

SIGAR

**Special Inspector General for
Afghanistan Reconstruction**

SIGAR 20-22 Audit Report

Afghan Business Taxes: Action Has Been Taken to Address Most Tax Issues, but the Afghan Government Continues to Assess Taxes on Exempt U.S.-Funded Contracts



JANUARY
2020

SIGAR

Special Inspector General for Afghanistan Reconstruction

WHAT SIGAR REVIEWED

Since 2002, Congress has appropriated over \$133 billion to U.S. government agencies, primarily the Department of Defense (DOD), Department of State (State), and the U.S. Agency for International Development (USAID), to implement reconstruction efforts in Afghanistan; contractors continue to play important roles in these efforts. DOD, State, and USAID have negotiated agreements in place with the Afghan government that exempt work performed by U.S. government contractors from certain Afghan business taxes. However, contractors told SIGAR that the Afghan government assessed inappropriate taxes and penalties on work they performed under tax-exempt contracts in Afghanistan.

In May 2013, SIGAR reported that the Afghan Ministry of Finance (MOF) had assessed over \$921 million in business taxes and associated penalties on contractors supporting U.S. government efforts in Afghanistan under tax-exempt contracts from 2002 to 2012. Since then, however, some contractors have stated that these issues persist. On January 24, 2018, the Chairman of the Senate Armed Services Committee requested that SIGAR conduct a follow-up audit of business taxes assessed on U.S. government contractors operating in Afghanistan.

The objectives of this audit were to assess the extent to which (1) the Afghan government has assessed and enforced taxes and penalties on contractors implementing U.S. government contracts in Afghanistan since 2013; (2) DOD, State, and USAID have taken steps to resolve tax-related issues since 2013; and (3) DOD, State, and USAID developed processes to collect information and report to Congress on taxes and penalties the Afghan government has assessed on contractors supporting U.S. government efforts.

January 2020

Afghan Business Taxes: Action Has Been Taken to Address Most Tax Issues, but the Afghan Government Continues to Assess Taxes on Exempt U.S.-Funded Contracts

SIGAR 20-22 AUDIT REPORT

WHAT SIGAR FOUND

SIGAR found that the Afghan government continues to assess taxes and penalties on U.S. government contractors. However, SIGAR could not determine the full extent of the problem due to unresponsive contractors and a lack of supporting documentation. SIGAR surveyed 190 contractors that performed work on U.S. government contracts in Afghanistan from 2013 to 2019. Of the 45 contractors that responded, 29 reported that the Afghan government had assessed taxes on them or that they had experienced tax-related issues. These contractors reported taxation totaling at least \$125.6 million on tax-exempt contracts since 2013. However, only three contractors provided documentation substantiating their claims. SIGAR's analysis of the documentation for the three contractors showed that the Afghan government improperly assessed over \$19.7 million in taxes and penalties on work under exempt contracts. The contractors SIGAR interviewed also reported experiencing other tax-related issues. For example, the Afghan government denied business licenses for contractors that it asserted did not meet their tax requirements, withheld visas from contractors' employees, and assessed financial penalties for lack of or late tax reporting.

To address these tax-related issues, SIGAR's 2013 report made five recommendations and two matters for congressional consideration. DOD, State, and USAID implemented four of the recommendations, and Congress addressed the two matters. As a result of SIGAR's recommendations, DOD, State, and USAID have worked with the Afghan government to address improper taxation and implement new agreements governing the tax status of contractors implementing U.S. government contracts. Despite these steps, however, SIGAR found that challenges with resolving tax issues resulted in continued disputes with the MOF. Several contractors asserted that these disputes have hindered their ability to compete for additional work in Afghanistan.

SIGAR also found that the Afghan government has taken unpredictable actions that threaten improvements made to the business environment since 2013. Specifically, the Afghan government has not uniformly applied the tax law, has adopted impractical requirements for operating in Afghanistan, and has inappropriately held shipments of U.S. Embassy supplies and humanitarian aid at ports of entry to enforce improper tax assessments.

The Consolidated Appropriations Acts for fiscal years 2014 through 2018 require State and USAID to report to Congress any taxes assessed by the Afghan government; the National Defense Authorization Act (NDAA) for Fiscal Year 2014 contained a similar provision for DOD reporting. Both laws required that future funding be withheld when taxes were assessed in violation of applicable agreements. To fulfill these

requirements, DOD, State, and USAID relied on contractors to self-report taxation and related issues. Based on responses from the contractors we surveyed and our analysis of DOD, State, and USAID reports to Congress, we found that contractors do not appear to have fully reported Afghan government tax assessments and related issues to their respective agencies. We found that contractors' self-reporting to U.S. agencies omitted instances of alleged improper taxation and underreported the magnitude of the Afghan government's taxation of contractors supporting U.S. efforts in Afghanistan. In addition, according to the NDAA for Fiscal Year 2014, the requirement for DOD to report to Congress on the Afghan government's taxation of DOD-funded contracts would not apply after the U.S. and Afghan governments signed the Bilateral Security Agreement (BSA), which occurred in 2014 and became effective in 2015. We found that the Afghan government has continued to assess taxes on DOD contractors, and the absence of a reporting requirement for DOD since 2015 has further hindered Congressional oversight of this important issue.

We also found that contractors underreported the amount of taxes assessed on them by the Afghan government. According to DOD, State, and USAID officials, the agencies rely on contractors to self-report instances of Afghan government taxation and tax-related issues. For example, in its 2014 report to Congress, DOD identified limited reporting from contractors of taxation on tax-exempt contracts. Of the 192 companies DOD surveyed, 6 responded, reporting \$83.1 million in taxes assessed and \$6.8 million in taxes paid. State and USAID's reports to Congress for fiscal years 2014 through 2018 did not identify any instances of taxation on tax-exempt contracts in their respective programs. Therefore, in total, the agencies only reported \$83.1 million in potentially improper taxation to Congress from 2014 through 2018. However, the contractors we surveyed identified \$125.6 million in taxes and penalties assessed by the Afghan government since 2013 on contracts across the three agencies. This indicates that the contractors and ultimately the agencies underreported the extent of taxation on U.S. government contracts in Afghanistan. As a result, Congress does not know the full extent to which U.S. assistance in Afghanistan is being taxed.

MATTERS FOR CONGRESSIONAL CONSIDERATION

To ensure that Congress has complete information on taxes assessed by the Afghan government and to address any improper taxation by the Afghan government, Congress may wish to include a provision in future National Defense Authorization Acts that requires DOD to collect information on and fully report all types of taxes and penalties assessed by the Afghan government on contractors implementing DOD contracts in Afghanistan, including contracts funded by the Afghanistan Security Forces Fund.

WHAT SIGAR RECOMMENDS

To ensure that DOD, State, USAID, and Congress are aware of all taxes and penalties the Afghan government has assessed on contractors supporting U.S. government efforts in Afghanistan and are able to take appropriate action to hold the Afghan government accountable to agreements entered into with DOD, State, and USAID, we recommend that the Secretary of Defense, the Secretary of State, and the Administrator of USAID require contractors to annually report any instances of taxation by the Afghan government.

SIGAR received written comments on a draft of this report from the Department of Defense's Office of the Undersecretary for Defense–Acquisition and Sustainment and the Combined Security Transition Command–Afghanistan (CSTC-A), and the USAID Mission for Afghanistan (USAID/Afghanistan). In its comments, DOD concurred with the recommendation. USAID/Afghanistan concurred with the recommendation and requested that it be closed for USAID upon the report's issuance. USAID/Afghanistan asserted that the agency's internal guidance already includes requirements for its contractors to report on instances of taxation. However, SIGAR determined that the language in the agency's guidance is narrow and does not include several types of taxes assessed on contractors supporting U.S. efforts in Afghanistan. Therefore, the recommendation will remain open until USAID expands the guidance to include requirements for all taxes levied by the Afghan government. SIGAR's recommendation remains open for DOD, State, and USAID.



SIGAR

Office of the Special Inspector General
for Afghanistan Reconstruction

January 15, 2020

The Honorable Michael R. Pompeo
Secretary of State

The Honorable Dr. Mark T. Esper
Secretary of Defense

The Honorable Mark Green
Administrator, U.S. Agency for International Development

This report discusses the results of SIGAR's audit of the Afghan government's taxation of contractors implementing U.S. government contracts in Afghanistan. In May 2013, we reported that the Afghan Ministry of Finance (MOF) had assessed over \$921 million in business taxes and associated penalties on contractors supporting U.S. government efforts in Afghanistan under tax-exempt contracts from 2002 to 2012. Since then, several contractors have stated that these issues have persisted. Given these ongoing concerns, in January 2018, Senator James Inhofe, Chairman of the Senate Armed Services Committee, requested that SIGAR conduct a follow up audit on this subject.

We found that since our prior report, the Afghan government has continued to improperly assess taxes and penalties on U.S. contractors. Since 2013, the Department of Defense (DOD), Department of State (State), and the U.S. Agency for International Development (USAID) have taken steps to address Afghan tax issues, but problems remain. Additionally, contractor underreporting of Afghan taxation and the lack of DOD-required reporting restricts the information available to Congress on Afghan taxation.

This report includes one matter for congressional consideration. Congress may wish to include a provision in future National Defense Authorization Acts to require DOD to annually collect information on and report to Congress regarding all types of taxes and penalties the Afghan government assesses on contractors implementing DOD contracts in Afghanistan, including contracts funded by the Afghanistan Security Forces Fund.

In addition, we are making one recommendation. We recommend that the Secretary of Defense, the Secretary of State, and the Administrator of USAID require contractors to annually report any instances of taxation by the Afghan government.

We received written comments on a draft of this report from the Office of the Undersecretary for Defense-Acquisition and Sustainment, the Combined Security Transition Command-Afghanistan (CSTC-A), and the USAID Mission for Afghanistan (USAID/Afghanistan), which are reproduced in appendices V, VI, and VII, respectively. The Department of State's South and Central Asian Affairs and Legal Bureaus, CSTC-A, and USAID/Afghanistan also provided technical comments, which we incorporated as appropriate.

In its comments, DOD concurred with our recommendation. USAID/Afghanistan concurred with the recommendation and requested that it be closed for USAID upon the report's issuance. USAID/Afghanistan asserted that the agency's internal guidance already includes requirements for its contractors to report on instances of taxation. However, we determined that the language in the agency's guidance is narrow and does not include several types of taxes assessed on contractors supporting U.S. efforts in Afghanistan. Therefore, our recommendation will remain open until USAID expands the guidance to include requirements for all taxes levied by the Afghan government.



SIGAR

Office of the Special Inspector General
for Afghanistan Reconstruction

SIGAR conducted this work under the authority of Public Law No. 110-181, as amended, and the Inspector General Act of 1978, as amended; and in accordance with generally accepted government auditing standards.

John F. Sopko
Special Inspector General
for Afghanistan Reconstruction

TABLE OF CONTENTS

Background.....	1
The Afghan Government has Continued to Improperly Assess Taxes and Penalties on U.S. Contractors Since 2013.....	4
DOD, State, and USAID Have Taken Steps to Address Afghan Tax Issues, But Some Tax Issues Remain Unresolved	6
Contractor Underreporting and a Lack of DOD-Required Reporting Limit Information Available to Congress on Afghan Taxation	11
Conclusion.....	13
Matter for Congressional Consideration	13
Recommendation	14
Agency Comments	14
Appendix I - Scope and Methodology	15
Appendix II - Status of Recommendations and Matters for Congressional Consideration From SIGAR's April 2013 Report on Afghan Business Taxes.....	17
Appendix III - Agreements Providing for the Tax Status of Contractors Supporting U.S. Efforts in Afghanistan Since 2002	19
Appendix IV - Examples of Afghan Business Tax Issues Contractors Reported to SIGAR	21
Appendix V - Comments from the Department of Defense Office of the Undersecretary for Defense-Acquisition and Sustainment	22
Appendix VI - Comments from the Combined Security Transition Command-Afghanistan.....	23
Appendix VII - Comments from the U.S. Agency for International Development Mission for Afghanistan	26
Appendix VIII - Acknowledgments	41

TABLES

Table 1 - Business Taxes Outlined in Afghanistan's 2009 Income Tax Law	3
Table 2 - Status of Recommendations and Matters for Congressional Consideration from SIGAR Audit 13-8... 17	
Table 3 - Agreements Providing for the Tax Status of Contractors Supporting U.S. Efforts in Afghanistan Since 2002.....	19
Table 4 - Examples of Tax Issues U.S. Government Contractors Reported to SIGAR	21

ABBREVIATIONS

BSA	bilateral security agreement
CSTC-A	Combined Security Transition Command–Afghanistan
DOD	Department of Defense
INL	International Narcotics and Law Enforcement Affairs
MOF	Ministry of Finance
MOU	memorandum of understanding
NDAA	National Defense Authorization Act
State	Department of State
TTWG	Technical Taxation Working Group
USAID	U.S. Agency for International Development
USAID/Afghanistan	USAID Mission for Afghanistan

Since 2002, Congress has appropriated over \$133 billion to U.S. government agencies, primarily the Department of Defense (DOD), Department of State (State), and the U.S. Agency for International Development (USAID), to implement reconstruction efforts in Afghanistan. These agencies have awarded billions of dollars to contractors to implement programs such as building schools, clinics, electric power stations and transmission lines, and other infrastructure; disrupting the narcotics trade; and training and equipping the Afghan National Defense and Security Forces.¹ DOD, State, and USAID negotiated and subsequently updated agreements with the Afghan government that exempt the work performed on these agencies' contracts from certain Afghan taxes. Despite this, however, contractors told SIGAR that the Afghan government has assessed inappropriate taxes and tax-related penalties on their work performed under tax-exempt contracts in Afghanistan.

In May 2013, we reported that the Afghan Ministry of Finance (MOF) had assessed over \$921 million in business taxes and associated penalties on contractors supporting U.S. government efforts in Afghanistan under tax-exempt contracts from 2002 to 2012.² We found that U.S. agencies and the MOF disagreed on the tax status of subcontractors, U.S. contracting officials did not fully understand the tax environment in Afghanistan, and the agencies lacked a unified approach on the treatment of taxation. Since 2013, several contractors we interviewed stated that these issues have persisted. On January 24, 2018, the Chairman of the Senate Armed Services Committee, Senator James Inhofe, requested that SIGAR conduct a follow up to our 2013 audit of taxes assessed on U.S. government contractors supporting U.S. government efforts in Afghanistan.

The objectives of this audit were to assess the extent to which (1) the Afghan government has assessed and enforced taxes and penalties on contractors implementing U.S. government contracts in Afghanistan since 2013; (2) DOD, State, and USAID have taken steps to resolve tax-related issues since 2013; and (3) DOD, State, and USAID have developed processes to collect information and report to Congress on taxes the Afghan government assessed on contractors supporting U.S. government efforts.

To accomplish these objectives, we requested and reviewed information from DOD, State, and USAID, including lists of contractors operating in Afghanistan since 2013, agency tax-related agreements with the Afghan government, and information on tax exemption processes. We contacted 190 contractors that operated in Afghanistan from January 2013 to April 2019 to request that they complete a questionnaire or interview with us to identify any tax liabilities or tax-related challenges they encountered during this time.³ Additionally, we conducted interviews and requested documentation from tax consultants, international organizations, non-governmental organizations, and U.S. and Afghan government officials to identify issues related to Afghan government taxation practices. We conducted our work in Kabul, Afghanistan, and Arlington, Virginia from April 2018 through October 2019, in accordance with generally accepted government auditing standards. Appendix I contains a more detailed discussion of our scope and methodology.

BACKGROUND

In its 2019 report, *Doing Business*, the World Bank ranked Afghanistan 167th out of 190 countries on enhancing business activity—a ranking based on business regulations and their enforcement.⁴ Furthermore, the World Bank's ranking of tax systems—consisting of its tax rates, laws, and processes—Afghanistan was

¹ For the purpose of this report, we use the term “contract” to refer to any form of contractual agreement, including contracts, cooperative agreements, and grants, between the U.S. government and the entity implementing that agreement, and any subcontracts or other awards under these agreements. The term “contractor” includes any individual, company, or organization hired to implement the contracts.

² SIGAR, *Taxes: Afghan Government Has Levied Nearly a Billion Dollars in Business Taxes on Contractors Supporting U.S. Government Efforts in Afghanistan*, SIGAR Audit 13-8-AR, May 14, 2013, p. 6.

³ As part of our data collection, we provided confidentiality to the contractors who responded to our questionnaire or interview, and do not include their names in this report.

⁴ The World Bank, *Doing Business 2019: Afghanistan*, October 2018, p. 4.

ranked 177th out of 190 countries for enhancing business activity.⁵ A senior Afghan MOF official noted that the Afghan government is working to increase revenue collection to meet international agreements and to fund Afghanistan's national budget. State officials noted the Afghan government is working to meet targets outlined in various agreements, specifically the International Monetary Fund Extended Credit Facility and the Geneva Mutual Accountability Framework.⁶

In our 2013 audit report, we found that the Afghan MOF's application of Afghanistan's 2009 Income Tax Law resulted in it assessing over \$921 million in taxes on contractors supporting U.S. government efforts in Afghanistan and that taxation may have hindered U.S. reconstruction activities.⁷ We also found that contracting agencies erroneously reimbursed contractors for Afghan taxes and had not taken sufficient steps to help contractors obtain tax-exemption certificates. In addition, we found that DOD, State, USAID, and the MOF disagreed on the tax status of subcontractors, and that the agencies lacked a unified approach on the treatment of taxation.

Multiple Agreements Govern the Tax Status of Contractors Operating on U.S. Funded Contracts in Afghanistan

As we reported in 2013, DOD, State, and USAID entered into separate agreements with the Afghan government to establish the tax status of the work contractors perform on behalf of the U.S. government in Afghanistan.⁸ These agreements did not provide a uniform tax status for all work U.S. government contractors perform in Afghanistan, nor did they include a blanket exemption for the contractors from all Afghan taxes. Instead, each agreement contained different language and required different procedures for contractors to gain tax exemptions. Since we issued that report DOD, State, and USAID each entered into new agreements with the Afghan government in an effort to clarify contractors' tax status. See appendix III for a list of the agreements that govern the tax status of contractors supporting DOD, State, and USAID efforts in Afghanistan since 2002.

Tax Law in Afghanistan

In November 2009, the Afghan government adopted the 2009 Income Tax Law to create a unified tax system governing all aspects of the government's revenue collection.⁹ The law contains five primary taxes associated with income earned by all companies operating in Afghanistan:

1. Business receipts tax—a levy on all revenues a company receives in a given year.
2. Corporate income tax—a levy on the profits a company earns annually.
3. Employee withholding tax—a levy on the wages of a company's employees that varies depending on the annual salary of each employee.
4. Contractor withholding tax—a levy on any work performed by, or products purchased from, companies that varies depending on the income and license status of the companies used.

⁵ Officials from the World Bank, State, and the Afghan government noted that these rankings partially result from Afghanistan's burdensome business environment, including regulations, taxation, and their enforcement.

⁶ The IMF Extended Credit Facility "supports countries' economic programs aimed at moving toward a stable and sustainable macroeconomic position consistent with strong and durable poverty reduction and growth." See International Monetary Fund, "IMF Extended Credit Facility," last modified March 5, 2019. The "Geneva Mutual Accountability Framework" represents an updated set of short-term deliverables for the period 2019–2020, and aligns to the overarching national policy framework designed to monitor concrete reform deliverables that support peace and development, reduce poverty, and improve the welfare of the people of Afghanistan. See United Nations Assistance Mission in Afghanistan, Geneva Conference on Afghanistan, "Geneva Mutual Accountability Framework," last modified November 27, 2018.

⁷ SIGAR, Taxes, SIGAR Audit 13-8-AR, p. 6.

⁸ SIGAR, Taxes, SIGAR Audit 13-8-AR, p. 4-5.

⁹ SIGAR, Taxes, SIGAR Audit 13-8-AR, p. 2-3.

5. Rental withholding tax—a levy on landlords of property leased for business use that varies based on the value of the rented property.

Table 1 provides an overview of the business taxes described in the 2009 Income Tax Law.

Table 1 - Business Taxes Outlined in Afghanistan’s 2009 Income Tax Law

Tax	Liability	Responsible Payer
Business Receipts Tax	<u>Based on industry and revenues</u>	Business must remit payment within 15 days after the end of the quarter
	Quarterly revenue < 750,000 Afs*: no tax due Quarterly revenue > 750,000 Afs: 2 percent of quarterly revenue, with special provisions for airline, hospitality, and telecommunications companies	
Annual Corporate Income Tax	<u>Annual flat tax</u>	Business must remit payment within 3 months of the end of the year
	20 percent of profits after deduction of allowable expenses	
Employee Tax Withholding	<u>Based on monthly employee wage</u>	Employer must remit withholding within 10 days after the end of the month of payment
	0 Afs - 5,000 Afs: no withholding	
	5,001 Afs - 12,500 Afs: 2 percent withholding	
	12,501 Afs - 100,000 Afs: 10 percent withholding plus 150 Afs fixed amount > 100,000 Afs: 20 percent withholding plus 8,900 Afs fixed amount	
Contractor Tax Withholding	<u>Based on annual value of payments to contractors</u>	Employing contractor must remit withholding within 10 days after the end of the month of payment
	Payments to a single contractor ≥ 500,000 Afs with a valid business license: 2 percent withholding Payments to a single contractor ≥ 500,000 Afs without a valid business license: 7 percent withholding of the gross amount payable to the contractor in lieu of income tax	
Rental Tax Withholding	<u>Based on rental cost</u>	Tenant must remit withholding within 15 days after the end of the month of payment
	0 Afs - 10,000 Afs: no withholding tax	
	10,000 Afs - 100,000 Afs: 10 percent withholding >100,000 Afs: 15 percent withholding	

Source: SIGAR analysis of the 2009 Afghan Income Tax Law.

*Note: “Afs” is the abbreviation of Afghanistan’s currency, the afghani.

In addition to defining the types of taxes, the 2009 Income Tax Law also established penalties for non-compliance. These penalties were amended in October 2018 to include the following:

- A 0.05 percent penalty, reduced from 0.1 percent, for each day that a tax payment is past due, with the penalty amount capped at 100 percent of unpaid tax amount;
- A 50 afghani penalty, reduced from 100 afghani, for each day past the due date that a tax return is not filed;
- 100 percent penalty, reduced from 200 percent, of the tax liability if a company is found to be evading taxes;

- A penalty adding a taxpayer to the no fly list for a tax liability exceeding 500,000 afghani that is at least 30 days overdue;
- A reduction from 100 percent to 30 percent of the tax assessed, to be paid prior to the initiation of a tax dispute.

The Afghan tax law requires each contractor to calculate its own tax liability and pay the Afghan government applicable taxes. According to MOF officials, contractors are responsible for withholding the taxes of their Afghan employees, subcontractors, landlords, and vendors even if the company itself is tax-exempt. For example, a tax-exempt DOD contractor can be held liable for a subcontractor failing to pay taxes to the MOF. The law also establishes reporting requirements for contractors operating in Afghanistan.

The MOF's Afghanistan Revenue Department is responsible for implementing the 2009 Income Tax Law and overseeing the tax process. The department has provincial offices, as well as three national tax offices—the Large, Medium, and Small Taxpayers Offices. The 2009 law requires that contractors file the necessary tax paperwork, in person, with their assigned Afghan tax office on a monthly, quarterly, and annual basis.

The process for filing taxes in Afghanistan has remained largely unchanged since our 2013 report. Contractors are still required to

- file a tax return to report income, tax withholding, and other financial information;
- maintain and present receipts, expenses, and disbursements to the MOF to determine their net income;
- file and pay a business receipts tax based on the value of their contracts;
- withhold taxes from their employees' salaries; and
- submit salary and employee withholding tax statements for each employee to the MOF.

After contractors file their tax returns, the MOF attempts to verify whether the information provided on the return correctly calculates the amount of tax due. If the MOF determines that the amount reported is incorrect, it calculates the amount due and issues an amended tax assessment to the contractor. Similarly, if a contractor has not prepared and filed a tax return as required, the MOF calculates the tax and any applicable penalties and issues an amended assessment.

Additionally, the Afghan government requires contractors to obtain a business license to operate in Afghanistan.¹⁰ To renew a business license, which is valid for 3 years, the contractor has to obtain a tax clearance letter from the MOF before submitting the license renewal application to the Afghanistan Investment Support Agency or the Ministry of Commerce and Industry.

THE AFGHAN GOVERNMENT HAS CONTINUED TO IMPROPERLY ASSESS TAXES AND PENALTIES ON U.S. CONTRACTORS SINCE 2013

In May 2013, we reported that the Afghan MOF had assessed over \$921 million in business taxes and associated penalties on contractors supporting U.S. government efforts in Afghanistan under tax-exempt

¹⁰ Government of Afghanistan, Embassy Afghanistan, Washington, DC, "Resource Guide," accessed November 12, 2019, <https://www.afghanembassy.us/business-investment/resource-guide/>. The Afghan Embassy website lists a five-step process for U.S. companies to register for business in Afghanistan. It includes: (1) being licensed and in good standing in the U.S.; (2) providing documentation of being licensed and in good standing in the U.S. to the Embassy of Afghanistan; (3) submission of U.S. business license, IRS tax number, and passports of key company officials for issuance of a referral letter from the U.S. Embassy in Kabul to the Afghan Ministry of Foreign Affairs; (4) delivery of physical documents (U.S. Embassy Kabul referral letter and "all relevant documents" to Ministry of Foreign Affairs in Kabul, which will then issue a final referral letter either to the Afghanistan Investment Support Agency or the Ministry of Commerce & Industry depending on the nature of the company's work; and (5) bring all of this documentation to either the Afghanistan Investment Support Agency or the Ministry of Commerce and Industry for issuance of a business license.

contracts.¹¹ More than six years later, contractors have reported to us that the Afghan government has continued to improperly assess taxes and penalties on the work contractors performed on tax-exempt contracts. Contractors also reported to us that in an attempt to force them to pay the improperly assessed taxes, the Afghan government has impeded contractors' operations by delaying the issuance of tax exemption and tax clearance letters, denying business licenses and visas, and imposing financial penalties for failing to file tax documentation on time or to pay past taxes.

To substantiate these claims, we surveyed 190 contractors that conducted work on U.S. government-funded contracts in Afghanistan since 2013. Forty-five contractors responded to our survey, with 29 indicating they had or continue to have tax issues. These contractors estimated that they had been improperly assessed over \$125 million in taxes by the Afghan government since 2013. However only three of these contractors provided us with documentation to support their claims of improper Afghan government taxation. Therefore, we were only able to substantiate \$19.7 million in improper taxes and penalties assessed on only three contractors.¹²

Contractors Reported Continued Taxation by the Afghan Government, but Provided Limited Documentation to Substantiate Their Claims

To determine the extent to which the Afghan government continued to assess taxes on tax-exempt U.S. government contracts, we surveyed 190 contractors that had performed work on U.S. government contracts in Afghanistan since 2013. We conducted this survey through both interviews and an online questionnaire. We received only 45 responses, despite multiple attempts to contact all of the contractors.¹³ Of those 45 contractors, 29 reported that they had been taxed by the Afghan government or had experienced tax-related issues since 2013, 25 of which reported taxation on tax-exempt contracts totaling at least \$125.6 million since 2013.¹⁴ However, only 3 of the 25 contractors provided us with documentation of that taxation. Our analysis of this documentation showed that the Afghan government improperly assessed \$19.7 million in taxes and penalties on those three contractors. Due to contractors' overall low response rate and limited corroborating documentation, we could not determine the full magnitude or legitimacy of the taxes assessed by the Afghan government on contractors supporting U.S. government efforts.

The Afghan Government Has Denied Business License Renewals, Withheld Visas, and Issued Financial Penalties to Enforce Compliance with Tax Assessments

According to U.S. Embassy officials and contractors, the Afghan tax system links business licensing and taxation requirements together, while the U.S. tax system separates these processes, which has caused some challenges for contractors operating in Afghanistan. As a result, according to several contractors, the Afghan government has delayed or denied business licenses for contractors that it asserts did not meet Afghan tax requirements. In addition, several contractors said Afghan officials withheld visas from contractors' employees and used financial penalties to enforce tax requirements.

¹¹ SIGAR, Taxes, SIGAR Audit 13-8-AR, p. 6.

¹² We calculated the \$19.7 million in taxation by the Afghan government using contractor-provided documentation of tax assessments from the Afghan government and payments to the Afghan government. DOD, State, USAID, and the Afghan government did not validate this figure.

¹³ Seventy-two companies responded to our request for information as part of our 2013 audit report, of which 43 provided data on taxation by the Afghan government. See, SIGAR, Taxes, SIGAR Audit 13-8-AR, p. 18.

¹⁴ For the purposes of this audit, we defined the term "taxation" as a combination of business taxes and penalties assessed as reported by contractors implementing tax-exempt contracts for DOD, State, and USAID. Some contractors' legal and tax consultants responded on behalf of their clients. The respondents held contracts with DOD, State, and USAID, but did not break down their self-reporting on a contract-by-contract basis. As a result, we could not identify the amount of taxation on each agency's contracts. For examples of some of the tax-related issues contractors reported, see appendix IV.

Denied Business License Renewals and Withheld Visas

Contractors we spoke with identified delays with the Afghan government in renewing their business licenses and, in some cases, an inability to renew their licenses at all until the taxes and penalties the MOF assessed were resolved.¹⁵ According to Afghan tax law, contractors seeking to renew a business license must complete all reporting requirements and resolve all outstanding tax assessments before the MOF will issue the tax clearance letter to the contractor required to renew a business license. According to several contractors and their tax representatives, the process to obtain the tax clearance letter can be time consuming and inconsistent between renewals. For example, two contractors told us this process took 6 to 8 months to complete, thereby delaying their new licenses and preventing them from competing for new contracts. In addition, the information the Afghan government requires from a contractor for renewal of a business license and the time it takes for renewal can be inconsistent.

Three contractors we surveyed told us that since 2013, the Afghan government delayed some of their employees' visas due to tax-related issues. Further, one contractor stated that in 2015, the Afghan government threatened to withhold its employees' visas and add them to a no-fly list if the contractor did not pay a tax assessment on a tax-exempt contract. An Afghan tax consultant we interviewed in September 2018 told us that the lack of a valid business license could result in a contractor's inability to renew its employees' work visas.

Financial Penalties

Afghanistan's 2009 Income Tax Law provides that contractors that fail to pay tax assessments or submit required tax reports in a timely manner will incur financial penalties. According to a senior MOF tax official from the Medium Taxpayers' Office, the office has assessed penalties on contractors that collected no revenue or operated only on tax-exempt contracts because they failed to file required paperwork. For example, a contractor that operated under one tax-exempt contract from 2014 to 2015 reported having penalties assessed for not meeting its reporting requirements. Another contractor had taxes assessed in 2016 for tax-exempt work it conducted from 2011 to 2013. The contractor stated that although the Afghan government ultimately waived these taxes, it still had to pay penalties on the improperly taxed amounts.¹⁶

DOD, STATE, AND USAID HAVE TAKEN STEPS TO ADDRESS AFGHAN TAX ISSUES, BUT SOME TAX ISSUES REMAIN UNRESOLVED

In 2013, we reported that the Afghan government assessed taxes and penalties on contractors conducting work under tax-exempt U.S. government contracts.¹⁷ We found that U.S. agencies and the MOF disagreed on the tax status of subcontractors, U.S. contracting officials did not fully understand the tax environment in Afghanistan, and U.S. agencies lacked a unified approach to addressing taxation. During our 2013 audit, U.S. officials stated that they were working with the Afghan government to address ongoing tax-related issues and implement our recommendations. Since 2013, U.S. and Afghan government officials have entered into new agreements and developed new procedures to help address tax-related issues. However, some challenges remain.

DOD, State, and USAID Actions Taken since 2013 to Address Afghan Tax Issues

In our 2013 report, we made five recommendations and provided two matters for congressional consideration to address tax-related issues. DOD, State, and USAID implemented four of the recommendations, and Congress

¹⁵ In its comments on a draft of this report, USAID/Afghanistan noted that USAID assists its contractors by providing tax-exemption letters to the MOF, consistent with USAID's agreements with the Afghan government. Additionally, the mission said, "USAID is not aware of any delays in the issuance of tax-exemptions as a result of their actions or inactions."

¹⁶ Neither contractor provided us with documentation showing the amount of taxes and penalties assessed by the Afghan government.

¹⁷ SIGAR, Taxes, SIGAR Audit 13-8-AR.

addressed the two matters for consideration.¹⁸ See appendix II for a list of the recommendations and matters for consideration, including status, as well as agencies' responses. As a result of our recommendations, DOD, State, and USAID worked with the Afghan government to address improper taxation and implement new agreements governing the tax status of contractors implementing U.S. government contracts.

DOD Efforts to Address Afghan Tax Issues

DOD has made efforts to clarify differences in agreements on the tax status of certain contractors; resolve tax assessments incurred prior to the 2015 Bilateral Security Agreement (BSA); and simplify the tax exemption process with the Afghan Government. The BSA between DOD and the Afghan government, which was signed in September 2014, and went into effect on January 1, 2015, establishes tax exemption. It states, "United States contractors shall not be liable to pay any tax or similar or related charges assessed by the Government of Afghanistan...on their activities and associated income, relating to or on behalf of United States forces under a contract or subcontract with or in support of United States forces."¹⁹

The BSA required representatives from DOD and the U.S. Embassy in Kabul to form a joint commission with the Afghan government to oversee the agreement's implementation. The BSA stated that the joint commission would establish procedures and working groups to manage implementation. Regarding taxation, the joint commission formed the Technical Taxation Working Group (TTWG) to address issues for U.S. government contractors such as disputed taxes, penalties assessed, and delayed and denied visas and business licenses. The TTWG is comprised of officials from DOD's Combined Security Transition Command-Afghanistan (CSTC-A), State, USAID, NATO Resolute Support's International Customs Coordination Cell, and the MOF's Afghanistan Revenue Department.²⁰ The TTWG does not address individual contract disputes over Afghan taxation on an individual contract or contractor. Instead, it monitors these issues and seeks to address them at an intergovernmental level, working to address Afghan taxation issues resulting from lacking or unclear policies and procedures.

One ongoing point of contention between DOD and the Afghan government since 2013 has been the status of so-called "legacy taxes;" that is, taxes contractors incurred before the 2015 BSA went into effect. Because the BSA did not specifically address legacy taxes or their associated penalties, CSTC-A and the MOF signed a memorandum of understanding (MOU) in 2016 that required the Afghan government to stop collecting these taxes as a condition for receiving \$52 million from CSTC-A to pay outstanding Ministry of Interior food bills.²¹ However, multiple contractors identified tax issues that persisted following the MOU which resulted in several more years of disputes with the MOF. Some contractors noted the inability to compete for work in Afghanistan due to disputes over legacy taxes and the inability to renew a business license until those taxes were resolved with the Afghan government.

¹⁸ State has not implemented SIGAR 13-8-AR's closed recommendation to "develop a consistent, unified position on what the U.S. government deems appropriate taxation of contractors supporting U.S. government efforts in Afghanistan; incorporate clear and complete language concerning this position into future bilateral agreements with the Afghan government; communicate this position to all contractors; and ensure that any taxes assessed by the Afghan government are accurately reported to Congress."

¹⁹ Security and Defense Cooperation Agreement between the United States of America and Islamic Republic of Afghanistan, Article 17 Taxation, Section 3, September 30, 2014.

²⁰ In its comments on a draft of this report, USAID/Afghanistan said, "Although USAID is a member of, and has participated in, the TTWG, USAID would like to clarify that the TTWG is not the sole or even primary means through which we engage with Afghan authorities with respect to taxation. USAID's staff have [sic] relevant contacts among the Afghan officials responsible for taxation and customs matters. As issues arise from time to time, USAID's team in Kabul engage [sic] directly with Afghan officials to resolve or clarify specific matters on behalf of our partners and programs."

²¹ The MOU states, "CSTC-A is committed to assisting the Government of the Islamic Republic of Afghanistan (GIROA) build and sustain the Afghanistan National Defense and Security Forces (ANDSF). To meet this objective, CSTC-A intends to assist GIROA with its request for funds to the Ministry of Interior (MOI) in order for the MOI to pay its overdue food bills from Fiscal Years 2012, 2013, and 2014...In addition to resolution of these overdue food bills, GIROA understands the importance of resolving the so-called 'Legacy Taxation' issues. GIROA further understands that any payments for overdue food bills are to be preconditioned on resolution of these Legacy Taxation issues."

Procedural issues associated with receiving tax clearance confirmation from DOD contracting officials and difficulties verifying the tax-exempt status of contractors compounded challenges associated with remedying improper legacy tax assessments. For example, one contractor acquired several companies with outstanding legacy taxes, but has been unable to receive tax-exempt status with the Afghan government because DOD contracting officials did not provide the tax-exempt status verification documents.²² Without DOD contracting officials certifying that the four contracts were tax-exempt, the Afghan government treated the contracts as taxable.²³

CSTC-A and the MOF modified the MOU in 2017 to develop a process for verifying the tax-exempt status of DOD contractors. Officials from CSTC-A, the MOF, and the NATO Resolute Support's International Agreements Branch developed a procedure, referred to as the "streamlined procedure," to assist contractors with verifying their tax-exempt status and resolving legacy tax issues for activities performed prior to signing the 2015 BSA.²⁴ In October 2018, the senior CSTC-A Resource Management Finance official told us that CSTC-A determined that the Afghan government had met the terms of the MOU addressing legacy tax issues. According to CSTC-A officials, they monitored the Afghan government's efforts to comply with the 2016 MOU and the 2017 modification, determined that the Afghan government met the terms, and paid the \$52 million for the outstanding Ministry of Interior food bills.

In addition to its efforts to resolve legacy taxes, DOD has worked to simplify the tax exemption process. The 2015 BSA requires contractors to obtain tax exemptions on a contract-by-contract basis. Similarly, the Afghan government requires verification of a contractor's tax-exempt status for each U.S. government contract. To simplify the tax exemption verification process, in 2018, DOD developed and then required its contractors to use a one-page form to document and submit all pertinent contract information—such as the contract number, amount, and period of performance—to the MOF, replacing the prior practice of contractors providing a copy of the full contract. In 2018, the MOF began accepting DOD's one-page form to verify contractors' tax-exempt status.

State and USAID Efforts to Address Afghan Tax Issues

The U.S. Embassy in Kabul's Economic Section negotiates with the Afghan government the policies and procedures the government requires for contractors to properly register and receive tax-exempt status for work on U.S. government contracts. State officials in the Economic Section represent State on the TTWG and typically address any tax-related issues on behalf of DOD and USAID, as necessary. However, USAID stated that it relies on its own approach and process for USAID contractors to receive tax exemption, adding that the agency has not had many tax-related issues.²⁵ According to State and USAID officials, the "1951 Point Four General Agreement for Technical Cooperation" and "1954 Amendment of Duty-Free Entry Agreement" agreements governed foreign assistance in Afghanistan prior to 2002. These agreements still apply to the tax status of contracts for State and USAID programs. State and USAID have also entered into new agreements with the Afghan government between 2002 and 2018.

²² In total, the contractor acquired seven companies with nine DOD contracts. The contractor said it was experiencing issues obtaining tax exemption letters from DOD contracting officials. We selected four of the contracts for review. The Army Contracting Command administered all four contracts.

²³ According to the acquiring company, the Afghan government assessed \$15 million in taxes on these contracts. However, the acquiring company did not provide documentation of the taxes assessed by the Afghan government. Further, a company official told us that in order to receive tax clearance necessary to operate in Afghanistan without the tax clearance documentation from the DOD contracting office, the alternative is to pay the tax assessment, despite the past contracts' being tax-exempt. The company official said they are considering paying the tax assessment to operate in Afghanistan.

²⁴ The Resolute Support International Agreements Branch provides contract-specific verification of tax-exemption for DOD and NATO contractors.

²⁵ Similarly, we reported in 2013 that the Afghan government had assessed contractors supporting USAID efforts in Afghanistan less than \$5.5 million of the total \$921.4 million assessed on U.S. government contractors by the Afghan government. See, SIGAR, Taxes, SIGAR Audit 13-8-AR, p. 6.

In addition to working with the Afghan government, State and USAID officials coordinate with their contractors to make them aware of the tax requirements associated with operating in Afghanistan. According to contracting officials at USAID and State's Bureau of International Narcotics and Law Enforcement Affairs (INL), they provide information on taxation and operations in Afghanistan to contractors after a contract is awarded. USAID officials noted that in addition to providing this guidance and having regular meetings with contractors following contract award, they advise that upon receiving an award, contractors should obtain independent local representation for advice relating to the legal and tax environment in Afghanistan.

Additionally, according to State officials, from 2012 to 2018, existing tax exemption agreements did not cover some of State's programs, such as the Conventional Weapons Destruction and Anti-terrorism Assistance programs.²⁶ Initially, contracts for the Conventional Weapons Destruction and Anti-terrorism Assistance programs only provided goods to the Afghan government, and State had a tax exemption agreement in place that specifically exempted the importation of goods from Afghan taxes. State officials said the programs' efforts shifted in 2012, when the programs started providing services. However, State did not have an agreement with the Afghan government that provided tax-exempt status for services provided under these programs. As a result, the Afghan government legally taxed work conducted under these programs for 6 years.

In July 2018 State and the Afghan MOF entered into an agreement to provide tax-exempt status to various State economic, technical, and humanitarian assistance in Afghanistan, including those not previously covered by other agreements. However, officials with the Economic Section told us that MOF legal advisors consider the *2018 Agreement between the Government of the United States of America and Afghanistan Regarding the Provision of Tax Exemptions for Assistance* to be a treaty that requires ratification by the Afghan Parliament, which the Parliament has not done. Because of this interpretation, the Afghan government has not fully implemented the agreement, and contractors are still legally subject to Afghan taxation on these U.S. government contracts. According to a State Economic Officer at the U.S. Embassy in Kabul, the Afghan government's interpretation is incorrect because the agreement clearly states that it would take effect upon signing and be retroactively applied to June 1, 2018. U.S. Embassy officials told us that they continuously raise this concern and work with the Afghan government to fully implement the agreement; however, as of April 2019, the issue remains unresolved.

Afghan Government Efforts to Address Afghan Tax Issues

The Afghan government has implemented improvements to the tax process, including

- streamlining processes for contractors to receive tax-exemption by using standardized forms;
- introducing electronic tax forms and some electronic filing;
- establishing a phone number for contractors to call with tax questions;
- capping the maximum amount of penalties; and
- introducing and using a tax administration system known as the Standard Integrated Government Tax Administration System, or SIGTAS.

An official at the U.S. Embassy in Kabul noted that the MOF was willing to work with the U.S. government to resolve tax issues. However, the MOF was bound to uphold the filing and reporting procedures for taxes established in Afghan law, and that in some cases, contractors had to pay financial penalties for failing to meet these requirements.

²⁶ The Office of Weapons Removal and Abatement in State's Bureau of Political-Military Affairs works to deliver programs and services aimed at reducing the harmful effects of at-risk, illicitly proliferated, and indiscriminately used conventional weapons of war. The office implements the Conventional Weapons Destruction program, which helps foreign governments destroy excess stockpiles of conventional arms, better secure the stockpiles they retain, and clear landmines and unexploded ordinance. State's Bureau of Diplomatic Security's Anti-terrorism Assistance program serves as the primary provider of U.S. government antiterrorism training and equipment to law enforcement agencies of partner nations throughout the world.

Differing Interpretations of the 2015 Bilateral Security Agreement and Unpredictable Actions by the Afghan Government Threaten Improvements

Despite efforts to improve processes for contractors to obtain appropriate tax-exemption, differing interpretations of the BSA between the U.S. and Afghan governments and the unpredictable nature of the Afghan tax environment have continued to present challenges for contractors supporting U.S. efforts in the country. We reported in 2013 that U.S. and MOF officials disagreed about the tax-exempt status of subcontractors. MOF officials asserted that the DOD and State INL agreements provided tax-exempt status only to prime contractors, and not subcontractors, whereas U.S. government officials contended that the agreements provided tax exemption for all non-Afghan companies, both prime and subcontractors, supporting U.S. government efforts.²⁷ According to a State Economic Officer involved with negotiating the 2015 BSA, DOD intended for the agreement to settle the ongoing dispute pertaining to the tax status of subcontractors. The BSA states that

United States contractors shall not be liable to pay any tax or similar or related charges assessed by the Government of Afghanistan within the territory of Afghanistan on their activities, and associated income, relating to or on behalf of United States forces under a contract or subcontract with or in support of United States forces.²⁸

Despite the language in the BSA, the U.S. and Afghan governments continued to disagree in their interpretations of it. Following the signing of the BSA, the Afghan government asserted that tax exemption only applied to prime contractors, thus excluding subcontractors from the tax-exemption established in the agreement. According to a State Economic Officer at the U.S. Embassy in Kabul, the Afghan government recognized this difference in interpretation of the BSA after a series of negotiations that occurred through the TTWG. In May 2018, the MOF approved the use of the streamlined procedure that includes both prime and subcontractors as tax-exempt under the agreement.

However, the Afghan government has taken unpredictable actions that have threatened improvements made to the business environment since 2013. Specifically, the Afghan government has not uniformly applied the tax law, has adopted impractical requirements for operating in Afghanistan, and has improperly held shipments of U.S. Embassy supplies and humanitarian aid at ports of entry to enforce unfounded tax assessments. The following examples from 2018 and 2019 demonstrate these issues:

- In August 2018, the President of Afghanistan issued a decree that required contractors to obtain an additional letter of referral to obtain a business license, this one from the commerce department of the contractor's national government. According to officials at the U.S. Embassy in Kabul, this action would have prevented all U.S.-based contractors from receiving business licenses to operate in Afghanistan because the Department of Commerce does not produce referral letters. U.S. Embassy officials worked with Afghan government officials to make them aware of the new language, identify the ramifications of the language, and monitor revisions of the decree. The Afghan President rescinded the decree in November 2018.
- In January 2019, Afghan government officials held humanitarian aid shipments at the country's entry points, alleging that the contractors importing the goods owed taxes. U.S. Embassy officials disagreed and asserted that these shipments were being imported under tax-exempt contracts. As of January 2020, the issue remains unresolved.
- In August 2018, January 2019, and February 2019, tax consultants representing U.S. contractors raised concerns to State about the Afghan government imposing dividend withholding taxes on tax-

²⁷ SIGAR, Taxes, SIGAR Audit 13-8-AR.

²⁸ Security and Defense Cooperation Agreement between the United States of America and Islamic Republic of Afghanistan, Article 17 Taxation, Section 3, September 30, 2014.

exempt contractors, despite prior Afghan court rulings exempting tax-exempt contracts from this tax.²⁹ We received documentation that in one instance, a tax-exempt DOD contractor was assessed \$94,736 in dividend taxes, despite having filed all necessary tax clearance documentation with the MOF.

- In April 2019, USAID officials told us the Afghan government requested that a contractor importing goods into the country pay business receipts tax at the point of entry, regardless of its tax status. In its comments on a draft of this report, USAID/Afghanistan said, “USAID subsequently worked with the contractor and the Afghan Government to resolve the issue, and the contractor paid no taxes at the point of entry.”

In addition to these issues, contractors told us they still have concerns that the Afghan government is now attempting to impose vendor taxes on insurance providers for U.S. government contractors.³⁰ According to contractors, consultants, and U.S. officials, these types of issues occur infrequently. However, the Afghan government inconsistently applies vendor taxes. Although State officials at the U.S. Embassy in Kabul are aware of the practice, they have not formally engaged with the Afghan government on the application of vendor taxes on insurance providers. Some contractors expressed concern that a lack of formal engagement would make it possible for the MOF to regularly assess taxes on insurance vendors.

CONTRACTOR UNDERREPORTING AND A LACK OF DOD-REQUIRED REPORTING LIMIT INFORMATION AVAILABLE TO CONGRESS ON AFGHAN TAXATION

The Consolidated Appropriations Acts for fiscal years 2014 through 2018 require State and USAID to report to Congress any taxes assessed by the Afghan government; the National Defense Authorization Act (NDAA) for Fiscal Year 2014 contained a similar provision for DOD reporting. To fulfill these requirements, DOD, State, and USAID relied on contractors to self-report taxation and related issues. Based on responses from the contractors we surveyed and our analysis of DOD, State, and USAID reports to Congress, we concluded that contractors did not appear to fully report Afghan government tax assessments or tax-related issues to their respective contracting agencies. We found that contractor self-reporting omitted instances of alleged improper taxation and underreported the magnitude of the Afghan government’s taxation of contractors supporting U.S. efforts. In addition, according to the NDAA for Fiscal Year 2014, the requirement for DOD to report to Congress on the Afghan government’s taxation of DOD-funded contracts would not apply after the U.S. and Afghan governments signed the BSA, which took effect in 2015. We found that the Afghan government has continued to assess taxes on DOD contractors, and the absence of a reporting requirement for DOD since 2015 has further hindered Congressional oversight of this important issue.

Contractors Have Underreported Afghan Government Taxation to U.S. Agencies, Limiting Congressional Oversight

As part of its work to monitor U.S.-funded efforts in Afghanistan and based in part on our 2013 recommendations, Congress passed several pieces of legislation since FY 2014 that requires U.S. agencies to report taxes assessed by the Afghan government on U.S. government contractors in the country. The Consolidated Appropriations Acts for fiscal years 2014 through 2018 required State and USAID to report to

²⁹ According to the Afghan Income Tax Law, a dividend “means any distribution by a company in money or in property and any benefit provided to shareholders in their capacity as shareholders including: (1) any tangible or intangible assets; (2) shares in the company; (3) discounts on any purchases from the company; (4) loans to shareholders; and (5) the use of any property of a company.”

³⁰ The vendor tax also is referred to as a contractor withholding tax. According to U.S. Embassy Kabul officials and Afghanistan-based tax consultants, the MOF is attempting to assess taxes on insurance companies that provide insurance for contractors operating in Afghanistan, asserting that the service provided is in Afghanistan and therefore subject to Afghan taxes. U.S. Federal law requires all U.S. government contractors and subcontractors to secure workers’ compensation insurance for their employees working overseas.

Congress any taxes assessed by foreign governments, such as the Afghan government, on U.S. foreign assistance.³¹ The laws also prohibited State and USAID from providing foreign assistance unless there was a tax-exemption agreement with the recipient government.³² Additionally, section 1216 of the NDAA for Fiscal Year 2014 required DOD to “report on the total taxes assessed during fiscal year 2013 by the Government of Afghanistan on all Department of Defense assistance.”³³ The Consolidated Appropriations Acts and NDAA require that future funding be withheld when taxes are assessed in violation of applicable agreements.

We found that contractors underreported the amount of taxes assessed on them by the Afghan government. According to DOD, State, and USAID officials, the agencies rely on contractors to report instances of Afghan government taxation and related issues. For example, in its 2014 report to Congress, DOD identified limited reporting from contractors of taxation on tax-exempt contracts. Of the 192 companies DOD surveyed, 6 responded, reporting \$83.1 million in taxes assessed and \$6.8 million in taxes paid.³⁴ State and USAID reports to Congress for fiscal years 2014 through 2017 did not identify any instances of taxation on tax-exempt contracts in the agencies’ respective programs. Therefore, in total, the agencies only reported \$83.1 million in potentially improper taxation to Congress from 2014 through 2018.³⁵ However, 25 of the contractors we surveyed reported \$125.6 million in taxes and penalties assessed by the Afghan government since 2013 on contracts across the three agencies. This indicates that the contractors, and ultimately the agencies, underreported the extent of taxation on U.S. government contracts in Afghanistan. As a result, Congress does not know the full extent to which U.S. assistance in Afghanistan is being taxed.

U.S. Law Does Not Require DOD to Report Taxes Assessed on DOD-Funded Contracts, Including Those Funded by the Afghanistan Security Forces Fund

Similar to the Consolidated Appropriations Acts for fiscal years 2014 to 2018, the 2014 NDAA required DOD to withhold future funding in cases of taxation in violation of tax-exemption agreements by the Afghan government.³⁶ The National Defense Authorization Act for Fiscal Year 2014 provides that

The Secretary of Defense shall submit to the Committees on Armed Services of the Senate and the House of Representatives a report on the total taxes assessed during fiscal year 2013 by the Government of Afghanistan on all Department of Defense assistance...This section shall terminate at the close of the date on which the Secretary of Defense submits to the Committees on Armed Services of the Senate and the House of Representatives a notification that the United States and Afghanistan have signed a bilateral security agreement and such agreement has entered into force.³⁷

³¹ Sections 7013 and 7044 of the Consolidated Appropriations Act, 2014, Pub. L. No. 113-76, 128 Stat. 5 (2014); Consolidated and Further Continuing Appropriations, 2015, Pub. L. No. 113-235, 128 Stat. 2130 (2015); Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, 129 Stat. 2242 (2016); Consolidated Appropriations Act, 2017, Pub. L. No. 115-31, 131 Stat. 135 (2017); and Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, 132 Stat. 348 (2018).

³² Section 7013 of the law stated that “the term ‘taxes and taxation’ shall include value added taxes and customs duties but shall not include individual income taxes assessed to local staff” (see Consolidated Appropriations Act, 2014, Pub. L. No. 113-76, 128 Stat. 5 (2014), Section 7013 (h)). Section 7044 of the law does not provide a definition for taxes, more broadly referring to “taxes or other fees,” Consolidated Appropriations Act, 2014, Pub. L. No. 113-76, 128 Stat. 5 (2014), Section 7044 (a).

³³ National Defense Authorization Act for Fiscal Year 2014, Pub. L. No. 113-66, (2014) Section 1216 (c)

³⁴ Letter from the Under Secretary of Defense for Acquisition, Technology, and Logistics to the Honorable John McCain, Chairman of the Committee on Armed Services, United States Senate, February 27, 2015.

³⁵ State reported \$1.26 million in taxes paid during fiscal years 2014 through 2017 to the Afghan government on the department’s Conventional Weapons Destruction Program and Antiterrorism Assistance Program programs. However, these programs did not have tax exemptions until 2018.

³⁶ The National Defense Authorization Act for Fiscal Year 2014 states the Secretary of Defense is “to withhold Department of Defense assistance to Afghanistan equivalent to 100 percent of all taxes assessed by Afghanistan to the extent such taxes are not reimbursed by Afghanistan.” See National Defense Authorization Act for Fiscal Year 2014, Pub. L. No. 113-66, (2014) Section 1216 (c).

³⁷ National Defense Authorization Act for Fiscal Year 2014, Pub. L. No. 113-66, (2014) Section 1216 (c).

Since 2015, Congress has appropriated over \$16.0 billion to DOD's Afghanistan Security Forces Fund. This is the largest source of DOD assistance in Afghanistan. According to the NDAA for Fiscal Year 2014, the requirement for DOD to report to Congress on the Afghan government's taxation of DOD-funded contracts would not apply after the U.S. and Afghan governments signed the BSA. Since the BSA was signed on September 30, 2014, and it went into effect on January 1, 2015, after which reporting was no longer required, the NDAs for fiscal years 2015 through 2018 did not explicitly require DOD to report on taxes the Afghan government assessed on DOD assistance.

However, we found that the Afghan government continued to assess taxes on contractors implementing DOD contracts. For example, through our survey and interviews, we found that one DOD contractor reported paying approximately \$246,000 in taxes from 2015 to 2016. A second contractor paid approximately \$500,000 in 2015. The Afghan MOF assessed \$18.9 million in taxes on a third contractor in 2015. This third contractor told us that it appealed the assessment twice with the MOF, but ultimately paid it despite concerns that the taxes assessed were on tax-exempt contracts.

Because DOD is no longer required to report improper taxation of its contractors in Afghanistan, Congress lacks information on the extent to which the Afghan government has assessed taxes on DOD-funded activities, including those funded by the Afghanistan Security Forces Fund, since 2015.

CONCLUSION

Although DOD, State, and USAID have taken steps to address and resolve many business tax-related issues since 2013, the Afghan government continues to assess taxes and penalties on tax-exempt U.S. government contracts. Contractors we surveyed reported \$125.6 million in taxes and penalties assessed on tax-exempt work they performed in Afghanistan. This has contributed to a difficult business environment and created additional time-consuming work for contractors to implement those contracts. Furthermore, the Afghan government's differing interpretations of agreements it signed with the U.S. agencies and its unpredictability in implementing those agreements further hinders progress made in addressing Afghan tax issues. Officials at the U.S. Embassy in Kabul continue to work with Afghan officials to resolve these challenges.

In addition, despite requirements for State and USAID to report on Afghan taxation each year, contractor underreporting and the lack of a requirement for DOD to report on taxation limited the amount of information DOD, State, and USAID reported to Congress on taxation of tax-exempt contracts in Afghanistan. Although State and USAID reported to Congress, as required by the Consolidated Appropriations Acts for fiscal years 2014 through 2018, their reports contained no instances of improper taxation. In contrast to State and USAID, DOD has not been legally required to report on taxes assessed on its contractors. However, since 2015, contractors reported to us that they were assessed \$125.6 million in taxation on tax-exempt contracts, including documentation of \$19.7 million in business taxes and penalties that the Afghan government improperly assessed. Without requirements for complete reporting on the Afghan government's taxation, especially improper taxation of U.S. government contracts, U.S. officials cannot fully resolve tax issues or hold the Afghan government accountable for its actions.

MATTER FOR CONGRESSIONAL CONSIDERATION

To ensure that it has complete information on taxes assessed by the Afghan government and to address any improper taxation by the Afghan government, Congress may wish to:

- 1. Include a provision in future National Defense Authorization Acts that requires DOD to collect information on and fully report all types of taxes and penalties the Afghan government assesses on contractors implementing DOD contracts in Afghanistan, including contracts funded by the Afghanistan Security Forces Fund.**

RECOMMENDATION

To ensure that DOD, State, USAID, and Congress are aware of all taxes and penalties the Afghan government has assessed on contractors supporting U.S. government efforts in Afghanistan and are able to take appropriate action to hold the Afghan government accountable to agreements entered into with DOD, State, and USAID, we recommend that the Secretary of Defense, the Secretary of State, and the Administrator of USAID:

- 1. Require contractors to annually report any instances of taxation by the Afghan government.**

AGENCY COMMENTS

We provided a draft of this report to DOD, State, and USAID for review and comment. We received written comments from the Department of Defense's Office of the Undersecretary for Defense–Acquisition and Sustainment, CSTC-A, and USAID/Afghanistan, which are reproduced in appendices V, VI and VII, respectively, along with our responses. State's Legal Bureau and Bureau of South and Central Asian Affairs, CSTC-A, and USAID/Afghanistan also provided technical comments, which we incorporated as appropriate.

In its comments, DOD concurred with our recommendation.

USAID/Afghanistan concurred with our recommendation. However, the mission said it already includes mandatory provisions in its contracts, grants, and cooperative agreements that require its implementing partners to report annually on challenges they experience with taxation by host-country governments, including Afghanistan. USAID/Afghanistan requested that we close the recommendation for USAID upon the report's issuance. We reviewed the provisions and associated guidance the mission cited, and determined that although they do mention a requirement for contractors to report taxation by the Afghan government to USAID, they only require contractors to report on value-added taxes and customs duties. The reporting requirement does not include other types of taxes that the Afghan government assesses on contractors implementing tax-exempt U.S. government contracts. As a result, we maintain that USAID should require its contractors to annually report any instances of taxation by the Afghan government.

SIGAR's recommendation remains open for DOD, State, and USAID.

APPENDIX I - SCOPE AND METHODOLOGY

This report provides the results of SIGAR's audit of the Afghan government's taxation of contractors implementing U.S. government contracts in Afghanistan. The objectives of the audit were to assess the extent to which (1) the Afghan government has assessed and enforced taxes and penalties on contractors implementing U.S. government contracts in Afghanistan since 2013; (2) the Department of Defense (DOD), Department of State (State), and U.S. Agency for International (USAID) have taken steps to resolve tax-related issues since 2013; and (3) DOD, State, and USAID have developed processes to collect information and report to Congress on taxes and penalties the Afghan government has assessed. This audit covers the period from January 2013 through April 2019.

To assess the extent to which the Afghan government has assessed and enforced taxes and penalties on contractors implementing U.S. government contracts since 2013, we reviewed agreements between the U.S. and Afghan governments that discuss tax exemption for these contractors, such as the 2015 Bilateral Security Agreement (BSA), State letters of agreement, and USAID strategic objective grant agreements. We collected and analyzed data from DOD, State, and USAID contractors operating in Afghanistan on tax-exempt contracts from January 2013 through April 2019 through surveys and requests for documentation. We used a variety of sources to identify the contractors for our survey, including respondents to a survey we conducted as part of our 2013 audit of business taxes;³⁸ members of two industry groups, the International Stability Operations Association and the Overseas Security Advisory Council; and lists of the top 50 tax-exempt contractors by award amount since 2013, as generated by DOD, State, and USAID officials. From this information, we compiled a list of 190 contractors to survey. We then developed and sent an online questionnaire or interview requests to those contractors. As part of our data collection, we provided confidentiality to the contractors who responded to our questionnaire or interview.

The questionnaire included questions asking the contractors to identify any tax liabilities and tax-related challenges they experienced both before and after January 1, 2015, when the BSA went into effect. We followed up with the respondents to request phone or in-person interviews. For contractors noting instances of taxation or tax-related issues, we requested documentation to support their claims during interviews and through follow-up emails. Overall, we received 45 distinct responses through the questionnaires and interviews.³⁹ In cases where the contractors responded to the questionnaire and participated in an interview, we used the most recent response to determine if the Afghan government assessed taxes or fees, and if so, the amount of the taxes and fees. Contractors self-reported all responses.

Additionally, we interviewed five tax consultants that represented tax-exempt contractors, as well as officials with the World Bank, the British Department of International Trade, the International Committee of the Red Cross, and the United Nations High Commissioner for Refugees to collect anecdotal information on taxation by the Afghan government. We interviewed and requested documentation from the Afghan Ministry of Finance's (MOF) Afghanistan Revenue Department, Large Taxpayers Office, and Medium Taxpayers' Office to confirm instances of taxation and efforts to collect taxes and penalties by the Afghan government.

To assess the extent to which DOD, State, and USAID, have taken steps to resolve tax-related issues since 2013, we reviewed the findings and recommendations from our 2013 audit of business taxes, and the status of those recommendations. We also reviewed documentation, such as Afghan tax laws, policies, and procedures, and bilateral agreements provided by tax consultants and U.S. and Afghan government officials. We examined a case involving a contractor that reported problems with legacy taxes after acquiring seven other contractors that implemented nine tax-exempt contracts. To assess the extent to which DOD contracting officials provided the acquiring contractor assistance resolving these tax issues, we interviewed the acquiring

³⁸ SIGAR, *Taxes: Afghan Government Has Levied Nearly a Billion Dollars in Business Taxes on Contractors Supporting U.S. Government Efforts in Afghanistan*, SIGAR Audit 13-8-AR, May 14, 2013.

³⁹ Some contractors' legal and tax consultants responded on behalf of their clients.

contractor, and interviewed officials with the Army Contracting Commands responsible for four of the nine sampled contracts.

In addition, we interviewed officials from:

- DOD's Offices of the Under Secretary of Defense for Policy and the Under Secretary of Defense for Acquisition and Sustainment, the Combined Security Transition Command–Afghanistan, nine Army Contracting Commands, and the U.S. Army Corps of Engineers;⁴⁰
- NATO Resolute Support's International Agreement Branch and Legal Office;
- State's Antiterrorism Assistance Program, Conventional Weapons Destruction Program, and Bureau of International Narcotics and Law Enforcement Affairs, and the U.S. Embassy in Kabul's Economic Section;
- the USAID Mission in Afghanistan's Office of Acquisition and Assistance, Office of Financial Management, and Regional Legal Office; and
- the MOF's Afghanistan Revenue Department and Medium Taxpayers' Office.

To assess the extent to which DOD, State, and USAID have developed processes to collect and report information to Congress on taxes and penalties the Afghan government has assessed, we reviewed the Consolidated Appropriations Acts for fiscal years 2014 through 2018, and National Defense Authorization Act for Fiscal Year 2014. We also consulted with representatives from State's Office of the Legal Advisor to discuss the implementation of the legislation.⁴¹ We requested documentation from DOD, State, and USAID officials about how the agencies collected data regarding taxes assessed by and paid to the Afghan government, and how that information was then reported to Congress. We also interviewed officials from DOD's Office of the Under Secretary of Defense for Acquisition and Sustainment, State's Bureau of South and Central Asian Affairs, and USAID Mission in Afghanistan's Office of Acquisition and Assistance, Office of Financial Management, and Regional Legal Office.

We did not use or rely on computer-processed data for purpose of our audit objectives. However, we did rely on data provided by DOD, State, USAID, and their contractors. While the latter appeared to be incomplete and inconsistent, it did not impact our audit objectives and was able to become part of the findings in this report. We assessed internal controls and adherence with laws and regulations as part of our analysis to determine the extent to which DOD, State, and USAID collected data on the Afghan government's taxation of U.S. government contractors and reported this information to Congress. The results of our assessment are included in the body of this report.

We conducted our audit work in Arlington, Virginia, and Kabul, Afghanistan, from April 2018 through October 2019, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. SIGAR performed this audit under the authority of Public Law No. 110-181, as amended, and the Inspector General Act of 1978, as amended.

⁴⁰ The nine Army Contracting Commands we interviewed were Army Contracting Commands: 408th Contract Support Brigade, Afghanistan, Aberdeen Proving Ground, Mission and Installation Contracting Command-Fort Drum, New Jersey, Orlando, Redstone Arsenal, Rock Island, and Warren.

⁴¹ Consolidated Appropriations Act, 2014, Pub. L. No. 113-76 (2014); National Defense Authorization Act for Fiscal Year 2014, Pub. L. No. 113-66 (2014); Consolidated and Further Continuing Appropriations, 2015, Pub. L. No. 113-235 (2015); Consolidated Appropriations Act, 2016, Pub. L. No. 114-113 (2016); Consolidated Appropriations Act, 2017, Pub. L. No. 115-31 (2017); and Consolidated Appropriations Act, 2018, Pub. L. No. 115-141 (2018).

APPENDIX II - STATUS OF RECOMMENDATIONS AND MATTERS FOR CONGRESSIONAL CONSIDERATION FROM SIGAR'S APRIL 2013 REPORT ON AFGHAN BUSINESS TAXES

In our April 2013 report on Afghan business taxes, we made five recommendations and two matters for congressional consideration. Table 2 lists the recommendations and matters for congressional consideration; responses from the Department of Defense (DOD), Department of State (State), and the U.S. Agency for International Development (USAID); and the status of the recommendations and matters.

Table 2 - Status of Recommendations and Matters for Congressional Consideration from SIGAR Audit 13-8

Recommendation or Matter for Congressional Consideration	Agency Response	Status
<p>To help ensure that contractors working with U.S. government agencies receive fair tax treatment, we recommend that the Secretary of State:</p> <ol style="list-style-type: none"> 1. Develop a consistent, unified position on what the U.S. government deems appropriate taxation of contractors supporting U.S. government efforts in Afghanistan; incorporate clear and complete language concerning this position into future bilateral agreements with the Afghan government; communicate this position to all contractors; and ensure that any taxes levied by the Afghan government are accurately reported to Congress. 	<p>State did not concur with our recommendation, stating that it believes the United States already has a global position on appropriate taxation of contractors.</p>	<p>Closed as implemented in August 2014</p>
<p>To ensure that taxes were not reimbursed inappropriately the Department of State Office of Procurement Executive and the USAID Office of Acquisition and Assistance should:</p> <ol style="list-style-type: none"> 2. Determine if taxes reimbursed by State's Bureau of International Narcotics and Law Enforcement Affairs (INL) and USAID were legitimate and recover any inappropriately reimbursed taxes. 	<p>State and USAID concurred with our recommendation.</p>	<p>Closed as implemented in August 2014</p>
<p>To help ensure that contractors gain tax-exempt status and prevent inappropriate reimbursement of taxes, we recommend that the Department of State Office of Procurement Executive; USAID Office of Acquisition and Assistance; the Commander U.S. Army Corps of Engineers; and the Commander U.S. Central Command Joint Theater Support Contracting Command:</p> <ol style="list-style-type: none"> 3. Develop procedures to help contractors obtain appropriate documentation of tax-exempt status with the Afghan government. 4. Issue guidance and training to contracting officers on how to properly identify taxes in contracts and invoices. 5. Ensure thorough guidance and training that contractors are reimbursed only for eligible tax payments. 	<p>DOD, State, and USAID concurred with our recommendations.</p> <p>State and USAID maintained that they have procedures in place to help contractors obtain appropriate documentation, properly review contracts and invoices, and only reimburse eligible taxes.</p> <p>DOD developed procedures and conducted training to address these recommendations.</p>	<p>All three recommendations were closed as implemented in August 2014</p>

To ensure that it has complete information on taxes levied by the Afghan government and to address any improper taxation by the Afghan government, Congress may wish to:

1. Require the Secretary of State to report annually to Congress the amounts of all taxes levied by the Afghan government on all assistance provided by the United States, either directly or through grantees, contractors, and subcontractors.
2. Require that an amount equivalent to 200 percent of the total taxes assessed by the Afghan government on all assistance provided by the U.S., either directly or through grantees, contractors, and subcontractors, during any fiscal year be withheld from obligation from funds appropriated for Afghanistan assistance for the succeeding fiscal year to the extent that such taxes have not been reimbursed.

Congress addressed both matters in sections 7013 and 7044 of the Consolidated Appropriations Acts for fiscal years 2014 through 2018, and section 1216 of the National Defense Authorization Act (NDAA) for Fiscal Year 2014.^a

Both matters have been implemented.

Sources: SIGAR Audit 13-8-AR; comments from DOD, State, and USAID on the 2013 report; responses and documentation the agencies submitted to SIGAR during recommendation follow-up; the Consolidated Appropriations Acts for fiscal years 2014 through 2018; and the NDAA for Fiscal Year 2014.

^a As a matter of practice, we do not seek comments from Congress on matters for congressional consideration. However, we do monitor any actions Congress takes to implement them.

APPENDIX III - AGREEMENTS PROVIDING FOR THE TAX STATUS OF CONTRACTORS SUPPORTING U.S. EFFORTS IN AFGHANISAN SINCE 2002

Table 3 provides a list of the agreements governing the tax status of contractors supporting Department of Defense (DOD), Department of State (State), and the U.S. Agency for International Development (USAID) efforts in Afghanistan since 2002.

Table 3 - Agreements Providing for the Tax Status of Contractors Supporting U.S. Efforts in Afghanistan Since 2002

Agreement Name	Agency/Bureau/Program	Effective Dates
Diplomatic Note No. 202	DOD	2002-2015
May 2003 Status of Forces Agreement	DOD	2002-2015
Bilateral Security Agreement	DOD	2015-Present
Memorandum of Understanding between Combined Security Transition Command-Afghanistan and The Ministry of Finance (MOF) of the Islamic Republic of Afghanistan for the Payment of Ministry of Interior Food Bills	DOD	2016-Present
Modification of the 2016 Memorandum of Understanding	DOD	2017-Present
1951 Point Four General Agreement for Technical Cooperation	State and USAID	2002-Present
Letter of Agreement on Police, Criminal Justice, and Counternarcotics Support Programs Between the Government of the United States of America and the Islamic Republic of Afghanistan	State Bureau of International Narcotics and Law Enforcement Affairs (INL)	2006-2011
Amendment to the Letter of Agreement on Police, Criminal Justice, and Counternarcotics Programs of March 9, 2006 Between the United States of America and the Islamic Republic of Afghanistan	State INL	2011-Present
Letter of Intent	State Bureau of Counterterrorism and Countering Violent Extremism's Anti-terrorism Assistance Program, and State Bureau of Political-Military Affairs' Conventional Weapons Destruction Program	2012-2018
Agreement Between the Government of the United States of America and the Government of the Islamic Republic of Afghanistan Regarding the Provision of Tax Exemptions for Assistance	State	July 2018-Present (retroactive to June 2018) ^a
1954 Amendment of Duty-Free Entry Agreement	USAID	2002-Present
2005 Strategic Objective Grant Agreements, Nos. 4, 5, 6, and 7 ^b	USAID	2005-Present

Source: DOD, State, and USAID responses and documentation submitted in response to SIGAR's requests for information.

Notes: There is no agreement between the U.S. and Afghan governments that exempts contractors providing security, construction, and other services in support of the U.S. Embassy in Kabul's diplomatic mission from Afghan business taxes.

^a MOF legal officials stated that this agreement still needs to be ratified by the Afghan Parliament. However, State officials said the agreement was effective when the U.S. Ambassador and Minister of Finance signed it in July 2018 and was retroactive to June 1, 2018.

^b In its technical comments on our preliminary findings, USAID officials stated that these agreements have been updated to include changes to contractors' operations in Afghanistan; however, the tax exempt status of the activities implemented under the agreements has not changed since 2005. In its comments on a draft of this report, the USAID Mission for Afghanistan said, "In September 2018, USAID and the Afghan Government signed an Assistance Agreement that, for purposes of the scope of SIGAR 20-XX AR/SIGAR-124A, is substantially similar to the four SOAGs [Strategic Objective Grant Agreements]. USAID and the Afghan Government have amended each of the SOAGs multiple times (and the Assistance Agreement thrice), but none of the amendments alter the tax-exemption provisions in each SOAG, or in the Assistance Agreement."

APPENDIX IV - EXAMPLES OF AFGHAN BUSINESS TAX ISSUES CONTRACTORS REPORTED TO SIGAR

Table 4 identifies examples of Afghan business tax-related issues that the contractors reported to us during our survey. The seven contractors listed held tax-exempt contracts with the Department of Defense (DOD), Department of State (State), and the U.S. Agency for International Development (USAID).

Table 4 - Examples of Tax Issues U.S. Government Contractors Reported to SIGAR

Contractor Number	Contracting Agency(ies)	Type(s) of Afghan Taxes Reported	Taxes Assessed by or Paid to the Afghan Government?	Experienced Issues with Business Licenses or Visas?
1	USAID	Business receipts tax, employee withholding tax, and rental withholding tax	Yes	Yes
2	USAID	Business receipts tax and contractor withholding tax	Yes	Yes
3	DOD USAID	Business receipts tax, employee withholding tax, contractor withholding tax, and rental withholding tax	Yes	Yes
4	State USAID	Business receipts tax and contractor withholding tax	Yes	Yes
5	DOD	Annual corporate income tax and employee withholding tax	Yes	No
6	DOD	Business receipts tax, annual corporate income tax, employee withholding tax, and contractor withholding tax	Yes	Yes
7	DOD	Business receipts tax	Yes	Yes

Source: SIGAR analysis of data obtained from survey questionnaires and interviews with seven U.S. government contractors.

Note: As a condition of our survey and interviews, we do not identify specific contractors by name or any other identifying information.

APPENDIX V - COMMENTS FROM THE DEPARTMENT OF DEFENSE OFFICE OF
THE UNDERSECRETARY FOR DEFENSE-ACQUISITION AND SUSTAINMENT

FOR OFFICIAL USE ONLY



OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

**MEMORANDUM FOR SPECIAL INSPECTOR GENERAL FOR AFGHANISTAN
RECONSTRUCTION**

SUBJECT: Response to Draft Audit Report – Afghan Business Taxes (Project Code SIGAR-124A)

Thank you for providing subject draft audit report for review and comment. I concur with the draft report and have no comments.

My point of contact for this action is Lt Col Bryan Lamb at bryan.d.lamb.mil@mail.mil or 703-693-0497).

Michael Pelkey
Acting Director, Contract Policy

FOR OFFICIAL USE ONLY

APPENDIX VI - COMMENTS FROM THE COMBINED SECURITY TRANSITION COMMAND-AFGHANISTAN



UNCLASSIFIED

HEADQUARTERS RESOLUTE SUPPORT
COMBINED SECURITY TRANSITION COMMAND-AFGHANISTAN
KABUL, AFGHANISTAN
APO, AE 09320

CSTC-A

21 December 2019

MEMORANDUM THRU

United States Forces – Afghanistan DCDR-S, APO AE 09356
United States Central Command (CCIG), MacDill Air Force Base, FL 33621

FOR Special Inspector General for Afghanistan Reconstruction, 2530 Crystal Drive,
Arlington, VA 22202-3940

SUBJECT: Special Inspector General for Afghanistan Reconstruction (SIGAR) SIGAR-124A Draft Report – “Afghan Business Taxes: Action Has Been Taken to Address Most Tax Issues, but the Afghan Government Continues to Assess Taxes on Exempt U.S.-Funded Contracts”

1. The purpose of this memorandum is to provide a response to the SIGAR 124A – Draft Report – “Business Taxes Assessed on US Contractors”
2. CSTC-A appreciates SIGAR’s review of business taxes and related penalties the Afghan government has purportedly levied on contractors supporting U.S. government activities in Afghanistan and the opportunity to respond and provide feedback to the resulting draft audit.
 - a. As highlighted on page 5 of the draft report, based on provided documentation by three of the 29 contractors that responded to SIGAR’s survey, you were only able to substantiate approximately \$19.7 million of the estimated \$125 million in improper taxes and penalties reportedly assessed since 2013. CSTC-A request SIGAR correct the reference to taxation totaling \$125.6 million in the introduction, page 5, page 12, and page 13 to reflect only the amount actually substantiated not the unsupported amount alleged by the contractors. SIGAR Comment 1
 - b. As outlined in our 15 April, 2019 response to the SIGAR 134A Statement of Facts, CSTC-A and the Ministry of Finance (MoF) did not signed a memorandum of understanding (MoU) in 2016 because the US-Afghanistan Bilateral Security Agreement (BSA) did not specifically address legacy taxes. The specific purpose of entering into the MoU was to address the Ministry of Interior’s (MoI) request for assistance paying old food bill. As is common practice and in an effort to encourage MoI to engage in good stewardship when managing their contract obligations, CSTC-A added conditions to the agreement. CSTC-A request that any reference to the MoU being a direct result of legacy tax issues be removed from the report. SIGAR Comment 2

UNCLASSIFIED

UNCLASSIFIED

CSTC-A

SUBJECT: Special Inspector General for Afghanistan Reconstruction (SIGAR) SIGAR-124A Draft Report – "Afghan Business Taxes: Action Has Been Taken to Address Most Tax Issues, but the Afghan Government Continues to Assess Taxes on Exempt U.S.-Funded Contracts"

c. The conditions outlined in the 2016 MoU and subsequent 2017 modification, required GIRoA to issue the Cabinet decision extending resolution of legacy taxation issues to all contractors and subcontractors and issue administrative instructions to the tax offices across the country. Neither, the MoU nor the modification required GIRoA to resolve all outstanding Legacy Tax disputes. CSTC-A requests the statement referencing the terms of the MoU on page 8 be corrected to reflect CSTC-A's determination that the Afghan government had meet the requirements identified under the effective implementation section of the 2017 MoU modification. In turn, CSIC-A honored the MoU by providing the requested funding to pay the outstanding food bill.

SIGAR
Comment 3

3. Point of contact for this action Ms. Katherine Bootle, CSTC-A External Audit Liaison, DSN 318-449-9935, email Katherine.E.Bootle.Civ@mail.mil.

LETCHER,KENNETH.
WAYNE,1113221433

Digitally signed by
LETCHER,KENNETH.WAYNE,11132-
21433
Date: 2020.01.27 18:03:03 +0430'

KENNETH W. LETCHER
Colonel, USA
CSTC-A, Director of Staff

UNCLASSIFIED

SIGAR Response to the Combined Security Transition Command–Afghanistan's (CSTC-A) Comments

SIGAR Comment 1. As noted in the report, we discuss what the contractors self-reported in business taxes and penalties both assessed and paid. Both figures, \$125 million in taxes and penalties assessed and \$19.7 million in documented taxes and penalties paid, are useful to inform Congress and the public of the Afghan government's ongoing taxation of contractors supporting the U.S. government's efforts in Afghanistan.

SIGAR Comment 2. We note in the report that CSTC-A and the Afghan Ministry of Finance signed the memorandum of understanding (MOU) to pay outstanding Ministry of Interior food bills. We also state that one of the conditions included in the MOU for CSTC-A to release the payment was for the Afghan government to address the legacy tax issues.

SIGAR Comment 3. On page 8, we state that

In October 2018, the senior CSTC-A Resource Management Finance official told us that CSTC-A determined that the Afghan government had met the terms of the MOU addressing legacy tax issues. According to CSTC-A officials, they monitored the Afghan government's efforts to comply with the 2016 MOU and the 2017 modification, determined that the Afghan government met the terms, and paid the \$52 million for the outstanding Ministry of Interior food bills.

As a result, we did not make any edits.

APPENDIX VII - COMMENTS FROM THE U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT MISSION FOR AFGHANISTAN



MEMORANDUM

TO: The Honorable John F. Sopko
The Special Inspector General for Afghanistan
Reconstruction

FROM: Elizabeth A. Chambers, Acting Mission Director *Elizabeth A. Chambers*

DATE: December 27, 2019

SUBJECT: Management Comments to Respond to the Draft Audit Report Produced by the Special Inspector General for Afghanistan Reconstruction (SIGAR) titled, *Afghan Business Taxes: Action Has Been Taken to Address Most Tax Issues, but the Afghan Government Continues to Assess Taxes on Exempt U.S.-Funded Contracts* (SIGAR 20-XX AR/SIGAR-124A).

The U.S. Agency for International Development (USAID) would like to thank you and your staff for the opportunity to provide comments on the subject draft report, which contains one recommendation for the Agency. USAID agrees with the report's recommendation, but notes that we already include mandatory provisions in our contracts, grants, and cooperative agreements with our implementing partners that require them to report annually on challenges they experience with taxation by host-country governments, including in Afghanistan. Therefore, we are requesting that you close the recommendation for USAID upon publication of Final Report SIGAR 20-XX AR/SIGAR-124A.

SIGAR
Comment 1

USAID is not aware of any instances of unresolved taxation of our implementing partners by the Government of Afghanistan, nor are we aware that any partner of ours has failed to report, or has under-reported, taxation problems in Afghanistan. We have not received complaints that our partners have had difficulty in obtaining business licenses in Afghanistan, either. The draft report does not identify instances of under-reporting that relate to USAID, and notes, "USAID reports to Congress for Fiscal Years 2014 through 2018 did not identify any instances of taxation on tax-exempt contracts." Thus, the "reported \$83.1 million in potentially improper taxation to Congress from 2014 through 2018" cited in the report does not relate to USAID. Therefore, it is improper to imply or conclude

SIGAR
Comment 2

that USAID's partners had, or have, any serious or systemic problems related to improper taxation in Afghanistan.

SIGAR
Comment 3

Also, while the contractors your office surveyed identified \$125.6 million in taxes and penalties assessed by the Government of Afghanistan since 2013 on contracts awarded by the U.S. Departments of Defense (DoD) and State (State) and USAID, the auditors could substantiate only \$19.7 million with documentation. DoD, State, USAID and the Afghan Government did not have the opportunity to validate this figure, so its accuracy is questionable. Final Report SIGAR 20-XX AR/SIGAR-124A needs to recognize the limitations of the survey at the center of the audit, because of the small number of respondents, as well as the reality that "only three contractors provided documentation substantiating their claims."

SIGAR
Comment 4

SIGAR
Comment 5

Furthermore, the draft report makes general statements that do not differentiate between DoD, State, and USAID, which leaves the reader with the impression that the auditors' findings apply equally to all three organizations. USAID noted this lack of clarity during our responses to the auditors' Requests For Information (RFIs) on this engagement; in the exit conference for the engagement on April 10, 2019; in our written response to the Statement of Facts (SOF) for this audit on April 30, 2019; as well as in part of our written response to the draft report's predecessor engagement, SIGAR Audit 13-8-AR.

SIGAR
Comment 6

Without additional information, including the specific Department or Agency in question, the nature of the taxes allegedly assessed, or other identifying data, USAID is unable to take any further action as a result of SIGAR 20-XX AR/SIGAR-124A.

SIGAR
Comment 7

Comments By The U.S. Agency For International Development (USAID) on the Draft Report Released By The Special Inspector General For Afghanistan Reconstruction (SIGAR) (titled, *Afghan Business Taxes: Action Has Been Taken to Address Most Tax Issues, but the Afghan Government Continues to Assess Taxes on Exempt U.S.-Funded Contracts* (SIGAR 20-XX AR/SIGAR-124A))

Please find below the Management Comments from USAID on the draft report produced by SIGAR, which contains one recommendation for the Agency's action:

Recommendation 1: *To ensure that [the U.S. Department of Defense] DoD, [the U.S. Department of] State, USAID, and Congress are aware of all taxes and penalties the Afghan government has assessed on contractors supporting U.S. Government efforts in Afghanistan and are able to take appropriate action to hold the Afghan government accountable to agreements entered into with DoD, State, and USAID, we recommend that the Secretary of Defense, the Secretary of State, and the Administrator of USAID require contractors to annually report any instances of taxation by the Afghan government.*

Management Comments: USAID concurs with the recommendation, and already has policies in place that address it. USAID has developed and applied standard provisions in its contracts, grants, and cooperative agreements that track the language of Section 7013, *Prohibition on Taxation of United States Assistance*, of the annual appropriations acts for foreign assistance, as follows:

SIGAR
Comment 6

1. Contracts: Section 752.229-71 of USAID's Acquisition Regulation (AIDAR)
(https://www.usaid.gov/sites/default/files/documents/1868/aidar_0.pdf);
2. Grants and Cooperative Agreements: Chapter 303maa (RAA12) of USAID's Automated Directives System (ADS)
(<https://www.usaid.gov/sites/default/files/documents/1868/303maa.pdf>) and ADS Chapter 303mab (RAA10)
(<https://www.usaid.gov/sites/default/files/documents/1868/303mab.pdf>); and
3. Awards with Public International Organizations: ADS Chapter 308
(<https://www.usaid.gov/sites/default/files/documents/1876/308mab.pdf>)

Implementing partners provide annual reports to USAID on taxation by host-country governments, which we, in turn, transmit to the Office of U.S. Foreign Assistance Resources (F) within the Department of State (State). State/F then submits to Congress an update that fulfills the annual reporting requirements of Section 7013(h).

SIGAR
Comment 9

Based on the above actions, we request that SIGAR concur with our Management Decision, and close the recommendation upon publication of the Final Report.

Comments on the Draft Report from the U.S. Agency for International Development (USAID)

- 1. What SIGAR Found, Page 1, Paragraph 1, Third Sentence:**
"SIGAR surveyed 190 contractors that performed work on U.S. Government contracts in Afghanistan from 2013 to 2019. Of the 45 contractors that responded, 29 reported that the Afghan government had assessed taxes on them or that they had experienced tax-related issues. These contractors reported taxation totaling at least \$125.6 million on tax-exempt contracts since 2013."

What SIGAR Found, Page 1, Paragraph 1, Sixth Sentence:
"SIGAR's analysis of the documentation for the three contractors showed that the Afghan government improperly assessed over \$19.7 million in taxes and penalties on work under exempt contracts. The contractors SIGAR interviewed also reported experiencing other tax-related issues."

What SIGAR Found, Page 2, Paragraph 1, Second Sentence:
"We found that contractors did not appear to fully report Afghan government tax assessments and related issues to their respective agencies. We found that contractors' self-reporting to U.S. agencies omitted instances of alleged improper taxation and underreported the magnitude of the Afghan government's taxation of contractors supporting U.S. efforts in Afghanistan."

What SIGAR Found, Page 2, Paragraph 2, First Sentence:
"We also found that contractors underreported the amount of taxes assessed on them by the Afghan government. According to DoD, State, and USAID officials, the agencies rely on contractors to self-report instances of Afghan government taxation and related issues."

SIGAR Letter to State, DOD, and USAID, Paragraph 2, Second Sentence:
"Since 2013, DoD, State, and USAID have taken steps to address Afghan tax issues, but problems remain."

USAID Comment 1:
USAID is not aware of any outstanding tax problems among our implementing partners in Afghanistan. USAID also notes that the above statements and others like it in the draft report are broadly inconsistent with the evidence provided by USAID to SIGAR in response to Requests For Information (RFIs); at the exit conference for this engagement on April 10, 2019; and in our written response to the Statement of Facts (SOF) for this audit on April 30, 2019.

SIGAR
Comment 10

In light of the above and similar assertions throughout the draft report, USAID requests SIGAR to provide additional information, including which Agency's contractors are making such claims, the nature of the taxes allegedly assessed, and other identifying data. In the absence of such information, SIGAR's statements and those made by implementing partners or officials of the Afghan Government are not actionable.

SIGAR
Comment 11

2. **What SIGAR Found, Page 1, Paragraph 1, Seventh Sentence:**
"However, only three contractors provided documentation substantiating their claims."

SIGAR Statement, Page 5, Paragraph 2, Fourth Sentence:
"However, only three of these contractors provided documentation to support their claims of improper Afghan government taxation. Therefore, we were only able to substantiate \$19.7 million in improper taxes and penalties assessed on only three contractors."

SIGAR Statement, Page 5, Paragraph 3, Fourth Sentence:
"However, only 3 of the 25 contractors provided documentation of that taxation. Our analysis of this documentation showed that the Afghan government improperly assessed \$19.7 million in taxes and penalties on those three contractors."

USAID Comment 2:

Out of the 190 contractors surveyed by SIGAR, only 45 responded, and only three of these could substantiate their claims with documentation. It appears SIGAR had limited information from which to draw conclusions for this audit engagement. It is also unclear whether the \$19.7 million is accurate, since SIGAR did not confirm the contractor "substantiate[d]" figures with the respective Federal Department or Agency and the Afghan Government. With a higher response rate and more verifiable and validated information, it is possible SIGAR might have reached a different conclusion. In light of this limitation, USAID requests that SIGAR do the following:

SIGAR
Comment 12

SIGAR
Comment 13

1. Make clear the limited scope of the audit because of the low response rate the survey and the small number of substantiated claims, and qualify the report's conclusions accordingly;
2. Provide a breakdown of the \$19.7 million by Department and Agency with other identifying information to enable each organization to take appropriate action; and,
3. Confirm that the Afghan Government and the respective Federal Department or Agency validated the alleged "improperly assessed \$19.7

SIGAR
Comment 14

SIGAR
Comment 15

million," or include a clarifying statement that DoD, State, USAID, and the Afghan Government did not validate the figure,

SIGAR
Comment
16

3. **What SIGAR Found, Page 1, Paragraph 2, Second Sentence:**
"DOD, State, and USAID implemented four of the recommendations "

SIGAR Statement, Page 6, Last Paragraph, Second Sentence:
"DOD, State, and USAID implemented four of the recommendations, and Congress addressed the two matters for consideration."

SIGAR Footnote 15, Page 6:
"DOD, State, and USAID have not implemented SIGAR 13-8-AR's closed recommendation to 'develop a consistent, unified position ... accurately reported to Congress.'"

USAID Comment 3:

The above statement and the corresponding footnote are incorrect. SIGAR 13-8-AR addressed its fifth recommendation, mentioned in footnote 15 of SIGAR 20-XX AR/SIGAR-124A, to the Secretary of State. Please refer to the section titled, "What SIGAR Recommends" and page 14 of SIGAR 13-8-AR, which states, "To help ensure that contractors working with U.S. Government agencies receive fair tax treatment, we recommend that the Secretary of State: I. Develop a consistent, unified position ... accurately reported to Congress."

SIGAR
Comment 17

USAID requests SIGAR to delete the statement that USAID has any open recommendations from SIGAR 13-8-AR.

4. **What SIGAR Found, Page 1, Paragraph 2, Third Sentence:**
"DOD, State, and USAID have worked with the Afghan government to address improper taxation and implement new agreements governing the tax status of contractors implementing U.S. Government contracts."

SIGAR Statement, Page 8, Paragraph 4, Fourth Sentence:
"According to State and USAID officials, the '1951 Point Four General Agreement for Technical Cooperation' and '1954 Amendment of Duty-Free Entry Agreement' agreements governed foreign assistance in Afghanistan prior to 2002, and still apply to the tax status of contracts for State and USAID programs. State and USAID updated these agreements and entered into new agreements with the Afghan government between 2002 and 2018."

Table 3, Page 19:
"2005 Strategic Objective Grant Agreements, Nos. 4, 5, 6, and 7b"

SIGAR Statement, Page 20, Item (b):

"In its technical comments on our preliminary findings, USAID officials stated that these agreements have been updated to include changes to contractors operations in Afghanistan; however, the tax exempt status of the activities implemented under the agreements has not changed since 2005."

USAID Comment 4:

In 2005, USAID and the Afghan Government signed four, separate Strategic Objective Grant Agreements (SOAGs), Nos. 4, 5, 6, and 7 (please refer to page 4 of SIGAR 13-8-AR). None of the SOAGs amend the 1951 Point Four General Agreement for Technical Cooperation (1951 Point Four Agreement) or the 1954 Amendment of Duty-Free Entry Agreement. Rather, each SOAG is an implementing agreement under the terms of the 1951 Point Four Agreement. In September 2018, USAID and the Afghan Government signed an Assistance Agreement that, for purposes of the scope of SIGAR 20-XX AR/SIGAR-124A, is substantially similar to the four SOAGs. USAID and the Afghan Government have amended each of the SOAGs multiple times (and the Assistance Agreement thrice), but none of the amendments alter the tax-exemption provisions in each SOAG, or in the Assistance Agreement.

USAID requests SIGAR to delete the incorrect statement that the SOAGs amended the 1951 Point Four Agreement and 1954 Amendment of Duty-Free Entry Agreement, as they did not change either.

SIGAR
Comment 18

5. **What SIGAR Found, Page 2, Paragraph 1, First Sentence:**
"DOD, State, and USAID relied on contractors to self-report taxation and related issues."

What SIGAR Found, Page 2, Paragraph 1, Third Sentence:
We found that contractors' self-reporting to U.S. agencies omitted instances of alleged improper taxation and underreported the magnitude of the Afghan government's taxation of contractors supporting U.S. efforts in Afghanistan."

What SIGAR Found, Page 2, Paragraph 2, Second Sentence:
"According to DOD, State, and USAID officials, the agencies rely on contractors to self-report instances of Afghan government taxation and related issues."

SIGAR Statement, Page 11, Paragraph 2, Second Sentence:
"To fulfill these requirements, DOD, State, and USAID relied on contractors to self-report taxation and related issues."

SIGAR Statement, Page 11, Paragraph 2, Fourth Sentence:
"We found that contractor self-reporting omitted instances of alleged improper taxation and underreported the magnitude of the Afghan government's taxation of contractors supporting U.S. efforts."

USAID Comment 5:

The above statements are inaccurate as written, because they assume that the information provided to SIGAR by contractors is factually correct and that the information provided to USAID by the same contractors is factually incorrect. The implementing partners were self-reporting to SIGAR in much the same way they self-report to DoD, State, and USAID. SIGAR itself cannot confirm whether contractors were assessed, or paid, the amount of taxes they reported to SIGAR. Another possibility in interpreting these inconclusive data is that contractors were simply mistaken in their reporting to SIGAR. The report presents no evidence of inaccuracy; rather, the evidence is that contractors fail to respond to requests for information—whether made by USAID or by SIGAR. Furthermore, it is not clear whether any of the reported instances of improper tax assessments relate specifically to USAID’s implementing partners, rather than to State or DOD contractors.

SIGAR
Comment 19

SIGAR
Comment 20

USAID requests that SIGAR revise the statements above in a manner consistent with the audit’s limited scope.

6. SIGAR Statement, Page 5, Last Paragraph, First Sentence:

“Contractors we spoke with identified delays in renewing their business licenses and, in some cases, an inability to renew their licenses at all until the taxes and penalties the MOF assessed were resolved.”

SIGAR Statement, Page 6, Paragraph 2, Last Sentence:

“An Afghan tax consultant we interviewed in September 2018 told us that the lack of a valid business license could result in a contractor’s inability to renew its employees’ work visas.”

USAID Comment 6:

The Afghan Government issues business licenses to an entity that has complied with all Afghan laws, including tax provisions. USAID provides letters for contractors to present to the Afghan Ministry of Finance (MoF) for tax-exemption purposes with respect to specific activities that form the USAID-funded portfolio of the implementing partner in the country, consistent with the SOAGs and the Assistance Agreement between the Agency and the Government of Afghanistan.

USAID is not aware of any delays in the issuance of tax-exemptions as a result of our actions or inactions. Without additional information from an implementing partner and the Afghan Government on the specific reason for a delay in issuing a business license, it is impossible to determine whether the MoF, the implementing partners, or we are responsible for the delay.

USAID requests SIGAR to do the following:

1. Include the above context on the section of the report on alleged delays by the MoF in issuing business licenses, to enable the reader to have a balanced view of the situation; and,
2. Provide additional details on the cause of any specific delays in the issuance of licenses, to enable USAID to take appropriate action.

SIGAR
Comment 21

7. **SIGAR Statement, Page 6, Paragraph 4, Fourth Sentence:**

"Since 2013, U.S. and Afghan government officials have entered into new agreements and developed new procedures to help address tax-related issues."

USAID Comment 7:

As discussed in the exit conference for this engagement on April 10, 2019, and as USAID specified in our written response to the SOF on April 30, 2019, USAID requests that SIGAR identify the name of the agreement mentioned above.

Assuming the agreement mentioned is the one dated July 2018, USAID believes that it does not apply to USAID's programming in Afghanistan. Although the July 2018 agreement covers "economic, technical, and humanitarian assistance . . . that may be furnished by the United States in Afghanistan" (Art. I, Sec. 1), the text expressly does not cover "any program or project agreement under the Point Four General Agreement . . . such as the Strategic Objective Grant Agreement . . ." (Art. I, Sec. 2). USAID's programming falls under the 1951 Point Four Agreement, with further definition contained in implementing agreements (e.g., the 2005 SOAGs and the 2018 Assistance Agreement). Please see our comment four above.

SIGAR
Comment 22

If the draft report means to refer to the July 2018 agreement, we request SIGAR to clarify that the document excludes USAID.

8. **SIGAR Heading, Page 6:**

"DOD, STATE, AND USAID HAVE TAKEN STEPS TO ADDRESS AFGHAN TAX ISSUES, BUT SOME TAX ISSUES REMAIN UNRESOLVED"

SIGAR Heading, Page 6:

"Since 2013, U.S. and Afghan government officials have entered into new agreements and developed new procedures to help address tax-related issues. However, some challenges remain."

USAID Comment 8:

The above headings are not accurate. As stated in the exit conference for this engagement on April 10, 2019, in our written responses to the SOF on April 30, 2019, and as provided in USAID's written response to this audit's predecessor engagement, SIGAR Audit 13-8-AR, USAID does not believe any "key issues

remain unresolved” or that “challenges remain” with its implementing partners concerning taxation in Afghanistan.

SIGAR
Comment 23

USAID requests that SIGAR either correct the statements above or identify the specific issues or challenges that pertain to DoD, State, and USAID that remain unresolved and/or any challenges to enable them to take appropriate action.

9. SIGAR Statement, Page 7, Paragraph 3, Fourth Sentence:

“The Technical Taxation Working Group (TTWG) is comprised of officials from DOD’s Combined Security Transition Command-Afghanistan (CSTC-A), State, USAID, NATO Resolute Support’s International Customs Coordination Cell, and the MOF’s Afghanistan Revenue Department. The TTWG does not address individual contract disputes over Afghan taxation on an individual contract or contractor. Instead, it monitors these issues and seeks to address them at an intergovernmental level, working to address Afghan taxation issues resulting from lacking or unclear policies and procedures.”

USAID Comment 9:

Although USAID is a member of, and has participated in, the TTWG, USAID would like to clarify that the TTWG is not the sole or even primary means through which we engage with Afghan authorities with respect to taxation. As demonstrated by the names and contact information of Afghan officials provided to SIGAR for this engagement, USAID’s staff have relevant contacts among the Afghan officials responsible for taxation and customs matters. As issues arise from time to time, USAID’s team in Kabul engage directly with Afghan officials to resolve or clarify specific matters on behalf of our partners and programs. Accordingly, it is not just the TTWG but also, with respect to USAID’s contracts and grants, USAID itself that “acts as an intermediary between the contractors [that are] implementing U.S. Government contracts and the Afghan government for tax-related matters.”

USAID requests that SIGAR supplement the discussion of the TTWG with the information above to provide more context on USAID’s interactions with the Afghan Government on tax-related matters.

SIGAR
Comment 24

10. SIGAR Statement, Page 10, Paragraph 3, Last Bullet:

“In April 2019, USAID officials told us the Afghan government requested that contractors importing goods into the country pay business receipts tax at the point of entry, regardless of their tax status.”

USAID Comment 10:

USAID requests SIGAR to add the following sentence immediately after the above statement: “USAID subsequently worked with the contractor and the

Afghan Government to resolve the issue, and the contractor paid no taxes at the point of entry.”

SIGAR
Comment 25

11. SIGAR Statement, Page 11, Paragraph 1, First Sentence:

“Contractors told us they still have concerns that the Afghan government is now attempting to impose vendor taxes on insurance providers for U.S. Government contractors.”

SIGAR Statement, Page 11, Paragraph 1, Fourth Sentence:

“Although U.S. officials are aware of the practice, they have not formally engaged with the Afghan government on the application of vendor taxes on insurance providers.”

USAID Comment 11:

USAID is not aware of the practice highlighted in SIGAR’s two statements above, and has no factual basis to engage its counterparts in the Afghan Government on this matter.

SIGAR
Comment 26

USAID requests SIGAR to provide additional information regarding the alleged cases in which the Afghan Government attempted to collect taxes on insurance and, in particular, whether any USAID awards were involved in such cases.

12. SIGAR Heading, Page 11:

“CONTRACTOR UNDERREPORTING AND A LACK OF DOD-REQUIRED REPORTING LIMITS INFORMATION AVAILABLE TO CONGRESS ON AFGHAN TAXATION”

SIGAR Heading, Page 11:

“Contractors Have Underreported Afghan government Taxation to U.S. Agencies, Limiting Congressional Oversight”

USAID Comment 12:

The above section headings imply that U.S. Government Departments and Agencies are not fulfilling their tax-reporting requirements. This is not accurate.

First, USAID is not aware of under-reporting by our contractors in Afghanistan, and has reported accordingly to State/F as required in Section 7013 of the annual appropriations acts for foreign assistance. It is unclear from SIGAR’s methodology how the auditors determined that the information they gathered from USAID’s implementing partners was accurate/reliable compared to the figures State/F reported to Congress, compiled from the data gathered from the same implementing partners.

SIGAR
Comment 27

Second, only three firms responded to SIGAR's survey that supported their statements with documents over the five-year period covered by the audit. Without vetting the documents with the Afghan Government, DoD, State, and USAID, SIGAR cannot determine whether the \$19.7 million figure cited in the draft report is even correct. USAID believes SIGAR does not have enough information to draw the categorical conclusions in the headings quoted above.

SIGAR
Comment 28

USAID requests that SIGAR investigate the cause of the variances between the figures it received and those reported to Congress and thereafter revise the above headings and the information immediately below them accordingly.

SIGAR
Comment 29

13. SIGAR Statement, Page 11, Paragraph 2, Third Sentence:

"Based on responses from the contractors we surveyed and our analysis of DOD, State, and USAID reports to Congress, contractors did not appear to fully report Afghan government tax assessments or tax-related issues to their respective contracting agencies. We found that contractor self-reporting omitted instances of alleged improper taxation and underreported the magnitude of the Afghan government's taxation of contractors supporting U.S. efforts."

SIGAR Statement, Page 12, Paragraph 2, Second Sentence:

"We found that contractors underreported the amount of taxes assessed on them by the Afghan government. According to DOD, State, and USAID officials, the agencies rely on contractors to report instances of Afghan government taxation and related issues."

SIGAR Statement, Page 12, Paragraph 2, Sixth Sentence:

"However, 25 of the contractors we surveyed reported \$125.6 million in taxes and penalties assessed by the Afghan government since 2013 on contracts across the three agencies."

USAID Comment 13:

As SIGAR noted, "State and USAID reports to Congress for Fiscal Years 2014 through 2017 did not identify any instances of taxation on tax-exempt contracts."

SIGAR
Comment 30

Given that the information provided to SIGAR and USAID was from our implementing partners, USAID requests that SIGAR investigate the causes of the variances between the figures it received and those reported to Congress and thereafter revise the above statements accordingly. We further ask that SIGAR disaggregate the alleged "\$125.6 million in taxes and penalties assessed" as they relate to DoD, State, and USAID, to enable any necessary corrective action.

SIGAR Response to the U.S Agency for International Development Mission for Afghanistan's (USAID/Afghanistan) Comments

SIGAR Comment 1. USAID/Afghanistan states that USAID has mandatory provisions in its contracts, grants, and cooperative agreements with its implementing partners that require implementing partners to report annually on challenges they experience with taxation by host-country governments, including the government of Afghanistan. USAID/Afghanistan provided references to the mandatory provisions, specifically section 752.229-71 of USAID's Acquisition Regulation, and Chapters 303 and 308 of USAID's Automated Directives System.⁴² Each of these provisions explicitly identify the circumstances under which implementing partners should report tax issues to USAID. Section 752.229-71 states that "foreign taxes means value-added taxes and customs duties assessed by a foreign government on a commodity. It does not include foreign sales taxes."⁴³ According to Chapter 303, the taxes implementing partners should report to USAID include

the total amount of value-added taxes and customs duties (but not sales taxes) assessed by the host government (or any entity thereof) on purchases in excess of \$500 per transaction of supplies, materials, goods or equipment.⁴⁴

However, these USAID provisions only require reporting on value-added taxes and customs duties. Other types of taxes assessed by the Afghan government, such as business receipts tax, are not included. As a result, our recommendation that USAID require its contractors to annually report any instances of taxation by the Afghan government is still valid.

SIGAR Comment 2. USAID/Afghanistan said "the draft report does not identify instances of under-reporting that relate to USAID," and "USAID reports to Congress for Fiscal Year 2014 through 2018 did not identify any instances of taxation on tax-exempt contracts." However, in table 4 of the report, we cite two examples where USAID contractors reported that they were assessed taxes and experienced other tax-related issues with the Afghan government since 2013. Evidently, the contractors did not report all their concerns to USAID, which is an issue with self-reporting, as we discuss further in SIGAR Comment 4.

SIGAR Comment 3. USAID/Afghanistan asserts that "it is improper to imply or conclude that USAID's partners had, or have, any serious or systematic problems related to improper taxation in Afghanistan." Our report does not assert that the problems are systemic or specific to USAID. Rather, we are clear that improper taxation of any tax-exempt U.S. government contract, cooperative agreement, or grant funded by U.S. taxpayers is a serious problem. Nevertheless, two USAID contractors did self-report having problems.

SIGAR Comment 4. USAID/Afghanistan states that the accuracy of the information we collected from contractors on the \$125.6 million in taxes and penalties assessed by the Afghan government since 2013 and the documentation three contractors provided to us substantiating \$19.7 million in taxes and penalties paid to the Afghan government "is questionable." As the report indicates, we relied on the contractors to self-report instances of taxation by the Afghan government and requested and reviewed documentation of tax assessments and payments made to the Afghan government. USAID/Afghanistan states in its comments that "mandatory provisions in [its] contracts, grants, and cooperative agreements with implementing partners that require them [implementing partners] to report annually on challenges they experience with taxation by host-country governments, including in Afghanistan."

⁴² USAID, Acquisition Regulation (AIDAR), Section 752.229-71, "Reporting of foreign taxes," April 3, 2019; USAID, ADS Chapter 303, "Standard Provisions for U.S. Nongovernmental Organizations," Section RAA10, "Reporting Host Government Taxes (June 2012)" and Section RAA12, "Reporting Host Government Taxes (December 2014)," May 22, 2019; and USAID, ADS Chapter 308, "Agreements with Public International Organizations," August 15, 2019.

⁴³ USAID, Acquisition Regulation (AIDAR), Section 752.229-71, "Reporting of foreign taxes," April 3, 2019, p 123.

⁴⁴ USAID, ADS Chapter 303, "Standard Provisions for U.S. Nongovernmental Organizations," Section RAA12, "Reporting Host Government Taxes (December 2014)," May 22, 2019, pp. 54-55.

In addition, USAID/Afghanistan states that

implementing partners provide annual reports to USAID on taxation by host country governments, which we, in turn, transmit to the Office of U.S. Foreign Assistance Resources (F) within the Department of State (State). State/F then submits to Congress an update that fulfills the annual reporting requirements of Section 7013(h).

As a result, USAID also relies on contractors to self-report instances of improper taxation by the Afghan government. Any discrepancies in contractor reporting highlights the challenges of relying on unverified self-reporting. As noted in our report, we were only able to verify \$19.7 million of \$125.6 million in taxes and penalties assessed by the Afghan government since 2013 that the contractors reported to us. The discrepancies in contractors' self-reporting further demonstrate the need for USAID, along with the Department of Defense (DOD) and State, to take proactive steps to ensure improper taxation does not occur.

SIGAR Comment 5. USAID/Afghanistan states that we need to recognize the limitations of the survey and the small number of respondents. Throughout the report and in our Scope and Methodology appendix, we note the limitations of the data we collected through the survey and interviews. On page 5, we specifically discuss the nature of the problem and the limited amount of reporting from contractors in detail. Furthermore, on pages 11 and 12, we discuss the limited reporting from contractors to the agencies on taxation by the Afghan government.

SIGAR Comment 6. USAID/Afghanistan notes that “the draft report makes general statements that do not differentiate between DOD, State, and USAID, which leaves the reader with the impression that the auditors' findings apply equally to all three organizations.” The Afghan government assesses taxes on a contractor, not on a contract-by-contract basis. As a result, contractors did not report instances of tax assessments by agency or contract when responding to our survey or interviews.

SIGAR Comment 7. See SIGAR Comment 6.

SIGAR Comment 8. See SIGAR Comment 1.

SIGAR Comment 9. See SIGAR Comment 1.

SIGAR Comment 10. See SIGAR Comment 2.

SIGAR Comment 11. See SIGAR Comments 2 and 6.

SIGAR Comment 12. See SIGAR Comment 4.

SIGAR Comment 13. See SIGAR Comment 5.

SIGAR Comment 14. See SIGAR Comment 5.

SIGAR Comment 15. See SIGAR Comment 6.

SIGAR Comment 16. In response to USAID/Afghanistan's comment, at the first mention the \$19.7 million in improper taxes and penalties levied by the Afghan government, we now note that DOD, State, USAID, and the Afghan government did not validate this figure.

SIGAR Comment 17. We have corrected the language in the footnote regarding the closure of the first recommendation from the 2013 audit report.

SIGAR Comment 18. We revised table 3 and clarified language on page 9.

SIGAR Comment 19. See SIGAR Comments 1 and 4.

SIGAR Comment 20. See SIGAR Comment 2.

SIGAR Comment 21. We appreciate the additional context USAID/Afghanistan provided on its process for working with its contractors and the Afghan government to ensure tax exemption is properly issued to contractors operating on tax-exempt contracts with USAID. We have incorporated USAID/Afghanistan's

comments into the report. However, USAID's contractors reported to us that as a result of outstanding taxes assessed on their USAID contracts, they have encountered issues with the Afghan government when renewing business licenses and obtaining visas.

SIGAR Comment 22. The draft report does not solely refer to the July 2018 agreement between State and the Afghan Ministry of Finance (MOF); it also refers to the amendments to the Strategic Objective Grant Agreements, the 2016 memorandum of understanding between Combined Security Transition Command–Afghanistan (CSTC-A) and the MOF, and the July 2018 agreement.

SIGAR Comment 23. See SIGAR Comment 2.

SIGAR Comment 24. We appreciate USAID/Afghanistan elaborating on its role as a direct intermediary between the Afghan government and the contractors implementing USAID's contracts. We incorporated this into our report.

SIGAR Comment 25. We incorporated USAID/Afghanistan's comments into the report.

SIGAR Comment 26. We revised the report for clarification.

SIGAR Comment 27. See SIGAR Comments 1, 2, and 4.

SIGAR Comment 28. See SIGAR Comments 1, 2, 4, and 16.

SIGAR Comment 29. See SIGAR Comments 1, 2, and 4.

SIGAR Comment 30. See SIGAR Comments 1, 2, 4, and 6.

APPENDIX VIII - ACKNOWLEDGMENTS

James Smith, Analyst-in-Charge

Annalise Latting, Program Analyst

Adam Bonfanti, Senior Auditor

This performance audit was conducted
under project code SIGAR-124A.

SIGAR's Mission

The mission of the Special Inspector General for Afghanistan Reconstruction (SIGAR) is to enhance oversight of programs for the reconstruction of Afghanistan by conducting independent and objective audits, inspections, and investigations on the use of taxpayer dollars and related funds. SIGAR works to provide accurate and balanced information, evaluations, analysis, and recommendations to help the U.S. Congress, U.S. agencies, and other decision-makers to make informed oversight, policy, and funding decisions to:

- improve effectiveness of the overall reconstruction strategy and its component programs;
- improve management and accountability over funds administered by U.S. and Afghan agencies and their contractors;
- improve contracting and contract management processes;
- prevent fraud, waste, and abuse; and
- advance U.S. interests in reconstructing Afghanistan.

Obtaining Copies of SIGAR Reports and Testimonies

To obtain copies of SIGAR documents at no cost, go to SIGAR's Web site (www.sigar.mil). SIGAR posts all publicly released reports, testimonies, and correspondence on its Web site.

To Report Fraud, Waste, and Abuse in Afghanistan Reconstruction Programs

To help prevent fraud, waste, and abuse by reporting allegations of fraud, waste, abuse, mismanagement, and reprisal, contact SIGAR's hotline:

- Web: www.sigar.mil/fraud
- Email: sigar.pentagon.inv.mbx.hotline@mail.mil
- Phone Afghanistan: +93 (0) 700-10-7300
- Phone DSN Afghanistan: 318-237-3912 ext. 7303
- Phone International: +1-866-329-8893
- Phone DSN International: 312-664-0378
- U.S. fax: +1-703-601-4065

Public Affairs

Public Affairs Officer

- Phone: 703-545-5974
- Email: sigar.pentagon.ccr.mbx.public-affairs@mail.mil
- Mail: SIGAR Public Affairs
2530 Crystal Drive
Arlington, VA 22202