

The Tax Collection Capacity of Afghanistan: An Answer in the Light of Rampant Tax Evasion Practices

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Abstract

Afghanistan has taken a number of measures to combat tax evasion, however, they have not led to strengthening tax compliance in the country. This is due to the prevalence of economic crimes and the weaknesses in the state's tax model. This article argues that these problems present the greatest hurdle in Afghanistan's quest towards a tax compliant society. By considering Kabul and Kandahar as its case study provinces, the article employs several methods to investigate tax evasion practices in the two provinces. In doing so, twelve indicators were developed as constructs to identify instances of tax evasion. The intention of this article is not to provide a comprehensive overview of estimates of every tax evasion component, nor of every tax evasion channel, but to specifically identify the common tax evasion practices in the two provinces. The findings suggest that as a result of the hierarchisation of the Afghan tribal society, the state co-opted tribal leaders and appointed them as local representatives, in charge of gathering taxes and duties from fellow tribesmen. This, the interviews revealed, has resulted in an obstacle for the state as the only sovereign with the monopoly to collect tax. Particularly in instances where the tribal leaders go far beyond their duty to collect tax and not remit it to the state. The resulting fragmented political structure that sits between local tribal leaders and state institutions have made it difficult for the Afghan government to get the local communities to remit taxes. Interviews with government officers, individuals and corporations in Kabul and Kandahar confirm that the rise of the underground economy due to poverty, warlord directives, contest between state and tribal leadership and insecurity has contributed to high incidences of smuggling, trade in narcotics, corruption, and money laundering. Political interference further prevents full disclosure on transactions and weak implementation of reporting standards.

Keywords: Afghanistan, Underground Economy, Tax Compliance, Tax Evasion, Political Interference, Regulation

Introduction

“Given the strictness of Taliban regarding implementation of their rules and regulations, I think they raise more money from tax collection than the Afghan government”.

Mohammdin, an Afghan.

Afghanistan is an inward-looking society with a formal democracy and an elected president and parliament. Post conflict, the country depended almost entirely on foreign assistance for its security and the delivery of basic social services.¹ It continues to rely on foreign aid as the Afghan government works to mobilize domestic sources of revenue. The capacity of the state to collect taxes in order to sustain its public wage bill, pay for both its recurrent and development expenditure as well as to secure basic public services however, is affected by the many different dimensions of tax evasion prevalent in the country.

This arguably results out of the frequency of internal conflict that has led to increase in poverty and decline in per capita income,² low tax morale, the underground economy, and non-state actors’ determination to challenge the state.³ The latter, in fact presents itself as the greatest barrier to tax compliance in Afghanistan. These factors combined with smuggling, corruption, trade in narcotics and rejection of the state model of governance and its tax architecture by the local Afghan tribal leaders has contributed to the decline of the Afghan economy and in turn, to tax leakages.

The interplay between economic development and taxation has long since been established through the works of various scholars, such as

¹ Alessandro Monsutti, “Anthropologizing Afghanistan: Colonial and Postcolonial Encounters,” *The Annual Review of Anthropology* 42 (2013), 269-85 at 270.

² World Bank, “The World Bank in Afghanistan; Overview”. Available online at: <https://www.worldbank.org/en/country/afghanistan/overview> (Last accessed: 11.12.2019).

³ James Putzel, “Why Development Actors Need a Better Definition of State Fragility,” *Policy Directions*, Crisis States Research Centre (2010).

Schumpeter,⁴ Tilly,⁵ Ormrod-Bonney,⁶ Waris⁷ and Latif.⁸ These scholars have argued that taxes play a very important role in the economic development of a country. They believe that taxes support state-sponsored welfare programs tailored towards improving citizens' living standards and in the distribution of wealth through the just allocation of resources.

Therefore, the process of tax collection has become one of the most powerful discourses and themes in politics, economics, law, sociology and development studies to determine the sign of life of the modern post conflict state. Relatedly, good fiscal administration has also become the paradigm that links the process of state-building with the capacity of rulers to collect tax.⁹ Taxation, hence, is one of the few objective indices we have that measures the power, authority and legitimacy of the state to mobilise resources.¹⁰

Taxation and tax reform, therefore, is central to state-building in Afghanistan for several reasons. First, due to conflict that persisted following 9/11, the state of Afghanistan could no longer sustain itself and thus sought for revenue externally in order to ensure sustainable funding for its social programmes, and for its public investments to promote economic development.

Second, taxation is the main nexus that binds state officials with citizens. Not only can taxation enhance government accountability, it also provides a focal point around which citizens can mobilise to support, resist, and even propose tax policies. In other words, taxation is as

⁴ Joseph Schumpeter, 'The Crisis of the Tax State', *International Economic Papers* 4, 1918 (1954).

⁵ Charles Tilly, *Coercion, Capital and European States: AD 990-1992* (Oxford: Blackwell, 1990).

⁶ Ormrod, Mark and Margaret Bonney, *Crises, Revolutions and Self Sustained Growth: Essays in European Fiscal History, 1130-1830* (Stamford: Shaun Tyas, 1999).

⁷ Attiya Waris, *Tax and Development* (Nairobi: LawAfrica, 2013).

⁸ Laila Abdul Latif, "Centralised Revenue Redistribution as a Potential Cause of Internal Conflict in Kenya," *Modern Africa: Politics, History and Society* 04:01, (2016), 91-105.

⁹ Schumpeter 1918, 1954; Tilly, 1990; and Latif, 2016.

¹⁰ Di John, "Taxation, Resource Mobilisation and State Performance" *Crisis States Working Papers Series No. 2*, Working Paper no. 84 (2010).

constitutive of state formation¹¹ as it is of citizen participation in budget making and delivery of social services.

Third, taxation, particularly in the form of land and property taxes, customs and border collection can help increase the territorial reach of the Afghan state. The diversity of the tax base is a telling indicator of the ability of the Afghan state to engage with different sectors and regions and is indicative of the degree to which the state's authority permeates society.

Fourth, fiscal capacities are needed to build a legitimate state.¹² Strong institutions and competent revenue authorities are therefore needed in order to ensure effective tax assessment and collection. Accordingly, tax legitimacy is critical to the existence of the post conflict Afghan state as it is the source of its support, it assists in state building and it promotes sovereignty and independence by reducing reliance on foreign aid.¹³

Regrettably, however, in post conflict states, citizens of all classes have sought to avoid paying taxes and state fees,¹⁴ decreasing the state's extractive capacity. It is therefore crucial to examine the tax collection capacity of the Afghan state in light of the fact that tax evasion practices in Afghanistan are now rampant.

Broadly, the unwillingness to pay tax, the rise of the shadow economy during the wars, disdain towards regulation designed to curb market monopoly, the lack of loyalty towards public institutions and low tax morale have become the common factors associated with tax evasion in the present day Afghanistan. Further, a number of taxable activities remain untapped by the Afghan government as a result of high instances and dependency on cash and cash-based transactions that are difficult to track.¹⁵ Also, the lack of a formal system of documentation of self-employed persons and their activities has led to tax leakages. Almost all of the self-employed persons are involved in tax evasion and underground economic activities in Afghanistan.

¹¹ Schumpeter 1918, 1954, and Tilly, 1990.

¹² Waris, 2013.

¹³ Philippe Nonet, and Philip Seznick, *Law and Society in Transition: Towards Responsive Law* (USA: Routledge, 2017).

¹⁴ Bratton, Michael, Robert B. Mattes and Gyimah-Boadi, *Public opinion, democracy and market reform in Africa* (UK: Cambridge University Press, 2005).

¹⁵ Interviews with government officers and private sector companies in Kabul and Kandahar. Interview transcripts on file with author.

These facts have not only been confirmed by previous empirical studies carried out by Maimbo,¹⁶ UNODC,¹⁷ the Special Inspector General for Afghanistan Reconstruction,¹⁸ Rosenberg,¹⁹ Integrity Watch Afghanistan²⁰ and Rai,²¹ but also by the interviews carried out by the author.

2. The Method of Inquiry and Structure

This article provides an overview of the different tax evasion practices prevalent in two out of 34 provinces in Afghanistan. It does not intend to generalize the findings as applicable across the entire country due to its limited sample size.

The aim was to identify the common and precise tax evasion practices in Kabul and Kandahar so as to present credible data that can then inform effective policy and legal changes to curb those tax evasion practices. Several methods have been used to investigate tax evasion in Kabul and Kandahar.

The primary sources of information were obtained through textual analysis of cases, reports and laws alongside extensive desk-based literature review. This was followed by a qualitative analysis of data that was collected through 30 interviews with Civil Society Organizations (CSOs), Non-Governmental Organizations (NGOs), government officials,

¹⁶ Samuel Munzele Maimbo, “The Money Exchange Dealers of Kabul: A Study of the Hawala System in Afghanistan” *World Bank Working Paper* No. 13 (2003), 4. Available online at:

<<http://documents.worldbank.org/curated/en/335241467990983523/pdf/269720PAPERoMoneyoexchangeodealers.pdf>> (Last accessed: 11.12.2019)

¹⁷ UNODC, “Financial Flows linked to the Illicit Production and Trafficking of Afghan Opiates” *The Orange Paper* (2008).

¹⁸ SIGAR, “Quarterly Report to the United States Congress” (2012). Available online at: <<https://www.sigar.mil/pdf/quarterlyreports/2012-10-30qr.pdf>> (Last accessed: 11.12.2019).

¹⁹ Matthew Rosenberg, “Afghan Government Faces Cash Crunch”. Available online at: <<http://www.nytimes.com/2013/05/03/world/asia/afghan-government-faces-cash-crunch-imf-says.html>> (Last accessed: 11.12.2019).

²⁰ Integrity Watch Afghanistan, “Extractives for Sustainable Development” (2015). Available online at: <<https://iwaweb.org/wp-content/uploads/2015/09/Policy-Brief-Extractives-for-sustainable-development-in-Afghanistan.pdf>> (Last accessed: 11.12.2019).

²¹ Sakshi Rai, “Illicit Financial Flows: Perspectives from Developing Asian Countries” *Centre for Budget and Governance Accountability, Policy Brief* (2017). Available online at: <<http://www.cbgaindia.org/wp-content/uploads/2017/06/ILLICIT-FINANCIAL-FLOWS-PERSPECTIVES.pdf>> (Last accessed: 11.12.2019).

journalists and community leaders to understand Afghanistan's tax structure and the instances that give rise to the rampant tax evasion practices. The comparative approach was utilized in order to understand whether the evasion practices identified in one province were also a determinant in the other.

The tax evasion practices were defined in terms of twelve indicators that the author relied on to ask the research questions. The twelve indicators were defined in terms of (i) unreported transactions, (ii) lack of regulation, (iii) no thresholds on funds transfer, (iv) smuggling, (v) weak implementation of reporting standards, (vi) absence of information on ownership, (vii) trade in narcotics, (viii) corruption, (ix) insiders, (x) technology, (xi) money laundering and (xii) the underground economy as key determinants of tax evasion.

The limitation encountered was in the lack of available data or sources that provide an indication of an estimate of the tax revenue that is lost to the Afghan state because of tax evasion practices; by individuals and corporations. The importance of identifying the tax evasion practices will assist the Afghan government in tracking and stopping such evasion.

The intention of this article is not to provide a comprehensive overview of estimates of every tax evasion component, nor of every tax evasion channel, but to specifically identify the common tax evasion practices in the two provinces.

Accordingly, the article is structured as follows: it begins by presenting the available information on tax evasion in policy papers, reports, working papers, journal articles and books. It considers the information provided from interviews conducted with government sources, the civil society, journalists and international organisations. The article then describes both the domestic and international initiatives taken by the Afghan government in curbing tax evasion. It then concludes by pointing out the current recommendations made by various domestic and international bodies that have conducted research relating to tax evasion in Afghanistan.

3. Tax Evasion Practices in Afghanistan

Goldscheid argued that the state, society and taxation are interconnected.²² Such interconnectivity, explained Waris, is expressed in the tax bargain between the state and society that grants the state the fiscal legitimacy to collect and distribute tax.²³

Arguably then, the Afghan taxpayer's morale is based on the confidence that they have in the governance of the post conflict Afghan state. This confidence can be assessed through a variety of ways in the evolving relationship between the state and society. At best, according to Backhaus, it is to be assessed through history.²⁴ Barfield explains that Afghanistan's history is defined by the historic relationship between the kinship-based solidarity of highlands and mountain range dwelling Afghans and the differentiated and hierarchical social organisations of the city life and urban civilization.²⁵ The Afghan state comprises of sedentary rural tribal Pashtun communities, and non-Pashtun groups (such as the Tajiks, Hazaras, Uzbeks and others).

The legitimization of tax, therefore, according to Mumford, can be seen through the culture of taxation prevalent in these groups, the method of collection, the ease, as well as the societal response to taxation.²⁶ In this regard, Giustozzi and Noor explain and clarify for us the position of tax in the Afghan society.²⁷

According to them, as a result of the hierarchisation of the Afghan tribal society, the state co-opted tribal leaders and appointed them as local representatives, in charge of gathering taxes and duties from fellow tribesmen. This, the interviews revealed, has resulted in an obstacle for the state, as the only sovereign with the monopoly, to collect tax. Particularly in instances where the tribal leaders go far beyond their duty

²² Rudolf Goldscheid, "A sociological approach to problems of public finance", in R.A. Musgrave & A. T. Peacock (eds), *Classics in the Theory of Public Finance*. (London: Macmillan, 1962), 202-213.

²³ Waris, 2013.

²⁴ Backhaus Jurgen, "Fiscal sociology – what for"? *American Journal of Economics and Sociology* 61:01 (2002), 55-77.

²⁵ Jon W. Anderson, "Thomas Barfield, Afghanistan: A cultural and political history." *Contemporary Islam* 06:01 (2012), 95-97.

²⁶ Ann Mumford, *Taxing culture: Towards a Theory of Tax Collection Law* (Burlington, VT: Ashgate, 2001).

²⁷ Antonio Giustozzi, and Noor Ullah, "Tribes and Warlords in Southern Afghanistan, 1980-2005" *LSE: Crisis States Research Centre* (2006).

to collect tax and not remit it to the state. The resulting fragmented political structure that sits between local tribal leaders and state institutions has made it difficult for the Afghan government to get the local communities to remit taxes.²⁸

Interviews with government officers, individuals and corporations in Kabul and Kandahar confirm that the rise of the underground economy, due to poverty, warlord directives, contest between state and tribal leadership and insecurity, has contributed to high incidences of smuggling, trade in narcotics, corruption, and money laundering. Political interference further prevents full disclosure on transactions and weak implementation of reporting standards.

The next sections reveal more information on these indicators and show how they have become entrenched tax evasion practices in Kabul and Kandahar.

3.1. Unreported Transactions

Interviews indicate a consensus that accurate estimates on the volume of illegal finance in Afghanistan have not been provided by any relevant governmental authority or other competent agencies. A key reason cited by an interviewee for the lack of such data is the very nature of illegal money: they are *unreported*, making it extremely difficult to measure. That said, according to the Ministry of Finance (MoF), of all the financial flows in Afghanistan, only about 35% are legitimate. As such, approximately 65% of the funds are illegally earned, transferred, or utilized. Gray and Adbi report that this 65% includes illegal money linked to money laundering, tax evasion, corruption/bribery, and lost customs revenues.²⁹

The Global Financial Index (GFI) reports that Afghanistan's cumulative illegal outflows from 2003-2012 was USD 2.22 billion, with an average annual illegal outflow of USD 222 million per year.³⁰ However, these figures are very conservative because GFI assigned a value of zero to Afghanistan's annual illegal outflows from 2007 to 2012. On the contrary,

²⁸ Hasan Kakar, *Government and society in Afghanistan* (Austin: University of Texas Press, 1979), 73-5.

²⁹ Timothy Gray, Ezatullah Adib, "Curbing illicit financial flows in Afghanistan Kabul", *Integrity Watch Afghanistan* (2015).

³⁰ Global Financial Integrity, "Anonymous Companies" (2015). Available online at: <<http://www.gfintegrity.org/issue/anonymous-companies>> (Last accessed: 11.12.2019).

Integrity Watch Afghanistan (IWA) reports that the USD 222 million estimate does not pick up movements of bulk cash, the mispricing of services, or many types of money laundering.³¹

Afghanistan's rising illegal money linked to increased opium production and drug trafficking are also not captured in GFI's estimate. As such, according to Gray and Adib, the total amount of illegal money from Afghanistan is likely significantly higher than GFI's estimate of USD 222 million per year.³²

The Special Inspector General for Afghanistan Reconstruction (SIGAR) in 2012 reported that in terms of bulk cash movement, USD 4.5 billion was taken out of the Hamid Karzai International Airport (HKIA) in 2011 alone.³³ While large cash movements are typical in Afghanistan, given the country's cash-based economy, these bulk cash flows raise the risk of money laundering and bulk cash smuggling—tools often used to finance terrorist, narcotics, and other illicit operations.

Similarly, in 2019 SIGAR reported the prevalence of fraudulent and falsified receipts showing inflated prices on a disproportionate number of subcontracts submitted by Hikmatullah Shadman, a young Afghan who operated several companies, for payment for delivery of fuel that was never delivered to the US military units but was in fact sold on Kandahar's black market.³⁴ The payment of kickbacks in cash to facilitate the award of the fuel delivery subcontracts was also uncovered by SIGAR reinforcing the view that unreported bulk cash flows continue to flow within the Afghan economy.³⁵

3.2. Lack of Regulation

A major challenge to disrupting the movement of illegal money in Kabul and Kandahar is the lack of regulation or control of the informal financial sector (*hawala*) which controls the vast majority (estimated at 90%) of financial flows within Afghanistan and transfers to foreign countries. This has also been previously confirmed by Rai.³⁶

³¹ Integrity Watch Afghanistan (2015).

³² Gray and Adib, 2015.

³³ SIGAR (2012).

³⁴ SIGAR, "Quarterly Report to the United States Congress" (2019). Available online at: <<https://www.sigar.mil/pdf/quarterlyreports/2019-04-30qr.pdf>> (Last accessed: 11.12.2019).

³⁵ *Ibid.*

³⁶ Rai, 2017.

MoF has reported that the *Da Afghanistan Bank* (DAB) has issued regulations to govern the informal Money Service Provider (MSP) – *hawala* – sector; however, the majority of *hawaladars* operate without licenses and do not comply with the DAB regulations.³⁷ With little trust in the formal banking system, the *hawala* emerged as the most convenient and reliable system for moving funds in and out of the country.

Hawala, explains Rai, is unlike any formal institution, it is based on mutual trust and an extensive network of family and regional affiliations.³⁸ Such a close-knit community of money exchange dealers or *hawaladars* provide a reliable, timely and cost-effective alternative to the traditional banking and financial establishments which are otherwise perceived as inadequate and corrupt.

3.3. No Thresholds on Funds Transfer

Interviews revealed that there is no limit on the volume of fund transfers the *hawaladars* can transfer; individually or severally. Since the fall of the Taliban regime, the volume of financial flows through the *hawala* system has grown significantly.³⁹ NGOs alone are estimated to have channelled at least US\$200 million in emergency, relief, and development funding through the *hawala* system.⁴⁰ Maimbo's findings also showed that single transactions in excess of US\$500,000, especially between Peshawar in Pakistan and Kabul, were not uncommon. The larger international aid institutions and NGOs have made individual transactions of US\$1,000,000. Because there are limited storage facilities in Kabul for large sums of money, however, the majority of organizations remit funds through the *hawala* system in smaller amounts of US\$100,000 to \$200,000. The smaller organizations regularly remit US\$20,000 to \$30,000 to meet operational expenses. Internally, the funds remitted to the provinces tend to be smaller, ranging from US\$10,000 to \$20,000.

Owing to security concerns, these *hawala* transactions are made only when the regional offices have ready invoices for payment.⁴¹ A journalist interviewed gave an example of the flows of illegal money between local

³⁷ Ministry of Finance “Annual Performance Report” Afghanistan (2015).

³⁸ Rai, 2017.

³⁹ EastWest Institute “Afghan Narcotrafficking. Illicit Financial Flows” *Joint US-Russia Working Group on Afghan Narcotrafficking* (2017).

⁴⁰ Maimbo, 2003.

⁴¹ *Ibid.*

hawala dealers and within the region trading in narcotics. The *hawala* operator in Kandahar offers a diverse range of services: money exchange, transfer of funds, microfinance and limited deposit taking. Their capital base depends both on legal and illegal trade in goods and opium. It was revealed that a drug trafficker would instruct the *hawaladar* to purchase goods on his behalf from the *hawaladar*'s network in the diaspora and import them into the country where the goods would be sold at a profit, thereby integrating the proceeds into the economy.

3.4. Smuggling

According to a confidential assessment of Afghan finances by the International Monetary Fund (IMF) and also reported by Rosenberg,⁴² the Afghan government's financial distress in 2013 was caused by widespread tax evasion and smuggling abetted by government officials and the increasing theft of customs revenues by provincial governors. Government officers interviewed revealed that the discretionary powers enjoyed by custom officials makes them vulnerable to many forms of corruption, from the payment of informal facilitation to permit smuggling of goods, to large scale fraud and other serious criminal activities. Poor infrastructure, lack of automation of customs procedures and informality at the border contributes to smuggling and evading customs due to the lack of transparency and accountability.

3.5. Weak Implementation of Reporting Standards

Weak implementation on the part of state authorities in establishing reporting and controlling standards allows several industries like the telecommunication, extractive and logistics to misappropriate their revenues.

Several large scale misappropriation and under-reporting of revenue across industries such as construction have been found, wherein the political elites consistently report no income. Similarly, the extractive industries from the regions of Badakshan to Nangarhar, for example, pay no royalties or taxes on mining activities for stones such as lapis and emeralds.⁴³

⁴² Rosenberg, 2013.

⁴³ Integrity Watch Afghanistan (2015).

3.6. Absence of Information on Ownership

Tax evasion in Afghanistan also permeates the corporate sector. For example, the now defunct Afghanistan Investment Support Agency (AISA) probed an international logistics firm catering to American soldiers stationed in Afghanistan, which owed a total of \$6 million to the Afghan government in unpaid taxes. The Audit report of SIGAR concluded that almost “43 contractors expanding US government efforts in Afghanistan” were found guilty of tax evasion, where a combined penalty of \$921 million was levied by the Afghan MoF.⁴⁴ According to AfghanZariza, tax evasion by foreign companies in Afghanistan is often associated with the absence of information on operations and ownership. Though a total of 40,000 national and international companies were registered with the then AISA, a large number of firms were still unaccounted for, and thus found it easy to evade taxes.⁴⁵

3.7. Trade in Narcotics

The UNODC reports that trade in narcotics is one of the most prominent sources of funds for illegal money in Afghanistan. The Financial Action Task Force (FATF), an international anti-money-laundering body, has categorized Afghanistan as the origin country of drugs, with Kyrgyzstan and Tajikistan often acting as consumption and transit countries for the drugs to Europe, as well as an intermediary for handling finance.⁴⁶ Consumers in Europe provide the funds back to Afghanistan while Pakistan operates as a consumption country as well as a financial center for drug money. Thompson, who has researched this process and conducted extensive fieldwork in Afghanistan, notes that Dubai operates as a central ‘clearing house’ for many of these transactions.⁴⁷

⁴⁴ SIGAR, “Taxes: Afghan Government Has Levied Nearly a Billion Dollars in Business taxes on Contractors Supporting US Government Efforts in Afghanistan Audit 13-8” (2013). Available online at: <<https://www.sigar.mil/pdf/audits/2013-05-14-audit-13-8.pdf>> (Last accessed: 11.12.2019).

⁴⁵ AfghanZariza (2014).

⁴⁶ FATF, “Improving Global AML/CFT Compliance: On-going process,” (Paris: FATF, 2014). <<http://www.fatfgafi.org/media/fatf/documents/statements/Compliance-14-February-2014.pdf>> (Last accessed: 11.12.2019).

⁴⁷ Edwina Thompson (n.d), “The Nexus of Drug Trafficking and Hawala in Afghanistan”, in Doris Buddenberg and William a Byrd (eds), *‘Afghanistan’s Drug*

FATF also refers to illicit activities of import–export companies registered in China that may transfer funds into Afghanistan, as well as *hawaladars* in Afghanistan controlling import–export companies to transfer money to recipients in China.⁴⁸ This is likely to be part of trade-based money-laundering schemes. Some transactions may show under- or over-invoicing, or simply use fictitious invoices, to avoid customs duties in both countries. This is a way to move illicit payments for drugs out of the country, or they may be used to balance debts between *hawaladars*.⁴⁹

3.8. Corruption

Corruption among the political elites in Afghanistan plays a significant role in earning and transferring illegal money. The prevalence of illegal money is enabled by the central government that is too weak to challenge the decentralized power elites who generate and benefit from it.⁵⁰ Lain *et al* also contend that the private sector tends to play a dual role in earning, acquiring or transferring illegal money. On the one hand, businesses participate in the underground economies by evading taxes or applicable regulations. This is particularly relevant to Afghanistan. On the other hand, private sector actors may knowingly or unknowingly provide opportunities for laundering the proceeds of crime, as in the property sector. In Afghanistan and Pakistan, much of the illicit finance is believed to be invested in Dubai property.⁵¹

Further, administrative bodies, such as customs and tax authorities, and law enforcement agencies, such as the border force and police, play a pivotal role in moving illegal money in most focus countries. Bribery and corruption are particularly prevalent on borders, such as the Afghanistan–Tajikistan border, where it is believed that some border guards, immigration and customs officials are directly engaged in the drug trade.⁵²

Industry: Structure, Functioning, Dynamics, and Implications for Counter-Narcotics Policy, UNODC and World Bank, 155–88.

⁴⁸ FATF (2014).

⁴⁹ *Ibid.*

⁵⁰ Sarah Lain, Haylea Campbell, Anton Moiseienko, Veerle Nouwens and Inês Sofia de Oliveira, “Illicit Financial Flows and Corruption in Asia,” *RUSI Occasional Paper* (2017).

⁵¹ Lain *et al*, Thompson (n.d.) (2017).

⁵² Filippo De Danieli, “Counter-Narcotics Policies in Tajikistan and their Impact on State-Building”, in John Heathershaw and Edmund Herzig (eds), *The*

It was reported by Lain *et al* that bribes are not necessarily seen as a corrupt act in Afghanistan. This was also confirmed by the interviews conducted. Paying a bribe is often the path of least resistance to getting things done. For example, the legal way to get things done on the border with Afghanistan is time consuming and expensive, and paying bribes speeds the process up, although only marginally.⁵³

Pajhwok Afghan News statistics show that since the fiscal year 2015 until May 2017, among every 10 middle level taxpayers, six evade taxes. Some of the taxpayers might have been evading tax while some might have been inactive.⁵⁴ Pajhwok lists administrative corruption, misuse of authority or use of influence, power and lack of awareness about the law as the main reasons behind the non-payment of taxes. Pajhwok's investigations revealed that some business markets owned by members of parliament or people who have close ties with government and tribal elders refused to pay taxes: "Some show them gun bullets and others offer bribe in order not to ask them for tax. They are so powerful that they can challenge our president and minister who according to them cannot ask them for tax".⁵⁵

Previously, the Afghan Business had cited an investigative report by 1TV which claimed that 15 out of 300 major companies in Afghanistan refused to pay taxes. The report claimed that these companies have tried to evade tax by using diplomatic channels and relying upon the NATO command to pressurize the government not to prosecute them.⁵⁶ The companies own a total of USD 7,307,000 in taxes, claims the report. It further adds that a number of foreign private security companies owe the government between USD 4-10mn each in taxes. This comes after the Afghan government accused U.S. military's main food supplier in Afghanistan, Supreme Foodservice GmbH for operating in Afghanistan illegally and refusing to pay taxes to the government. Supreme, on the other hand, says it is not engaging in any commercial activity in Afghanistan that should make it liable for taxes. According to the Large

Transformation of Tajikistan: The Sources of Statehood (Abingdon: Routledge, 2013).

⁵³ Lain *et al*, 2017.

⁵⁴ Zarghona Salehi, "6 in every 10 mid-level taxpayers evade taxes," *Pajhwok Afghan News*. Available online at: <<https://www.pajhwok.com/en/2017/06/05/6-every-10-mid-level-taxpayers-evade-taxes>> (Last accessed: 11.12.2019).

⁵⁵ *Ibid*.

⁵⁶ The Afghan Business (2012).

Taxpayer Office (LTO) officials, Supreme was engaged in 50 contracts in Afghanistan, of which 15 were main contracts and exempted from tax. However, the remaining 35 contracts were subsidiary contacts that made the company eligible for tax payments to the government.⁵⁷

3.9. Insiders

The US Department of State Bureau for International Narcotics and Law Enforcement Affairs reports that in some cases in Afghanistan, there are reports of financial institutions captured by criminal interests. The most well-known example of this is the Kabul Bank scandal, where the bank's founder and its former Chief Executive were sentenced to five years' imprisonment after being convicted of stealing \$810 million from the bank.⁵⁸ Also convicted were a number of the bank's employees, as well as some officials of the DAB and other state institutions.

Funds had been embezzled from the Bank by means of fraudulent insider loans and overpayments for goods and services, with much of the money transferred to Dubai.⁵⁹ President Ghani reopened the investigation into the Kabul Bank fraud by presidential decree two days after his inauguration. He had fought the election on an anti-corruption platform and the case was of symbolic importance, especially since Mahmood Karzai, the brother of Afghanistan's former president, was among the alleged beneficiaries of the fraud.

3.10. Technology

Afghans have been moving money through value transfer services (MVTs) since the eighth century and the system is well established and used in all parts of the country. Its low cost, speed, convenience and accessibility are all factors that ensure that MVTs will continue to be popular, even in urban areas where there are banks.⁶⁰ Although the volume of transactions that pass through the MVTs system in Afghanistan is significant, FinTRACA has only been able to begin registering MVTs operators in 2007. By March 2012, the FinTRACA had

⁵⁷ *Ibid.*

⁵⁸ BBC News, "Kabul Bank Fraud: Ghani Reopens Afghan Corruption Case" (1 October 2014).

⁵⁹ Grant McLeod, *Responding to Corruption and the Kabul Bank Collapse* (Washington, DC: United States Institute of Peace, December 2016).

⁶⁰ FATF, *Hawala and Other Similar Service Providers*, (FATF, Paris, 2013). <www.fatf-gafi.org/topics/methodsandtrends/documents/role-hawalas-in-ml-tf.html> (Last accessed: 11.12.2019)

registered and licensed over 640 MVTs operators that account for about 40% of the total volume of business.⁶¹ As of April 2014, over 1,000 MVTs operators were registered (compared to around 800 operators in the beginning of 2013).

More needs to be done for MVTs to be regulated since the majority of countries identified as consumer markets of Afghan opium, indicate that drug-related money is being transferred via MVTs to Afghanistan through intermediate countries, primarily: Pakistan, Iran, UAE and China. Funds are transferred via the banking system to an intermediate country or countries, which act as 'gateways' for money flows. Another service (mostly MVTs and cash couriers) then facilitates payment into Afghanistan. There are also indications that the majority of funds move from Afghanistan to Dubai, which acts as the region's financial center for most of the legitimate trade.⁶²

3.11. Money Laundering

In 2015, the profits generated by Afghanistan's illicit economy were worth more than \$1 billion. Drug trafficking, smuggling, unregulated trade, and fraud in procurement contracts are encumbering the country's economic development and funding the terrorist groups that undermine its stability. Accordingly, money laundering plays a crucial role in supporting this criminality. Yet over the past decade, the government has not been able to do much to crack down on it and of the many clear cases of the practice that have appeared, only a few have been prosecuted. The problem is a product of several factors, including lax financial and customs controls, inadequate expertise in the Afghan government, high-level opposition to change, and weak enforcement mechanisms.⁶³

3.12. Underground and Informal Economy

Most of the Afghan economic activity is informal, and data provided by the MoF suggest that only 35% of the financial flows within the country are legal. Unregulated cash transactions and remittances through the

⁶¹ Government of the Islamic Republic of Afghanistan at the Paris Pact Expert Working Group Meeting, Vienna, April 2014.

⁶² FATF (2014), Thompson (n.d.).

⁶³ Ahmad Javid, "Dirty Money in Afghanistan" *Foreign Affairs*, 2016; Barfield, Thomas, "Afghanistan: A Cultural and Political History", *South Asia Multidisciplinary Academic Journal* (2011).

country's traditional money transfer system, *hawala*, are the rule.⁶⁴ According to FATF, more than half of all transactions in Afghanistan involve *hawala* brokers.⁶⁵ Ordinary Afghans do not have many other options because although the country's banking sector has grown significantly in recent years, most commercial banks are still concentrated in cities. For many Afghans, *hawala* brokers, whose services often leave no paper trail, provide services that are cheaper and more convenient than their counterparts in the official banking sector.⁶⁶ Drug-related financial flows bear serious consequences for Afghanistan, including activities ranging from funding terrorism and supporting criminal enterprises to nurturing corruption, undermining the rule of law, impeding economic development and depriving the state of desperately needed revenue and resources, among others. Transgressing various division lines, these financial flows bring together in a single network state officials and insurgents, poor farmers and rich landlords, the fighters of competing insurgent groups and residents of competing regional and non-regional states. Thus, they form part of the Afghan and regional underground economy, which remains non-transparent and poorly studied.⁶⁷

4. National and International Initiatives taken to Curb Tax Evasion

Despite these grim statistics on tax evasion practices, Afghanistan has put in place a tax administration and collection structure. It has enacted legislation, regulations and policies on finance, taxation, corporations, banks and financial institutions including the Afghan *hawala* markets and informal sector in order to streamline the Afghan tax system. The government has attempted to put in place international standards to assess the level of tax compliance and tax management. It has striven to ensure the effectiveness of the Afghan revenue authority and its competencies and it has also established the corporate tax structure for various industries such as the telecommunication, construction, trading and extractives sector. In addition, the government has identified the

⁶⁴ Weston Aviles, "Afghanistan Inequality Report" (NSI 2019). Available online at: <https://nsiteam.com/social/wp-content/uploads/2019/10/NSI-Aggrrieved-Populations-Reports_Afghanistan-Country-Report_Final.pdf> (Last accessed: 11.12.2019).

⁶⁵ FAFT, 2014.

⁶⁶ Ahmad, 2016.

⁶⁷ EastWest Institute (2017).

key transactions that corporations in those industries are involved in to assess its tax base. All this is summarized in the next section.

4.1. National Level Initiatives

Almost all state institutions had deteriorated or been distorted in Afghanistan prior to the ousting of the Taliban in 2001. This included the tax system which was fragmented between tribal leaders and state institutions. In order to claim back fiscal legitimacy, the Afghan government began a series of tax reforms. The entry of the international community into Afghanistan also fronted public finance as one of the first institutions to be addressed in the post conflict state.

Some of the first actions included re-establishing and staffing up the MoF, introducing a new tax legislative framework, and building the Afghanistan Revenue Department (ARD) and hence the institutionalization of tax as a means to fund the state and public services.⁶⁸ This had the effect of removing tax collection powers from the tribal leaders.

In building the domestic tax system, the Afghan government introduced a number of simplified taxes, including a turnover tax (Business Receipt Tax or BRT) and withholding tax on wages, rent and contracts. The BRT was considered more feasible than a modern corporate income tax, given the underdeveloped state of the economy and low capacity of the ARD.

The ARD established an official presence in Kabul and Kandahar as well as in other provincial offices (known as *Mastofiats*) around the country reporting to the Director General of Administration.⁶⁹ Following this, the ARD established Large Taxpayer Office (LTO), Medium Taxpayers Office (MTO) and the Small Taxpayer Office (STO) in Kabul and Kandahar. This taxpayer segmentation is meant to assist the ARD provide better services to these taxpayers and encouraging voluntary taxpayer compliance. At the same time, the ARD has trained many staff in audit, taxpayer services, and general tax administration and has installed a

⁶⁸ DFID, “The Strengthening Tax Administration Project (STAP) 2007–2012, Intervention Summary” (2007), DfID, “Strengthening Afghanistan’s Tax Administration System and National and Provincial Levels, Terms of Reference” (2008).

⁶⁹ DFID (2007).

new, commercial off-the-shelf IT tax administration system that supports streamlined processes and procedures.⁷⁰

In order to streamline the tax collection process, the MoF established a Fiscal Policy Unit, which is mostly focused on macroeconomic programmes and medium-term budgeting, but is also responsible for monitoring and reviewing fiscal, including tax, policy and conducting tax analyses and developing tax policy reform recommendations.⁷¹ Following from this, Afghanistan enacted an Income Tax Law in 2009, covering individuals and companies, which is much more consistent with international tax practice. The Afghan government in 2015 also drafted a new Value Added Tax (VAT) law to progressively replace the BRT through the lowering of the VAT registration threshold over time and the Tax Administration Law.

4.2. International Law Initiatives

Afghanistan has taken a number of measures to combat against tax evasion. In 2004, the Afghan state passed the Anti- Money Laundering (AML) and Proceeds of Crime Law, on which the Financial Transactions and Reports Analysis Center of Afghanistan (FinTRACA), a financial intelligence unit (FIU), was established.⁷² Following long delays due to parliamentary inaction, suggesting weak rather than genuine political will, Afghanistan passed new AML/Combating the Financing of Terrorism (CFT) laws in 2014, but the process of implementing regulations and actual enforcement practices remain slow. The notable progress made with this legislation is that money laundering is properly criminalized and adequate provisions regarding the seizure and confiscation of crime proceeds as a result of cross border smuggling, trading in narcotics, corruption through the use of the *hawala* informal market are included.

In order to extract the taxes not paid by various corporations, the Afghan Business reports that a special commission which comprises the MoF, the Ministry of Justice (MoJ) and the Attorney General's Office was formed to resolve disputes with large companies that owe taxes to the

⁷⁰ *Ibid.*

⁷¹ Mark Gallagher, "Building Infrastructure in Post-Conflict Societies", Fiscal Reform and Economic Governance Project, USAID, (2007).

⁷² FinTRACA, "Financial Intelligence Unit" Available online at: <<http://www.fintraca.gov.af/Overview.html>> (Last accessed: 11.12.2019).

Afghan government.⁷³ MoF's then head of treasury department, Gul Maqsood Sabit, had revealed that three large companies owe approximately 15bn AFN in back-taxes to the Afghan government. Sabit said the special commission was formed to settle issues the treasury department had with various companies. According to the official, 10% of the 500 large businesses registered with the Afghan government were alleged to be evading taxes to varying extents. Sabit added that the Ministry is facilitating installment-based payment plans to companies that lack the capacity to pay taxes right away, while those who were refusing to pay taxes due were supposed to face legal action.⁷⁴

Despite these measures that have been put in place, an interview with an agent of a private company revealed that all sorts of cash and other flows take place unmonitored and unchecked due to geography (especially the Afghanistan-Pakistan border), resource constraints, unclear customs rules on dealing with suspicious transactions and the country's porous international borders. The US Department of State Bureau of International Narcotics and Law Enforcement Affairs has also noted that even HKIA does not have proper controls for all passengers and this in turn risks trade-based money laundering.⁷⁵

Despite laws and institutions to control money laundering, terrorism financing and other illicit flows introduced, they are proving ineffective in light of the uncontained underground economy, corruption, porous borders and poor infrastructure. Similarly, Passas pointed out that "new laws drafted with foreign assistance constitute another layer in need of harmonization."⁷⁶ However, efforts to fight financial crime and corruption in the country are inconsistent, *ad hoc*, and discriminatory. The

⁷³ Wadsam, "Special commission formed to resolve Afghanistan's tax collection issues" *The Afghan Business*, July 7, 2015. Available online at: <<https://wadsam.com/afghan-business-news/special-commission-formed-to-resolve-afghanistans-tax-collection-issues-232/>> (Last accessed: 11.12.2019).

⁷⁴ *Ibid.*

⁷⁵ U.S. Department of State Bureau of International Narcotics and Law Enforcement Affairs, "Countries/Jurisdictions of Primary Concern-Afghanistan," (2016). Available online at: <<https://www.state.gov/j/inl/rls/nrcrpt/2016/vol2/253377.htm>> (Last accessed: 11.12.2019).

⁷⁶ Nikos Passas, "Financial intermediaries – Anti-money laundering allies in cash-based societies?" U4 Anti-Corruption Resource Centre, 2016. Available online at: <<http://www.u4.no/publications/financial-intermediaries-anti-money-laundering-allies-in-cash-based-societies>> (Last accessed: 11.12.2019).

normative dissonance resulting from this lack of coordination—along with the judicial exclusion of certain groups, dysfunctional governance, corruption, turmoil and insecurity in the midst of foreign involvement—have given rise to continued drug trafficking and terrorism.”

Overall Afghanistan’s economy has many features commonly associated with a low tax base; such as (i) extremely low level of development; (ii) a large informal sector implying a narrow tax base; (iii) the dominance of tribal leaders; and (iv) capacity constraints hindering the ability of the government to collect taxes and of taxpayers to comply with tax regulations. Revenue mobilization is further complicated by the large opium economy that cannot be taxed directly, the need to consolidate government control throughout the country, and heavy reliance on aid funds that are exempt from taxation.

5. Key Findings and Recommendations

The journalists from Kabul and Kandahar who were interviewed stated that a number of important ministries and institutions either do not view tax evasion as a significant challenge or are unaware of the extent of the problem in the country. Accordingly, raising awareness and training governmental institutions, agencies, and relevant authorities on tax evasion issues and related measures must therefore, be a priority. In addition, the declaration system and money laundering controls for cross-border transportation of currency and bearer negotiable instruments need to be rigorously enforced.

One interviewee referred to the 2013 SIGAR report criticising government’s action of installing bulk currency counters at the HKIA to counter the risk of money laundering and bulk cash smuggling. This interviewee felt that these machines are not used for their intended purposes. According to him, in the case of Very Important Persons (VIPs), the main customs screenings or use of bulk currency counters are completely ignored. Thus, another needed change is the reduction in the limit on the amount of currency persons travelling outside of Afghanistan are required to declare from \$20,000 to \$10,000 was a suggestion the interviewee made.

Given the cash-based nature of Afghanistan’s economy, strict enforcement of the declaration system and anti-money laundering measures along Afghanistan’s porous crossings is critical to curbing tax evasion.

Laws regarding establishing beneficial ownership of corporations have not been implemented and control of legal persons in Afghanistan is opaque. The Afghanistan Central Business Registry (ACBR) of the Ministry of Industries and Commerce (MoIC) should be required to collect information on beneficial ownership of all registered business entities, trusts and foundations. Any organization not fulfilling such requirements of the ACBR should be prohibited from conducting business, opening a bank account or transferring funds within or outside the country, by whatever means. This would reduce instances of tax evasion and provide the government with an accurate register of the owner of corporations liable for tax.

The absence of adequate state structures has led to the misuse of political influence along with the emergence of provincial governors, which facilitates tax collection in their respective regions, increasing the risk of revenue loss.⁷⁷ Unregulated *hawaladars* have not been brought under the ambit of the financial system to track informal transactions through the *hawala* system and to curb tax evasion.

A publicly accessible ‘beneficial owner’ registry would aid in establishing transparency standards for entities in Afghanistan. This registry should publish, but not be limited to, information on the natural persons, related parties, shareholders and stakeholders of legal entities, including companies, trusts or foundations. A registry with details on the account of payments made by a legal entity, the royalties and incentives received, especially for contracts in the extractives sector, and the licensing of assets offered to a legal entity to scrutinize any misreporting on revenues should also be maintained. Furthermore, bringing transparency in foreign aid declaration by donors will discourage companies from escaping their tax obligations and report on activities.

Speaking to government officers in Kabul and Kandahar, it was expressed that it is worth considering ways to leverage *hawala* information nodes and willingness of participants to collaborate with authorities in order to minimize tax evasion. *Hawala*, the government officers explained is a “headache” for controllers and bank compliance officers, but it is also a resource for risk analysis, monitoring, intelligence gathering and investigations. Outreach and good connections within

⁷⁷ Rai, 2017.

hawala networks provide unique and valuable insights into otherwise non-observable shady networks and operations.

According to them, it is a problem but also a solution. The EastWest Institute has also proposed that all international financial centers, that currently serve as major transit points and hubs for cash and other assets flowing out of Afghanistan, should implement policies that enable their own, other countries' and/or international regulating bodies' counter-narcotics financial investigators to audit cash and assets and individuals conducting these transactions in a manner consistent with international AML/CFT standards (e.g. FATF recommendations and best practices guidance).⁷⁸

Further, it recommends that customs, transit and port authorities in Pakistan, Iran and the UAE should develop stronger cooperation with each other, as well as other involved actors, to gather documentation on goods transported to and from Afghanistan and to assemble high-quality trade data on volumes, types of goods and services, values, end use and destination, etc.⁷⁹ This move would help furnish credible information about Afghanistan's trade partners and would facilitate the identification of payment routes and types critical to curb illegal movement of money.

An interview with a freelance journalist in Kabul also revealed that digitalization had the scope to reduce tax evasion, especially if implemented at the border and for self-assessment of tax. The interviewee argued that tribal leaders sometimes bully taxpayers and blackmail government, a modernized tax system would bypass these instances of intermediaries necessary to collect taxes. According to him 'there should be no talk of so-called paper money, if the tax cyst is digitized this would be better for the citizen to be able to hand over his tax at the earliest opportunity'.

Another Kandahar based interviewee also confirmed the hostile approach taken by tribal leaders towards payment of taxes or charges. According to the interviewee "these leaders; both tribal as well as politicians, have been accused of even not paying electricity bills. Electricity bills worth millions of Afs have not been paid by political

⁷⁸ EastWest Institute (2017).

⁷⁹ *Ibid.*

figures. Since they also engage in business, they are foremost in evading customs duties as well”.

Reports prepared by an investigative journalist interviewed showed that tax collection from holding wedding parties, which are by law required to remit 5% of the income received, are not collected by the government. The duty lies with the MTO and corruption plays a significant role in the non-payment of this tax. An interview with an NGO representative also confirmed the high level of corruption within the government that leads to the erosion of the tax base. According to this interviewee, large scale tax evasion occurs within the Customs Department for which private sector companies are largely to blame.

An interviewee representing the private sector in Kabul argued that Afghanistan’s corporate tax rate of 20% was excessively high and recommended a reduced rate of between 2-4% to prevent tax evasion. Another explained that most foreign companies do not pay taxes saying that they pay tax in their own countries. “I believe Afghanistan is an independent country; anyone earning income in Afghanistan should obey Afghanistan’s laws. Currently, the law isn’t implemented on these foreign companies because they have the power. They also pay bribes to reduce the taxable amount”.

An authorized representative of a company from the private sector in Kandahar during the interview discussed how government itself abuses the tax system. According to him “politicians wield their authority to evade tax payment. They import goods illegally and do not pay customs duty”.

Another interviewee from a different company also complained that the lack of punitive laws in punishing against payment of customs has resulted in its wide scale spread. According to him:

Most Afghans don’t have positive opinions about tax. They don’t have positive opinion due to a number of reasons. First reason is lack of confidence in government. For example, I see people and I talk to them and they ask about the 10% tax on telephone credit cards. Since SIM cards aren’t registered, companies have more customers. Due to lack of a proper mechanism, people are doubtful whether the 10% tax goes to the pockets of telecommunication companies or to the account of government to be spend for development. Lack of confidence in government is one of the main reasons. It has many

reasons. Lack of awareness. Afghans have witnessed decades of war and they don't know where the money taken out from their pockets is spent. They should be given awareness. People should be given awareness by the government that the tax they are paying is spent for the future of their kids. People should pay taxes. They should willingly pay taxes. Another reason is the poverty of people. Another reason is existence of corrupt officials among high ranking government officials. For example, *Da Brishna Shirkat* announces on its site that high ranking officials such as MPs don't pay their electricity bills. People think they pay their bills on time while their law makers violate the laws they make. They result in tax evasion and non-payment of taxes.

Accordingly, the proposed recommendations that can be made resulting from the findings are as follow:

- Prevent tribal leaders and others from collecting tax and imposing fees by enacting laws criminalizing such action.
- Digitalize the entire tax structure and require all eligible taxpayers to acquire a mandatory personal identification number for tax purposes and file returns online using the same.
- Attribute criminal liability to corporations for the criminal acts of their employees, agents or those who provide services for or on their behalf in evading customs.
- Remove from office and/or penalize government officials involved in tax evasion, corruption, smuggling and avoiding payment of or providing favor to those evading taxes and customs duty.
- Train the judiciary and law enforcement authorities on money laundering trends and investigations.
- Enhance transparency of beneficial ownership and the control structure of legal persons/organizations.
- Provide support and technical assistance to the DAB by resuming collaboration with the international community.
- Empower and support FinTRACA and other relevant institutions involved in tax policy making and enforcement.
- Increase national coordination and cooperation among relevant ministries, agencies, and authorities to detect, monitor, trace and curb tax evasion.

- Ensure strict compliance with and enforcement of the laws, regulations and circulars against MSPs (*hawaladars*).
- Punitive sanctions on evasion of taxes and customs duty and all other violation of the laws regulating the financial sector.
- Execute agreements for data and information sharing in relation to financial assets and bank accounts of Afghan nationals with countries that are deemed to be safe havens for tax evaders including UAE, Turkey, and Uzbekistan.