

**CHAPTER VIII**

**TAXATION OF BANKS, CORPORATIONS, LOAN AND  
INVESTMENT CORPORATIONS**

**Article 54 — Article 57**

Gains subject to tax

Article 54. Income of banks, loan and investment corporations are 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 13 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 but not from the business receipts 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.*

Deduction of necessary expenses

Article 55. Necessary and ordinary business expenses are 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 are also 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	<u>15,000,000</u>
	3. Net deposits during the year (difference of items 1 and 2)	<u>5,000,000</u>
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.

Example: *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.*

Additions to reserves

Article 56. Additions to reserves against losses on loans are deductible only if such reserve does not exceed 25 per cent of loans outstanding at the end of the taxable year. Any transfers or payments from such reserve, except in accordance with the purpose of the reserve, is 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.

Example 1: *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.*

Example 2: *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.*

Increase or decrease in value of securities

Article 57. An increase or decrease in value of securities owned, loans and similar items is not 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.*