

CHAPTER III

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

Article 21 – Article 30

Gains Subject to Income Tax

Article 21. The gain from the sale or exchange of a capital asset or investment in a trade or business is 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	<u>1,000,000</u>	<u>9,000,000</u>
		4,000,000
Less: Expense of sale		<u>50,000</u>
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 his trade or business.

Taxable Gain of Fiscal Year

Article 22. The gain from the sale or exchange of any asset of a corporation or limited liability company is taxable income in the taxable year 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 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 taxable year 1385, the year that the apartment is sold.*

Tax on Transfer of Property

Article 23. (1) Gain from the sale, exchange, or transfer of the following assets is 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 property; 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 is excluded from the provisions of paragraph (1) of this Article.

23.1 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 a profit derived from the construction and sale of buildings by individuals in the business of constructing and selling buildings. Neither 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 during 1387. 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 is not taxable.

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	<u>1,000</u>
c.	Cost when sold	Afs. 126,000
d.	Sale price	Afs. 150,000
	minus cost when sold	- <u>126,000</u>
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.

Deduction of Expenses from Taxable Income

Article 24. 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. Expenses of sale including sales commissions, advertising expenses, legal expenses, transaction and document taxes, and other expenses of selling and 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)	<u>315,000</u>
c. depreciation value (cost – total depreciation)	Afs. 105,000
d. plus cost of tires	60,000
e. plus expense of sale	<u>600</u>
f. adjusted cost when sold	165,600
g. sale price	Afs. 350,000
h. minus adjusted basis	<u>- 165,600</u>
i. gain realized	Afs. <u>184,400</u>

Tax Determination based on Market Value

Article 25. The market value of the movable or immovable asset at the time it was transferred or exchanged (except by 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)	<u>200,000</u>
c. Gain received from the transfer of stocks	Afs. 800,000
d. Minus expense of transfer	<u>2,000</u>
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.

The provision of Article 29 of the Income Tax Law should be applied in computing the income tax on this gain because stock is intangible property. As such, it is not considered moveable or immoveable property subject to tax prescribed in Article 30.

Form of Transfer no effect on Tax Liability

Article 26. The form or nature of the transfer of movable or immovable assets shall not affect taxability of gain from the transfer, except by inheritance, which is not taxable.

- 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, under 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 servant 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.*

Deduction of Loss Incurred from Taxable Income

Article 27. Losses from the sale or exchange of capital assets used in trade or business are deductible from the taxable income of the taxpayer in the taxable 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 XI 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.

Non-deduction of Additional loss from Taxable Income

Article 28. Loss from sale or exchange of shares of stock is not 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 is not 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.

Example 1: *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 taxable 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.*

Example 2: *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.*

Example 3: *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.*

Example 4: *If the loss of Afs. 5,000 in Example 2 above had been suffered in one taxable 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 Company A 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.*

	<u>Cost</u>	<u>Sale</u>	<u>Gain</u>	<u>Expense of Sale</u>	<u>Net Profit</u>
<u>Purchased</u>					
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				
<u>Sold</u>					
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 A 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 Company A. 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:*

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

Computing Tax on Capital Gains

Article 29. The method of determining and computing tax on capital gains is 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 is subject to the provisions of this Article if one or more of the following criteria and conditions is met:
 - the transfer (except by inheritance) of property was not a sale;
 - the asset transferred was a capital asset;
 - the asset was transferred in the sale or liquidation of a business.
- (2). The income tax of any person in any taxable 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 obtained, divided by the amount of taxable income for which it was computed, is the special rate. If the resulting rate is less than ten percent the applicable rate shall be ten 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 1385 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 $1,000,000/4 = \text{Afs. } 250,000$.*

The person selling this stock has taxable income from other sources of Afs. 1,300,000 (after deductions), and his tax for 1385 will be calculated as follows:

a.	1385 taxable income from other sources	Afs. 1,300,000
b.	Average gain per year during period stock was held	<u>250,000</u>
c.	Total	Afs.1,550,000
d.	Tentative tax from Article 4 of the Law	175,000
e.	Special rate is $175,000/1,550,000$	11.29%
f.	1385 taxable income other sources	1,300,000
g.	Taxable income from sale of shares	<u>1,000,000</u>
h.	Total taxable income	2,300,000
i.	Tax ($2,300,000 \times 11.29\%$ *)	Afs.259,670

** As the special rate of 11.29% is more than the 10% minimum percentage prescribed, the rate of 11.29% applies.*

Remark: *If the special concession rate above had not been applied, the tax on Afs. 2,300,000 would have been Afs. 325,000.*

- 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.

Tax on sale of Movable or Immovable Property

- Article 30 (1) Except by inheritance and as mentioned in Article 23 of this Law, the price of sale or transfer of immovable property is subject to a fixed tax of one percent at the time of transfer of ownership in lieu of income tax.
- (2) The price from sale or transfer of movable property or a vehicle is subject to a fixed tax of two percent at the time of transfer of ownership in lieu of income tax.

30.1 The sale or transfer of land and buildings owned by corporation or limited liability company is not subject to the tax imposed by Article 30 of the Income Tax Law. Corporations and limited liability companies are required to pay income tax on all gains from sales and transfers of assets according to Article 21 of the Income Tax Law.

30.2 The one percent tax imposed by Article 30(1) of the Income Tax Law does not apply to land sold by the Government of Afghanistan or its municipalities in the exercise of ordinary governmental powers.

30.3 The tax imposed by Article 30(1) of the Income Tax Law applies to sale or transfer of any immovable property such as land owned by an individual, individuals in ordinary partnerships, or by families. Leases that run from year to year or for terms of 10 years or less are not, however, considered to be transfers of land rights for purposes of this tax. Leases with a term in excess of 10 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.

30.4 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.

30.5 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.*

- 30.6 The sale or transfer of movable property or a vehicle is subject to a fixed of two percent of the sale price (or market value if the sale price is different to market value). Any individual who sells or transfers the ownership of a motor vehicle will be required to pay this fixed tax.

Example: *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 2 percent of Afs 150,000 ie Afs 3,000 at the time that the motor vehicle is sold.*

Remark: *A motor vehicle sold by a limited liability company or a corporation will not be subject to tax under this Article. Rather, the gain or loss on the sale of the motor vehicle will be subject to income tax under Articles 22 and 27.*