



## Research on Tax Evasion in Afghanistan

### Introduction

Tax evasion is a general term often used in cases where an individual or a company evades taxes all together in violation of a country's tax laws. Tax evasion can take many forms: individuals or businesses underreporting their income, or failing to report their income all together; companies and individuals also hide or evade obligatory tax withholding on rental income and rental payments, on business services, on dividends and on staff salary payments. Large-scale underreporting of profits in various sectors such as telecommunications, construction, trading and extractive industries, is also quite common.

Tax evasion is an activity widely practiced in Afghanistan by national and international companies, organizations and individuals. The willingness of a country's citizens to pay taxes and the ability of a country's government to collect taxes is a critical factor in improving the economic situation of a country, especially for third world countries such as Afghanistan which are suffering from terrorism, corruption and poor governance. Taxes also play a crucial role in maintaining the existence of the state. Small firms, large firms and international companies and organization are required to pay taxes and the role of any government should be to establish procedures for the collection of taxes in order to support its public service sectors. For example, public health care, government employees' salaries, education, the work of the National Police and National Army, and the maintenance of public utilities which provide people and industries with energy and water – all such government expenditures rely, at least to some extent, on taxes.

Based on the information provided by various sources (Afghan Zariza & AISA) there are 40,000 local and international companies registered with Afghanistan Investment Support Agency (AISA) and investigations shows that some of these companies, especially foreign companies owe billions Afghanis (AFN) as tax to the Afghan government and some of them function without the obligatory business license. Some of these foreign companies which are working in Afghanistan has continuously failed to clear the dues, despite repeated reminders from the Afghan government's Ministry of finance.

There are various reasons for the tax evasion problem in Afghanistan. The fundamental problems are manifold, but include the lack of a strong political will, an overly bureaucratic system, poor government standards, loopholes in the rules, weak enforcement mechanisms, and a lack of resources and expertise. Another reason relates to corruption, the payment of bribes and the use of political influence. Many Afghans who should be paying large tax bills, especially wealthy businessmen, are closely linked to senior officials and political figures. These "untouchables" do

not always pay their full tax bill. In addition, customs revenues, which account for about half of Afghan government revenues, have been declining due to the theft of custom duties. (Rosenberg, 2013)

Tax evasion determinants have not been investigated in Afghanistan, nor have any published studies fully examined the factors influencing tax evasion. Thus far only a few media pieces have reported on occasional superficial cases of tax evasion with researchers referring to this issue in their studies or desk reviews. Research on tax evasion and tax avoidance is an urgent requirement to identify the actors involved and to highlight the revenue loss to the country. The proposed study will cover the matter comprehensively in two parts; 1) a literature review and some qualitative research will be conducted; 2) legal gap analysis research will be undertaken to find the gaps and to develop an accurate measure of tax evasion at the individual and corporation levels and identify the variables associated with tax evasion.

In this study various forms of tax evasion will be evaluated;

**1. Non Declaration of Income:**

This is the most common form of tax evasion practiced by individuals and companies. Under this form of tax evasion, individuals and companies have not declared all their income to the tax officials or to the Ministry of Finance. In this case, some companies and individuals have more than one source of income or do not disclose all of their income or all of their sources of income to the government.

**2. Non Payment of Customs Duties:**

Customs duties are often under paid or not paid at all in Afghanistan. Importers avoid paying customs duties by either underpricing the products that are imported into the country or by understating the quantity of such goods imported.

**3. Smuggling of Goods:**

Some businessmen or people pay no customs duties on the products that are brought in or taken out of the country. Individuals pay bribes on the main transit routes or they use transit routes where there are no custom offices functioning. Alternatively, these individuals pay bribes to high government authorities who, in turn, let them take goods in or out in the country without the payment of legally required duties.

Beside these forms of tax evasion, most of the big companies working in Afghanistan evade rent withholding, business receipt tax, dividend taxes, and staff withholding taxes. In the latter case this arises because there is no proper system to track staff salaries paid by employers.

## **Objectives of the study**

The broad objective of this study is to determine why people evade tax owed to the government of Afghanistan and to suggest ways of minimizing these practices in Afghanistan. The objectives will be further broken down to the following specific objectives:

1. The current state of tax evasion in Afghanistan
2. An assessment of the relationship between tax rates, tax evasion and existing legal gaps
3. An investigation as to why people evade taxes and in which sectors tax evasion is most common
4. An analysis of the effect of tax evasion on the revenues of the Ministry of Finance of Afghanistan
5. To propose solutions to the problem of tax evasion in Afghanistan

## **Research questions**

1. What forms does tax evasion typically takes in Afghanistan?
2. Is the existence of loopholes in the Afghan tax law system an opportunity for tax evasion?
3. Is there any effect of tax evasion on the Afghan economy?
4. How can tax evasion and tax avoidance be minimized in Afghanistan?
5. In which sector tax evasion is common or not controlled? And
6. How much money are we talking about?

While we will try to make an estimate of the total amount of revenue which is foregone by the government as a result of tax evasion. This is clearly a difficult task and will require separate research on each type of tax which is under collected.

## **Methodology**

Aid for Afghanistan is reducing and Afghan government is expected by international community to generate internal revenue. Therefore, this research will attempt to identify priority areas where there is potential for the government to ameliorate leakages. Our research will require visits to different government and non-governmental organizations and to private companies to gather information and documents related to tax evasion. We will seek to gather accurate data and information about various contracts, the nature of the contracts and the tax declaration process. The study will require on-the-ground research and site visits, an in depth literature review, key informant interviews and focus group discussions with several categories of people from Government and non-governmental organizations as well as subject matter experts with experiences in different countries and with individuals having in depth knowledge of the tax situation in Afghanistan. The study will be based on a literature review and interviews with individuals involved directly or indirectly in tax evasions and contracting. The study will be conducted through experienced researchers who have extensive knowledge of tax matters in Afghanistan.

The Research Manager of IWA, who has background in a variety of different qualitative and quantitative research subjects, will lead the entire project beginning with data and information collection up to the final stage of the project. An expert researcher will draft the report. IWA will build a team of researchers under the direct supervision of international experts to design the research methodology to effectively collect data, analyze the collected data and write up the analytical report.

The outcome of this study will help to build on the existing knowledge base regarding tax evasion. It will also provide the tax authorities at the MoF with an insight into what measures they might take in reorganizing the overall operations of the tax office in the future. Furthermore, it is hoped that this research will assist the tax authorities and the National Procurement Authority to identify those individuals and companies/corporations currently evading taxes due to the Government of Afghanistan.

### Project Timeline

We will implement this research within the timeline below;

S. No	Activity	Timeline					
		April	May	June	July	August	September
1	Research Design / Methodology						
2	Develop Questionnaire, review and approval						
3	Data Collection including Literature review						
4	Data Analysis						
5	Write up Research Report						
6	Review and Revision						
7	Design, Translate and Print						
8	Advocacy, Communication activities						

**Staffing**

Integrity Watch Afghanistan will implement this project under direct supervision and leading of the IWA Research Manager and will recruit subject matter expert researchers to implement this project within the planned timeframe.

**Budget**

Budget breakdown of expenses will be provided upon acceptance of the Concept Note.