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AFGHANISTAN TAX POLICY CONUNDRUMS AND RECOMMENDED SOLUTIONS

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Afghanistan's taxation system is improving but remains one of the greatest impediments to economic growth and foreign direct investment. Despite sustained efforts of the AACC, the International Stability Operations Association (ISOA) and other trade groups and donor government representatives over the years the issue continues to haunt the National Unity Government (NUG). If problems with the current system could be resolved concretely, this would immediately impact business growth and capital investment (especially in the short term). Taken together with other equally important market-oriented policy reforms this change could help improve national employment and private sector development for decades to come. Below the AACC has laid out the problems and challenges with the current Afghanistan taxation system and we close with specific recommendations on moving forward strategically to solve these issues.

Background on Afghanistan Tax Policy

First, it should be acknowledged that the Government of the Islamic Republic of Afghanistan (GIRoA) is under significant pressure from the World Bank, bilateral and multilateral donor institutions to ensure that its collected tax revenue system is growing to the point it becomes fully, financially self-sufficient and eventually sustainable. This difficult task is compounded by the reality that many of the foreign private firms operating in Afghanistan are considered "tax-exempt" under U.S. law since their services are provided by American foreign assistance (or those of other donor states) that support the GIRoA and people of Afghanistan. Under U.S. law, no U.S. assistance is taxable by the host government that receives this assistance through implementation by U.S. foreign policy/assistance implementing organizations like DynCorp or Chemonics or by international NGOs like Save the Children or Islamic Relief. Even today however, these programs are not exempt under Afghanistan law.

Second, after the formation of the National Unity Government (NUG) GIRoA has focused on increasing its own "domestic resource mobilization or DMR" revenues by more aggressively pursuing tax cheats and individuals and organizations who try to shield or hide wealth from taxation inside Afghanistan. The result has been a significant improvement in the percent of DRM revenues collected and to a great extent they should be complemented on this undertaking. However, in the process of achieving these milestones the GIRoA, principally through the Ministry of Finance, has also determined that a number of foreign organizations (mostly for profit businesses) that were implementing U.S. foreign assistance and thus tax exempt under U.S. law, were also operating inside Afghanistan in certain non-foreign assistance projects and services and were using their U.S. Government support contracts to hide or avoid tax obligations to the GIRoA.

Special Deals and Governmental Interventions

As a result, a number of ad hoc compromises or "deals" have been made between private sector organizations and GIRoA, allowing taxes to be collected for some aspects of business, such as local employees and services unrelated to foreign-government assistance projects. Further, the current NUG has taken an active, if daunting role, in rooting out the endemic corruption that undermines efficient governmental operations and more effective tax collection. There have been signs of progress in that respect. Unfortunately, the Afghan taxation system (not having evolved yet to a "standardized process") has been plagued by accounting requirements with little or no relation to international standards, with laws that result in incarceration of company executives over simple and sometimes ridiculous tax disputes, and ongoing corruption issues within GIRoA itself.

In the last 12-18 months these disputes have reached an unprecedented level of chaos and confusion. It seems that Afghan tax policy is now often caught in government fabricated tax demands, withholding of business license renewals, non-issuance of business visas, freezing of bank accounts without notice and other punitive, extralegal measures. These activities severely hamper commercial business operations; dissuade international traders and investors from venturing into formal economic transactions inside the country and tarnish Afghanistan's "open for business" reputation at a time when private sector growth and incentives for trade and investment should be front and center.

A joint working group between the U.S. and Afghanistan Governments established an agreement that addressed some of the legacy tax issues for more than 30 specified companies but really did not adequately address the larger systemic tax issues. Many companies are not included in these "secret" agreements, and worse, as key U.S. Government (USG) personnel have rotated out, these contractors report that GIRoA tax hindrances are returning. Implementing organizations working for donor governments and trying to navigate these murky GIRoA tax demands and who refuse to pay bribes to solve these issues get quickly mired in Afghan legal troubles. As a result, many companies are deciding to leave Afghanistan and not consider it a location for commercial enterprise development.

Contractor Organizations Seek Congressional and Administration Help

The International Stability Operations Association (ISOA) and the Professional Services Council (PSC) have taken the lead in requesting U.S. Congressional legislation designed to protect their contractor members who work inside Afghanistan (at great physical peril) from predatory tax practices by GIRoA and the Ministry of Finance. PSC and ISOA were successful in getting amendments to the annual State and Foreign Operations Appropriations Act sections in 2016 and 2017 that should be preventing these acts.

But punitive threats by Congress and U.S. law to withhold funding to GIRoA or protection from effective sovereignty are blunt weapons when the two nations should be solving these problems quickly and effectively without Congressional intervention. The Trump Administration has demonstrated its interest in ending these predatory practices and is surprised that GIRoA is pushing these practices, especially when U.S. public opinion has shifted on Afghanistan and the practices could backfire and cause Congress (or the Administration) to dramatically slash Afghanistan economic assistance going forward.

Recent GIRoA Resolution

We are happy to report that in the last several weeks GIRoA has finalized an agreement to resolve these complicated legacy tax issues for U.S. military subcontractors under pre-BSA contracts (those awarded prior to 1/1/2015). As of 11/27/17 the implementation of this new agreement has not begun. As for post-BSA contracts awarded after 1/1/2015, the existing Tax Exemption Confirmation (TEC) procedures remain the same. As has been explained to the AACC, the primary differences between these two procedures are:

- The list of 31 eligible companies attached to the previous cabinet package ruling has been eliminated, now all international military contractors and subcontractors (both local and foreign) are eligible for TECs and reversal of tax enforcement actions under that ruling.
- For pre-BSA contracts, the ARD no longer requires a copy of the contract with TEC application. A cover letter (also called an application letter) and a signed Contracting Officer Request Letter is still required.
- ARD is to issue a TEC within 3-5 working days of receiving the required documents.
- ARD is to issue a Tax Clearance Letter (TCL) within 5 working days of receiving the completed income tax returns. A TCL allows renewal of an expired business license, and active business licenses are required to apply for visas.

For any AACC members who are affected by this new ruling**,** in order to take advantage of this opportunity for resolution, we recommend the following as per GIRoA guidelines:

- For all U.S. DOD prime or subcontracts awarded prior to 1/1/2015 with performance in Afghanistan that you haven't received a TEC for, please have the DOD contracting officer sign a Request Letter. You should then work toward submitting for a consolidated tax exemption ruling for all your pre-BSA contracts. If you have already applied and received a rejection because your company wasn't on the list of 31, you should apply again with a new cover letter.

- For all fiscal years that haven't yet submitted an Afghanistan income tax return for, please send the corresponding financial data in any format to get started on preparing draft returns. In particular, the 1396 income tax returns can be submitted starting immediately. You should then work towards submitting for a tax clearance letter for each of those years.

- For reference, here are Afghan fiscal years:
  1396 – 21 December 2016 to 20 December 2017: due 21 March 2018
  1395 – 21 December 2015 to 20 December 2016: due 21 March 2017
  1394 – 21 December 2014 to 20 December 2015: due 21 March 2016
  1393 – 21 December 2013 to 20 December 2014: due 21 March 2015
  1392 – 21 December 2012 to 20 December 2013: due 21 March 2014
  1391 – 21 March 2012 to 20 December 2012: due 21 March 2013 (9 months, new filing schedule)
  1390 – 21 March 2011 to 20 March 2012: due 21 June 2012
  1389 – 21 March 2010 to 20 March 2011: due 21 June 2011
  1388 – 21 March 2009 to 20 March 2010: due 21 June 2010

Moving Forward with a New Pro-Business Tax Policy in Afghanistan

The AACC applauds the efforts that GIRoA (especially Ministry of Finance) has taken to address these problems in recent weeks, some of which have been swift and hopefully effective. There is still a long way to go but the potential rewards in a country with the resources of Afghanistan are phenomenal. The recent recommitment of the U.S Government to a strategic (not a fixed time) presence in Afghanistan and its renewal of support for the GIRoA has done much to reinvigorate interest from the private sector in the country and outside. One need only review the new **2017 Afghanistan Survey** by the Asia Foundation for a better understanding of the renewed sense of national purpose inside Afghanistan in spite of recent bombings, kidnappings and attacks.
https://asiafoundation.org/publication/afghanistan-2017-survey-afghan-people/

In closing, the AACC believes that the coming year has the potential to be a watershed economic investment year for Afghanistan. To do so, the AACC recommends that GIRoA undertake three changes over the next 12 months:

First, continue to address any counterproductive GIRoA tax policy initiatives, systemic corruption and commercial business hindrances.

Second, GIRoA should work to reduce the effective tax rates on business enterprises throughout Afghanistan. The current 48% marginal effective tax rate (as confirmed by the World Bank) is not business friendly, discourages domestic and foreign direct investment and causes the business community to retain capital and assets outside of Afghanistan. It also helps sustain the informal economy where businesses focus on small projects where cash and informal economic inputs are a priority. In addition, the double taxation of both business receipts and corporate income is seen as punitive. By comparison, GIRoA should look at the marginal corporate tax rates of Afghanistan's regional neighbors as a good barometer: Qatar- 11%, UAE-16%, Kazakhstan and Kyrgyzstan-29%, Pakistan-33%, Uzbekistan-38% and Azerbaijan-39%.

Lastly, the most successful developing country economies have focused on building a welcome trade and investment environment for global businesses to come and work in partnership. GIRoA should be poised to seek the betterment of the Afghan economy through improved institution building that supports an improved market led economy like working to create greater capacity in commercial courts, improving corporate and investment laws, simplifying procedures for implementation of international arbitral awards and de-criminalizing commercial disputes, just to name a few.

But GIRoA must also support the private sector enabling environment. This is something to be encouraged, not demeaned or dis-incentivized going forward. Sound tax policy, effectively implemented, together with low marginal tax rates will bring the trade and investment partnerships needed to sustain this nation's economy well into the future. The AACC is optimistic on Afghanistan's future but only if changes begin now and we believe tax reform is a great place to start.

Note: Several AACC member and partner organizations can help to resolve tax disputes with the GIRoA. Please feel free to contact any of the following members: Whiteford, Taylor and Preston, LLC Law Firm (eqasimi@wtplaw.com); Ernest & Young (EY) Afghanistan (mirweis.azizi@ae.ey.com).

ABOUT AACC

The Afghan-American Chamber of Commerce (AACC) is the leading organization facilitating U.S.-Afghanistan business, investment, and trade ties through its Matchmaking Conferences and related activities. AACC promotes the exchange of information and provides resources to members through business advice, conferences, seminars, networking events, publications, and other avenues to stimulate U.S.-Afghanistan business and investment. AACC is a growing national organization, bringing together companies, organizations, and individuals with a stake in helping Afghanistan succeed and developing opportunities in an emerging economy.