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Assessment of current taxation in Afghanistan

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Keywords: Taxation, Equity and Efficiency Principle, Government Revenue, Tax Reforms, Taxpayers

Abstract

This study aimed to assess the current taxation system in Afghanistan. Since the pre-Taliban taxation in Afghanistan was out of date and was not well functioning in accordance to the new economics trend in the country, the system was reformed and amended in 2005. In addition, government also brought some adjustment to the reformed system in 2009. The system was designed in such a way that could comply with equity and efficiency principles and also to increase government revenues in order to finance public goods and services. However, the assessment has focused on the achievements of the current system, its main characteristics and the taxpayers' awareness and expectations towards the new reformed system.

The empirical assessment of the system was mainly pivoted on the available sources of secondary data and interviews with tax authorities. The sources were mainly tax laws and regulations during pre-Taliban, Taliban and new government in Afghanistan for comparison of different systems and highlighting major reforms and amendments in the system. In addition, published documents, reports and websites of relevant national and international organizations were explored to extract data related to the achievements in the public finance sector.

The assessment's results revealed that reformed steps has been positive with regard to efficiency and equity consideration and tax revenue remarkably increased since 2004. Additionally, the sources of tax revenue also varied considerably. Nevertheless, existing of challenging obstacles caused that the system could not fully succeed fulfilling its intended objectives.

Description of Data

In order to assess the taxation system in Afghanistan, the empirical research relied on both type of primary and secondary data. Although, the main data source is secondary data collected from journals, reports and documents of governmental and international organizations, some complementary direct interviews with relevant central and local tax authorities have also been conducted. Furthermore, through intensive exploration of documents and regulation papers, three practiced taxation systems, pre-Taliban system, Taliban's taxation system and new reformed system were investigated. This exploration led to highlight the significant amendment and improvements in the new taxation system.

The secondary data that was extracted from Central Statistics Office' (CSO) statistical yearbooks, reports of ministry of finance and some international organizations' reports, such as World Bank and International Monetary Fund (IMF) were mostly information on public finance recordings and some macro-level indices of Afghanistan in the period of 2004 to 2009. Country's GDP, government revenue, components of government revenue, revenue from taxes, type of taxes, rate of different taxes, changes of revenues from taxes and etc. were the most extracted data. Based on these recordings and indices, the achievements of current taxation system in Afghanistan have been assessed. In addition, some recording and indices from past periods also reviewed for the sake of further interpretation and conclusion of the current reformed taxation system.

Additionally, In order to examine taxpayers' awareness, perspective, obedience and expectations with regard to the current taxation, a semi-structured questionnaire used to collect some primary data. Through these questionnaires, familiarity with the taxation, willingness for paying taxes, difficulties confronting with tax payment, impact of taxes on income, saving and productivity of taxpayer were surveyed among the selected correspondents.

It should be mentioned that prior to exploration of secondary sources and finalization of semi-structured questionnaire, conducts of some face-to-face formal and informal interviews and discussion with local tax staff and authorities, expertise of the field and authorities in ministry of finance greatly contributed to the enrichment of secondary data revision and analysis and also preparation and conducting of survey with taxpayers in the field.

Research Question/Theoretical contextualization

Raising revenue to fund government expenditures for provision of public goods and services are one of the fundamental purposes of taxation. All the governments in the world impose different taxes, direct and indirect, to raise their revenue. However, in doing so, they follow the principles of a good tax system, such as tax equity (Fairness) and tax efficiency. These principles mean that the taxation system must be based on taxpayers' paying ability and have low transaction and administrative cost. In addition, the taxes need to be reasonably collected with minimized excess burdens.

Nevertheless, taxation system in most of the developing countries is attributed with inequity, inefficiency, ineffectiveness and corruption. Therefore, despite large taxable areas, they are unable to collect sufficient taxes for covering public expending in their countries. Moreover, incidences of tax avoidance and tax evasion are also considerably high in these countries. Afghanistan, as one of these countries, significantly suffers from these problems. Tax regimes or systems have structurally been so far defected and incompetent to fully collect taxes. Lack of equity and efficiency was obvious and also corruption was a wide spread challenge in front of the

government. However, the new government has succeeded to reform the taxation system of the country and since 2005 the new reformed tax regime are implemented.

Hence, the purpose of this research is to assess current taxation and the related achievements in Afghanistan during the period of 2004 to 2009. Hence, the research is mainly focusing to examine the following research questions:

- Has the tax revenue increased by this current tax reform and taxation bases have varied?
- Is the current tax system in Afghanistan efficient, equitable and fair?
- How far the taxpayers in Afghanistan are familiar with the tax law and obey the law and pay taxes?

The first research question is focusing on the level of revenue increases occurred in the aforementioned period with the implementation of reformed taxation system. In addition, variation in the taxable items and activities were explored. Through the resulted changes in public financing and examination of taxpayers' perspective, efficiency and fairness of current taxation is implicitly assessed by second research question. The third question intends to assess taxpayers' awareness and perspective about the current taxation in Afghanistan.

One of the best principles in a tax system is the efficiency principle. Taxes influence relative prices in the economy and, consequently have an impact on the pattern of production, income, and consumption. Here, the objective should be to gradually establish a tax system that minimizes distortions. In practice, efficiency is achieved by levying simple taxes on tax-payer as broad a tax base as possible and at fairly low and uniform rate and keeping the tax exemption to minimum (Vermeend, Van Der Ploeg, Timmer, 2008). Efficiency principle measurement is possible by analysis of the, administration and compliance cost and also the welfare cost of taxation (excess burden of tax system).

Low administration and compliance cost is very important for a country's tax system because, the high administration and compliance cost of taxation the more inefficient and inequitable is a tax system. Administration cost and compliance costs are called operating cost. Administration costs are borne by the government to collect taxes, such as the cost of processing tax returns, enforcing payment and providing taxpayer assistance. Compliance costs are the costs incurred for encouraging or forcing the taxpayer to comply with the tax law (Vermeend, Van Der Ploeg, Timmer, 2008).

Another principle of a good tax system is equity principle. It is a basic criterion for tax structure design. Every one agrees that the tax system should be equitable that each taxpayer should contribute his or her fair share to the government expenditure. Benefit and ability to pay are the two most important consideration of tax equity (Musgrave and Musgrave, 2005).

The benefit consideration argues that, financing government supplied goods and services should be linked to the benefit of citizen who receive and use the goods and services. When people pay

for highway, park, and security, they should benefit from these services. This consideration has obvious appeal from equity stand point (Salanie, 2002). As Holcombe (1996) argues that the system will be only fair when people should pay for the received benefits and they should not be forced to pay. In effect, the benefit consideration views a tax as the price that paid for government supplied goods like the prices people pay for the goods receiving from the private sectors (Holcombe, 1996). Consequently, the benefit consideration can further both equity and efficiency goals of a taxation system.

The ability to pay consideration is the second main facet of the tax equity. The ability to pay facet, as the name suggests, states that individual should pay taxes in proportion of their ability to pay. Hence, citizen with greater ability to earn income should be taxed more heavily than those with less income capacity. From the point of ability to pay the implementation of tax system requires, some collective agreement concerning of equitable distribution of taxes between the people. While one of the governments' goals is to help those people who have less fortune through those people who are better off and have more income and more resources (Holcombe, 1996).

Additionally, It is regularly asserted that taxation provides a disincentive to people to undertake economic activity. As it can be imagined when the tax rate increases it has negative effect on the taxpayers and also on the government revenue. We know that taxation has negative effect on people's working efforts. Individuals tries and works hard to increase their income and by this income they want to maximize their welfare. This welfare can be provided to individuals from working income itself and the psychic benefits receiving from leisure activities (James and Nobes, 1988). An Individual will maximize his welfare by working until the point where the benefits that he receives from an extra work would be equal to the welfare loss that he might incur by not spending time on leisure. Below that level the marginal benefit from work would be exceeded the welfare loss from leisure and, vice versa, it is above that level (James and Nobes, 1988).

Nevertheless, tax system in developing countries, are strongly influenced by their economic structure. Many developing countries have significant informal economy, informal jobs and workers, large traditional agriculture sector, large tax areas and limitation in the capacity of tax administration. These all together make difficulties to impose the taxes properly and even inability to collect certain taxes. Also, the cost of collection, due to weak institutional framework, is too high in these countries (Bird and Bahl, 2008).

Furthermore, the tax reforms in these countries involve issues of economic policy as well as specific problem of administration and tax structure design. Moreover, most of the developing countries are simultaneously experiencing standing deficit in their budget, due to inadequate revenue collection from taxes. In addition, the wide gap between rich and poor, which is one of the prominent features of developing countries, the importance of distribution policy and the design of taxes are obvious challenges in these countries (Newberry and Stern, 1987). Also, in developing countries, tax revenues are lost due to tax evasion and avoidance. This is a big

problem for developing countries that they cannot collect desirable tax revenues for financing their public goods.

Nevertheless, based on the specific context of the developing country, taxation system needs to be properly designed to possibly collect taxes with lower cost and more equitable manner. Increasing public awareness and improving transparency of the system are also known the fundamental requirements of successful tax reform in these countries.

Field research design/ Methods of data gathering

As the main purpose of the study is assessing new reformed taxation system in Afghanistan, the field research was accordingly planned to gather relevant primary and secondary data for the empirical assessment. Prior to the field research, available sources of secondary data, mostly relevant websites and online publication reviewed and a comprehensive checklist of necessary data prepared to extract from the accessible sources during field research. In addition, a semi-structured questionnaire was prepared in order to collect necessary and relevant primary data from taxpayers in the new reformed system.

The first practical step in the field research was the conduct of direct interviews and discussion with local and central tax authorities in Kabul and Herat cities. The interviews at central level in ministry of finance were held with director of law and large taxpayers, director of revenue planning, manager of custom office, administrator of custom revenue office and general inspector of custom. At local level in Herat city, the interviews with director of custom office and head of revenue department at finance directorate were the major contributing discussions. These interviews greatly helped to furthering the insight about the current tax system and the relevant reforms in the system. Furthermore, these interviews and discussions led to the enrichment of primary and secondary data collection process and made access to the relevant documents and reports of these organizations possible.

As the study covers period from 2004/2005 to 2009/2010, all relevant published documents, statistical reports and statistical yearbook from ministry of finance, its relevant departments and central statistics office (CSO) were provided. The valid and related data for the empirical analysis for this period were extracted from these sources. In addition, published documents and reports and websites of World Bank and International Monetary Fund were used in order to extract the complementary data for the analysis.

For the primary data collection, the aforementioned cities of the country were also used as sites for conducting taxpayers' survey. The reasoning behind selection of these city for the survey were as follow:

- Kabul and Herat city was the residency of most taxpayers in the country during the conduct of this survey (ministry of finance, 2006).
- Custom offices in these cities were among the most government revenue sources of the country (ministry of finance, 2006).
- Transportation facilities and security were relatively more reliable in these cities.

Prior to the conduct of survey, the questionnaire translated in Dari language and a research member was trained for effective data collection. Based on an accidental sampling method, the research team targeted 80 taxpayers in these cities to do the survey.

Additionally, some relevant regulations and tax law papers from different period were reviewed to furthering the insight of the prevailing systems and highlighting major reforms in the current system in the country. This revision could considerably help for proper conclusion and interpretation of the revealed results of the study.

Results

In accordance to the available data, the assessment's results of the current taxation system were heavily reported in the form of descriptive statistics. Instead of comparing the current tax system with past system on a document-based approach, the achievements of the new system were examined and also the trends of these achievements were illustrated through presenting relevant variables.

The indication of the results are firstly concentrated on the micro-level changes in the related variables in public financing of the country, particularly taxes. In the second step, the results of the taxpayers' experiences with the system are reported.

Country's revenue portfolio

Afghanistan's revenue has grown by almost 7 times form 5,864 million Afghanis (105.3 \$ Million) in 2002/2003 to 40100 million Afghanis (823.07 \$ Milloion) in 2008/2009. Table (1) below shows increases in the total amount of taxes and different type of government revenue from 2004 to 2010.

Table 1: Bulk of Afghanistan's revenue from 2004 to 2010 (Million US \$)

Years	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Type Of Revenue						
Total Government Revenue	266.75	418.13	576.57	676.69	823.07	1039.01
Total Taxes Revenue	200.58	284.05	431.64	509.85	618.57	786.82
Taxes on Income, Profit and CG*	23.75	53.04	135.25	165.91	199.01	211.8

Tax on good and services	21.11	35.84	48.12	59.87	87.6	205.95
Other Taxes	7.91	3.98	16.14	18.7	23.75	37.45
Tax on International trade	147.79	191.17	264.88	265.36	308.21	331.6
Social contribution	2.67	0	0	0	0	0
Non-Tax Revenue	63.5	134.06	144.93	166.83	204.49	252.19
*CG=Capital Gains						

Source: CSO Afghanistan, 2004 - 2009 and Ministry of finance 2009

In the duration of indicated years in the table, the government revenue increased four times, from 266.75 \$ Million to 1039.01 \$ Million. Also, the revenue from taxes is almost indicating this increasing trend.

Sources of revenue collection

The administration structure of Afghan government consists of 24 ministries, in which they are mostly providing non-tax revenues for government. Table (2) shows the total revenue that Afghan governmental bodies and organizations collected in the period of 2007/2008.

Table 2: Government's revenue from different administrating organization in the period 2007/2008 (Million US \$)

Ministry	Direct Tax	Customs Duties	Other tax	Non tax Revenue	Total Revenue	Share
Ministry of Finance	106.7	29.35	0.02	6.23	142.27	21.01%
M.of Information & Culture	0.01	0	0.006	1.06	1.076	0.15%
M.of Foreign Affairs	0	0	0.005	9.94	9.945	1.47%
M.of Interior	4.94	0	0.008	6.25	11.198	1.65%
M.of Commerce & Industry	0	0	0	0.85	0.85	0.12%
M.of Communication	0	0	0.02	11.55	11.57	1.71%
M.of Transport	0	0	0.0005	34.4	34.4	5.08%
M.of Labor & Social & Martyrs	0	0	0.14	7.05	7.19	1.06%
Other Ministries (n=16)	0.28		0.03	9.33	9.64	1.42%
Total Revenue in Kabul	111.9	29.35	0.2295	86.66	228.139	33.70%
Total Provinces Revenue (n=33)	132.96	236	0.004	79.77	448.734	66.30%
Total Domestic Revenue	244.9	265.35	0.2335	166.43	676.873	100.00%
Distribution	36.18%	39.20%	0.03%	24.59%	100.00%	

Source: CSO Afghanistan, 2008

As the table shows, direct tax and custom duties form the major part of the government revenues in this period, 36.18% and 39.2% respectively. Most of this revenue is collected through ministry of finance and its related directorate and offices in the provinces.

Share of taxes in government revenue

Collected taxes have constituted major part of the government revenue during this time period. As table (3) indicates, from 2004 to 2010 almost one third of government revenue has been coming from taxes.

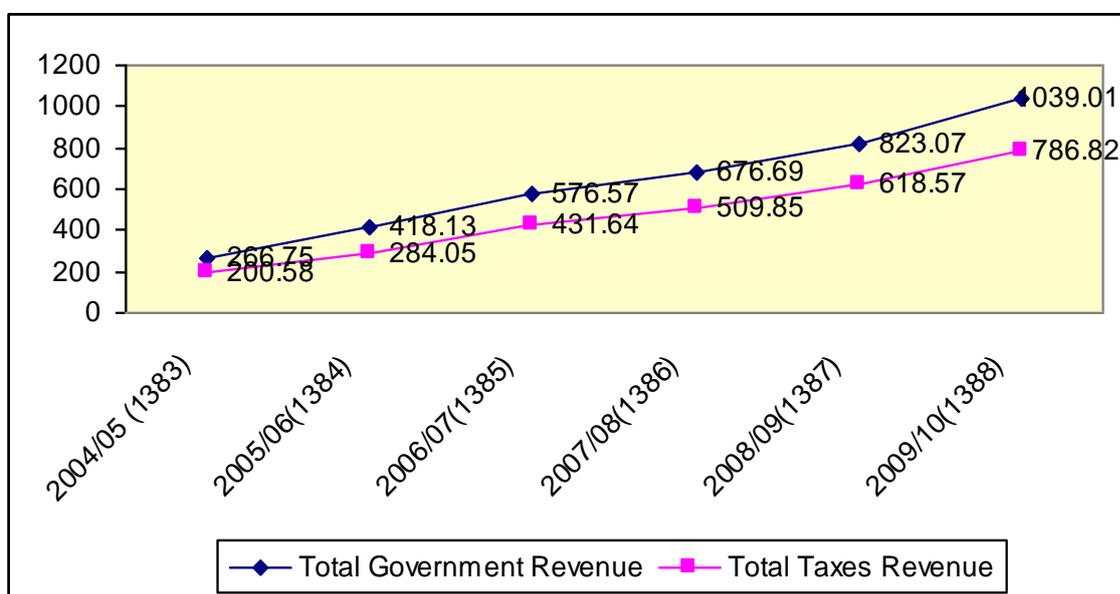
Table 3: Share of taxes in government revenue from 2004 to 2010 (%)

Years	2004/05 (1383)	2005/06(1384)	2006/07(1385)	2007/08(1386)	2008/09(1387)	2009/10(1388)
Type Of Revenue						
% of Taxes Revenue to Total Revenue	75.19%	67.93%	74.84%	75.34%	75.15%	75.72%
% of Non-Tax Revenue to Total Revenue	24.80%	32.06%	25.14%	24.65%	24.84%	24.27%
Total Revenue in Percentage %	100%	100%	100%	100%	100%	100%

Source: CSO Afghanistan 2004 - 2009 and Ministry of Finance, 2009

Additionally, figure (1) depicts the increasing trend of the revenue from taxes parallel to the total revenue from 2004 to 2009.

Figure 1: Comparison of total domestic revenue and total tax revenues in 2004 to 2009 (Million US \$)



Source: CSO Afghanistan, 2004 - 2009, Ministry of Finance, 2009

Type of taxes

Based on the current system, different taxes are imposed on the eligible taxpayers in the country. Most of the imposed taxes are direct taxes on income, properties, sales and profits of businesses. Table (4) presents most of these taxes and the amount of revenue that tax authorities collected during 2006 to 2010.

Table 4: Type and revenue taxes from 2006 to 2010 in Afghanistan (Million US \$)

Year	2006/07 (SY1385)	2007/08 SY(1386)	2008/09 SY(1387)	2009/10 -2Q of SY(1388)
Revenue Excluding Grants	622.22	679.15	849.37	593.61
Total Tax Revenues	479.44	510.21	626.76	486.84
Domestic Taxes	247.3	244.85	334.11	276.31
Fixed Taxes	8.3	56.02	78.23	73.45
Income Taxes	87.51	50.39	93.01	66.99
Property Taxes	1.5	2.27	2.29	1.95
Sales Taxes	105.61	117.48	133.13	122.41
Other Taxes	58.54	12.95	21.87	8.97
Tax Penalties & Fines	3.88	5.74	7.63	2.53
Customs Duty, Import Taxes	232.14	265.36	292.65	210.52

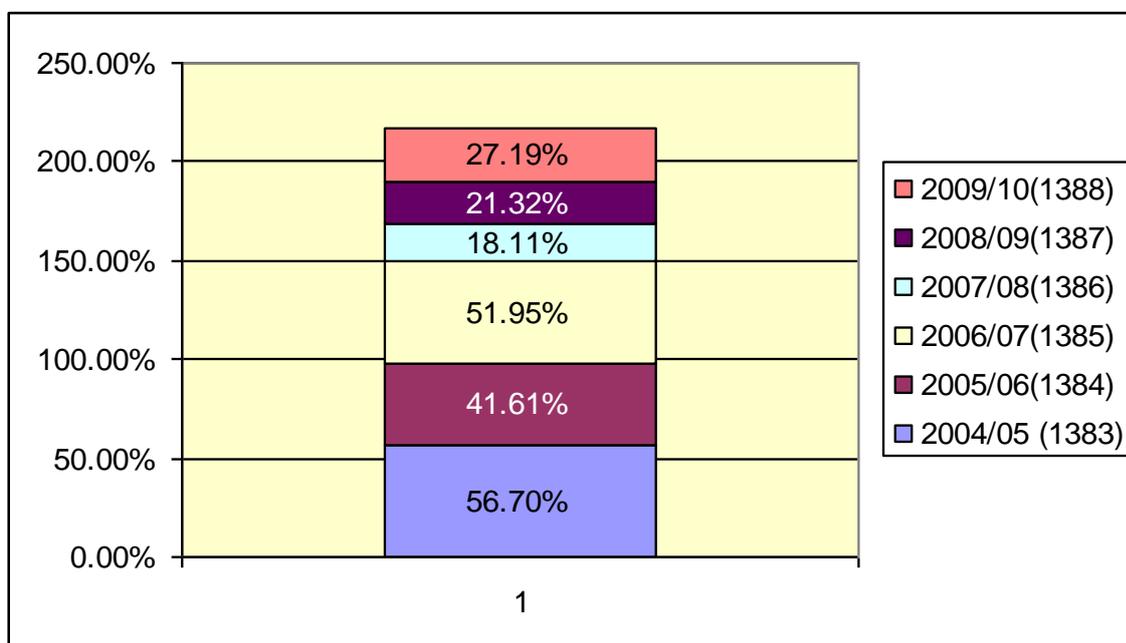
Source: Ministry of Finance, 2009

The numbers for 2010 are from two quarter of the year. However, the figures have been increasing from 2006 to 2009, except income taxes in 2007. Taxes on income and sales contribute considerably to the revenue from domestic taxes in the country in this period.

Tax revenue increases in Afghanistan

The revenue of government has been increased since 2002. Moreover, the increases in tax revenue during 2004 to 2010 were considerably remarkable. Figure (2) indicates percentage increases of tax revenue in this period.

Figure 2: Percentage of increase in tax revenue from 2004 to 2010 in Afghanistan



Source: CSO Afghanistan, 2004 - 2009, Ministry of Finance, 2009

The percentage of increase in tax revenue for the first three years in this period has been very significant, 56.7%, 41.61% and 51.95% respectively. The increase in last three years, 18.11%, 21.32% and 27.19% respectively, has also been considerable.

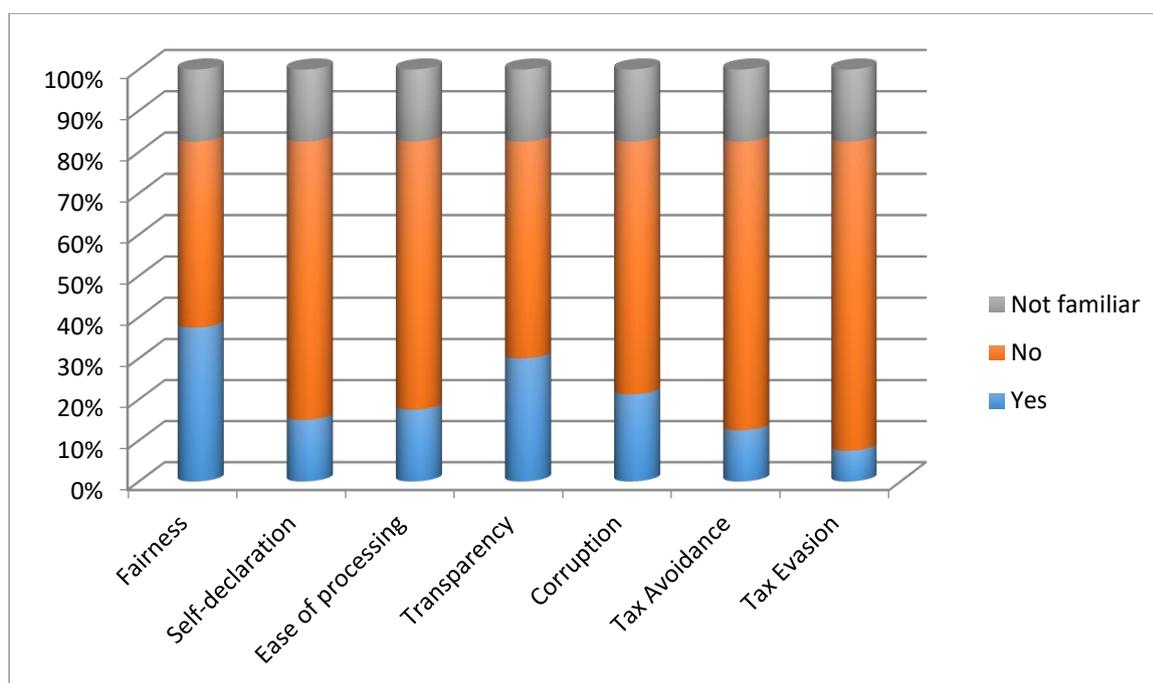
Assessing the system through taxpayers’ experiences

In this part, the results of the evaluation of the taxpayers’ experiences with the current tax system are presented. In the survey, the respondents own experiences in interaction with the system and administrative authorities have been questioned.

The correspondents firstly asked to generally evaluate the fairness of the imposed taxes and the corresponding rates. As it is shown in the figure (3), more than 20% of the correspondents admitted that they have not had any information about the taxes and the rates. However, this figure cannot directly be used as a figure for indicating unfamiliarity of the people with the taxation in the country.

All other aspects of the evaluation are indicating the incidences of experiencing them through the tax payment practices by the correspondents. The incidences of not experiencing ease of paying process and transparency are considerably high among the studied sample and also quiet remarkable number of correspondents reported experience of corruption through the paying process.

Figure 3: Evaluation of taxpayers experience and expectation with regard to tax paying mechanism



Source: Field research survey data (N=80)

The figures of tax avoidance and evasion show the expectation of the correspondents that are not very high. The figure for the taxpayers who personally submits their own tax declaration form is not very high among the studied sample.

Discussion & Conclusion

Based on the available data, the assessment of current taxation, which was reformed in 2005, implicitly revealed that the system was trying to be based on the efficiency and equity principle (Ministry of justice, 2009). The removal of tariffs on the imported primary goods along with the reduction in personal income tax rates has not distorted the consumptions of the people. Therefore, reflection of zero tariffs on primary goods' prices, lower tax rate on the personal income and higher bracket of income tax exemption leave more income available for consumption. This has somehow increased the purchasing power of the people.

Furthermore, the cost of collection has relatively decreased in the current system. The empowerment of regulatory framework and legal system, after the establishment of new government, has enforced the implementation of the tax law. Enacting high rates for surtaxes also contributed to the enforcement of law. The higher power of enforcement caused lower incidences of tax avoidance and tax evasion in the country (Ministry of finance 2007).

Additionally, the figures for tax revenue in the years 2005, the inception of new system implementation, to second quarter of 2009 show that taxes revenue for government had significantly increased. As it was seen the percentage of increase has been more than 200%. Although the system was successful to increase the tax revenue for the government, but still it has not been able to fully absorb the revenue fully and this increasing trends caused through economic situations in the country during this period.

Furthermore, the new system was reformed based on the international standards and is concerned with the equity and efficiency principles as much as possible, but there are some challenging obstacles in front of the success of the system (Ministry of finance 2008). One of the major obstacles is the unfamiliarity of majority of the people to the logic, law and practices of the taxes. Almost 78% of the people are uneducated and they comprise significant numbers of taxpayers (Afghanistan ANDS, 2008). However, they are not adequately aware of the system, laws and the consequences of evasion and avoidances. The relatively unstable political situation with insecure environment is another challenging problem in front of the system. The traditional and weak accounting system and standards among Afghan firms, enterprises and other taxable entities is another prominent challenge in front of the system. The existence of high incidences of corruption in the country, especially among tax authorities is another key challenge for the system. Nevertheless, efforts toward removing the obstacles would greatly contribute to the success of the system with promising higher revenue increases in the future.

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