



SIGAR

Office of the Special Inspector General
for Afghanistan Reconstruction

John F. Sopko
Special Inspector General

May 20, 2013

The Honorable Dr. Omar Zakhilwal
Minister of Finance
Islamic Republic of Afghanistan

Dear Minister Zakhilwal:

Thank you for your letter dated May 16, 2013, regarding SIGAR's recent audit report on taxation of U.S. contractors supporting U.S. government efforts in Afghanistan.¹ As you noted in your letter, the core contention of our report is that "the Afghanistan Government has inappropriately levied millions of dollars in taxes upon U.S. contractors doing business in Afghanistan." Our auditors found strong support for this conclusion. Nevertheless, I would like to respond to the specific concerns raised in your letter.

First, and most important, you contend that my office "neglected to consult with or seek meaningful input from the Afghan Ministry of Finance." Evidently you have been misinformed on this point. My audit team initially met with your office in July 2012. Specifically, the team interviewed two of your senior officials—the Director General of the Treasury and the Director General of Revenue and Customs—as well as some of their top personnel, including the Director of the Large Taxpayer Office Legal Department and the Technical Director of Customs. These officials were identified by the U.S. Embassy in Kabul as the individuals who were best prepared to answer our questions and provide the information we needed. My team met again with your senior revenue officials in October 2012.

Over the course of four meetings with your senior officials, our auditors gathered information about how the Ministry of Finance levies and processes business taxes and about the ministry's perspective on the bilateral agreements between the U.S. and Afghan governments regarding taxation of contractors. These candid discussions were an important component of our audit work, and I appreciate the cooperation your officials demonstrated in meeting with my auditors.

Unfortunately, your senior officials did not demonstrate the same level of cooperation in responding to our repeated requests for data. For example, we requested on multiple occasions a list of the foreign contractors on whom taxes had been levied and a list of those that have paid taxes. Although your officials initially agreed to provide this information and we followed up with them on several occasions to remind them of our outstanding request, your agency never provided the requested information.

Second, you charge SIGAR with "uncritically accepting the testimony of . . . noncompliant contractors." On the contrary, while SIGAR did gather information from contractors (in part because we were unable to obtain the data we requested directly from your office), we did not rely

¹ SIGAR 13-8, *Taxes: Afghan Government Has Levied Nearly a Billion Dollars in Business Taxes on Contractors Supporting U.S. Government Efforts in Afghanistan*, May 2013.

exclusively on this information to formulate our findings. For example, we collected and analyzed supporting documentation from the contractors (including documents they had received from the Afghan Ministry of Finance) and, wherever possible, verified this information with an independent, third-party source, such as the cognizant contracting officer.

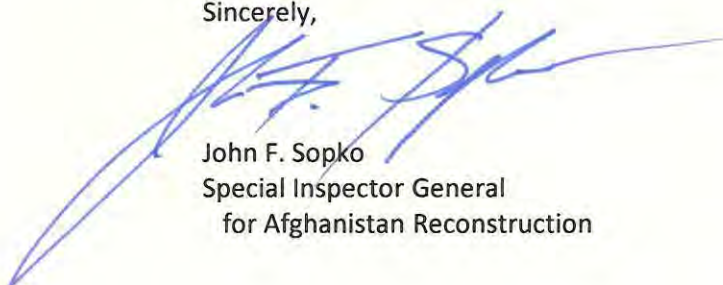
Third, your letter states that two of the bilateral agreements discussed in the report—the 2002 Military Technical Agreement with ISAF and the 2003 Status of Forces Agreement—are “legally suspect, poorly drafted, and ill-suited to the complex reality of 2013.” Regardless of your opinion of these agreements, they were agreed to by the Government of Afghanistan and are in effect today. Therefore, these bilateral agreements constitute sound criteria for assessing the legitimacy of levied taxes. As we reported, we identified at least \$93 million in taxes that had been assessed by the Afghan government on U.S. contractors in contravention of these and other standing bilateral agreements. Based on our analysis, we believe that much more of the total \$921 million in taxes we identified is likely illegitimate.

In summary, SIGAR conducted this audit under generally accepted government auditing standards, which 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. SIGAR has met or exceeded these standards and, therefore, our findings, conclusions, and recommendations are valid and sound. We will continue to monitor this situation to ensure that all U.S. agencies take the appropriate corrective action and ensure that U.S. taxpayer dollars are effectively and efficiently spent.

Finally, I strongly disagree with your contention that our audit has “unwittingly encouraged legal impunity and undermined the ability of the Government of Afghanistan to become self-sustaining.” On the contrary, SIGAR’s audit exposed a serious weakness that must be corrected if the Government of Afghanistan is to achieve self-sustainability. More specifically, we believe the Government of Afghanistan will only become self-sustaining when it is able to attract private capital investment, rather than depending primarily on foreign assistance. This is unlikely to occur until the government administers its tax laws in a manner that is fair, transparent, and predictable.

Thank you for your expression of support for our mission, and I wish you well.

Sincerely,



John F. Sopko
Special Inspector General
for Afghanistan Reconstruction



**Islamic Republic of Afghanistan
Ministry of Finance**

May 16 2013

John F. Sopko
Special Inspector General for Afghan Reconstruction (SIGAR)
2530 Crystal Drive,
Arlington, VA 22202
United States of America

Dear Mr. Sopko:

I would like to take this opportunity to comment on the findings in SIGAR Audit 13-8 regarding "Afghan Business Taxes on U.S. Contracts," the core contention of which is that the Afghan Government has inappropriately levied millions of dollars in taxes upon U.S. contractors doing business in Afghanistan. This report is deeply flawed in several respects. Most important of these, your office neglected to consult with or seek meaningful input from the Afghan Ministry of Finance, which is the responsible authority for collection of taxes in Afghanistan. This oversight renders the conclusions contained in the report suspect.

While the report indicates that its authors sought the cooperation of the Ministry of Finance, my office has never received any request for information from SIGAR, nor have any of your personnel ever visited us to seek our input. It appears from review of the audit report that SIGAR relied heavily upon information gathered from the taxpayers themselves, some of whom may have been subject to fines or other sanctions for violations of Afghan law. It would be naive for the authors of the report to rely upon the testimony of self-interested parties without also obtaining the views of the public authorities. Such an oversight would open the door to manipulation of the audit findings, as has happened in this case.

Afghanistan, with the support of its international partners, has worked hard to build a revenue service capable of meeting Afghanistan's future revenue needs. We are very proud of the fact that our revenue team is challenging major international corporations operating in Afghanistan to abide by Afghan law. I was distressed to note that the audit report overlooked the persistent problem of some U.S. government contractors operating with impunity inside Afghanistan. Some of the tax assessments cited in the audit report in fact relate to instances where contractors failed to file tax returns at all, failed to report income, failed to claim exemptions that may have been due to them, or were found to have abused for private gain the tax or customs exemptions afforded to them. By uncritically accepting the testimony of some of these noncompliant contractors, SIGAR has unwittingly encouraged legal impunity and undermined the ability of the Government of Afghanistan to become self-sustaining.

In addition, the report has overlooked the single most important factor affecting the treatment of tax-exempt income from U.S. sources under Afghan law, which is the inadequacy of the underlying international agreements to provide meaningful guidance. The Government of Afghanistan is absolutely committed to honoring its international agreements; it is equally committed to defending its rights under those agreements as well as Afghanistan's national sovereignty. The agreements primarily at issue, the 2002 Military

Technical Agreement with ISAF (MTA) and the 2003 Status of Forces Agreement with U.S. military (SOFA), are legally suspect, poorly drafted, and ill-suited to the complex reality of 2013. They were battlefield documents, intended to provide limited guidance at a time when the capacities of the Afghan Government were much more limited. We have nonetheless done our best to implement the MTA and SOFA in a reasonable manner, while also urging our international partners to work with us to replace them with agreements that meet present needs.

Despite our disappointment and dissatisfaction with the content of this audit report, we continue to support and encourage your mission to promote economy and efficiency of U.S.-funded reconstruction programs in Afghanistan and to detect and deter fraud, waste, and abuse. We only hope that in future you will engage more fully with the Government of Afghanistan so that you have the full facts at your disposal, and can make accurate assessments of these important issues.

Sincerely

A handwritten signature in black ink, enclosed within a hand-drawn oval. The signature is stylized and appears to read 'Dr. Omar Zakhilwal'.

Dr. Omar Zakhilwal
Minister of Finance
Islamic Republic of Afghanistan