

**CHAPTER I**

**GENERAL PROVISIONS**

**Article 1 - Article 11**

**Authority**

Article 1      This Law is imposed under the authority of Article 42 of the Constitution of Afghanistan for the purpose of tax determination and tax payment.

1.1      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.

Every kind of tax, duties, and incomes collected shall be delivered to the State account.

This law was approved by the Council of Ministers and subsequently endorsed by the President of the Islamic Republic of Afghanistan on 14 November 2005. The law came into effect from that date. The enactment of this law is in accordance with the Constitution of Afghanistan.

1.2      This Income Tax Manual is issued under the authority granted to the Ministry of Finance by Article 113(2) of the Income Tax Law of 2005. 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 of 2005.

**Tax Implementation**

Article 2. (1) A tax is imposed on the income from Afghan sources of all natural persons, corporations, limited liability companies, and other legal entities whether in Afghanistan or abroad, and on the foreign income of residents of Afghanistan in accordance with the provisions of this Law.

(2) A natural or legal person is considered a resident of Afghanistan in the following circumstances:

1. The person has his or her principal home in Afghanistan at any time during the fiscal year; or
2. The person is present in Afghanistan for a period or periods amounting to one hundred eighty-three days in the fiscal year; or
3. The person is an employee or official of the Government of Afghanistan assigned abroad at any time during the fiscal year.
4. Any other entity is resident in Afghanistan for a fiscal year if it was established in Afghanistan or has the centre of its administrative management in Afghanistan at any time during the year.

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 or industrial 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. having a determined basic capital represented by non-negotiable partners' certificates;
3. whose liabilities shall be satisfied only by the assets of the limited liability company and
4. 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.*

### **Tax (Fiscal) Year**

#### Article 3.

- (1) The income tax is imposed for each taxable year on the taxable income of each person, corporation, limited liability company, or other entity. The taxable year is the solar year which starts from the first day of Hamal (21 March) and ends on the last day of Hoot (20 March).
- (2) A legal person wishing to use a different taxable year than that mentioned 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 taxable year to another twelve-month period. The Ministry of Finance may approve such application but only where the application is justified.
- (3) A taxable year approved under paragraph (2) of this Article takes effect from the date specified by the Ministry of Finance by notice in writing.
- (4) The Ministry of Finance is authorized to withdraw the approval prescribed in paragraph (3) of this Article when required.

- 3.1 The 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.

Example: *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.

Tax Calculation

Article 4.

- (1) The income tax of legal persons is 20 percent of its taxable income in the fiscal year.
- (2) Income in foreign money shall be converted to afghanis for purposes of taxation. The rate of conversion shall be the average of free rates used by Da Afghanistan Bank to purchase such foreign money at the end of each month.
- (3) The income tax of a natural person is the amount calculated in accordance with the following schedule:

TAXABLE INCOME		INCOME TAX	
From 1 Afs	Up to Afs 12,500 per month		0%
From 12,501 Afs	Up to Afs 100,000 per month		10%
From 100,000 Afs	per month	In addition to afs 8,750	20%

4.1 The amount of income tax for a natural person is calculated by applying the schedule in Article 4 (3). Where total taxable income for a month is Afs 12,500 or less, no tax is payable. Where total taxable income is more than Afs 12,500, then only the amount which exceeds Afs 12,500 will require tax to be paid.

For example, the tax on Afs. 1,500,000 of annual taxable income for a natural person is computed as follows:

0%	first Afs. 12,500 per month	(150,000 per year)	Afs. 0
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
Tax on Afs. 1,500,000			Afs. 165,000

**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.

4.2 “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 Afghani.

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 is \$1:50Afs. in the first month and \$1:52Afs in the second month. The individual’s income in the first and second month is as follows:

*First Month:*  $\$500 \times 50 = 25,000 \text{ Afghani}$

*Second Month:*  $\$500 \times 52 = 26,000 \text{ Afghani}$

*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 Afghani.*

*Remark: In the absence of a free rate of exchange, the cash buy rate used by Da Afghanistan Bank may be used.*

- 4.3 Income in foreign exchange is required to be converted to afghani. 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 afghani 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 afghani.

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 afghani is computed as follows:*

<i>Step 1: Change Canadian dollars to U.S dollars, that is:</i>	<i>\$26,315</i>
<i>30,000\1.14</i>	
<i>Step 2: Convert US dollars so obtained to afghani: 26,315</i>	
<i>x Afs. 50</i>	<i>Afs.1,315,750</i>

### Tax on Residents

Article 5. (1) Tax on income of resident natural persons in Afghanistan shall be calculated as follows:

1. In accordance with taxable income including income from sources outside Afghanistan.
2. Any income tax paid to the government of a foreign country by a resident natural person of Afghanistan may be taken as credit only against that part of his annual income tax attributable to his foreign income.
3. If the income of a resident natural person is derived from more than one foreign country, the income tax credit shall be applied in proportion to the income from each country as provided in the Income Tax Manual established by the Ministry of Finance.

(2) All legal persons are subject to income tax on all taxable income from all sources within Afghanistan and outside Afghanistan according to the provisions 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.

*Example:* 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.

Example: 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 attributable 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:

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

= 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:

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

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

Remark: 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:

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

= 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.

Remark: 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.*

Non-residents Tax Exemptions

Article 6. Non-resident persons are exempt from income tax provided that the foreign country grants a similar exemption to residents of Afghanistan.

- 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 an alien;*
  - 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.*

### Non-residents and Allowable Deductions

Article 7. (1) Individuals, companies and other non-resident persons not engaged in trade or business in Afghanistan are subject to income tax on the amount received from sources within Afghanistan as interest, dividends, rents, royalties, and gain or profit of any kind according to the provisions of this Law.

(2) Deductions allowed under this Law are only allowed in respect of income other than interest, dividends, rents and royalties to those non-resident legal persons which file a true and accurate 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. 100,000 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. 150,000 during the year, Feroz is not subject to tax in Afghanistan under Article 4 (Afs. 12,500 per month x 12 months = Afs. 150,000). Feroz can file an income tax return and claim a refund for the Afs. 20,000 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.

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 within the Ministry of Finance 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.*

Tax on Business Activities

- Article 8. (1) Non-resident natural persons, companies and other organizations engaged in economic, service or business activities in Afghanistan are subject to income tax on all taxable income from sources within Afghanistan.
- (2) Deductions are allowable only if and to the extent that they are connected with income from sources within Afghanistan.
- (3) Income derived from the operation of aircraft and its staff under the flag of a foreign country are exempt from taxation provided that the foreign country grants a similar exemption to aircraft and its staff under the flag of Afghanistan.
- (4) A correct apportionment of expenses with respect to sources of income within Afghanistan shall be determined as provided by this Law and the Income Tax Manual.
- (5) Where a non-resident person carries on business in Afghanistan through a branch in Afghanistan, the taxable income of the branch is determined as if the branch were a separate legal person and calculated as follows:
1. payments or amounts incurred to another part of the non-resident person are deemed to be dividends under paragraph (3) of Article 13 of this Law,
  2. no deduction is allowed for payments or amounts incurred to another part of the non-resident person according to paragraph (2) of Article 18 of this Law, and
  3. expenses incurred by the branch or another part of the non-resident person that related directly to the earning of gross income by the branch are 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:

<u>Independent Trader</u>	<u>Branch of Company</u>
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 II 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 II 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.

Step 3: *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:*

$$2,500,000 \div 25,000,000 = 0.1 = 10\%$$

Step 4: *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:*

$$10\% \times \text{Afs. } 6,000,000 = \text{Afs. } 600,000$$

Step 5: *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:*

$$20\% \times \text{Afs. } 600,000 = \text{Afs. } 120,000 \text{ tax}$$

- 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 place of business 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 permanent establishment:
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.*

Tax on foreign Governments and International Organizations

Article 9. The taxability of income in Afghanistan of foreign governments, international organizations, and of their employees not residents of 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.

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

*Example 2:* 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.

*Example:* Income of foreigners from their employment in Afghanistan as members of a diplomatic mission of their country is not subject to taxation.

9.3 The income of an alien who is employed in Afghanistan by a foreign organization and paid by its own government shall be treated in the same way as the income of aliens employed directly by that government on the same project is treated.

### Tax Exempt Organizations

Article 10. (1) Contributions received and income from the necessary operations of organizations that meet the following conditions are exempt from taxation:

1. The organization must be established under the laws of Afghanistan.
2. The organization must be organized 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 process of exemption from income tax for organizations prescribed in paragraph (1) of this Article shall be provided in the Income Tax Manual.

10.1 An organization meeting the qualifications set forth in Article 10 of the Income Tax Law is exempt from taxation under that Law. However, the organization cannot itself determine that it qualifies for such exemption. The Ministry of Finance determines this from facts set forth in the Application for Exemption and from other information available. If the Ministry of Finance issues an unfavorable determination, the taxpayer may appeal to the court and the court will determine whether the requirements are satisfied. The application for exemption from taxation shall be submitted to the Ministry of Finance on the form contained in the appendix to this manual (Application for Tax Exemption) or obtained from the tax information page on the Ministry of Finance website (<http://www.mof.gov.af/tax/>). The form shall be submitted in triplicate. After a determination of the status of the applicant has been made by the Ministry of Finance, the forms shall be distributed as follows:

- one copy returned to the applicant
- one copy retained by the Ministry of Finance
- one copy sent to the tax office which has jurisdiction over the applicant.

10.2 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.*

Tax Exemptions of Government

Article 11. The income of agencies and departments of the State and of municipalities is exempt from taxation. Government enterprises are 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 Room Rental Receipts (Afs 1,522,000)	152,200
b) 2% of Sales of Gift Shop Items (Afs. 403,000)	8,060

<i>Business Receipts Tax</i>	<i>160,260</i>
------------------------------	----------------

**Income Tax:**

<i>Total Income</i>	<i>1,925,000</i>
<i>Operating Expenses</i>	<i>(1,590,000)</i>
<i>Income Before Business Receipts Tax</i>	<i>335,000</i>
<i>Less: Business Receipts Tax</i>	<i>(160,260)</i>
<i>Net Taxable Income</i>	<i>174,740</i>

<i>Income Tax (20% of net taxable income)</i>	<i>34,948</i>
---	---------------