Islamic Republic of Afghanistan

Ministry of Finance

General Presidency of Revenue

Income Tax: Tax Holidays, Exemptions and Concessions for Investment

Purpose of this Public Ruling

This is a public ruling within the meaning of Article 96 of the Income Tax Law. It explains how the Ministry of Finance interprets the operation of Article 53 of the Income Tax Law. Information in this ruling may be relied upon by taxpayers as the basis for determining their tax liability. This means that if a taxpayer has declared his or her tax liability on the basis of the ruling, the Ministry of Finance will not seek to reassess the taxpayer for a higher tax liability in respect of taxable income covered by the ruling, even if the interpretation accepted by the Ministry of Finance is later determined to be incorrect by a Court and the taxpayer's liability to tax is higher under the alternative interpretation accepted by the Court. Similarly, the Ministry of Finance will not seek to impose penalties on any person who has declared his or her tax liability on the basis of this ruling.

Introduction

1. Under the Income Tax Law 134 4, as amended, residents of Afghanistan are liable for income tax on their income from sources inside and out of Afghanistan and non-residents are liable for income tax on their income from sources in Afghanistan. The general rules in the Income Tax Law are subject to exceptions. The Income Tax Law was interpreted as being subject to tax exemptions and concessions provided in foreign or foreign and domestic investment laws and Article 76 ensured that the exemptions and concessions also took precedence over the business receipts tax provisions in the Income Tax Law. Article 76 has been repealed with effect from 19 July 2004 (30 Jawza 1383). In recent years, some businesses have sought tax exemptions and concessions in private agreements with government ministries outside the foreign investment laws.

2. In addition to the tax exemptions and concessions in foreign or foreign and domestic investment laws, the general rules in the Income Tax Law are subject to some concessional rules. Article 47 provides for a carry-forward of net losses over three years. Article 52 provided for a 15 percent tax credit for investment in assets of mining and manufacturing companies. This Article 52 has been repealed with the effect form 21 March 2005 (1 Hamal 1384). Article 53 provides for tax concessions for approved enterprises in the form of accelerated depreciation and loss carry- forward until fully recouped.

3. All tax exemptions and concessions in laws other than the Income Tax Law which are inconsistent with the Income Tax Law ceased to have effect as a result of Presidential Decree number 1018 of 2004 (1383). The Income Tax Law has been amended in accordance with this Presidential Decree. Article 53 provides that in the event of any conflict between contracts, agreements or provisions of other laws with the Income Tax Law, the provisions of the Income Tax law prevails. As an exception to this general situation, Article 53 further provides that tax exemptions will continue for any approved enterprise which has both registered under the Law on Domestic and Foreign Investment Law in Afghanistan 1381 and commenced business activities before 22 November 2003 (1 Kawos 1382) provided that the approved enterprise fully complied with all regulatory requirements including the requirements of the licence under which the exemption was granted. That is, the Income Tax law does not withdraw a tax exemption from an approved enterprise that has documentary proof that it complied with all regulatory requirements. However, the continuation of a valid exemption will only apply to an originally granted exemption period and not to any extension granted after 21 June 2004 (1 Saratan 1383).

4. This Ruling explains the operation of tax exemptions and concessions prior to 21 June 2004 (1 Saratan 1383), new income tax concessions that are available after that date, and the transitional rules for businesses whose entitlements to tax exemptions and concessions changed from 21 June 2004 (1 Saratan 1383) because they have not complied with all regulatory requirements.

Part 1: Tax Concessions in Private Agreements with Ministers or other Government Officials

5. Prior to 21 June 2004 (1 Saratan 1383), some businesses entered into investment agreements with ministries of the government of Afghanistan. Some of these agreements provided tax concessions including tax exemptions.

6. There is no provision in Afghanistan law for the granting of tax exemptions and concessions in private agreements between investors and ministries of the government of Afghanistan. The provision of tax exemptions and concessions in such agreements is contrary to the Afghanistan constitution which requires all measures imposing taxation (including zero rate taxation) to be imposed through laws, not private agreements (Article 42, Afghanistan Constitution).

Accordingly, tax exemptions and concessions provided in private agreements are of no legal effect and generally are not recognised by the Ministry of Finance.

7. Persons entering into private agreements that contained tax exemptions or concessions often understood the agreements to be in conformity with the provisions of the Law on Domestic and Foreign Private Investment in Afghanistan 1381 and presumed the agreements were permitted under that law. In some cases, government officials who were parties to the agreements may have also presumed that the agreements were in conformity with the provisions of the Law on Domestic and Foreign Private Investment in Afghanistan 1381.

8. In light of the mutual assumptions by businesses which are parties to private agreements entered into prior to 21 June 2004 (1 Saratan 1383) and the government officials who subscribed to the agreements, the Ministry of Finance has concluded it is appropriate to treat these agreements as if they provided tax exemptions and concessions in conformity with the Law on Domestic and Foreign Private Investment in Afghanistan 1381.

9. Accordingly, the tax position of businesses which are parties to such agreements may be determined by reference to the tax position of persons who were granted tax exemptions under the Law on Domestic and Foreign Private Investment in Afghanistan 1381. These are described in Part 2 of this Ruling. In accordance with paragraph 1 of Article 53, the provisions of agreements entered into on or after 21 June 2004 (1 Saratan 1383) that purport to grant tax exemptions or concessions contrary to the income tax law are of no effect. Where agreements were entered into before 21 June 2004 (1 Saratan 1383) with provisions that purport to grant tax exemptions or concessions contrary to the income tax law, those provisions cease to have effect from 21 June 2004 (1 Saratan 1383).

Part 2: Tax Exemptions in the Law on Domestic and Foreign Private Investment in Afghanistan 1381

10. Tax exemptions and concessions outside the Income Tax Law are governed by the Law on Domestic and Foreign Private Investment in Afghanistan 1381. The government of Afghanistan has proposed to replace the Law on Domestic and Foreign Private Investment in Afghanistan 1381 (“the 1381 law”) with the Law on Private Investment in Afghanistan 1384 (“the 1384 law”). The new law has not been enacted at the time

of release of this Public Ruling. However, this Ruling assumes the 1384 law will be enacted and may operate from 21 June 2004 (1 Saratan 1383). Accordingly, this Ruling explains how tax exemptions and concessions will apply to businesses which will be registered under the 1384 law as well as those currently registered under the 1381 law.

11. The 1381 law establishes a High Commission on Investment which monitors an Office of Private Investment. The 1381 law provides tax exemptions for approved enterprises, with the duration of the exemption to be determined by the Office of Private Investment. Prior to mid-1382, the functions of the Office of Private Investment were carried out by the Investment Promotion Unit of the Ministry of Commerce. Since mid-1382, those functions have been carried out by the Afghanistan Investment Support Agency (AISA).

12. Approved enterprises for which tax exemptions are granted are required to prepare their accounts according to international standards and to submit them annually to the Office of Private Investment (or the successor AISA) for auditing in accordance with Article 5 of the 1381 law.

13. To qualify for continuing tax exemption granted under the 1381 law by the Investment Promotion Unit or the successor AISA, an approved enterprise must demonstrate that it has complied with all regulatory requirements. In particular, it must be demonstrated that accounting statements based on international accounting standards have been prepared and submitted to the relevant authority. Where an approved enterprise has been granted a tax exemption by either the Investment Promotion Unit or AISA and can demonstrate it has complied with the accounting standards requirements and any other government regulatory requirements, the approved enterprise will be entitled to claim a tax exemption (including an exemption from business receipts tax under the Income Tax Law) from the date of licensing until the date on which the exemption expires under the licence.

14. Approved enterprises that were granted tax exemptions by either the Investment Promotion Unit or AISA but which failed to maintain accounts using international accounting standards are not entitled to any tax exemptions. However, the Ministry of Finance will assume that all approved enterprises that were granted tax exemptions by either the Investment Promotion Unit or AISA have complied with these requirements until the date that the tax exemption expires or 21 June 2004 (1 Saratan 1383), whichever is first.

15. Where tax exemptions available under the 1381 Law cease on 21 June 2004 (1 Saratan 1383), enterprises that

previously enjoyed exemptions under this law are required to provide accounts of its business activities for the fiscal year 20 March 2004 (1 Hamal 1383) to 20 March 2005 (30 Hoot 1383). However, in the absence of separate accounts for the period 21 June 2004 (1 Saratan 1383) until the end of the 1383 fiscal year, a reasonable apportionment of taxable income, allowable deductions and credits for income tax purposes will be acceptable. As indicated in paragraph 3 of this Ruling, this requirement will not apply to approved enterprises which registered and commenced business activities before 22 November 2003 (1 Kawos 1382) and have provided documentary proof of their compliance with all regulatory requirements.

16. Where an approved enterprise is entitled to a tax exemption, income tax that would otherwise be levied upon the business will not apply. This tax exemption will include exemption from annual income tax or fixed taxes in lieu of annual income tax, business receipts tax, and income tax on the disposal of assets. However, the tax exemption will not extend to exemption of taxes levied on other persons or entities on whose behalf the approved enterprise may be required to withhold tax. For example, rent withholding tax is a tax on the income of the landlord. An approved enterprise with a tax exemption will be required to withhold tax from rent that it pays to its landlord. Similarly, wages withholding tax will apply to employees of approved enterprises regardless of whether the approved enterprise is entitled to a tax exemption. Further, an approved enterprise with a valid tax exemption will be required to withhold tax on dividends that it pays to its shareholders.

Part 3: Tax concessions and the Proposed Law on Private Investment in Afghanistan 1384

17. As indicated earlier, the government of Afghanistan has proposed to replace the 1381 Law with a new Law on Private Investment in Afghanistan. As a result of Presidential Decree number 1018 of 2004 (1383) and paragraph 1 of Article 53, the new Law will not contain any tax exemptions or concessions. However, the Income Tax Law has been amended to provide two types of tax concessions that will be available to businesses that are approved as Registered Enterprises under the provisions of the proposed 1384 law.

18. The two concessions which have been added to the Income Tax Law for Registered Enterprises are accelerated depreciation and loss carry-forward until fully recouped. The

concessions apply from 21 June 2004 (1 Saratan 1383), the day on which the former tax exemptions ceased.

Part 4: Continuation of Tax Concessions for Approved Enterprises Granted Tax Exemptions under the 1381 Law

19. The new tax concessions apply to businesses that are approved enterprises under the current Law on Domestic and Foreign Private Investment in Afghanistan 1381 or the proposed 1384 law. It may be that not all businesses that were granted tax exemptions under the 1381 law will be approved as Registered Enterprises under the proposed 1384 law. However, it is intended to extend the new concessions to all businesses that were entitled to tax exemptions under the 1381 Law, including those that may not be subsequently approved as Registered Enterprises under the proposed 1384 law.

20. As noted in paragraph 14, the Ministry of Finance has assumed that all enterprises which were granted tax exemptions prior to 21 June 2004 (1 Saratan 1383) complied with all regulatory requirements imposed on approved enterprises.

21. This assumption will not apply to the period commencing 21 June 2004 (1 Saratan 1383). Accordingly, enterprises that were granted tax exemptions prior to 21 June 2004 (1 Saratan 1383) by the Investment Promotion Unit or AISA under the 1381 law will be relieved of the requirement to demonstrate compliance with all regulatory requirements if they wish to utilise the two new concessions.

Part 5: Transitional Rules for Qualifying Businesses

22. As noted in paragraph 19, it is expected that approved enterprises that were granted a tax exemption under the Law on Domestic and Foreign Private Investment in Afghanistan 1381 will be entitled to utilise the two tax concessions added to the Income Tax Law.

23. The first of the two tax concessions is accelerated depreciation for buildings and capital assets acquired and first used in the year in which the enterprise was approved or the following two years. For depreciation purposes, the value of capital assets held by approved enterprises on 21 June 2004 (1 Saratan 1383), the date on which the new concessions

commenced, will be the depreciated value of the assets on that date. This value is calculated by applying the ordinary depreciation rules to assets acquired prior to that date.

Example 1:

Kabul Construction purchased machinery on 21 June 2003 (1 Saratan 1382) to use in its construction business. The machinery cost 100,000 afghanis and has an estimated life of ten years. Kabul Construction was given a four year tax exemption under the Law on Domestic and Foreign Private Investment in Afghanistan 1381 however that tax exemption ceased as of 21 June 2004 (1 Saratan 1383). When the accelerated depreciation concession commenced on 21 June 2004 (1 Saratan 1383), the depreciated value of the machinery was 100,000 less 10,000 (one year's depreciation) = 90,000 afghanis. Kabul Construction is entitled to depreciate the notional 90,000 afghanis cost of the machinery over two years.

24. The second of the two tax concessions is the carry forward of a net loss incurred for a fiscal year until recouped in full. For those approved enterprises which cease to be entitled to tax exemptions from 21 June 2004 (1 Saratan 1383), their entitlement to recoupment of losses indefinitely commences with losses incurred from 21 June 2004 (1 Saratan 1383). Losses incurred before 21 June 2004 (1 Saratan 1383) do not qualify for the loss carry-forward concession.

Example 2:

Herat Telecommunications commenced business activities in 1381. Because of large infrastructure costs, Herat Telecommunications does not expect a profitable year until 1385. It was granted a tax exemption but failed to comply with all regulatory requirements. Its tax exemption ceased as at 21 June 2004 (1 Saratan 1383). Any loss incurred from that date onwards will be allowed as a tax deduction in future years until the loss has been fully recouped.

References to Articles in the Income Tax Law:

3 year loss carry-forward	Article 47
15% investment tax credits	Article 52
tax concessions	Article 53
tax concessions and business profits tax	Article 76

Appendix: Article 53

. Article 53

(1) In the event of any conflict between contracts, agreements and provisions of other laws with the Income Tax Law, the provisions of the Income Tax Law shall prevail.

(2) International contracts and agreements signed by the Government of Afghanistan with foreign countries or United Nations agencies are not subject to paragraph (1) of this Article.

(3) Enterprises approved under the Law on Domestic and Foreign Private Investment in Afghanistan (Official Gazette number 803 dated 20 Sunbulla 1381) ("approved enterprises") (*tashabuz mansur shuda*) prior to 22 November 2003 (1 Kawos 1382) which have commenced activities may use the concessions mentioned in the provisions of that Law only if they have complied with all the requirements set out in the provisions of related laws.

(4) Approved enterprises which have not met the requirements set out in the Law on Domestic and Foreign in Afghanistan are not entitled to use the tax exemptions mentioned in the provisions of that Law after 21 June 2004 (1 Saratan 1383).

(5) Approved enterprises shall be entitled to a deduction for the depreciation of capital assets as follows:

- four years for buildings; and
- two years for other capital assets.

(6) As an exception to Article 47 of the Income Tax Law, approved enterprises which incur a net operating loss in a fiscal year based on legal records and accounting records may carry this loss forward as a deduction from taxable income in each subsequent year until the loss is fully extinguished. The loss incurred by such approved enterprises shall be calculated in accordance with Article 47.

(7) If approved enterprises granted tax exemption under the provisions of the Law on Domestic and Foreign Private Investment in Afghanistan hold capital assets on the date on which the tax exemption ends as a result of paragraph (4) of this Article, after the calculation of the depreciation for the capital assets, the remaining value of the capital assets on that date will be treated as the cost of the capital assets for the purpose of applying paragraph (5) of this Article.

(8) The depreciation deduction for buildings and equipment shall be an equal deduction for each fiscal year of depreciation. If a capital asset is owned by the enterprise for less than one half of the year, then a deduction for half the annual amount will be allowed.

(9) The depreciation deduction shall only apply to capital assets acquired and first used in the year in which the enterprise was approved or the following two years.