanistan Revenue Department will apply the following rules in determining whether two taxpayers are controlled by the same person.

a) A taxpayer is connected with a legal person (*e.g.*, partnership, limited liability company or corporation) if the taxpayer owns more than fifty percent of the voting rights in the entity.

<u>Example 1</u>: *Wahid owns 51% of the issued stock of an Afghan corporation. Unrelated parties own the remaining 49% of the stock of the corporation. The corporation has a single class of stock issued. Wahid's stock gives Wahid the right to elect the majority of the corporation's board of directors. Wahid is therefore connected with the Afghan corporation.*

<u>Example 2</u>: *Company A is an Afghan corporation that has a single class of stock issued. Wahid owns 20% of the issued stock of Company A. Wahid's wife, Asieh, owns 20% of the issued stock of Company A. Wahid's son, Najib, owns 12% of the issued stock of Company A. Wahid, Asieh and Najib are all considered connected persons. They are all considered connected with Company A.*

b) A taxpayer is connected with a legal person if the taxpayer owns more than fifty percent of the voting rights of the entity indirectly.

<u>Example 1</u>: *Wahid owns 80% of the issued stock of Company A, an Afghan corporation. Company A owns 80% of the issued voting interests in Partnership B, an Afghan limited partnership. Wahid will be considered connected with Company A because he owns more than 50% of the voting rights in Company A directly. He will also be considered connected with Partnership B, because he owns 64% of the voting rights in Partnership B indirectly (80% x 80% = 64%).*

c) If two legal persons are considered to be connected to the same taxpayer, the two legal persons will be considered to be connected with each other.

<u>Example 1</u>: *Wahid owns 80% of the issued stock of Company A. Company A is an Afghan corporation. Wahid also owns 51% of the voting rights in Partnership B. Partnership B is an Afghan limited partnership. Wahid is considered to be connected with Company A and Partnership B. Moreover, Company A and Partnership B are considered to be connected to each other.*

<u>Example 2</u>: *Company A is an Afghan corporation. Company A owns 80% of the issued stock of Company B. Company B is an Afghan corporation. Company A also owns 51% of the voting rights in Partnership B. Partnership B is an Afghan limited partnership. Company A is considered to be connected with Company B and Partnership B. Moreover, Company A and Partnership B are considered to be connected to each other.*

d) A taxpayer will be considered "connected" with a legal person if the taxpayer owns less than a majority of the voting rights in that legal

person, if the facts and circumstances indicate that the taxpayer has the power to control the decisions of the company.

*Example 1*: *Zaid owns 50% of the issued stock of Company A, an Afghan corporation. Zaid's two cousins, Saad and Najib, each own 25% of the Afghan corporation. Zaid, Saad and Najib are not connected with each other, because they are cousins. Nevertheless, a review of the minutes of the board of directors meetings and shareholders meetings for Company A indicates that Saad and Najib take direction from Zaid and typically vote the way that Zaid wants them to vote. Thus, Zaid should be considered to control Company A and be connected to Company A.*

*Example 2*: *Zaid owns 50% of the issued stock of Company A, an Afghan corporation. Zaid's two cousins, Saad and Feroz, each own 25% of the Afghan corporation. Zaid, Saad and Feroz are not connected with each other, because they are cousins. Moreover, after investigation, the Afghanistan Revenue Department learns that Zaid disagrees with Saad and Feroz about many issues. All three individuals have very different ideas about how to operate Company A. Moreover, no single individual controls the operation of Company A. In this case, Zaid should not be considered connected to Company A.*

97.3 A "connected transaction" is any transaction between connected taxpayers. An "unconnected transaction" is any transaction between taxpayers that are not connected. The price at which a connected transaction takes place is called a "transfer price".

*Example*: *Wahid owns all of the issued stock of Company A, an Afghan corporation. Wahid also owns all of the issued stock of Company B, an Afghan corporation. Wahid, Company A and Company B are all considered "connected" taxpayers. If Company A sells a product to Company B, the sale is considered a connected transaction. The price that Company B pays for the good is considered the transfer price.*

97.4 In determining the true taxable income of taxpayers under Article 97, the Afghanistan Revenue Department should look to unconnected transactions.

*Example*: *Wahid owns all of the issued stock of Company A, an Afghan corporation. Wahid provides services to Company A every year as the president of Company A. Company A pays Wahid for his services as president. Wahid knows that Company A will be entitled to a deduction for every Afghani that Company A pays Wahid. Wahid also knows that Company A is taxed at a 20% rate, but that Wahid is taxed on some of his income at a 0% rate and a 10% rate. To determine whether or not the payments made by Company A to Wahid comply with Article 97, the Afghanistan Revenue Department must look to the salaries that other companies pay presidents in unconnected transactions. For example, assume that Company B, an Afghan corporation, is similar to Company A. It is approximately the same*

*size as Company A. It is in the same business as Company A. Company B is not controlled by any single individual. Company B is not owned by the government or any branch of the government. Company B pays its president Afs. 10,000,000 per year. The salary that Company B pays its president is an unconnected transaction. The Afghanistan Revenue Department can use that transaction to determine whether or not the salary paid to Wahid is reasonable.*

97.5 The Afghanistan Revenue Department may use a number of different methods, described below, to determine what the correct price would be between unconnected persons. Each method relies on different types of unconnected transactions to determine the appropriate taxable income. Thus, to determine the best method, the Afghanistan Revenue Department should consider the similarity between the connected transactions and unconnected transactions used with respect to each method. In particular, the Afghanistan Revenue Department should consider the following facts and circumstances:

a) Functions. The functions performed in the connected transaction and unconnected transaction should be similar. If the functions performed in the connected transaction and the unconnected transaction are similar, the unconnected transaction will be more helpful in determining the accurate transfer price. If the functions performed in the connected transaction and the unconnected transaction are not similar, the unconnected transaction will be less helpful in determining the accurate transfer price.

*Example:* *Adib owns all of the issued stock of Company A, an Afghan corporation. Company A operates a business in the Wazir Akbar Khan area of Kabul. The store sells used automobiles. Adib also owns 60% of the voting rights in Partnership B, an Afghan limited partnership. Partnership B operates a business near Kabul that sells spare auto parts. Partnership B does not offer any assistance with the repair of the automobile itself. Partnership B only sells the parts. When Company A purchases an automobile for the automobile shop, Company A will usually need to repair the vehicle. Company A will always purchase the spare parts from Partnership B. Adib is connected with Company A. Adib is connected with Partnership B. Thus, Company A and Partnership B are connected with each other. The price that Partnership B charges Company A for spare parts is a "transfer price." To determine whether the transfer price complies with Article 97, the Afghanistan Revenue Department will review unconnected transactions. There are two unconnected transactions that the Afghanistan Revenue Department identifies. The first unconnected transaction involves Company C. Company C is an Afghan corporation that is located near Kabul. Company C sells auto parts to various customers in the Kabul area. Company C does not assist in the repair of the automobile. It only sells auto parts. The second unconnected transaction involves Company D. Company D is an Afghan corporation. Company D is also located near Kabul.*

*Company D sells auto parts in the Kabul area. Company D employs a number of mechanics. Company D provides significant assistance to anyone who purchases auto parts. Company D helps the purchaser of the parts to determine how the repair work should be done. Company C transactions are similar to Partnership B's transactions, because the functions of the first company and Partnership B are similar. Hence, Company C's transactions may provide better evidence of the correct transfer price.*

b) Contractual Terms. The contract terms used in the connected and unconnected transactions should be similar. In this respect, the Afghanistan Revenue Department should focus on terms that relate to the economic arrangement between the parties (*i.e.*, payment terms, time for performance, etc.).

*Example:* *Daood owns all of the issued stock of Company A. Company A is an Afghan corporation. Company A publishes a magazine. Company A sells the magazines for money. Company A also charges people money for printing advertisements in the magazine. Daood also owns Company B. Company B is an Afghan corporation that operates a courier service. If someone wants to send a document from one location to another within a particular Afghan city, they can contact the courier service and pay the courier to deliver the document. Company B usually guarantees that the document will arrive at its destination within one day. Company B charges Afs. 100 for the delivery. Company A always uses Company B's courier service when it wants to deliver a document to someone. But when Company B provides services to Company A it does not guarantee that the document will be delivered in one day. It only charges Company A Afs. 80 for the delivery. The price charged by Company B to Company A is not necessarily unacceptable. This is because Company B provides delivery services to most of its customers on the same day that Company B receives the document. Company B does not provide the same timely service to Company A. Thus, it may be appropriate under these facts that Company B charges Company A less money. Thus, if possible, the Afghanistan Afghanistan Revenue Department should try to find an unconnected transaction that more closely matches the connected transaction.*

c) Risks. The risks borne by the parties in the connected and unconnected transactions should be similar.

*Example:* *Adib owns all of the stock of Company A, an Afghan corporation, that imports motorcycles. Adib also owns all of the issued stock of Company B, an Afghan corporation that purchases motorcycles from Company A and sells them to customers throughout Afghanistan. When Company A sells the motorcycles to Company B, Company A bears the risk that there will be a loss during shipment. Thus, if a motorcycle is lost or damaged during transit, Company A bears the loss, not Company B. When the Afghanistan Revenue Department is*

*analyzing unconnected transactions, it should try to find unconnected transactions where the seller bears the risk that a loss will occur during the transportation of the products.*

d) Economic Conditions. Afghanistan is emerging from a conflict environment. Thus, in analyzing connected and unconnected transactions, the Afghanistan Revenue Department must be careful to take into account the relevant economic conditions. In particular, the level of profit that one might expect from a business in Afghanistan may be dramatically different from the level of profit that one may expect from a business located in a more developed country, given the risks of investing in a post-conflict environment. Thus, in determining the correct transfer price, the Afghanistan Revenue Department is encouraged to look to the profit levels that are generated with respect to similar investments under similar economic conditions.

*Example: The Afghanistan Revenue Department is investigating Company A. Company A is an Afghan corporation that purchases radios from a connected person in China. Company A then sells the radios to various stores in Afghanistan. In determining whether the price paid by Company A for the radios is reasonable, the Afghanistan Revenue Department could look to transactions between unconnected parties in more developed countries. In reviewing these transactions, the Afghanistan Revenue Department should carefully consider whether the special economic and other conditions in Afghanistan make those other transactions less helpful in providing guidance.*

e) Similarity of Property or Services. In ascertaining the correct transfer price, the connected and unconnected transactions should involve similar property or services. If the connected transaction involves the sale of a car, the Afghanistan Revenue Department should attempt to find comparable unconnected transactions involving the sale of a car. The Afghanistan Revenue Department should not attempt to rely on an unconnected transaction involving the sale of a motorcycle, because the sale of a motorcycle is very different than a sale of a car.

97.6 It may be necessary in certain cases to make adjustments to ensure that the unconnected transaction is comparable to the connected transaction.

*Example: The connected transaction involves a sale of auto parts from Company A to Company B for Afs. 300,000. The terms of sale require that Company A bear the risk that the auto parts may be lost or damaged as they are transferred to Company B. The Afghanistan Revenue Department has identified one unconnected transaction that is comparable to the foregoing transaction. In the unconnected transaction, however, the purchaser bears the risk of loss for the parts during the time that the goods are transported. The Afghanistan Revenue Department may, in this case, adjust the price used in the unconnected transaction upward to approximate the sales price that*

*would have been used in the unconnected transaction had it been structured in the same way as the connected transaction.*

97.7 In some cases, the application of a pricing method (described below) may generate a single result that represents the best indication of what the appropriate transfer price should be. Alternatively, application of a pricing method may generate a range of results.

If each of the unconnected transactions is similar in all material respects to the connected transactions, or can be adjusted so that it is similar in all material respects, then all of the results create a range of reasonable transfer prices. If the taxpayer's transfer price falls within that range of results, then the taxpayer's transfer price should not be adjusted.

If, however, all material differences cannot be eliminated, then the results should be divided into three distinct categories. The first category should include the lowest 25% of the results. The second category should include the next 50% of results. The third category should include the last 25% of results. If the taxpayer's transfer price is within the second category, the taxpayer's transfer price should not be adjusted. If the transfer price is in the first or third category, the Afghanistan Revenue Department has the authority to restate the transfer price so that it is within the second category.

*Example 1: Adib is an Afghan citizen. Adib owns all of the issued stock of a Canadian corporation. Adib also owns all of the issued stock of an Afghan corporation. The Canadian corporation sells raw materials including color dyes and ink to the Afghan corporation. The Afghan corporation uses those dyes and ink to produce carpets. The Afghan corporation then sells those carpets to customers throughout the world. The Afghanistan Revenue Department locates 4 comparable transactions involving the sale of color dyes. The results are listed below:*

| | |
|---|---|
| *1st Comparable Transaction* | *100 Afs. per Liter* |
| *2nd Comparable Transaction* | *300 Afs. per Liter* |
| *3rd Comparable Transaction* | *380 Afs. per Liter* |
| *4th Comparable Transaction* | *500 Afs. per Liter* |

*If all of these unconnected transactions are similar in all material respects to the connected transaction, then the range of reasonable transfer prices is Afs. 100 to 500 per liter. If the connected transaction falls within that range, it should not be adjusted.*

*Example 2: The facts are the same as in Example 1, except that the comparable transactions are not similar in all material respects with the connected transaction. Moreover, adjustments cannot be made to ensure that the comparable unconnected transactions will be similar in all material respects to the connected transaction. Thus, the foregoing comparables should be separated into categories. The 1st Comparable*

*Transaction represents the bottom 25% of the results. The 2nd and 3rd comparables fall into the middle 50% of results. The 4th comparable is in the top 25% of results. Hence, if the Canadian corporation sells colored dyes to the Afghan corporation at a price that is more than Afs. 100 per liter, but less than Afs. 500 per liter, then the transfer price should not be adjusted.*

In certain situations, the number of results will not be a multiple of the number four (4). In these cases, all of the results should be added and then divided by the number of results to create an average. This average should be added to the lowest result and divided by two. This figure will establish the highest result in category one. The average should be added to the highest result and divided by two. This figure will establish the lowest result in category three.

*Example 3: Adib is an Afghan citizen. Adib owns all of the issued stock of a Canadian corporation. Adib also owns all of the issued stock of an Afghan corporation. The Canadian corporation sells raw materials including color dyes and ink to the Afghan corporation. The Afghan corporation uses those dyes and ink to produce carpets. The Afghan corporation then sells those carpets to customers throughout the world. The Afghanistan Revenue Department locates 7 comparable transactions involving the sale of color dyes. The results are listed below:*

| | |
|---|---|
| *1st Comparable Transaction* | *100 Afs. per Liter* |
| *2nd Comparable Transaction* | *300 Afs. per Liter* |
| *3rd Comparable Transaction* | *380 Afs. per Liter* |
| *4th Comparable Transaction* | *500 Afs. per Liter* |
| *5th Comparable Transaction* | *520 Afs. per Liter* |
| *6th Comparable Transaction* | *540 Afs. per LIter* |
| *7th Comparable Transaction* | *600 Afs. per Liter* |

*There are differences between these transactions and the controlled transaction. Adjustments cannot be made to eliminate these differences. Thus, a range of reasonable results must be created. There are seven results. If the number of comparable transactions (7) is divided by the number four (4), the result will be a fraction (1¾). Thus, the results should be added together and divided by seven (7). This average figure is 420. The lowest result is 100. Thus, the highest edge of the first category is 260 (100 + 420)/2. The highest result is 600. Thus, the lowest edge of the third category is 510. Thus, if the price charged by the Canadian company is higher than 260 and lower than 510 then it should not be adjusted.*

97.8 If an adjustment is made to the taxpayer's transfer price, the Afghanistan Revenue Department should also be prepared to make or accept a corresponding adjustment to the income earned by the other taxpayers that

were involved in the connected transaction. Thus, if a transfer pricing adjustment has the effect of increasing the income of one connected taxpayer, a corresponding adjustment should typically be made to reduce the income of the other connected taxpayer that participated in the connected transaction. A corresponding adjustment should only be made pursuant to the following rules:

(a) A corresponding adjustment should not be made until there has been a "final determination" of the primary adjustment.

<u>Example 1</u>: *Corporation A is an Uzbek corporation. Corporation B is an Afghan corporation. Adib is an Uzbek resident that owns all of the issued stock of Corporation A and Corporation B. Corporation A leases equipment to Corporation B. The Afghanistan Revenue Department determines that the rent charged by Corporation A to Corporation B is Afs. 100,000 higher than the rent that would be charged between unconnected taxpayers. The Afghanistan Revenue Department increases Corporation B's income by Afs. 100,000. If Corporation B accepts the increase and pays any resulting income tax due, then the Afghanistan Revenue Department should also make a corresponding downward adjustment in the amount of tax due with respect to the rental payment.*

<u>Example 2</u>: *The facts are the same as Example 1, but Corporation B disputes the Afghanistan Revenue Department's position. The Afghanistan Revenue Department should not reduce the amount of tax due with respect to the rental payment unless or until there has been a final determination as to what the rental charge should be.*

(b) If a corresponding adjustment is made, the connected taxpayers may want to make a cash transfer in order to conform their books and records to the new transfer price. Thus, if a corresponding adjustment is made, the connected taxpayers should be permitted, at their option, to create a receivable and payable in their books and records with the following characteristics:

1) The receivable or payable should be created as of the last day of the year in which the connected transaction took place.

2) The receivable or payable should accrue a reasonable rate of interest from that date.

3) The receivable or payable should be denominated in the currency of the underlying transaction.

4) The receivable or payable should be large enough to cover the entire transfer pricing adjustment. The amount should not be larger than the transfer pricing adjustment. As such, the creation of the receivable/payable should not cause either party to be subject to additional tax.

*Example:* *Corporation A is an Uzbek corporation. Corporation B is an Afghan corporation. Corporation A and Corporation B are owned by Adib, an Afghan resident. Corporation A sells goods to Corporation B during 1386. The sales are all paid for in Afghanis. The Afghanistan Revenue Department audits Corporation B's 1386 tax return during 1388. After its investigation, the Afghanistan Revenue Department determines that the transfer price charged by Corporation A to Corporation B is too high. The Afghanistan Revenue Department therefore increases Corporation B's taxable income by Afs. 1,000,000. Corporation B agrees with the revision and pays additional Afghan income tax. Corporation A and Corporation B may elect to set up a payable and a receivable equal to Afs. 1,000,000 on the last day of 1386. Corporation A will have a payable of Afs. 1,000,000 to Corporation B and Corporation B will have a receivable from Corporation A of Afs. 1,000,000. This intercompany receivable/payable must bear a reasonable rate of interest from the last day of 1386 until the amount is ultimately paid. Because the amount is the same size as the transfer pricing adjustment, the creation of the receivable/payable will not cause Corporation A or Corporation B to be subject to additional tax.*

97.9 The method for determining an appropriate interest rate with respect to a loan advanced between connected parties is set forth in this paragraph.

(a) The appropriate interest rate is the rate that would be charged between two persons who are not connected pursuant to a loan with similar conditions. In determining the appropriate rate, the Afghanistan Revenue Department should look to all of the loan terms including the term of the loan, the repayment provisions, and the security provided for the repayment.

*Example 1:* *Adib is an Afghan citizen, but he is resident in the United States of America during the year 1386. Adib lends his wholly owned Afghan corporation Afs 1,000,000. The loan bears interest at a 13% rate. The loan must be repaid in 10 years. The loan is unsecured, which means that Adib does not have a security interest in any of the corporation's assets. The Afghan corporation can demonstrate that it recently obtained a loan that has to be repaid in 8 years from a bank. The bank loan bears interest at a 12% rate. The 13% rate charged by Adib should be considered appropriate.*

*Example 2:* *The facts are the same as Example 1, but the bank loan had to be repaid in 3 years and not 8 years. In this case, the bank loan does not represent a valid comparison. Adib and his Afghan corporation will have to rely on different evidence to prove that the 13% rate is appropriate. For example, they may refer to the interest rates that banks are charging on loans with longer terms.*

(b) The Afghanistan Revenue Department shall issue procedures from time to time with respect to appropriate interest rates. In the meantime the benchmark interest rate should be based on rates charged by Da Afghanistan Bank for the use of funds. For example, Da Afghanistan Bank issues 30-day capital notes bearing a rate of interest that changes from time to time. A loan with a term of less than 1 year will be presumed to have an appropriate interest rate if the rate charged is within 3 percentage points of the rate charged on 30-day capital notes. Connected persons will always be permitted to use a rate other than the benchmark rate listed in procedures. If a different rate is used, however, the taxpayer must be prepared to show that the rate is appropriate under the preceding paragraph.

97.10 The method for determining an appropriate charge for services in a connected transaction is set forth in this paragraph.

(a) A person will usually charge a connected person a fee for services if the services provide a definite benefit for the person receiving the services and the service is one that unconnected persons would be willing to pay for. If the service does not provide a definite benefit or the service is one that unconnected persons normally do not pay for, then no charge is required.

<u>Example</u>: *Company A is a Pakistani corporation that owns all of the issued stock of Company B, an Afghan corporation. Company A periodically sends its representatives to Afghanistan to monitor Company B's performance and review its financial information. The services provided by Company A do not provide a definite benefit for Company B and they are not the type of services that an unconnected company would pay Company A to provide. Company A should not charge Company B for these services but if it does, Company B will not be entitled to an income tax deduction for the payment.*

(b) If a person decides to charge a connected person for services provided, the charge should be similar to the amount that one person would charge an unconnected person for the same or similar services.

<u>Example</u>: *Azziz owns all of the stock of Company A. Company A is an American corporation. Azziz owns all of the stock of Company B. Company B is an Afghan corporation. Company B provides telecommunications services to customers in Afghanistan. Company A provides consulting services to Company B. The services that Company A provides include repair services and computer support services. The services that Company A provides to Company B provide a direct benefit to Company B and the services are the type of services that one person would pay an unconnected person for. Company A is entitled to charge Company B for the services that Company B receives. The amount charged should be similar to the amount that one person would charge an unconnected person for the same or similar services.*

97.11 The method for determining an appropriate charge for the lease or rent of tangible property between connected persons is set forth in this paragraph. In summary, the appropriate charge is the amount that would have been charged for the lease or rent of the same or similar property between unconnected persons under similar circumstances.

97.12 The method for determining an appropriate charge for the sale or transfer of tangible property between connected persons is set forth in this paragraph. In summary, there are five possible methods for determining the appropriate charge for the transfer of tangible property between connected persons.

1. Comparable Unconnected Price Method
2. Resale Price Method
3. Cost Plus Method
4. Transactional Net Margin Method
5. Unspecified Method

The best method to use is the method determined under the rules described above in paragraph 97.5.

(a) Comparable Unconnected Price Method. The purpose of the Comparable Unconnected Price method is to compare the price that is charged for the tangible property in the connected transaction to the price that is charged in unconnected transactions involving the same property.

*Example 1: Azziz owns all of the issued stock of Company A and Company B. Company A is a French corporation. Company B is an Afghan corporation. Company A sells steel pipes to Company B. Company B purchases the pipes from Company A and uses them in its construction business in Afghanistan. Company A sells a one-meter pipe for Afs. 50. The sales contract provides that Company A bears all risks related to the transportation of the pipe from France to Afghanistan. Company B can demonstrate that it can buy the exact same one meter pipe from unconnected Chinese companies for Afs. 40 or Afs. 42. The Chinese suppliers will also bear all risk related to the transportation of the pipe from China to Afghanistan. The transfer price from Company A to Company B should be adjusted to reflect the fact that Company A should only be charging Company B Afs. 42 for the pipe.*

*Example 2: The facts are the same as in Example 1, except that the Chinese suppliers do not bear all of the risks related to the transportation of the pipe from China to Afghanistan. The Afghanistan Revenue Department estimates that the cost of insuring the risks associated with the transportation of pipe would be approximately Afs. 5 to Afs. 10 per pipe. Thus, no adjustment to the transfer price is necessary in this case.*

(b) Resale Price Method. The Resale Price Method is used to determine whether the amount charged in a controlled transaction is appropriate by reference to the gross profit margin earned in similar unconnected

transactions. Gross profit equals the revenues from the sale of a product minus the cost of the product for the seller. Gross profit is not reduced by operating expenses, like advertising expense or interest expense. To determine the appropriate transfer price, the appropriate gross margin percentage is multiplied by the applicable resale price. The appropriate gross margin percentage is the ratio of the gross profit earned on sales of similar property to the sales price of the property. The applicable sales price is the price at which the connected party sells the property to unconnected persons. This method is typically used when one of the connected parties purchases and sells tangible personal property without adding substantial value to the property. For this purpose, packaging, labeling and minor assembly do not constitute the addition of substantial value. Whether or not this method represents the best method is determined using the factors set forth in paragraph 97.5 above.

*Example 1*: *Adib owns all of the issued stock of Company A, an Uzbek corporation, and Company B, an Afghan corporation. Company A sells electric generators to Company B. Company B then sells the electric generators to customers in Afghanistan. Company B charges Afs. 20,000 per generator. Company B purchases the generators from Company A for Afs. 18,000 per generator. The applicable sales price for the generator is Afs. 20,000. The gross margin earned by Company B is Afs. 2,000 (Afs. 20,000 – Afs. 18,000). The gross margin percentage is 10%.*

*Example 2*: *The facts are the same as Example 1, except that the Afghanistan Revenue Department determines that Company B's competitors purchase generators from unconnected companies. The Afghanistan Revenue Department also determines that these companies earn the following gross margin percentages:*

| | |
|---|---|
| *Company C* | *12%* |
| *Company D* | *15%* |
| *Company E* | *18%* |
| *Company F* | *22%* |

*Because there are differences between the products sold by Companies C, D, E and F, that cannot be corrected for, the percentages above 12% and below 22% represent the relevant range of gross margins that Company B should earn with respect to the generators. Thus, the Afghanistan Revenue Department is entitled to adjust the transfer price between Company A and Company B to ensure that Company B earns a gross margin of at least 12%.*

(c) Cost-Plus Method. The Cost-Plus Method is used to determine the appropriate transfer price by looking at the amount by which the sales price of property exceeds the cost to produce the property. This excess is referred to as the "markup". The "markup percentage" is the ratio of this excess markup over the costs of producing the property. This method is usually used in cases involving the manufacture, assembly or other

production of goods that are sold to connected parties. The Cost-Plus Method is used to determine an appropriate price by adding the appropriate gross profit to the connected taxpayer's cost for producing the property involved in the connected transaction. The appropriate gross profit is computed by looking at the markup percentage earned in unconnected transactions.

*Example 1*: *Wahid owns all of the issued stock of Company A, an Afghan corporation, and Company B, a British corporation. Company A makes carpets in Afghanistan and sells them to Company B. Company B sells the carpets to customers in Britain. Company A sells the carpets to Company B for Afs. 30,000 per carpet. It costs Company A Afs. 25,000 to make each carpet. The mark-up earned by Company A is Afs. 5,000. The markup percentage is 20% (Afs. 5,000 / Afs. 25,000).*

*Example 2*: *The facts are the same as in Example 1, except that the Afghanistan Revenue Department identifies three other Afghan carpet manufacturers in the same geographic location. These manufacturers sell very similar carpets to unconnected companies in Europe. The Afghanistan Revenue Department determines that these three manufacturers incur costs that are similar to Company A. These other companies earn different mark-up percentages, however:*

| | |
|---|---|
| *Company C* | *16%* |
| *Company D* | *22%* |
| *Company E* | *23%* |

*The Afghanistan Revenue Department determines that Companies C, D, and E are all providing very similar goods on terms that are very similar to the terms offered by Company A. Thus, all three of the foregoing results create a range of reasonable results. Because the markup percentage earned by Company A is within this range, no adjustment should be made.*

*Example 3*: *The facts are the same as in Example 2, but the Afghanistan Revenue Department discovers four potential unconnected transactions. These transactions are very similar to the transactions conducted by Company A, but there are differences. For example, some of the carpets sold in the unconnected transactions are not made of 100% sheep's wool. The Afghanistan Revenue Department does not believe that it can make adequate adjustments to the unconnected transactions to make them more similar to Company A's sales to Company B. The applicable markup percentages are set forth below:*

| | |
|---|---|
| *Company F* | *15%* |
| *Company G* | *18%* |
| *Company H* | *21%* |
| *Company I* | *24%* |

*Because these unconnected transactions are not sufficiently similar to Company A's sales of carpets to Company B, the Afghanistan Revenue Department has to create a reasonable range of results. The reasonable range of results excludes the lowest 25% of the results and the highest 25% of results from the unconnected transactions. In the foregoing list of results, the lowest result is 15% and the highest result is 24%. Thus, the range of reasonable results is above 15% but below 24%. The Afghanistan Revenue Department may adjust the transfer price between Company A and Company B so that Company A's mark-up is above 15% but below 24%.*

(d) Transactional Net Margin Method. The Transactional Net Margin method can be used for transfers of tangible and intangible property. Thus, the rules regarding the Transactional Net Margin Method are described separately in paragraph 97.14.

(e) Unspecified Methods. Unspecified Methods can be used for transfers of tangible and intangible property. Thus, the rules regarding unspecified methods are described separately in paragraph 97..5.

97.13 The method for determining an appropriate charge for the sale or transfer of intangible property is set forth in this paragraph. Determining the appropriate transfer price for the sale or transfer of an intangible can be very difficult. Determining the appropriate transfer price is made complicated by the fact that the right to use an intangible can be separated into a number of different parts. Thus, a single item of intangible property can have multiple owners. For example, one person could have the right to use a specific name to sell carpets in Helmand province and someone else could have the right to use the exact same name to sell carpets in Bamiyan province. Thus, the first task in analyzing the transfer price for intangible property is to determine the owner of the property. Normally, if the intangible property is legally protected, the legal owner of the intangible property will be considered the owner, unless that person transfers substantially all of their rights to someone else pursuant to a contract.

The following examples assume that Afghan law provides one person with the sole legal right to use a particular name in the conduct of a trade or business for a province. The examples are for illustration only and should not be interpreted as a comment on the intangible property laws within Afghanistan.

*Example 1: Afghan law provides Azziz with the exclusive right to use the name "Afghan Carpets" in the Helmand and Bamiyan provinces. As a result, Azziz can open carpet stores in Helmand and Bamiyan with the name "Afghan Carpets" but no one else is permitted to open a carpet store with the same name. Azziz would normally be considered to own the intangible right to use that name in his business in those provinces for tax purposes.*

<u>Example 2</u>: *The facts are the same as in Example 1, except that Azziz enters into a contract with Wahid. The contract provides that Azziz will transfer all substantial rights in the name "Afghan Carpets" to Wahid for the Bamiyan province in exchange for Afs. 1,000,000. Thereafter, Azziz will be the only person permitted to use the name "Afghan Carpets" in Helmand province and Wahid will be the only person permitted to use the name "Afghan Carpets" in Bamiyan province. In this case, Azziz will only be considered the owner of the intangible in Helmand province. Wahid will be considered the owner of the intangible in Bamiyan province.*

If the intangible property is not legally protected, then the person that developed the intangible property will be considered to own the intangible property. If two or more connected persons develop the property, then the owner will be that person that bore the largest portion of the direct and indirect costs associated with the property.

<u>Example 3</u>: *Azziz owns all of the issued stock of Company A and Company B. Company A is an Afghan corporation. Company B is an Uzbek corporation. Employees from Company A and Company B work together to develop a new process for applying colored dye to cloth. At the time the process is developed, Afghanistan does not have a law that would provide Company A or Company B any legal protection for the new process. Hence, both Company A and Company B need to ensure that their employees do not tell other people about their new secret process. They both enter into contracts with their employees to try and protect the secrecy of the process. Company A incurred Afs. 3,000,000 in developing the secret process and Company B incurred Afs. 2,800,000 in developing the secret process. Company A should be considered to own the secret process.*

It is important to determine the owner of the intangible property because the owner of the property is the person that is entitled to receive compensation for the use of the intangible. The other parties that assisted in the development of the intangible are only compensated for their services.

<u>Example 4</u>: *The facts are the same as in the previous example. Because Company A is the owner of the process, Company A should pay Company B to reimburse Company B for its costs plus a reasonable profit. Company A needs to make this payment, because Company B provided services for Company A. If Company B uses the process in its business, Company B must pay Company A for the use of the process.*

Once the owner has been determined, the Afghanistan Revenue Department must use a transfer pricing method in order to determine whether the transfer price for the intangible property is appropriate. In summary, there are three acceptable methods for determining the appropriate price for the transfer of intangible property. These methods are the Comparable Unconnected Transaction Method, the Transactional Net Margin Method and Unspecified Methods.

(a) Comparable Unconnected Transaction Method. The purpose of the Comparable Unconnected Transaction Method is to determine whether the amount charged between two connected persons for the transfer of an intangible property is reasonable by comparing that charge to the amount that would be charged in a similar transaction between two unconnected persons. This method is typically only used when a very similar transaction between unrelated persons can be found.

*Example 1:* *Azziz owns the right to use the name "Afghan Carpets" in Helmand province and Bamiyan province. He grants Wahid the right to use the name in Helmand in exchange for a fee equal to 5% of Wahid's carpet sales every year for the next six years. At the same time, Azziz grants his son, Adib, the right to use the same name in Bamiyan province in exchange for a fee of 3% of Adib's carpet sales every year for the next six years. The Afghanistan Revenue Department determines that there is no significant reason why the right to use the name "Afghan Carpets" is any more valuable or any less valuable in Helmand province than Bamiyan province. Thus, the Afghanistan Revenue Department has the right to adjust Azziz's income upward to reflect the fact that Azziz should be receiving an amount equal to 5% of his son's carpet sales.*

*Example 2:* *Azziz owns all of the issued stock of Company A and Company B. Company A is an Afghan corporation. Company B is a Canadian corporation. Company A puts soda into bottles for sale in Afghanistan. To perform its business, Company A imports bottles and syrup from outside of Afghanistan. Company A then takes the bottles and syrup and converts them into soda for sale in the markets. Company B owns the rights to a secret process that makes it easier to put soda into plastic bottles. Company B grants the right to use this process to Company A in exchange for a fee equal to 5% of Company A's revenues. Company C is unconnected to Azziz, Company A and Company B. Company C owns the right to use the name "Afghan Cola" in Afghanistan. Company C grants Company A the right to use this name when Company A puts labels on the bottles that it sells. Company C charges Company A a fee equal to 1% of Company A's revenues. The right to use a secret process and the right to use a name are completely different rights. Thus, the Afghanistan Revenue Department cannot use the Comparable Unconnected Transaction Method to decrease the fee paid by Company A to Company B to 1% of net revenue, and thereby increase Company A's profits.*

(b) Transactional Net Margin Method. The Transactional Net Margin Method can be used for transfers of tangible and intangible property. Thus, the rules regarding the Transactional Net Margin Method are described separately in paragraph 97.14.

(c) Unspecified Methods. Unspecified Methods can be used for transfers of tangible and intangible property. Thus, the rules regarding the unspecified methods are described separately in paragraph 97.15.

97.14 Transactional Net Margin Method. The Transactional Net Margin Method is used to determine whether the amount charged in a connected transaction is reasonable based on objective measures of profitability. The Transactional Net Margin Method can be used for transfers of tangible and intangible property. These objective measures of profitability are often referred to as "Profit Level Indicators". These Profit Level Indicators are derived from an investigation of transactions occurring between unconnected taxpayers that engage in similar business activities under similar circumstances. This method should only be used if the other methods described above cannot be used.

*Example 1: The Afghanistan Revenue Department reviews the profits earned by automobile sellers in Kabul, Herat, and Mazar-e-Sharif, for the past three years. The department learns that a typical businessman's profit from the sale of automobiles to customers will equal between 3% of his sales revenue and 10% of his sales revenue. Thus, if the sales price for an automobile is Afs. 100,000, the businessman's profit from that sale is between Afs. 3,000 and Afs. 10,000. This ratio of profit to revenue is a Profit Level Indicator.*

Under the Transactional Net Margin Method, a reasonable profit margin is determined by applying the Profit Level Indicator that was derived from unconnected parties to the transactions under investigation.

*Example 2: The facts are the same as in the previous example, except that the taxpayer under investigation is Wahid. Wahid owns and operates a business in Kabul that sells used automobiles to customers. One of Wahid's most significant customers is his son, Adib. Adib owns a company in Kabul that provides security. Adib purchases all of his vehicles from his father's business. The Afghanistan Revenue Department discovered that the ratio of Wahid's profit to his revenue from selling cars to his son is typically less than 1%. The Afghanistan Revenue Department can use the information it derived from unconnected transactions in Kabul, Herat and Mazar-e-Sharif to increase Wahid's profit from the sale of cars to his son until the ratio of the profit that Wahid earns to the revenue that Wahid earns is between 3% and 10%.*

Many different ratios can be considered Profit Level Indicators. For example, the ratio of profit to revenue is one type of Profit Level Indicator. Another Profit Level Indicator is the ratio of operating profit to operating expenses. It is important to attempt to isolate the profit with respect to a particular transaction, rather than the profit generated by an entire company.

*Example 3*: *Azziz owns a store in Pakistan that makes cloth. Azziz sells the cloth to his son, Adib, who lives in Afghanistan. Adib uses the cloth to make suits for men. Adib sells these suits in his store located in the Shar-e-Now area of Kabul. The Afghanistan Revenue Department investigates Adib for the tax year 1387. The Afghanistan Revenue Department learns that Adib earned the following profit during the year 1387:*

| | |
|---|---|
| *Revenue* | *Afs. 10,000,000* |
| *Cost of Goods Sold* | *- 8,000,000* |
| *Gross Profit* | *2,000,000* |
| *Operating Expenses* | *- 1,000,000* |
| *Net Profit* | *1,000,000* |

*The foregoing information can provide a number of different Profit Level Indicators. For example, the ratio of net profit to revenue is 10%. Razique is unconnected to Azziz and Adib. Razique also owns a store in Shar-e-Now. The Afghanistan Revenue Department knows, from reviewing the tax returns of Razique for the last four years, that Razique's ratio of net profit to revenue is approximately 5%. Unlike Adib, however, Razique sells men's suits, and shoes and various Afghan crafts. The Afghanistan Revenue Department cannot determine what profit Razique earns only on the sale of suits. Thus, the Afghanistan Revenue Department should not use Razique's results to adjust Adib's profit under the Transactional Net Margin Method.*

To enhance the accuracy of the method, a number of years of data should be reviewed. Generally, at least three years of data should be analyzed to develop a Profit Level Indicator.

*Example 4*: *The Afghanistan Revenue Department wants to determine what a reasonable profit should be for the sale of used automobiles so that it can develop a Profit Level Indicator. The Department obtains information for two companies, Company A and Company B. Company A has the following information:*

| *Year* | *Revenue* | *Profit* | *Ratio* |
|---|---|---|---|
| *1386* | *1,000,000* | *100,000* | *1%* |
| *1387* | *2,000,000* | *200,000* | *1%* |
| *1388* | *5,000,000* | *500,000* | *10%* |

*The Afghanistan Revenue Department should take the average of the results for the past three years, or 4% (1% + 1% + 10%)/3. The Afghanistan Revenue Department should not simply take the 10% figure from 1388 because it is the highest figure.*

*Company B has the following information:*

| *Year* | *Revenue* | *Profit* | *Ratio* |
|---|---|---|---|
| *1386* | *1,000,000* | *200,000* | *2%* |
| *1387* | *2,000,000* | *200,000* | *1%* |
| *1388* | *5,000,000* | *300,000* | *6%* |

*The Afghanistan Revenue Department should take the average of the results for the past three years, or 3% (2% + 1% + 6%)/3.*

The Afghanistan Revenue Department should take the same steps with other companies that it believes engage in similar activities in order to develop a reasonable range of Profit Level Indicators as required under paragraph 97.7.

In addition, it is important to ensure that the businesses that are analyzed to develop the reasonable range of Profit Level Indicators use the same methods of accounting.

*Example 5*: *Azziz owns a store in the Wazir Akbar Khan area of Kabul. The store sells breads and cookies and pastries. Azziz uses the cash method of accounting. Azziz buys all of his flour from his son, who owns a store in Pakistan. If the Afghanistan Revenue Department wants to use the Transactional Net Margin Method to investigate the transfer price that Azziz pays for flour, it must find a similar transaction between unconnected parties who use the cash basis of accounting.*

As noted above, the Transactional Net Margin Method can be used to establish an arm's length price on transfers of tangible or intangible property.

*Example 6*: *Najibullah is an Afghan citizen and resident that owns all of the issued stock of a Canadian corporation and an Afghan corporation. The Canadian corporation licenses the Afghan corporation the right to use certain technology in the Afghan corporation's business of manufacturing steel. The Afghan corporation pays a royalty to the Canadian corporation during the year 1390. The payment of the royalty is the only connected transaction between the Afghan corporation and the Canadian corporation. The royalty equals 8% of the Afghan corporation's sales revenue. The Afghanistan Revenue Department chooses net profit as a percentage of sales as its profit level indicator. The Afghanistan Revenue Department reviews the net profits and sales revenues earned during the last three years for each of four companies. The results are as follows:*

| *Company* | *Year* | *Profts/Sales* |
|---|---|---|
| *Company A* | *1389* | *6%* |
| | *1388* | *5%* |
| | *1387* | *7%* |
| | *Average* | *6%* |

| | | |
|---|---|---|
| *Company B* | *1389* | *5%* |
| | *1388* | *2%* |
| | *1387* | *8%* |
| | *Average* | *5%* |
| *Company C* | *1389* | *2%* |
| | *1388* | *4%* |
| | *1387* | *0%* |
| | *Average* | *2%* |
| *Company D* | *1389* | *2%* |
| | *1388* | *1%* |
| | *1387* | *0%* |
| | *Average* | *1%* |

*Company D's average 1% profit margin represents the bottom 25% of results. Company A's average 6% profit margin represents the top 25% of results. To the extent the Afghan corporation generates a ratio of profits to sales above 1% but below 6%, the royalty it pays to the Canadian corporation should not be adjusted.*

*Assume that the Afghan corporation generates a loss in 1390. The Afghanistan Revenue Department can reduce the royalty that the Afghan corporation pays the Canadian corporation until the Afghan corporation's ratio of profits to sales exceeds 1%.*

97.15 Unspecified Methods. The Afghanistan Revenue Department and taxpayers may both use methods that are not described above to determine the appropriate transfer price in a connected transaction. In the event that one of the specified methods (mentioned above) and an unspecified method can be used, the specified method is preferred. Like the Transactional Net Margin Method, Unspecified Methods can be used to determine the arm's length price for transfers of tangible and intangible property.

*Example 1: Wahid owns all of the issued stock of Company A and Company B. Company A is an Afghan corporation. Company B is a Pakistani corporation. Company A supplies lapis stone to Company B. Company B takes the lapis stone and transforms it into jewelry. Company B then sells the jewelry throughout the world. Company A only sells lapis stone to Company B. Company A does not sell lapis stone to any other unconnected person. Company A does not have enough information to use one of the specified methods to determine what the appropriate transfer price should be between Company A and Company B. The Afghanistan Revenue Department does not have enough information to use one of the specified methods. Company A has received an offer from Company C, an unconnected Pakistani company, to purchase lapis stone for Afs. 90,000 per kilogram. This*

*offer from the Pakistani company is not considered an "unconnected transaction" because it is only a bid. It does not represent a completed transaction. Because one of the specified methods above cannot be used, Company A and the Afghanistan Revenue Department can both rely on this offer from Company C to determine what the appropriate transfer price should be.*

*Example 2*: *Wahid owns all of the issued stock of a Canadian corporation and an Afghan corporation. The Canadian corporation licenses certain technology to the Afghan corporation in exchange for an annual royalty equal to 8% of the Afghan corporation's net sales. The Afghan corporation is in the business of manufacturing steel. The Afghanistan Revenue Department attempts to apply the Comparable Uncontrolled Transaction Method, but it cannot find a reasonable comparable unconnected transaction. The Afghanistan Revenue Department attempts to apply the Transactional Net Margin Method, but it cannot obtain financial information about unconnected corporations in the same business as the Afghan corporation. If it is impossible to apply one of the specified methods, both the Afghanistan Revenue Department and the Afghan corporation can look at the profit level indicators generated by unconnected companies in related businesses to determine whether the Afghan corporation's profits are appropriate. For example, they could look at the profits earned by businesses that manufacture concrete or bricks or other building materials.*

| | |
|---|---|
| Article 98 | Anti-avoidance (1) Where any person enters into any transaction or arrangement with the intent to cause reduction of liability to pay tax, the Ministry of Finance may disregard such transaction or arrangement and assess all persons affected by the transaction or arrangement as if the disregarded transaction or arrangement had not taken place.<br><br>(2) Any person who evades income tax shall be required to pay the income tax due and additional tax as follows:<br><br>- in the first instance, additional tax of double the evaded tax, and<br><br>- in the second instance, additional tax of double the evaded tax and the business activity of the person shall be ceased by order of the court. |

98.1 The anti-avoidance rule in Article 98 can only be applied if the taxpayer enters into a transaction and the most significant result of the transaction is to reduce the taxpayer's income tax liability.

98.2 To apply Article 98, it is necessary for the Afghanistan Revenue Department to demonstrate that the taxpayer's tax liability was reduced by the transaction. Nevertheless, it is not sufficient for the Afghanistan Revenue Department to establish only that the taxpayer's tax liability was reduced.

*Example 1*: *Company A is an Afghan corporation. Company A is engaged in the business of providing telecommunications services to customers throughout Afghanistan. During the year 1387 Company A generates a loss of Afs. 50,000,000. During the year 1388, Company A uses the Afs. 50,000,000 loss from the year 1387 to reduce its taxable profit and its tax liability. Article 98 should not be applied in this situation. It is true that Company A engaged in transactions during the tax year 1387 which had the effect of reducing Company A's tax liability in 1388. Nevertheless, the primary purpose of Company A's transactions during 1387 was to provide telecommunications services to customers. The primary purpose was not to achieve a tax benefit.*

*Example 2*: *Azziz is an individual who needs to use land and a building for his business in Herat. Azziz knows that if he purchases the land and the building, he will be able to claim depreciation deductions for the building. Azziz also knows that he will not be able to claim depreciation deductions for the land. Azziz knows that if he chooses to rent the land and the building, he will be able to claim a deduction for the entire rental payment. Thus, Azziz decides that he should rent the land and the building. Article 98 should not apply in this case. Azziz's primary purpose in renting the building was to do his business in Herat. The fact that renting the land and building creates more of a tax benefit than purchasing the land and the building is not sufficient reason to apply Article 98.*

98.3 Before Article 98 can be applied, the Afghanistan Revenue Department must also be able to prove that the taxpayer's intention to reduce taxes was the primary reason that the taxpayer chose to enter into the transaction. The taxpayer's intention is determined by looking at the facts surrounding the transaction, and not the taxpayer's personal testimony.

*Example 1*: *Wahid owns all of the stock of Company A and Company B. Company A and Company B are both Afghan corporations. Company A is not registered under the Private Investment Law of Afghanistan. Thus, Company A is not able to carry forward its tax losses indefinitely. Company A believes that, in the tax year 1388, one of its tax losses will expire. To prevent the loss from expiring unused, Company A sells an asset to Company B on the last day of 1388. Company A recognizes a gain on the sale. Company A uses its tax loss to reduce the amount of gain it recognized during 1388. On the first day of Hamal, 1389, Company B sells the same asset to Company A. Thus, Company A owned the asset before this transaction. Company A owned the asset after this transaction. Company A was able to use its tax loss. Company A was also able to increase the depreciation basis of the asset to fair market value without paying any tax. Company A can now claim larger depreciation deductions with respect to the asset, and lower its tax liability. The sole reason for this transaction is to reduce Company A's tax liability. If the tax consequences were not considered, Company A would not want to sell the asset to Company B and Company B would not want to buy the asset from Company A. It is therefore appropriate for the Afghanistan Revenue Department to apply Article 98 in this situation.*

*Example 2*: *Wahid owns all of the stock of Company A. Company A is an Afghan corporation. Company A is in the business of manufacturing and selling ceramic plates, jugs and cups. Company A employs 20 of Wahid's cousins. All of these cousins are less than 15 years old. Wahid pays these cousins Afs. 5,000 per month for services that they perform. Because the amounts paid to each cousin is only Afs. 5,000 per month, none of the amounts paid are subject to wage withholding. Nevertheless, Company A claims a deduction for the Afs. 5,000 that is paid to each cousin. The Afghanistan Revenue Department investigates Company A. Wahid tells the Afghanistan Revenue Department that he employs his cousins because they are good workers. Nevertheless, the Afghanistan Revenue Department discovers that many of these cousins are too young to work. Moreover, Wahid is unable to prove that the cousins actually perform services for Company A. It is appropriate for the Afghanistan Revenue Department to apply Article 98 and disregard the payments to the cousins.*

98.4 The first time Article 98 (2) is applied to a taxpayer that is a natural or legal person, the taxpayer must pay the additional tax that is owed. The taxpayer must also pay a penalty equal to two times the additional amount of tax that is owed.

98.5 The second time Article 98 (2) is applied to a taxpayer that is a natural or legal person, the taxpayer must pay the additional tax that is owed. The taxpayer must also pay a penalty equal to two times the additional amount of tax that is owed. In addition, the Afghanistan Revenue Department may choose to apply to the commercial court (*maqima tejurat*) for an order to close down the taxpayer's business. Before pursuing the order, the following requirements should be satisfied:

(a) the Afghanistan Revenue Department personnel who are involved with the taxpayer's file should consider the seriousness of the taxpayer's offenses.

(b) the Afghanistan Revenue Department should consider whether the amounts involved justify closing down a taxpayer's business.

(c) the Afghanistan Revenue Department should consider whether the taxpayer has taken any actions to prevent tax evasion in the future.

(d) authorized Afghanistan Revenue Department personnel should decide whether they want to request a temporary business closure or a permanent business closure.

(e) the responsible persons should file their request for closure with the commercial court (maqima tejurat).

(f) if the court order is granted, the responsible persons should take the steps necessary to enforce the order. Enforcement should involve contacting the Ministry of Interior.

# CHAPTER 16

# ADDITIONAL TAX AND PENALTIES

## Article 99 – Article 107

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| Article 99 | <u>Offenses and penalties</u> (1) Where a person has not complied with tax obligations under the provisions of this Law, the person shall incur additional income tax liability and penalties under this Chapter in addition to payment of tax due. The provisions of this Law shall apply to the assessment and collection of additional income tax in the same manner as for other taxes under this Law.<br><br>(2) Additional income tax shall be payable in the following cases:<br><br>1. failure to pay the due tax by the due date prescribed by the provisions of this Law,<br>2. failure to maintain or provide access to books and records of business transactions,<br>3. failure to file a tax return and balance sheet,<br>4. failure to withhold tax,<br>5. failure to pay tax,<br>6. failure to obtain a Taxpayer Identification Number. |

99.1 Chapter 16 provides for additional tax and penalties where there has been non-compliance with this Law. Additional tax and penalties may be imposed and collected according to the same provisions as apply to taxes imposed by this Law. That is, additional tax and penalty may be levied according to the provisions of Chapter 13 regarding assessment and payment of taxes and collected according to the provisions of Chapter 14 regarding the enforcement of tax payments.

99.2 Paragraph 2 of Article 99 lists the situations where non-compliance with this Law may result in additional tax and penalties being payable. Each of the situations listed is dealt with in more detail in the remaining Articles of this Chapter.

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|---|---|
| Article 100 | Additional income tax where tax paid late Where a person has failed to pay tax due by the due date, the person is liable to pay additional income tax of 0.10 per cent of the tax due per day. |

100.1 The Income Tax Law imposes an additional tax of 0.10 per cent per day on any amount of tax that is not paid by its due date. This additional tax applies even if the tax return is filed on time.

*Example 1:* *Adib owns all of the issued stock of Company A. Company A is an Afghan corporation. Company A is required to file its income tax return for the 1386 year by the last day of Jawza, 1387. Company A is required to pay the tax that is due with the return. Company A does not file its income tax return until 10 days after the end of Jawza. The income tax liability shown on the return is Afs. 100,000. If Company A pays the Afs. 100,000 on the date that is 10 days after the end of Jawza, the company will owe penalties of Afs. 1,000 (Afs. 100,000 x 0.001 (= 0.1 per cent) x 10 days).*

*Example 2:* *The facts are the same as in Example 1, except that Company A files its tax return on the last day of Jawza. As the tax was not paid until 10 days after the end of Jawza, the additional tax for late payment of tax is the same as in Example 1. The fact that Company A filed its tax return (but did not pay) on time is not relevant.*

100.2 The additional tax in Article 100 applies to any unpaid tax liability, including the business receipts tax or fixed taxes imposed in lieu of income taxes.

100.3 The Afghanistan Revenue Department may refrain from applying the 0.10 per cent per day additional tax imposed under Article 100 where the additional tax is less than Afs. 250. The Afs. 250 threshold may be applied separately to different tax types.

*Example:* *Haroon owns a restaurant in Herat. In respect of the 1388 year, the restaurant has gross receipts of 2,000,000 Afs and makes a profit after deducting expenses of 160,000 Afs. Haroon is required to pay income tax (by the last day of Jawza 1388) and business receipts tax (by the 15th day following the end of each quarter). Haroon inadvertently misses making these tax payments by their due dates but only by a few days. If the 0.01 per cent additional tax calculated under this Article would be 200 afghanis in respect of income tax and 100 afghanis in respect of business receipts tax, the Ministry of Finance can refrain from applying both amounts, despite their total being above the 250 Afs. threshold.*

100.4 The Afghanistan Revenue Department may refrain from applying the 0.01 per cent per day additional tax imposed under Article 100 for amounts up to Afs. 500,000 additional tax where the following requirements are satisfied:

a) An additional tax assessment has been issued.

b) The taxpayer has requested that the additional tax should not be applied and the request sets forth facts supporting the taxpayer's attempt to comply with this Law in good faith.

c) The Director-General of Revenue, or a Deputy Director-General of Revenue has requested the Deputy Minister for Revenue and Customs in writing to refrain from applying the additional tax. Any such request shall require a consideration of the taxpayer's entire tax compliance history and be made only where a determination has been made that the taxpayer has made a good faith effort to comply with this Law.

d) The Deputy Minister for Revenue and Customs has agreed that the additional tax should not be applied.

| | |
|---|---|
| Article 101 | Additional income tax where records not maintained (1) A person who, without reasonable cause, fails to prepare and maintain records required by the provisions of this Law or fails to provide the officers of the Ministry of Finance access to the records shall pay additional income tax of Afs. 5,000 if the person is a natural person or Afs. 20,000 if the person is a legal person.<br><br>(2) A person who fails to prepare and maintain records as required by the provisions of this Law with the intent of evading payment of tax shall, in addition to the payment of an additional tax under paragraph (1) of this Article, be referred to the office of the Attorney-General. |

101.1 According to Article 101 of Income Tax Law, a natural person may be subject to Afs. 5,000 additional tax and a legal person may be subject to Afs. 20,000 additional tax where all the following circumstances apply:

(a) The natural person or the legal person was required to maintain records under this Income Tax Law;

(b) The natural person or the legal person failed to maintain appropriate or reasonable records OR the natural or legal person failed to provide Ministry of Finance, Afghanistan Revenue Department officers with access to its records as required by the Income Tax Law;

(c) The natural person or the legal person did not have a reasonable justification or excuse for failing to maintain the appropriate records OR failing to provide Ministry of Finance Afghanistan Revenue Department officers with access to its records.

*Example 1:* *Ahmad Reshad manufactures furniture and operates a large business in Kabul province. Ahmad keeps a record of his revenues, but does not keep a record of his expenses. Ahmad files an income tax return that shows Afs. 4,000,000 of revenue and Afs. 3,800,000 of expenses. Ahmad is required to maintain records under Article 36 of the Income Tax Law. When the Afghanistan Revenue Department asks Ahmad why he failed to keep records of his expenses, he said that he was not aware of this requirement. Even if Ahmad had never been audited or contacted by the Afghanistan Revenue Department before, he does not have a justifiable reason for failing to keep the appropriate records. Ahmad is expected to be aware of the requirements of the Income Tax Law (including those relating to record-keeping) as would any reasonable business person. Under Article 101, Ahmad Reshad is subject to the Afs. 5,000 additional tax.*

*Example 2:* *Azziz owns a warehouse in Kabul. During 1387, Azziz's warehouse is destroyed by a fire. Azziz takes a deduction for the cost of his warehouse under Article 18 (1) 9 during 1387. Article 18 (1) 9 provides that in order to claim the deduction Azziz is required to have proper records, including records that show how much Azziz's warehouse cost. When Azziz is asked for the documentation that*

*supports the cost of his warehouse, Azziz replies that he does not have any records. Azziz says that the reason that he does not have any records is that all of his records were in the warehouse that was destroyed by the fire. Azziz has a justifiable reason for failing to keep the appropriate records. Azziz is not subject to additional tax under Article 101.*

*Example 3:* *Kabul Engineering Company prepares its 1387 tax return and lodges it with the Afghanistan Revenue Department. Officers from the Afghanistan Revenue Department audit the revenue of Kabul Engineering Company and request to inspect contract documents which are known to be held in the company's office. The officers show the manager a copy of Article 101 of the Income Tax Law which authorizes the officers take this action. The manager denies the officers access to the documents on the basis that, in his opinion, only a court can compel him to allow access to Kabul Engineering Company's business records and that the company's confidential information may be given to its competitors. The manager's belief is unreasonable since the Income Tax Law, a validly enacted law of Afghanistan, clearly allows access to records without a court order. Further, the Income Tax Law treats information collected by revenue officers as confidential and prevents disclosure of such information to anyone outside the Ministry of Finance unless authorized by law. The manager does not have reasonable cause to deny access to the company's records. According to Article 101, additional tax of Afs 20,000 may be assessed to Kabul Engineering Company.*

101.2 Natural and legal persons may be referred to the Attorney General's office where all the following circumstances apply:

(a) The natural person or the legal person was required to maintain records under this Income Tax Law.

(b) The natural person or the legal person failed to maintain appropriate or reasonable records.

(c) The natural person or the legal person failed to prepare or maintain the appropriate records with the intent of evading tax.

*Remark: A person will be presumed to have intentionally failed to prepare or maintain appropriate records with the intent to avoid tax where the person:*

*i. failed to prepare and maintain records as stipulated by the Income Tax Law though was previously informed by tax officers of the requirements,*
*ii. repeatedly failed to prepare and maintain records as stipulated by the Income Tax Law, or*
*iii. records lower income or higher expenses in books of account than other business records show or documents are falsified.*

*In such cases, the person will be considered to have failed to prepare and maintain records with the intent of evading tax and therefore Article 101(2) will be applicable and the person shall be referred to the Attorney General's Office (Saranwali) for investigation and prosecution.*

*Example 1:* *Bahar Security Company is an Afghan corporation. It provides security services to various businesses throughout Afghanistan. Bahar Security Company has two bank accounts. It has one bank account with a bank in Afghanistan and another bank account with a bank in Pakistan. The Afghanistan Revenue Department audits Bahar Security Company for the tax year 1387. During the audit, the Afghanistan Revenue Department learns that Bahar Security Company deliberately asked its clients to transfer money to the Pakistani bank account. Bahar Security Company did not record the monies that were transferred to Pakistan as revenue even though the money related to services that it performed in Afghanistan. The company did not maintain any records of the revenues that were earned from these contracts. In this case, Bahar Security Company failed to maintain adequate records of its revenues. Bahar Security Company failed to record the revenue in order to avoid paying the tax that it was required to pay in Afghanistan. Therefore, according to Article 101(2), Bahar Security Company should be referred to the Attorney General's Office (Saranwali) for investigation and prosecution.*

*Example 2:* *Naemi Security Company is an Afghan corporation. It provides security services to various clients throughout Afghanistan. During the year 1387, Naemi Security Company claims that it has Afs. 1,000,000 of revenue and Afs. 900,000 of expenses. The Afghanistan Revenue Department learns, upon auditing Naemi Security Company, that it created invoices to justify Afs. 250,000 of expenses that did not exist. Naemi Security Company created these false invoices in order to lower its income tax liability. According to Article 101(2), the Afghanistan Revenue Department may refer Naemi Security Company to the Attorney General's Office (Saranwali) for investigation and prosecution.*

| | |
|---|---|
| Article 102 | Additional income tax where tax return not filed (1) A person who, without reasonable cause, fails to file a tax return by the due date shall pay additional income tax of Afs. 100 for each day other than holidays that the return was overdue if the person is a natural person or Afs. 500 for each day other than holidays that the return is overdue if the person is a legal person.<br><br>(2) A person who fails to file a tax return by the due date with the intent of evading payment of tax shall, in addition to the payment of additional tax under paragraph (1) of this Article, be referred to the office of the Attorney-General. |

102.1 A natural person shall pay additional income tax of Afs. 100 and a legal person shall pay Afs. 500 for each day (other than holidays) that their tax return is filed after the due date required under the provisions of this law. This additional tax shall only apply if the taxpayer does not have reasonable justification for the failure to file their tax return in a timely manner.

*Example 1:* *Baran Company is an Afghan corporation. It is required to file its 1387 income tax return by the last day of Jawza, 1388. Baran Company does not file its tax return until ten (10) days after the last day of Jawza. When the Afghanistan Revenue Department asks Baran Company why it failed to file its tax return on time, Baran Company's management respond that they had trouble completing their financial statements. Baran Company does not have a reasonable excuse for not preparing and filing its tax return on time. Baran Company should be subject to the Afs. 500 per day additional tax.*

*Example 2:* *Gul Company is an Afghan corporation. It is required to file its tax return for the 1387 year by the last day of Jawza, 1388. Gul Company fails to file its tax return until the first day of Hamal, 1389. The reason Gul Company did not file its tax return on time is that its office burned down and all of its financial records were destroyed. Gul Company filed its tax return as soon as it was able to do so after the fire. Gul Company should not be subject to the Afs. 500 per day additional tax.*

*Example 3:* *Nesar Ahmad is individual businessman who is engaged in export of fresh and dry fruits. He files his tax return for 1388 on the last day of Saratan 1389. When the Afghanistan Revenue Department asks him for the reason for delay in filing, he answered that he was busy with buying fresh fruits in the provinces, so he was unable to file his tax return on time. Nesar Ahmad`s excuse was not found reasonable, therefore he should be subject to additional tax of Afs 100 per day from first Saratan to end of Saratan except holidays.*

*Example 4:* *Gul Ahmad owns a market in Mandavi where he rents out his shops to shopkeepers. The market has three floors and the rent for each floor differs. The rent of shops in the first and second floors is more than Afs. 10,000 per month and the lessees when paying the rent withhold tax and transfer it to the government bank account. The rent for shops*

*which are used as warehouse in third floor is less than Afs. 10,000. According to the Income Tax Law, Ahmad is required to file his tax return by the end of Jowza of the next year and pay his tax liability after deducting withholding tax. Ahmad filed his tax return on 25 Mizan of the following year. When asked about the reason for late filing, he responded that due to a dispute with shopkeepers over determination of rent price, he was unable to file his last return. This excuse was not found reasonable. Therefore he is obliged to pay additional tax of Afs 100 per day except holidays up to date of filing the return*

*Remark: If Gul Ahmad had a legal dispute with his shopkeepers over the rent price for last year and he had been in prison because the shopkeepers sued him and no one else had authority to file his return and pay his tax liabilities, then this reason will be considered reasonable subject to Gul Ahmad presenting confirmation of these circumstances from court and prison officials.*

102.2 A person who fails to file a tax return as required under the provisions of this law with the purpose of evading payment of tax shall pay additional tax required under Article 102(1). In addition, the person shall be referred to the Attorney General's Office (Saranwali) for investigation and prosecution.

*Example:* *Azziz is a United States citizen, but is a resident of Afghanistan. Azziz has been a resident of Afghanistan during the tax years 1387, 1388 and 1389. Azziz knows that he is required to file an income tax return in Afghanistan because the Afghanistan Revenue Department formally advised him in 1387 that he needed to file an income tax return. Azziz deliberately failed to act on the Afghanistan Revenue Department's advice. Azziz also knows that if he pays tax in Afghanistan he will not be able to reduce his tax liability in the United States by an equal amount. Thus, every Afs. 1 Azziz pays to the Afghanistan government reduces Azziz's income for the year. Azziz chooses not to file a tax return because he wants to pay less tax in Afghanistan. The Afghanistan Revenue Department, in addition to imposing additional tax described in Article 102(1), may refer Azziz to Attorney General's Office (Saranwali) for investigation and prosecution.*

**Remark:** A person will be presumed to have intentionally failed to file a tax return by the due date with the intent to avoid tax where the person:

a. delays or fails to file the tax return, though they were officially informed about requirements for filing tax returns through public awareness programs, workshops, seminars, official letters etc ,
b. delays or fails to file tax returns on more than one occasion, or
c. attempts to justify delaying or failing to file their tax return on the basis of falsified documents.

102.3 The additional tax under Article 102 can only be applied where a tax return has been filed after the due date. If the tax return is filed by the due date then even if information declared in the tax return is not correct, the Revenue Department will not apply additional tax according to Article 102. Whenever a tax return is not correct, the Revenue Department may consider imposing additional tax under other provisions of the Income Tax Law.

*Example:* *Aman Company is an Afghan corporation that owns and operates grocery stores throughout Afghanistan. It files its tax return for the 1387 year and pays the tax shown as due on the return on the last day of Jawza in the year 1388. In calculating its tax liability, however, Aman Company claimed a deduction for the cost of electric generators that it purchased. The electric generators are used to provide lighting and heating in the grocery stores that Aman Company owns. The cost of the electric generators should not have been deducted. Instead, the cost of the electric generators should have been depreciated over time. Because of this error, Aman Company's income tax return is incorrect. Aman Company owes more income tax to the government than the tax return shows. Aman Company is not subject to the additional tax under Article 102 because it filed its tax return on time. However, Aman Company may be subject to the additional tax under Article 104 if it did not have reasonable justification for claiming the cost of the generators as a deduction.*

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| Article 103 | Additional income tax where tax not withheld (1) A person who, without reasonable cause, fails to withhold tax from salary and wages, interest income, dividends, rent, commissions, royalties, and similar income in accordance with the provisions of this Law shall be subject to additional tax of ten percent.<br><br>(2) A person who fails to withhold tax with the intent of evading payment of tax under paragraph (1) of this Article shall, in addition to the payment of additional tax under paragraph (1) of this Article, be referred to the office of the Attorney-General. |

103.1 A person who fails to withhold tax as required under the provisions of this law which apply to payments of dividends, interest, royalties, wages, salaries, rents, commissions, and other amounts as provided by Income Tax Law without reasonable cause shall pay additional income tax of 10 per cent of the tax that should have been withheld.

*Example:* *Shash Darak Enterprises is an Afghan corporation that employs three individuals. The three individuals are Razique, Adib and Azziz. Because Shash Darak Enterprises employs three individuals, it is required to withhold tax from the wages of the employees. The person at the company that is responsible for making sure that the proper amounts are withheld is Faroz. Razique started working for Shash Darak Enterprises on the first day of Saratan, in the year 1387. Faroz fails to withhold tax from the wages of Razqiue during 1387 because Faroz believed that Razique was an independent contractor. Faroz based his belief on the fact that Razique had a written contract with Shash Darak Enterprises, but Adib and Azziz did not. When the Afghanistan Revenue Department investigates Shash Darak Enterprises, they conclude that Razique is an employee and not an independent contractor. If, based on facts and circumstantances, Faroz's belief was reasonable, then the 10% additional tax will not apply. The mere fact that the contract was not in writing is not a reasonable basis to conclude that Razique was a contractor and not an employee.*

103.2 A person who fails to withhold tax with the intent of evading payment of tax, in addition to the payment of additional tax under Article 103(1), shall be referred to the Attorney General's Office (Saranwali) for investigation and prosecution.

*Example:* *Pak Co. is a Pakistani corporation. Af Co. is an Afghan corporation. Pak Co. owns all of the issued stock of Af Co. Pak Co. has a loan outstanding to Af Co. Af Co. pays Afs. 1,000,000 of interest on the loan during the year 1387. Af Co. fails to withhold 20% of the interest payment as withholding tax. Af Co. claimed a deduction for the full Afs. 1,000,000 interest payment that it made to Pak Co. When the Afghanistan Revenue Department investigates Af Co. for the tax year 1387, the department learns that Af Co. management informed Pak Co. management that Af Co. would have to withhold 20% of the interest*

*payment. The management of Pak Co. instructed Af Co. that Af Co. should not withhold any portion of the interest payment. By deducting the full Afs. 1,000,000 and failing to withhold 20% of the payment, Pak Co. and Af Co. attempted to reduce the amount of tax that they have to pay in Afghanistan. Therefore, in addition to payment of additional tax described in Article 103 (1), these companies should be referred to the Attorney General's office (Saranwali) for investigation and prosecution.*

*Example 2:* *Bahlol Construction Company Ltd. constructs roads in Kabul. The company employs 50 people for its projects of which 15 are technical employees who earn Afs. 30,000 salary per month and the remaining employees are employees providing labour who are paid Afs. 4,500 per month. To encourage its technical employees, the Bahlol Company withheld tax from their wages based on a salary of Afs 20,000 per month. During an audit, tax officers were told that tax based on Afs 30,000 salary was 'too much' tax. In addition to payment of 10 % additional tax, Bahlol Construction Company Ltd. should be referred to Attorney General's Office (Saranwali) for investigation and prosecution.*

Remark: A person will be presumed to have failed to withhold tax with the intent to avoid payment of tax where the person:

a. fails to withhold tax though they were officially informed about withholding tax obligations through public awareness programs, workshops, seminars, official letters etc ,
b. fails to withhold tax on more than one occasion, or
c. attempts to justify failing to withhold on the basis of falsified documents.

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| Article 104 | Additional income tax where tax not paid (1) A person who, without reasonable cause, fails to pay tax imposed under the provisions of this Law shall, in addition to the payment of additional tax under the Article 100 of this Law, be liable to additional tax of ten percent.<br><br>(2) A person who, with the intent of evading payment of tax, fails to pay tax imposed according to the provisions of this Law shall, in addition to the payment of additional tax under paragraph (1) of this Article, be referred to the office of the Attorney-General. |

104.1 A person who fails to pay due taxes determined under the provisions of this law without reasonable cause shall pay 10 percent additional tax. This is in addition to any additional tax that may be due for the late payment of tax under Article 100.

*Example 1:* *Azziz earned Afs. 1,000,000 of rental income from property that Azziz owns. Azziz owes Afs. 80,800 in tax on this rental income (Afs. 1,000,000 taxed at rates for individuals). Azziz fails to pay the Afs. 80,800 by the due date of the last day of Jawza. Azziz does not have any justification for his failure to pay the tax due by the due date. Azziz is subject to additional tax of Afs. 8,080 (Afs. 80,800 x 10%).*

*Azziz must pay Afs. 88,880 tax and penalty plus the additional tax computed under Article 100 for each day that the tax is late in payment. If Azziz pays the tax and additional tax 10 days after the last day of Jawza, Azziz will owe additional tax under Article 100 of Afs. 888 (10 days x 0.001 x Afs. 88,880).*

*Example 2:* *The facts are the same as in Example 1, except that Azziz failed to file his tax return and pay his tax because he was in the hospital recovering from a car accident. In this case, Azziz has a reasonable excuse for not paying his tax on time. Azziz should not be subject to the 10% additional tax.*

*Example 3:* *Qasim Air operates as a commercial airline and has withheld tax from the salary of its staff members for the month of Hamal. The company is required to pay the withheld tax to the government bank account by 10th day of the following month. The amount was not transferred to the bank account until the end of Saratan of that year. During an audit, tax officers where advised that the tax withheld from employees salaries was spent on repairs to an airplane owned by the company. This is not reasonable cause for failure to pay tax as required by the law. Qasim Air is therefore liable for payment of 10 percent additional tax as well as additional tax for late payment provided by Article 100.*

104.2 A person who fails to pay the tax determined under the provisions of this law with the intent of evading payment of tax, in addition to paying additional tax mentioned in paragraph 1 of Article 104, shall be referred to the Attorney General's office for investigation and prosecution.

*<u>Example1</u>:* *ABA Corp is an American company engaged in construction operations in Kabul. ABA Corp is not exempt from Afghan tax under any applicable treaty or international agreement. ABA Corp operates in Afghanistan for three years. The Afghanistan Revenue Department investigates ABA Corp in the tax year 1388. During the investigation, the Afghanistan Revenue Department obtains electronic mail correspondence from the company's Kabul office to its primary shareholder. The correspondence indicates that the ABA Corp's management knew that the company was obligated to pay income tax and business receipts tax in Afghanistan. The correspondence indicates that the primary shareholder told ABA Corp personnel not to pay the tax because ABA Corp would only be operating within Afghanistan for a short period of time. The Afghanistan Revenue Department should refer this case to the Attorney General's Office (Saranwali) for investigation and prosecution.*

*Example 2:* *The facts are the same as mentioned in Example 3 above. Qasim Air again fails to pay the tax withheld from payments made to its employees. Therefore, Qasim Air, in addition to paying additional tax mentioned in paragraph 1 of Article 104, shall be referred to the Attorney General's office for investigation and prosecution.*

Remark: A person will be presumed to have intentionally avoided payment of tax where the person:

1- fails to pay tax though they were officially informed about tax payment obligations through public awareness programs, workshops, seminars, official letters etc,
2- fails to withhold tax on more than one occasion, or
3- attempts to justify failing to pay tax on the basis of falsified documents.

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| Article 105 | Additional income tax related to taxpayer identification numbers A person who is required to have a Taxpayer Identification Number under Article 86 of this Law and who, without reasonable cause, fails to apply for a Taxpayer Identification Number shall pay additional income tax of Afs. 5,000 if the person is a natural person or Afs. 20,000 if the person is a legal person. |

105.1 A person required to have a Tax Identification Number under Article 86 of this Law who fails to apply for a Tax Identification Number without reasonable cause shall pay additional income tax of 5,000 Afs. if the person is a natural person or 20,000 Afs. if the person is a legal person.

*Example 1*: *Asiyeh lives in Badakhshan province. Asiyeh lives in a small village. Asiyeh is employed by an international non-governmental organization. Asiyeh works as a mid-wife in her village. She assists women who are giving birth. Asiyeh's employer withholds a portion of Asiyeh's wages as it is required to do under the law for the tax year 1388. Under Article 86, Asiyeh is required to have a taxpayer identification number in the tax year 1388. Asiyeh is illiterate and has failed to obtain and fill out the proper forms to obtain a taxpayer identification number. Her employer has not provided her with any information about obtaining a taxpayer identification number. Moreover, Asiyeh would be required to travel for days to attend the office that has the forms that will enable her to obtain a taxpayer identification number. When the Afghanistan Revenue Department investigates Asiyeh and informs Asiyeh that she needs a taxpayer identification number, Asiyeh agrees to sign the correct forms and obtain her number. Asiyeh has a reasonable cause for failing to obtain a taxpayer identification number.*

*Example 2*: *Sarika lives in Kabul province. Sarika works for an international non-governmental organization. Sarika works as a mid-wife. She assists women who are giving birth. Sarika's employer withholds tax from Sarika's wages during the tax year 1388. Sarika asks her employer why the employer is withholding tax. The employer informs Sarika that she is subject to income tax and that she needs to obtain a taxpayer identification number. In Kabul province, Sarika has access to the internet from which she can obtain tax forms. She is also able to travel to the Ministry of Finance offices in Kabul from which she can obtain tax forms but does not care to do so and does not obtain a tax identification number because it will cost money to use the internet and it will cost money to travel by taxi to the Ministry of Finance. Sarika does not have a reasonable justification for not obtaining a taxpayer identification number. Sarika would be subject to the Afs. 5,000 additional tax.*

*Example 3*: *Kabul Construction Company is an Afghan company. It undertakes construction operations in Afghanistan. Kabul Construction Company has been operating in Afghanistan during the tax years 1388 and 1389.*

*The company believes that its operations in Afghanistan are almost finished. The company does not believe that it will receive any construction contracts in the future. Kabul Construction Company knows that it is required to obtain a taxpayer identification number but decides that it will not do so. When the Afghanistan Revenue Department investigates Kabul Construction Company, it learns that the company has not paid its income tax liability for two years. The company has not withheld tax from its employees' wages. Kabul Construction Company deliberately avoided obtaining a taxpayer identification number in order to hide its activities from the Afghanistan Revenue Department. Kabul Construction Company would be subject to the Afs 20,000 additional tax.*

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| Article 106 | Offenses committed by taxation officers (1) A taxation officer who discloses information that is confidential under this Law with the intent of any direct or indirect benefit from the disclosure, or other persons who assist a taxation officer to disclose confidential information shall be referred to the office of the Attorney-General.<br><br>(2) A taxation officer who misuses their position in any unauthorized way for the purpose of direct or indirect financial or other benefits shall be referred to the office of the Attorney-General. |

106.1 Where a taxation officer discloses confidential information for the purpose of any direct or indirect benefit, or other persons assist them in that regard, those persons shall be referred to the Attorney General's Office (Saranwali) for investigation and prosecution.

*Example:* *Feroz works in the large taxpayer office of the Afghanistan Revenue Department. During an investigation of Company A, Feroz learns about Company A's revenue and profit figures. Company A's primary competitor in Afghanistan is Company B. Feroz agrees to sell the information he has learned about Company A to Company B for Afs. 200,000. This case should be referred to the Attorney General's Office (Saranwali) for investigation and prosecution for violation of confidentiality imposed by the law.*

106.2 Where a taxation officer misuses their position for the purpose of direct or indirect financial or other benefit, those persons shall be referred to the Attorney General's Office (Saranwali) for investigation and prosecution.

*Example:* *Wahid is an employee of a provincial moustafiat. Siddiq Transport Company files its tax return with the provincial moustafiat. Wahid reviews the tax return. Wahid tells Siddiq Transport Company that if the company pays him Afs. 30,000, Wahid will agree to reduce the amount of profits that are shown on the company's tax return. Wahid has misused his position for personal benefit, therefore according to Article 106(2), Wahid should be referred to the Attorney General's Office (Saranwali) for investigation and prosecution.*

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| Article 107 | Authority for collection of additional tax Additional tax imposed under the provisions of this Chapter shall be collected by Ministry of Finance tax offices. |

107.1 Taxpayers who are required to pay additional tax should pay that tax in the same manner as payments of the tax itself. In accordance with Regulation 87.1, taxpayers should pay additional tax to an authorized bank. The Revenue Department will arrange to collect copies of the additional tax payment form from the authorized bank and will treat those payments as having been made at a tax office.

# CHAPTER 17

# FINAL ARTICLES

## Article 108 – Article 113

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| Article 108 | Provision of forms and rulings (1) The Ministry of Finance shall provide forms that are necessary for the purpose of determination and collection of tax according to this Law.<br><br>(2) The Ministry of Finance may issue an income tax manual and separate public and private rulings regarding income tax for the better administration of the provisions of this Law. |

108.1 The Afghanistan Revenue Department of the Ministry of Finance is responsible for the administration of the income tax law. As part of that responsibility, the Afghanistan Revenue Department has developed forms, and will continue to develop and update forms, as required by taxpayers in order that taxpayers may comply with the income tax law.

Forms are available from the mustofiat in each province. Forms are also available from the Afghanistan Revenue Department, Ministry of Finance, Kabul.

108.2 The authority for the Ministry of Finance to issue this Income Tax Manual is provided by this Article. The purpose of the Income Tax Manual is to clarify the interpretation and application of the income tax law. It can however only provide general guidance. It cannot be expected to cover every possible circumstance for all taxpayers.

108.3 For the Ministry of Finance position on matters not covered by the Income Tax Law, there are two courses of action. The Ministry of Finance (through the Afghanistan Revenue Department) may issue public rulings and private rulings.

108.4 A public ruling is the Ministry of Finance's position, in writing, regarding the application of the income tax law to an issue which affects many taxpayers. For example, the Ministry of Finance has issued a public ruling regarding the termination of 'tax holidays' under the Law on Domestic and Foreign Private Investment in Afghanistan (Public Ruling 1383/4). The Ministry of Finance will continue to issue public rulings on matters of importance as and when required. It remains the sole discretion of the Ministry of Finance to decide in what circumstances to issue a public ruling and the position it takes regarding the interpretation and application of the law.

108.5 A private ruling is the Ministry of Finance's position, in writing, regarding the application of the income tax law to an issue which affects a certain, identified person or a group of certain, identified persons. The Ministry of Finance will provide its position on the application of the income tax law on the facts, supported by documentary evidence where appropriate, provided by the applicant for the private ruling. A private ruling can only be issued on the interpretation of the income tax law. This process cannot be used to clarify the application of other laws. Nor can it be used to clarify the tax liability of anyone other than the applicant(s). If persons other than the

applicants wish to obtain advice regarding their tax liability they must apply for a private ruling in their own name(s).

108.6 In both cases of public rulings and private rulings, the Ministry of Finance will be bound by its interpretation of the law.

For further information on the public and private rulings process, reference should be made to the Public Ruling titled ‘The Public and Private Rulings System’.

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| Article 109 | <u>Non issuance of licenses</u> (1) Where natural or legal persons have not paid their tax due by the due date according to the provisions of this Law, the Ministry of Finance may officially inform those government agencies and departments which have the authority to issue licenses not to renew their licenses. The licenses of the persons shall only be issued when they present their tax clearance documents from Ministry of Finance to the relevant agency. Also, the license issuing agencies cannot issue another license for individuals and directors of corporations and limited liability companies who have not fulfilled their own or their company's tax responsibilities.<br><br>(2) 1- License issuing agencies are required to provide government agencies with a list and details, by electronic copy, of the natural and legal persons who have valid licenses.<br><br>2- While signing contracts, all government entities and agencies shall be required to ensure that licenses are valid and current.<br><br>(3) Persons mentioned in Article (2) of the Government Authorities Salary Law shall be required to complete the Ministry of Finance tax clearance forms before election or appointment to a government position. |

109.1 According to Article 109, all taxpayers whether legal or natural persons and regardless of the type of activities they run, and persons who are required to have a work permit shall fulfill their tax obligations before renewing their activity license or permit. For the purpose of tax collection, the Ministry of Finance is authorized to issue an official letter to authorities distributing commercial and sectoral activity licenses not to renew such license for persons who do not present a tax clearance certificate from the Ministry of Finance or tax office. Likewise, according to Article 109, government departments and organizations issuing licenses shall not issue a license for the same persons, including managers of companies, as long as their tax obligations have not been fulfilled.

*Example 1:* *Ghaznawi Company obtained it's license for commercial activities at the beginning of Sunbulla 1387 from the Ministry of Commence which would be valid until the beginning of Sunbulla 1388. In Mizan 1388, Ghaznawi Company imported goods into the country. As one month has elapsed since the license expired, the Customs Department officers hold the goods imported and demand Ghaznawi Company renew its license. The manager of Ghaznawi Company applies to the Ministry of Commence to renew its license. Since Ghaznawi Company has not presented its tax return for 1387 to the relevant tax office and also has not fulfilled it's tax obligations, the Ministry of Commerce cannot renew Ghaznawi Company's license. Ghaznawi Company's license will be renewed when it presents its tax return for 1387 to the relevant tax office, fulfills its tax liabilities and obtains a tax clearance certificate from the relevant tax office and presents it to the Ministry of Commerce.*

*Example 2:* *Mike who is a French national is a computer technician recruited by the Ministry of Communication on 25 Sawr 1388 to provide technical services for two years. According to the Labor Law, Mike is required to obtain an activity license from the Ministry of Labor and Social Affairs before resuming work in the Ministry of Communication. Mike's license shall come to an end on 25 Sawr 1389. Thus, he is required to have his license renewed before continuing to work. According to paragraph 1 of Article 109, so long as Mike does not present a tax clearance certificate for 1388 to Ministry of Labor and Social Affairs from the Ministry of Finance or tax office, the Ministry of Labor and Social Affairs does not have the right to renew Mike's activity license.*

*Example 3:* *Ahmad is the manager of Bahar Beverage Company. Bahar Beverage Company is engaged in producing mineral water, non-alcoholic drinks and other types of beverages. Bahar Beverage Company has not lodged its tax return or paid its tax for the 1387 year. In 1388, Ahmad takes steps to establish and register a company to supply building materials with his brother Mahmood. Since Ahmad has not received a tax clearance certificate for Bahar Beverage Company, Afghanistan Investment Support Agency may not issue a license for the company associated with Ahmad.*

*Remark 1: A tax clearance letter may be issued to the applicant taxpayer when (1) the tax for the current year and tax due for the preceding years have been paid and the taxpayer has also discharged the obligation of withholding tax under Articles 17, 46, 59 and 72 of the Income Tax Law, wherever applicable, and (2) any additional tax liabilities assessed up till the date of application for renewal have been paid.*

*Remark 2: Any pending proceedings to assess additional tax liabilities should not prevent issuance of tax clearance letter required by the tax payer for renewal of business license.*

109.2 According to subparagraph 1 of paragraph 2 of Article 109, all license-distributing agencies are required to provide a list of individuals and companies whose licenses are legally valid to governmental departments and agencies in electronic format.

109.3 At the time of entering into contract in the bidding sessions are required to avoid recruiting persons whose license validity has expired. At the time of evaluating bidding documents of companies and other persons participating in the bidding sessions, all government agencies shall be required to make sure that the duration for their license is valid. They need to set a criterion for the right to participation in the bidding process. It means that all those whose license activity has expired, will no have the right to participate in bidding sessions for governmental contracts.

109.4 According to paragraph 3 of Article 109 of Income Tax Law, persons can not be appointed or selected for senior governmental posts without presenting tax clearance certificates.

*Example1:* *During the year 1387, Mohammad Ashraf worked with a children's unit of an hospital as a health-care specialist. The Ministry of Public Health advertises the post of Technical Director of the ministry through the Independent Agency of Administrative Reform. Among all the candidates, Mr. Ashraf is the most suitable for the post. He is required to present a tax clearance certificate for the previous post for which he worked. Then, IAAR authorities may complete his appointment documents.*

*Example 2:* *The President appoints Ms. Suraya as a senator to the Upper House of Parliament. Prior to participating in sessions of the Upper House, Suraya is required to present a tax clearance certificate. Without presenting a tax clearance certificate, she can not attend sessions of the Upper House.*

*Example 3:* *The President has introduced Mr. Noori as a proposed minister for the Ministry of Labor and Social Affairs to Parliament for obtaining a confidence vote. The Parliament inspects education qualification documents, citizenship documents and other relevant documents for Mr. Noori. Parliament has not been provided a tax clearance certificate with the other documents. The Parliament officially asks for information on clearance of tax obligations and Mr. Noori writes that he has not, as yet, presented his tax returns for previous years to the relevant tax office. The Parliament should return documents of the proposed candidate and postpone the issue of vote of confidence until Mr. Noori fulfills his tax obligations.*

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| Article 110 | Requirements for entitlement to exemption (1) Approved businesses (enterprises) which have not met the requirements of the provisions of the Law on Domestic and Foreign Private Investment in Afghanistan published in official gazette number (803) dated 1381/6/20 and other related laws shall no longer be entitled to income tax exemption under the provisions of that Law from 21 June 2004 (1 Saratan 1383).<br><br>(2) Approved businesses (enterprises) according to the provisions of the Law on Domestic and Foreign Private Investment in Afghanistan mentioned in paragraph (1) of this Article which have commenced business activities prior to 22 November 2003 (I Kawos 1382) may benefit from the income tax exemptions mentioned in the investment law only if they have complied with and continue to comply with the provisions of that law and other related laws.<br><br>(3) If an approved business (enterprise) granted tax exemption under the provisions of the Law on Domestic and Foreign Private Investment in Afghanistan holds capital assets on the date the exemption ends as a result of paragraph (1) of this Article or the date the tax exemption expires, the remaining undepreciated value of the capital assets on that date will be treated as the cost of those capital assets. |

110.1 The Law on Domestic and Foreign Private Investment 1381 provided exemption for 'approved enterprises' from taxation, including income tax, for periods for 4, 6, 8 and in special cases more than 8 years. Subsequent amendments to the Income Tax Law (1965) brought an end to the continued granting of tax holidays which were contrary to the income tax law. No tax holidays granted from 21 June 2004 will be recognized by the Ministry of Finance. Of those tax holidays granted before 21 June 2004, only those 'approved enterprises' which have meet two requirements may be entitled to continue their tax holiday until its expiration. The two requirements are:

1. the approved enterprise must have commenced business activities prior to 22 November 2003, the date that the Afghanistan Investment Support Agency took over responsibility for registration of private investment from the Ministry of Commerce; and

2. the approved enterprise must have complied with, and continues to comply with the provisions of the Law on Domestic and Foreign Private Investment 1381 (or its successor law) and the provisions of related laws.

110.2 Where the tax holiday for an approved enterprise ceased from 21 June 2004, the approved enterprise will become liable to income tax from that date. For the purposes of calculating a deduction for depreciation of assets held at that date, the remaining undepreciated value of those assets will be treated as the cost of those assets.

*Example:* *Kabul Constructions is an approved enterprise with a tax holiday which ended 21 June 2004. On 21 June 2003, it had purchased*

*machinery for 100,000 Afs. which has a useful life of 5 years. At the time that the tax holiday ended, the machinery will have been used for one year. The depreciation will be 1 year/5 years x 100,000 Afs. = 20,000 Afs. The undepreciated value of the machinery as at the end of the tax holiday will be the cost of the machinery less the depreciation to 21 June 2004 ie 100,000-20,000 = 80,000. Kabul Construction will be entitled to claim a deduction for depreciation for the use of the machinery from 21 June 2004 on the basis that the machinery cost 80,000 Afs. at that date.*

*Kabul Constructions may calculate depreciation on a straight line basis over the asset's useful life in accordance with paragraph 7 of Article 18 (1) or on an accelerated basis under Article 47 if Kabul Constructions satisfies the requirements of that Article.*

For guidance on the Ministry of Finance position on the transition from tax holidays to tax concessions in the form of accelerated depreciation and unlimited loss carry forward, reference should be made to the Public Ruling titled 'Income Tax: Tax Holidays, Exemptions and Concessions for Investors'.

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| Article 111 | Primacy of Income Tax Law (1) In the event of any conflict between contracts, agreements, and provisions of other laws with the provisions of this Law, the Income Tax Law shall prevail.<br><br>(2) International contracts and agreements entered into by the Islamic Republic of Afghanistan with foreign countries or United Nations agencies are excluded from the provisions of the paragraph (1) of this Article. |

111.1 Paragraph (1) of 111 asserts the primacy of the Income Tax Law over contracts, agreements or other laws. If a contract, agreement or another law makes provisions for income taxation which are different to the Income Tax Law, then those provisions will be considered to have no effect and the provisions of the Income Tax Law shall apply.

111.2 In the normal course of government administration, a public official e.g. a Minister of a government Ministry will enter into contracts or agreements. Although the Minister may have the authority to purchase goods or services, the Minister cannot override the laws of Afghanistan on his/her authority alone. Where these contracts or agreements presume to provide special tax treatment inconsistent with the Income Tax Law, those provisions of the contract (but not necessarily other provisions) will be ineffective.

*Example:* *A government Minister, on behalf of a Ministry, enters into an agreement for the construction of a building. The agreement states that the building contractor will be exempt from income tax. Unless the Minister is acting with the authority of the Government of Afghanistan, or the agreement is subsequently ratified by the Government of Afghanistan, the agreement will not override the income tax law. The tax exemption granted by the Minister will not be effective. The Income Tax Law will apply.*

111.3 Paragraph (2) of Article 111 recognises exceptions to the statement that contracts and agreements which provide special tax treatment cannot override the Income Tax Law. Those exceptions must meet the pre-condition that the contract or agreement is entered into with the Islamic Republic of Afghanistan.

One exception is the situation where contracts or agreements are entered into by the Islamic Republic of Afghanistan with foreign countries. Multilateral organizations (such as the European Union or European Community) comprised of various member countries shall be considered foreign countries for this purpose.

Another exception is the situation where contracts or agreements are entered into by the Islamic Republic of Afghanistan with the United Nations or its agencies. Examples of agencies of the United Nations include United Nations Children's Fund (UNICEF), United Nations Development Program (UNDP), United Nations High Commission for Refugees (UNHCR), United

Nations Office for Special Projects (UNOPS), the World Bank group, the International Monetary Fund etc.

111.4 The Ministry of Finance shall publish guidelines, after consultation with the Ministry of Foreign Affairs and Ministry of Justice, to address the circumstances pursuant to which a treaty, contract, or other agreement shall be considered approved in accordance with Article 111(2) and/or Article 90 of the Constitution for the Islamic Republic of Afghanistan.

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| Article 112 | Tax due and responsibilities (1) All legal and natural persons are exempt from payment of tax and other tax obligations for the years before 1381.<br><br>(2) Legal and natural persons shall be exempt from tax penalties and late filing of balance sheet (tax return) for the years 1381 to 1385 (including the year 1385) if they pay the actual tax due within three months from the date this Law is published in the Official Gazette.<br><br>(3) Persons who have paid their taxes before this Law comes into effect are excluded from the privileges of paragraphs (1) and (2) of this Article. |

112.1 Paragraph 1 of Article 112 provides an amnesty from the requirement to pay tax and other tax obligations otherwise imposed by the Income Tax Law. The amnesty applies to payment of tax, additional tax in the form of penalties and the lodgement of tax forms. Taxes include income tax, business receipts tax, fixed taxes and withholding taxes and applies for the tax years before, but not including, the 1381 tax year.

*Example 1:* *Ahmad Company prepared its balance sheet for the 1379 year and has calculated tax of Afs 100,000. The company will be exempt from lodging a tax return and paying the tax otherwise due for the 1379 year.*

*Example 2:* *Nabi owns a commercial market and rented out his shops to different persons in 1380 and 1381. At the same time, he was working in an institute as an employee. Nabi is exempt from lodgement of his balance sheet and tax return and payment of tax on his income from renting his shops and employment income for the 1380 year. However, Nabi is not exempt from lodging his balance sheet and tax return and paying tax for the 1381 year.*

*Example 3:* *Qasim who owns a shop in Maiwand Road and has fixed tax of Afs 5,000 due for years before 1381. He is exempt from payment if the tax has not already been paid.*

*Example 4:* *In 1378, Ahmad Construction had a contract with the Ministry of Education to build a school. Payments were made to Ahmad Construction in 1378 without any amount being withheld for taxes. The Ministry of Education is exempt from the responsibility to have withheld the tax from the payments to Ahmad Construction. Ahmad Construction is exempt from income tax and business receipts tax on the amounts received in 1378.*

112.2 Paragraph 2 of Article 112 provides a limited amnesty for penalties otherwise payable by persons who submit their tax return and pay their tax for the years of 1381, 1382, 1383, 1384, or 1385 within 3 months after the Income Tax Law 2009 is published in the official gazette. The Income Tax Law 2009 was

published in official gazette number 976 dated 18th March 2009. The amnesty applies to all additional taxes and penalties for non-compliance with the law.

*Example 1:* *Ahmad Gule Ltd Co submitted its balance sheet and tax returns for the 1381 to 1385 years to the tax office ten days after the date the Income Tax Law was published in the gazette. Therefore Ahmad Gule Ltd Co is exempt form any additional tax and penalties for the late lodgement of tax forms and late payment of tax for the 1381 to 1385 years.*

*Example 2* *Sardar Wali is the owner of a tea market in Mandavi and did not file his tax returns from 1381 to 1385. He filed his tax return with the tax office ten days after the Income Tax Law was published in the gazette and he paid all tax due on the rent received from his shops. He is exempt from additional tax and penalties.*

112.3 Persons who enter into a transaction intended to evade payment of tax will not be entitled to the amnesty for the tax subject to evasion. Also, any persons who are required to withhold tax on salary or wages, rent, dividends, interest and other sources subject to withholding tax, but do not withhold those taxes, will be denied a deduction against taxable income in accordance with Article 18 and liable to additional tax in accordance with Article 103.

*Example 1:* *The Five Star Construction Company which had not submitted its balance sheet and tax return for the 1385 year has delivered it 20 days into the amnesty period. Five Star Construction Company would be exempt from additional tax for delay in lodgement of tax forms and payment of tax. After an audit, it is found that the company intentionally understated its taxable income. As the company has attempted to avoid tax, the company shall be liable to pay additional tax according to the Law.*

*Also, the audit shows that the company has not withheld tax from the wages of its employees. Therefore the company will be liable to pay the withholding tax due and will be subject to penalty for failing to withhold tax.*

112.4 Those taxpayers who have paid their tax for the tax years prior to the 1386 year before the commencement of this law are not entitled to the tax amnesty provided by paragraphs 1 and 2 of this Article. Tax paid before the amnesty came into effect is not refundable. The Income Tax Law 2009 commenced with effect on the signing of Presidential Decree number 171 dated 17 March 2009.

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| Article 113 | <u>Enforcement date</u> (1) This Law shall be effective from the date of approval and shall be published in the Official Gazette.<br><br>(2) The provisions of paragraph (3) of Article 4, Articles 59, 64, 65, 66, 67, 72, 74, 75 and paragraphs (5) and (6) of Article 88 of this Law shall be applicable from 1 Hamal 1388.<br><br>(3) With this Law coming into effect, the following laws are cancelled from 1 Hamal 1388:<br><br>1 The Income Tax Law published in Official Gazette number 867 of 1384 and its other amendments, annexes and contrary provisions.<br><br>2 The Law on Depreciable Materials Tax published in Official Gazette number 453 dated 31 Saur 1359 with its annex 1 on the amendment of Articles 10 and11 of this Law published in Official Gazette number 517 dated 15 Mizan 1361.<br><br>3 The Sukook Law published in Official Gazette number 514 dated 31 Asad 1361. |

113.1 Presidential Decree number 171 of 17 March 2009, signed on 17 March 2009, states that the Income Tax Law comes into effect upon signature of the decree. The decree is published with the Income Tax Law 2009 in official gazette 976 dated 18th March 2009.

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