

# SIGAR

**Special Inspector General for  
Afghanistan Reconstruction**

**SIGAR Audit 13-8**

**Taxes: Afghan Government Has Levied Nearly a  
Billion Dollars in Business Taxes on Contractors  
Supporting U.S. Government Efforts in Afghanistan**



**M A Y  
2013**

# SIGAR

Special Inspector General for  
Afghanistan Reconstruction

## WHAT SIGAR REVIEWED

U.S. agencies, including the Department of Defense (DOD), Department of State (State) Bureau of International Narcotics and Law Enforcement Affairs (INL), and U.S. Agency for International Development (USAID), have negotiated agreements with the Afghan government that exempt their contracts from certain Afghan business taxes. However, since 2008, the Afghan government has levied taxes and tax-related penalties on contractors supporting U.S. government contracts in Afghanistan that should be exempt from such taxes under the negotiated agreements.

The U.S. government has an interest in addressing the business taxation challenges that contractors are facing to reduce the cost of projects to the American taxpayer. This audit focuses on business taxes and associated penalties levied on contractors supporting the U.S. government's efforts. Specifically, our objectives were to determine (1) the amount and types of inappropriate business taxes and associated penalties the Afghan government assessed and the amount paid and reported by contractors supporting U.S. government contracts in Afghanistan, and (2) the extent to which U.S. government agencies have taken steps to minimize the tax burden imposed by the Afghan government on these contractors.

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May 2013

**Taxes: Afghan Government Has Levied Nearly a Billion Dollars in Business Taxes on Contractors Supporting U.S. Government Efforts in Afghanistan**

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SIGAR AUDIT 13-8

## WHAT SIGAR FOUND

Since 2008, the Afghan Ministry of Finance (MOF) has levied over \$921 million in business taxes, and associated penalties, on 43 contractors that support U.S. government efforts in Afghanistan. DOD, INL, and USAID have agreements with the Afghan government that provide exemption from certain Afghan taxes. SIGAR identified instances where contractors were taxed despite these agreements. For example, \$93 million of the \$921 million represented taxes levied on business receipts and annual corporate income—a tax category that both the U.S. and Afghan governments have agreed should be exempt for contractors operating under covered agreements. SIGAR also identified instances in which the MOF assessed tax liabilities on contractors even though the contractors held MOF-issued tax exemption certificates. For example, the MOF issued Business Receipts Tax and annual corporate income tax assessments on some DOD contractors, even though the contractors should have been exempt from both tax categories. Three DOD contractors in SIGAR's sample that held MOF-issued tax exemption certificates were improperly assessed nearly \$59 million in business receipts and annual corporate income taxes. U.S. and MOF officials disagree about the tax-exempt status of subcontractors. MOF officials assert that the DOD and State INL agreements provide tax-exempt status only to prime contractors, and not subcontractors, whereas U.S. government officials contend that the agreements provide tax exemption for all non-Afghan companies (both prime and subcontractors) supporting U.S. government efforts. Given these ongoing disputes and the ambiguous nature of the MOF-issued assessments, the 43 contractors in SIGAR's sample have paid approximately \$67 million of the \$921 million in total tax assessments, and most still face unresolved assessments. As a result of the outstanding assessments, the MOF has restricted contractors' freedom of movement and refused to renew business licenses, and the Afghan government has even arrested some contractor personnel. The combined effect is the potential interruption of support to U.S. military operations.

SIGAR also found that INL and DOD contracting officers do not fully understand Afghanistan's tax laws and, as a result, they have improperly reimbursed contractors for taxes paid to the Afghan government. Additionally, while DOD, INL, and USAID have taken some steps to help their prime contractors gain tax exemption, DOD and INL have not taken sufficient steps to ensure that their subcontractors obtain required tax exemption certificates.

## Afghan Government Tax Assessment on Contractors Supporting U.S. Government Contracts

Agency	Total Tax	Withholdings	Business Receipts & Annual Corporate Income Taxes	Undeterminable <sup>c</sup>	Number of Contractors
USAID	\$5,458,7138	\$5,223,048	\$235,665	\$0	7
DOD	\$92,875,298	\$8,671,298	\$62,704,000	\$21,500,000	17
State	\$19,095,672	\$5,238,000	\$1,200,000	\$12,657,672	8
Multiple Agencies <sup>a</sup>	\$803,967,530	\$25,677,833	\$29,300,000	\$748,989,697	11
<b>Total <sup>b</sup></b>	<b>\$921,397,213</b>	<b>\$44,810,180</b>	<b>\$93,439,665</b>	<b>\$783,147,368</b>	<b>43</b>

Source: SIGAR analysis of contractor data.

Notes:

<sup>a</sup>Multiple agency contractors are contractors that work under contracts for a combination of DOD, State, and USAID. No contractor in our sample indicated that it had contracts with agencies other than DOD, State, and USAID. <sup>b</sup>For figures presented to SIGAR in Afghanistan, we converted to U.S. dollars using the Afghani to U.S. dollar exchange rate published by Da Afghanistan Bank on October 18, 2012. This table reflects paid and assessed amounts. <sup>c</sup>Some taxes were undeterminable because the tax assessment issued by the Afghan government did not indicate the specific category of tax that was being assessed. However, based on our analysis, much of this total amount is likely illegitimate.

### WHAT SIGAR RECOMMENDS

SIGAR recommends that the Secretary of State, among other things, develop a consistent, unified position on what the U.S. government deems appropriate taxation of contractors supporting U.S. government efforts in Afghanistan. SIGAR also recommends that State and USAID determine if taxes reimbursed by INL and USAID were legitimate and recover any inappropriately reimbursed taxes. SIGAR is also making three recommendations to State, USAID, U.S. Army Corps of Engineers (USACE), and the U.S. Central Command's Joint Theater Support Contracting Command (CJTSCC) to develop procedures for contractors to obtain appropriate documentation of tax-exempt status with the Afghan government, issue guidance to properly identify taxes in contracts and invoices, and take steps to prevent the improper reimbursement of taxes to contractors. In addition, SIGAR identifies two matters for Congressional consideration to ensure that Congress has complete information on taxes levied by the Afghan government and to address any improper taxation by the Afghan government.

In commenting on a draft of this report, CJTSCC and USACE concurred with SIGAR's recommendations. State did not explicitly agree or disagree with SIGAR's recommendation to develop a consistent, unified position on what the U.S. government deems appropriate taxation of contractors; it argued that such a unified position already exists and that it is inappropriate to suggest that there are inter-agency differences. SIGAR disagrees. SIGAR's finding that contractors have failed to receive guidance on differing tax treatment by different federal agencies shows that inter-agency differences do, in fact, exist. Regarding SIGAR's recommendation to determine if reimbursed taxes were legitimate and to recover any inappropriately reimbursed taxes, State neither agreed nor disagreed but requested further details on SIGAR's analysis. SIGAR provided State with specific information on the types of taxes it identified during an exit conference in January 2013. This information should be sufficient for State to implement SIGAR's recommendation. Although SIGAR is willing to provide additional information on our analysis, SIGAR notes that it is State's responsibility to ensure that the taxes it reimburses are legitimate and to recover any inappropriately reimbursed taxes. USAID neither agreed nor disagreed with SIGAR's recommendations, but instead stated that the recommendations made had already been implemented, were not applicable, or lacked detailed analysis for the agency to implement. SIGAR disagrees and believes its recommendations are well supported and valid.



**SIGAR** | Office of the Special Inspector General  
for Afghanistan Reconstruction

May 14, 2013

The Honorable John F. Kerry  
Secretary of State

The Honorable Charles T. Hagel  
Secretary of Defense

General Lloyd J. Austin III  
Commander, U.S. Central Command

Lieutenant General Thomas P. Bostick  
Commanding General and Chief of Engineers  
U.S. Army Corps of Engineers

Major General Brown  
Commander, CENTCOM Joint Theater Support Contracting Command

Dr. Rajiv Shah  
Administrator, U.S. Agency for International Development

This report discusses the results of SIGAR's audit of business taxes levied by the Afghan government on contractors supporting U.S. government efforts in Afghanistan. We recommend that the Secretary of State 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. We also recommend that the Secretary of State determine if taxes reimbursed by the Bureau of International Narcotics and Law Enforcement Affairs (INL) and the U.S. Agency for International Development (USAID) were legitimate and recover any inappropriately reimbursed taxes.

In addition, we recommend that the State Department Office of the Procurement Executive; the USAID Office of Acquisition and Assistance; the Commander, U.S. Army Corps of Engineers (USACE); and the Commander, CENTCOM Joint Theater Support Contracting Command (CJTSCC), develop procedures for contractors to obtain appropriate tax-exemption certificates, issue guidance on how to properly identify taxes in contracts and invoices, and ensure through guidance and training that contractors are reimbursed only for eligible tax payments. SIGAR also identified two matters for congressional consideration.

We received written comments on a draft of this report from USACE, CJTSCC, State, and USAID, which we incorporated, as appropriate. With regard to our recommendations, USACE and CJTSCC concurred and described the actions they are taking to address them. Their comments are presented in appendices II and III respectively.

State generally concurred with three of our recommendations to develop procedures to: (1) help contractors obtain appropriate documentation of tax exempt status; (2) issue guidance and training to contracting officers on how to properly identify taxes in contracts and invoices; and (3) ensure that contractors are reimbursed only for eligible tax payments. As for our recommendation that State determine whether taxes reimbursed by INL and USAID were

legitimate and that it recover any inappropriately reimbursed taxes, State asserted that it could not act on that recommendation until we provide further details about the taxes identified in the report before it can act. State also declined to either agree or disagree with our recommendation to develop a consistent, unified position on what the U.S. government deems appropriate taxation of contractors supporting U.S. government efforts. It argued that such a unified position already exists and that it is inappropriate to suggest that there are inter-agency differences. State's comments and our response are presented in appendix IV.

USAID did not explicitly agree or disagree with our recommendations, but instead stated that the recommendations had already been implemented, were not applicable to USAID, or—in the case of our second recommendation to determine if taxes reimbursed by USAID were legitimate and to recover any inappropriately reimbursed taxes—lacked detailed analysis for the agency to implement the recommendation. USAID also took issue with a number of our findings. USAID's comments and our response are presented in appendix V.

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

A handwritten signature in black ink, appearing to read 'John F. Sopko', with a long horizontal flourish extending to the right.

John F. Sopko  
Special Inspector General  
for Afghanistan Reconstruction

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## ABBREVIATIONS

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AISA	Afghan Investment Support Agency
BRT	Business Receipts Tax
CENTCOM	U.S. Central Command
CJTSCC	CENTCOM–Joint Theater Support Contracting Command
DOD	Department of Defense
FPDS	Federal Procurement Data System
INL	Bureau of International Narcotics and Law Enforcement Affairs
ISAF	International Security Assistance Force
MOF	Ministry of Finance
NATO	North Atlantic Treaty Organization
SIGAR	Special Inspector General for Afghanistan Reconstruction
SOFA	Status of Forces Agreement
USACE	U.S. Army Corps of Engineers
USAID	U.S. Agency for International Development
VAT	Value Added Tax

Since 2002, Congress has appropriated over \$89 billion to U.S. government agencies, including the Department of Defense (DOD), Department of State (State), and the U.S. Agency for International Development (USAID), to implement humanitarian and reconstruction programs and projects in Afghanistan.<sup>1</sup> U.S. government agencies, in turn, have awarded billions of dollars to contractors to implement those programs and projects. Contractors play important roles in the reconstruction effort by procuring goods and services needed to build roads, schools, hospitals; equip, train and house Afghan security forces; and support U.S. personnel working in Afghanistan. DOD, State's Bureau of International Narcotics and Law Enforcement Affairs (INL), and USAID negotiated agreements that exempt their contractors from select taxes levied by the Afghan government. In this audit, we examined contracts awarded by U.S. government agencies that support both reconstruction and non-reconstruction efforts.<sup>2</sup>

This audit focuses on business income taxes and associated penalties that the Afghan government levies on contractors supporting U.S. government contracts in Afghanistan.<sup>3</sup> Specifically, our objectives were to determine: (1) the amount and types of inappropriate business taxes and associated penalties the Afghan government assessed and the amount paid and reported by contractors supporting U.S. government contracts in Afghanistan and (2) the extent to which U.S. government contracting agencies have taken steps to minimize the tax burden imposed by the Afghan government on these contractors.

To accomplish these objectives, we reviewed Afghan laws, U.S. policies, and bilateral agreements governing contractor taxation in Afghanistan. We also obtained and analyzed tax assessments and met with officials from DOD, State, USAID, the Afghan government, and numerous companies operating in Afghanistan. We conducted our work in Washington, D.C., and Kabul, Afghanistan, from June 2012 through February 2013, in accordance with generally accepted government auditing standards. Appendix I includes a discussion of our scope and methodology.

## BACKGROUND

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Afghanistan has maintained a formal tax code since at least 1965, adopting various updates between 1965 and 2009. In November 2009, the Afghan government adopted a comprehensive tax reform law—the 2009 Income Tax Law—that created a unified tax system governing all aspects of revenue collection. The 2009 law contains five primary taxes associated with income earned by all companies working in Afghanistan. The primary taxes include the following:

- Business Receipts Tax (BRT)—a levy on all revenues a company receives in a given year.
- Annual Corporate Income Tax—a levy on the profits a company earns annually.
- Employee Withholding Tax—a levy on the wages of employees of companies that varies depending on the annual salary of each employee.

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<sup>1</sup>Reconstruction funding falls into five categories: security, governance and development, counter-narcotics, humanitarian, and oversight and operations. As of September 30, 2012, cumulative appropriations for reconstruction in Afghanistan total approximately \$89 billion, \$51 billion of which is appropriated to build the Afghan National Security Forces.

<sup>2</sup>Non-reconstruction efforts include things such as providing food for U.S. troops, security for U.S. installations, and transporting U.S. materials.

<sup>3</sup>Although we had planned to review all Afghan taxes levied on contractors supporting U.S. efforts in Afghanistan, after our initial fieldwork, we determined that this audit will focus on business income taxes. Contractors we interviewed stated that tax assessments relating to business income taxes were their primary tax concern.

- Contractor Withholding Tax—a levy on any work performed by or products purchased from vendors that varies depending on the income and license status of the vendors used.
- 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 taxation mechanisms in the 2009 Income Tax Law.

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

Tax	Liability	Responsible Payer
<b>Business Receipts Tax</b>	<u>Based on industry and revenues:</u> Quarterly revenue <\$14,191: no tax due; Quarterly revenue >\$14,191: 2 percent of quarterly revenue, with special provisions for airline, hospitality, and telecommunications companies	Business must remit payment within 15 days after the end of the quarter
<b>Annual Corporate Income Tax</b>	<u>Annual flat tax:</u> 20 percent of profit after deduction of allowable expenses	Business must remit payment within 3 months of the end of the year
<b>Employee Withholding Tax</b>	<u>Based on monthly employee wage:</u> \$0 - \$94: no withholding; \$94 - \$236: 2 percent withholding of amount over \$94; \$236 - \$1,892: \$3 + 10 percent withholding of amount over \$236; >\$1,892: \$168 + 20 percent withholding over \$1,892	Employer must remit withholding within 10 days after the end of the month of payment
<b>Contractor Withholding Tax</b>	<u>Based on annual value of payments to subcontractors:</u> Under \$9,460: No withholding; Over \$9,460 to a contractor with a valid business license: 2 percent withholding; >\$9,460 to a company without a valid business license: 7 percent withholding	Employing contractor must remit withholding within 10 days after the end of the month of payment
<b>Rental Withholding Tax</b>	<u>Based on rental cost:</u> \$0 - \$189: no withholding tax; \$189 - \$1,892: 10 percent withholding; >\$1,892: 15 percent withholding	Tenant must remit withholding within 15 days after the end of the month of payment

Source: SIGAR Analysis of Afghan Income Tax Law (2009). The figures are based on conversion rate of 52.85 Afghanis per U.S. dollar published by Da Afghanistan Bank on October 18, 2012.

In addition to defining the types of taxes, the 2009 Income Tax Law also establishes penalties for non-compliance. These penalties include:

- 0.1 percent penalty for each day that a tax payment is past due;
- 10 percent penalty for failing to withhold taxes from employees, contractors and landlords;

- 20,000 Afghani (\$378) penalty for failing to keep adequate tax records, failing to provide access to tax records, or failing to have a tax identification number;<sup>4</sup>
- 500 Afghani (\$9.46) penalty for each day past the due date that a tax return is not filed; and
- 100 percent penalty of the tax liability if the company is found to be evading taxes.

The tax law places the burden of tax liability determination, collection, and remittance on the employing company. According to MOF officials, the employing companies are responsible for the taxes of their employees, 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.

Additionally, the 2009 Income Tax Law requires contractors to file a detailed tax return and balance sheet to report income, tax withholding, and other financial information; maintain and present their receipts, expenses, and disbursements to determine their net income; file and pay a business receipts tax, based on the value of their contracts; withhold taxes from salaries of their employees; and submit to the MOF salary and tax statements for each employee. Similarly, contractors are required to withhold taxes from payments to vendors and landlords and transfer those amounts to the MOF. In cases where the MOF believes that the information provided on a contractor's tax return does not correctly disclose the tax due, the MOF determines the amount it believes is due and issues an amended assessment. Similarly, if a company has not prepared and filed a tax return as required, the MOF determines the tax amount due and issues a notice of assessment for this amount, including applicable penalties.

State agreed with the Afghan government that contractors supporting DOD contracts would comply with the requirement that companies register with and be licensed by the Afghanistan Investment Support Agency (AISA).<sup>5</sup> Further, State has included guidance on a website maintained by the U.S. Embassy in Kabul stating that contractors must obtain a business license to operate a business legally in Afghanistan.<sup>6</sup> DOD, State, and USAID contracting offices subsequently began requiring that contractors obtain a business license from AISA in order to be awarded or continue operating in Afghanistan.<sup>7</sup> After registering with AISA, the MOF assigns the contractors a tax identification number. Contractors must renew their business licenses annually by presenting a tax clearance letter from the MOF certifying the contractor's compliance with Afghan tax law and obligations.

## Agreements with the Afghan Government Exempt Contractors Supporting U.S. Government Efforts from Paying Afghan Taxes

The U.S. government does not have a comprehensive agreement with the Afghan government that governs taxation of all contractors working on its behalf. Rather, individual U.S. government agencies have executed separate bilateral agreements with the Afghan government that exempt contractors supporting their agency-funded contracts from paying Afghan taxes. Although these bilateral agreements were adopted prior to the enactment of the 2009 Tax Law, both U.S. and Afghan government officials agree that these agreements remain in force and apply to current business transactions.

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<sup>4</sup>Based on conversion rate of 52.85 Afghani per US dollar published by Da Afghanistan Bank on October, 18, 2012.

<sup>5</sup>Based on Diplomatic Note 12-4021 sent by the Embassy in Kabul to the Afghan government on September 10, 2012.

<sup>6</sup>Embassy of the United State Kabul, *Afghanistan Frequently Asked Questions*, <http://kabul.usembassy.gov/business-faq.html>, accessed on December 3, 2012.

<sup>7</sup>To establish and operate legally, all foreign and local companies are required to obtain an AISA Business License.

## DOD

The U.S. and Afghan governments entered into a Status of Forces Agreement (SOFA) in May 2003. The SOFA exempts DOD personnel and contractors from paying taxes on goods and services provided in Afghanistan. Specifically, the SOFA states that,

“the Government of the United States of America, its military and civilian personnel, contractors and contractor personnel shall not be liable to pay any tax or similar charge assessed within Afghanistan.”

The SOFA further states that the acquisition of goods and services in Afghanistan by or on behalf of the U.S. government are not subject to any taxes, custom duties, or other similar charges. Even though the SOFA refers to U.S. personnel and contractors, DOD and State officials agree that the SOFA applies only to DOD personnel and contractors.<sup>8</sup>

## INL

In February 2003 and in March 2006, INL entered into agreements with the Afghan government to provide tax-exempt status to non-Afghan contractors supporting INL’s counternarcotics and law enforcement efforts. INL’s agreements state,

“Any funds, material and equipment introduced into Afghanistan by the USG [United States Government] or by any person or entity (including but not limited to contractors and grantees) funded by the USG pursuant to this Agreement shall be exempt from taxes, service charges and investment or deposit requirements and currency control in Afghanistan, and the import, export, acquisition, use or disposition of any such property or funds in connection with this Agreement shall be exempt from any tariffs, custom duties, import and export taxes, taxes on purchases or disposition and any other taxes or similar charges in Afghanistan.”<sup>9</sup>

Aside from INL’s activities, State does not have a formal agreement with the Afghan government to provide tax exemption for other State contractors providing security, construction, and other services for the diplomatic mission of the Embassy. In State’s response to a draft of this report, State noted that seeking a sales or income tax exemption for contractors working at its mission in Afghanistan would be something that it does not normally negotiate with other nations.

## USAID

In September 2005, USAID established four Strategic Objective Grant Agreements with the Afghan government. These agreements allow U.S. foreign assistance to be used for development and civil society projects and state that the “assistance... is free from any taxes imposed under laws in effect in [Afghanistan].” The agreements further stipulate that non-Afghan contractors working on behalf of USAID are tax-exempt.

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<sup>8</sup>SIGAR interviewed officials from all contracting agencies and met with officials from DOD Office of General Counsel, State Office of the Legal Adviser, and USAID Regional Legal Office. DOD Office of General Counsel and State Office of the Legal Adviser stated that the SOFA only applies to DOD contractors. USAID Regional Legal Office officials stated that SOFA does not apply to USAID contractors.

<sup>9</sup>*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* (March 9, 2006); *Letter of Agreement on Police, Justice, and Counternarcotics Programs Between The Government of the United States of America and The Transitional Islamic State of Afghanistan* (February 19, 2003).

## ISAF and NATO

In addition to the agreements between U.S. government agencies and the Afghan government, the North Atlantic Treaty Organization (NATO) has entered into its own agreement with the Afghan government. The Military Technical Agreement, signed in January 2002, governs the International Security Assistance Force's (ISAF) activities and grants ISAF military and civilian personnel tax-exempt status.<sup>10</sup> The agreement also provides that,

“ . . . ISAF will be allowed to contract direct [sic] with suppliers for services and supplies in Afghanistan without payment of tax or duties. Such services and supplies will not be subject to sales or other taxes.

\* \* \* \*

. . . local personnel hired by ISAF will . . . [b]e exempt from taxation on the salaries and emoluments paid to them by the ISAF.”<sup>11</sup>

On March, 9, 2011, ISAF's Commanding General issued a letter of interpretation to the Afghan government's Minister of Finance declaring that, as of March 21, 2011, Afghan contractors and employees were no longer tax-exempt with regard to profits and wages earned while working on behalf of ISAF. In addition, the letter declared that non-Afghan subcontractors to ISAF, as well as contractors, are exempt from taxes.<sup>12</sup>

## MOF Has a Process for Granting Tax-Exempt Status

Even though these bilateral agreements exempting contractors from paying taxes are in place, contractors must still obtain a tax exemption certificate from the MOF Revenue Department. The process for obtaining a tax-exemption certificate involves three steps.

1. Obtain a copy of the applicable bilateral agreement(s) that allow(s) exemption from taxes along with a letter from the awarding US government entity confirming the details of the contract, such as contract number and date, contract amount, period of completion of the contract project, and the income of which is claimed to be exempt from tax.
2. Submit the above documents to the MOF Revenue Department along with details of the company, such as the legal name of the company, Tax Identification Number, and point of contact at the company.<sup>13</sup> The letter of request is required to be in the Dari or Pashto language with a copy in English.

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<sup>10</sup>ISAF conducts operations in Afghanistan to reduce the capability and will of the insurgency, support the growth in capacity and capability of the Afghan National Security Forces, and facilitate improvements in governance and socio-economic development. ISAF funding and forces come from the various NATO member states, primarily the US government.

<sup>11</sup> *Military Technical Agreement between the International Security Assistance Force (ISAF) and the Interim Administration of Afghanistan ('Interim Administration') (January 2002).*

<sup>12</sup>2011 COMISAF Letter of Interpretation: (March 9, 2011).

<sup>13</sup>The company is also required to submit its interpretation of the applicability of the bilateral agreement to the company's activities in Afghanistan.

3. The MOF Revenue Department will issue a written ruling in response to the submission within 21 calendar days of the receipt of all relevant information. “This private ruling will state clearly which activities are exempt (if any) and will also specify which tax types are exempt (if any).”<sup>14</sup>

## MOF APPLICATION OF THE TAX LAW RESULTED IN NEARLY A BILLION DOLLARS IN TAXES LEVIED ON CONTRACTORS SUPPORTING U.S. EFFORTS AND MAY HAVE HINDERED OPERATIONS IN AFGHANISTAN

We identified over \$921 million in taxes and associated penalties levied by the Afghan government on 43 contractors working on U.S. contracts from 2008 to 2012 (see table 2).<sup>15</sup> Of this amount, \$93 million represented taxes levied on business receipts and annual corporate income—a tax category that both the U.S. and Afghan governments agree should be exempt for contractors operating under covered agreements. An additional \$45 million represented withholdings from landlords, subcontractors, and employees. We could not determine the legitimacy of these taxes, as the U.S. and Afghan governments disagree on the proper tax treatment of subcontractors, as discussed below. We could not determine a tax category or the legitimacy of the assessments for the remaining \$783 million because we could not obtain adequate descriptions of the taxes or penalties imposed. For example, contractors we interviewed were able to provide some documentation that they received from the MOF detailing the taxes levied; however, this documentation was often vague or contained errors such as mathematic miscalculations. In other cases, contractors told us that tax assessments were verbally communicated by MOF personnel and that the MOF did not provide supporting documentation. During this audit, we conducted several interviews at the Afghan Revenue Department requesting documentation of tax assessments levied against contractors supporting U.S. operations. However, these requests were denied and the documentation was never provided. Nevertheless, USAID, DOD, and INL agree that Afghan taxes levied on non-Afghan contractors working for those agencies are illegitimate.<sup>16</sup>

**Table 2 - Afghan Government Tax Assessment on Contractors Supporting U.S. Government Contracts**

Agency	Total Tax	Withholdings	Business Receipts & Annual Corporate Income Taxes	Undeterminable <sup>c</sup>	Number of Contractors
USAID	\$5,458,7138	\$5,223,048	\$235,665	\$0	7
DOD	\$92,875,298	\$8,671,298	\$62,704,000	\$21,500,000	17
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Multiple Agencies <sup>a</sup>	\$803,967,530	\$25,677,833	\$29,300,000	\$748,989,697	11
<b>Total <sup>b</sup></b>	<b>\$921,397,213</b>	<b>\$44,810,180</b>	<b>\$93,439,665</b>	<b>\$783,147,368</b>	<b>43</b>

<sup>14</sup>Afghanistan Revenue Department, *Confirming an Exemption from Income Taxation Under a Bilateral or Multilateral Agreement*, (March 7, 2011) p 2.

<sup>15</sup>The Afghan tax code allows for the review of a firm’s previous tax years if the MOF suspects that firm of evading taxes; thus, the MOF may assess companies for tax years prior to the issuance of the 2009 tax revision.

<sup>16</sup>This position does not apply to contractors supporting Embassy operations, such as those providing security, construction, and maintenance services.

Source: SIGAR analysis of contractor data.

Notes:

<sup>a</sup>Multiple agency contractors are contractors that work under contracts for a combination of DOD, State, and USAID. No contractor in our sample indicated that it had contracts with agencies other than DOD, State, and USAID. <sup>b</sup>For figures presented to SIGAR in Afghani, we converted to U.S. Dollars using the Afghani to U.S. Dollar exchange rate published by Da Afghanistan Bank on October 18, 2012. This table reflects paid and assessed amounts. <sup>c</sup>Some taxes were undeterminable because the tax assessment issued by the Afghan government did not indicate the specific category of tax that was being assessed. However, based on our analysis, we believe that much of this total amount is likely illegitimate.

## MOF Issues Tax Assessments on Contractors Holding Tax Exemption Certificates

In our sample, we identified instances in which the MOF assessed tax liabilities on contractors even though the contractors held MOF-issued tax exemption certificates. (For a complete discussion of our sample methodology, see appendix I.) For example, the MOF has issued Business Receipts Tax and annual corporate income tax assessments on some DOD contractors, even though the contractors should have been exempt from both tax categories, and three such contractors in our sample were improperly assessed nearly \$59 million in Business Receipts Tax and annual corporate income taxes. Similarly, despite the contractors' tax-exempt status, a contractor working with USAID, DOD, and INL was assessed more than \$27 million in Business Receipts Tax and Annual Corporate Income Taxes, and a USAID contractor was assessed over \$1 million in these taxes and incurred associated penalties for the 4 previous years.

Contractors we interviewed have filed for reimbursements from their contracting agencies to recover taxes paid to the Afghan government. One contractor we interviewed was granted a reimbursement by USAID for \$234,391 for taxes paid in Afghanistan,<sup>17</sup> another contractor was reimbursed more than \$230,000 by State, and a third contractor was reimbursed more than \$287,000 by DOD. Furthermore, other contractors we interviewed stated that they have adjusted their winning bids to account for increased costs due to the Afghan taxes. For example, one contractor that works with DOD, State, and USAID stated that it instructs its subcontractors to include withholding taxes on their invoices and then factors taxes into its bids for government contracts.

## U.S. Government Agencies and MOF Disagree on Subcontractor Tax-exempt Status

U.S. and Afghan government officials disagree about the tax-exempt status of subcontractors. MOF officials stated that the SOFA and INL agreements provide tax-exempt status only to prime contractors and not subcontractors. U.S. government officials disagree with this position and stated the agreements provide tax exemption for all non-Afghan companies (both prime contractors and subcontractors) supporting U.S. government contracts.

The SOFA and INL agreements use the term "contractors," but do not specifically mention "subcontractors." According to U.S. government officials we interviewed, the term "contractors" was intended to encompass both prime contractors and subcontractors. The Department of State has issued diplomatic notes to the Afghan government,<sup>18</sup> and DOD's Office of General Counsel issued a "Fact Sheet" supporting this position.<sup>19</sup> However,

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<sup>17</sup>According to USAID, this reimbursement was approved in September 2009 on an exceptional basis. USAID determined that it was appropriate to reimburse the contractor for penalties for late payment of withholding taxes.

<sup>18</sup>Diplomatic note sent from the U.S. Embassy Kabul to the Afghan Ministry of Foreign Affairs (U.S. Embassy Kabul note 12-4021, dated September 10, 2012)

<sup>19</sup>DOD Office of General Counsel Memorandum, Contractors in Afghanistan and Iraq—Assistance in Responding to Questions Regarding Taxation under the Respective Status of Forces Agreements (March 29, 2011).

the MOF has asserted that the DOD and INL agreements apply only to prime contractors, because subcontractors are not mentioned in the agreements. Because MOF officials assert that subcontractors supporting DOD and INL prime contracts do not have tax-exempt status, the MOF requires prime contractors to withhold a portion of subcontractor payments to meet tax obligations.

Unlike their positions on the SOFA and INL agreements, MOF officials we interviewed concur that USAID’s agreements apply to all USAID contractors, including subcontractors. USAID’s agreements specifically state that “...any contractor, grantee or any other organization” is tax-exempt.

Table 3 shows the MOF’s interpretation and applicability of various bilateral agreements and the U.S. government agencies’ agreement or disagreement.

**Table 3 - Afghan Ministry of Finance Interpretation of U.S. Bilateral Agreements**

US Government Entity (Agreement)	Prime Contractor	Subcontractor	Prime Contractors Tax Withholding for Non-Afghan Subcontractor
DoD (SOFA) <sup>a</sup>	Exempt	Not Exempt	Not Exempt
USAID (Strategic Objective Grant Agreements)	Exempt	Exempt	Not Exempt
State INL (Letters of Agreement)	Exempt	Not Exempt	Not Exempt
State Non-INL(No Agreement)	Not Exempt	Not Exempt	Not Exempt

Source: SIGAR analysis of various bilateral agreements and interviews with U.S. agencies and Afghan government officials.

<sup>a</sup> ISAF Contractors and Subcontractors operate under the Military Technical Agreement, which the MOF interprets as similar to DOD’s SOFA

US Agency Agrees



US Agency Disagrees



If prime contractors fail to withhold or do not withhold a sufficient amount, they—not the subcontractor—must pay the tax that would be assessed, plus any associated penalties. For example, our review showed that MOF penalized one INL prime contractor \$1.7 million for failing to withhold payments to a subcontractor; the MOF later levied an additional \$3.3 million for back taxes and penalties associated with this subcontractor, raising the total assessment to approximately \$5 million. At the time of our report, the issue remains unresolved. Additionally, the MOF levied over \$450,000 in taxes on one DOD subcontractor and approximately \$900,000 in taxes on an INL subcontractor; the INL subcontractor refused to pay these taxes and closed its Afghan business activities.

## In the Absence of a Unified U.S. Government Position, Individual Agency Efforts to Resolve Tax Issues Have Been Unsuccessful and MOF's Tax Collection Efforts Hinder Contractors Supporting the U.S. Government in Afghanistan

DOD, State, and USAID are each responsible for the operation and management of their contracts in Afghanistan and the corresponding taxation issues. According to State, DOD, and USAID officials, the legal offices of each agency are responsible for the interpretation of each agency's agreement with the Afghan government and have dealt with contractor taxation issues only in regard to their respective agencies. DOD, State, and USAID legal offices each offered interpretations of their own agreements with Afghanistan. As a result, the U.S. government has created a tax environment for contractors that differs from agency to agency and allows the Afghan government to take advantage of differences in the application of the various agreements. Contractors we spoke to that work with multiple U.S. agencies in Afghanistan stated that the contractor taxation issue can only be solved by presenting a unified approach across agencies.

Interest groups representing more than 400 contractors have asked DOD and State for clarification regarding Afghan taxation issues impacting their members. In response to these concerns, on March 29, 2011, the DOD's Deputy General Counsel (International Affairs) issued a memorandum regarding contractor taxation concerns in Afghanistan. This memorandum, issued to the DOD Director of Defense Procurement and Acquisition Policy, stated that the Deputy General Counsel has "tried to resist" and "will continue to resist direct questions from contractors and their representatives" with regard to taxation issues. This is because of the Deputy General Counsel's "firm view that contractors should be addressing any such questions to their respective DOD contracting officers or their representatives." The memorandum went on to state that the U.S.-Afghanistan SOFA constitutes an enforceable international agreement between the two governments, and "no further action is required by any U.S. Government or Afghan Government department, agency, or official in order for the U.S.-Afghanistan SOFA provisions to apply to entities and individuals covered by its terms."

In response to contractor requests for assistance from State, the U.S. Embassy in Kabul has held multiple meetings with MOF officials to help resolve taxation issues. The Embassy also sent a Diplomatic Note in September 2012, which reiterated the position that all DOD contractors, including prime and subcontractors, should be tax exempt and advocated on behalf of U.S. government contractors.<sup>20</sup> However, those efforts have not resulted in any meaningful resolution as the Afghan government continues to levy taxes on work performed by contractors on behalf of the U.S. government and impose penalties for failure to pay those taxes.

To date, the 43 contractors in our sample have paid \$67 million of the \$921 million (or about 7 percent) of the taxes levied by the Afghan government, and most of these contractors still face unresolved assessments. One of the reasons contractors have not paid the assessed taxes is because the MOF's tax assessments do not provide sufficient descriptions of the taxes or penalties levied. As a result of outstanding (unpaid) tax assessments, the MOF has restricted some contractors' freedom of movement and refused to renew some contractors' business licenses. The inability of contractors to move personnel and goods into, out of, and throughout Afghanistan or to obtain required licenses hampers contractors' ability to provide continued support to U.S. operations. The MOF's attempted enforcement of tax assessments has also resulted in arrests and arrest warrants for contractor personnel and freezing of company bank accounts. For example, three employees of one contractor we interviewed were arrested in January 2013, during a meeting with the Afghan Revenue Department because the company had an unpaid assessment. These employees were released 3 days later; however, the contractor's taxation issues persist.

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<sup>20</sup>The US Embassy Kabul engages the Afghan government as the primary U.S. agency responsible for negotiating on behalf of other U.S. government agencies and its contractors, as well as the interpretation of applicable bilateral agreements.

Additionally, to import goods into Afghanistan, contractors must complete an Afghan government customs clearance form—commonly known as the T1 form—and the Afghan government requires contractors to have a valid AISA license prior to processing the T1 form. Outstanding tax assessments that prevent the renewal of a contractor’s AISA license therefore prevent the contractor from importing goods necessary to support U.S. government operations. At least nine of the contractors we interviewed had shipments of goods critical to U.S. and coalition operations delayed as a result of unresolved tax assessments; the Afghan government also revoked “freedom of movement” privileges for at least eight contractors since 2009, because they had outstanding tax assessments. According to one of the affected contractors, these restrictions have delayed multiple deliveries of cargo destined for U.S. troops, including goods necessary for the construction of new camps to meet the needs of the shifting military operations.

## **Contractor Taxation Issues Are to be Included in the New Bilateral Security Agreement**

The U.S. and Afghan governments are currently in the process of negotiating a new bilateral security agreement to regulate the presence of U.S. military and its civilian personnel in Afghanistan. According to State officials, DOD contractor taxation issues will be included as a part of the new agreement. They stated that, as a part of the next bilateral security agreement, many of the current taxation issues would be addressed to provide clarity to contractors working in Afghanistan in support of DOD operations. However, because the next agreement is not expected to take effect until the end of 2014, DOD contractors will continue to face unresolved taxation issues until that time. Furthermore, contractors not covered by the bilaterally security agreement will likely continue to experience tax problems.

## **U.S. Laws Do Not Require All Taxes Levied on Foreign Assistance Funds to Be Reported to Congress**

The 2003 Consolidated Appropriations Resolution<sup>21</sup> and subsequent annual appropriations<sup>22</sup> prohibit the taxation of U.S. foreign assistance. The legislation requires that if a foreign central government assesses taxes on U.S. foreign assistance and refuses to reimburse the tax, assistance to that country for the subsequent fiscal year will be reduced by 200 percent of the imposed tax. This withholding is contingent on the Secretary of State reporting to the Committees on Appropriations that the foreign government has not reimbursed the U.S. government for the assessed taxes. However, the prohibition on taxation is limited to certain types of taxes and types of U.S. government appropriations. Only Value Added Tax (VAT) and customs duties imposed on imports under foreign assistance programs specifically funded by select titles in the Department of State, Foreign Operations, and Related Programs Appropriations Acts, which include the Economic Support Funds and funds provided to INL, are prohibited.<sup>23</sup> The limited scope of this prohibition means that the Secretary of State has not been required to report the \$67 million in business taxes paid by the 43 contractors in the sample for this audit. As a result, the tax risk that contractors and, ultimately, the U.S. government face in Afghanistan may not be accurately reflected. For instance, the documents provided to us by State showed that

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<sup>21</sup>Consolidated Appropriations Resolution, 2003, Pub. L. No. 108-7, § 579, 117 Stat. 11 (2003).

<sup>22</sup>See e.g., Consolidated Appropriations Act, 2012, Pub. L. No. 112-74, § 7013, 125 Stat. 786 (2011).

<sup>23</sup>The Consolidated Appropriations Resolution, 2003 and subsequent appropriations require that the taxation of the Economic Support Fund and funds appropriated to State INL be reported to the appropriations committees. It does not apply to other U.S. assistance provided under appropriations such as the Afghanistan Security Forces Fund and Afghanistan Infrastructure Fund.

in 2010, State reported to the appropriations committees that the Afghan government levied approximately \$4,000 in taxes on foreign assistance. In 2011, it reported \$6,000 in taxes levied on foreign assistance.<sup>24</sup>

Because the 2003 Consolidated Appropriations Resolution and subsequent annual appropriations require only VAT and custom taxes levied on specific appropriations, such as the Economic Support Fund and INL funds, be reported to Congress, the Secretary of State is not required to report the \$67million in business taxes paid by contractors. In addition, there is no reporting requirement in the Department of Defense appropriation legislation, such as the Afghan National Security Fund (ANSF).<sup>25</sup> Therefore the Secretary of State is not required to report taxes levied on appropriated ANSF because those funds are outside the scope of the prohibition on taxation of U.S. foreign assistance funds. For instance, in a prior audit of fuel contracts for the Afghan National Security Forces, we identified approximately \$15 million in import tariffs and other fees levied on contractors that were also not required to be reported to the appropriations committees.<sup>26</sup> We did not categorize taxes levied by specific appropriations in this audit; however, given the nearly \$50.7 billion appropriated in the Afghan Security Forces Fund as of January 2013, the amount of taxes levied on these funds could be significant.

## CONTRACTING AGENCIES ERRONEOUSLY REIMBURSED CONTRACTORS FOR AFGHAN TAXES AND HAVE NOT TAKEN SUFFICIENT STEPS TO HELP CONTRACTORS OBTAIN TAX-EXEMPTION CERTIFICATES

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Our review of INL and USAID contracts and invoices, and our interviews with contracting officers, indicate that these agencies and responsible officials do not understand Afghanistan's tax laws as they relate to contracts they oversee and, as a result, have erroneously reimbursed contractors for taxes levied by the Afghan government. For example, we reviewed six INL contracts and found that four of the contracts stated that the contractors would be reimbursed for taxes the contractors paid. Specifically, the contract award documents state that INL will reimburse contractors for VAT taxes as well as "Employee Withholding (BRT)." Furthermore, "Employee Withholding (BRT)" mistakenly combines two separate and unrelated categories of taxes—employee withholding tax and business receipts tax—neither of which should be reimbursed by INL. We also reviewed invoices related to these contracts and found that they contained instances in which the contractors included business receipts taxes and VAT taxes on the invoices and subsequently received reimbursement from INL. In 2012, INL improperly reimbursed contractors in our sample over \$155,000 for claimed "Employee Withholding (BRT)" taxes and over \$595,000 for claimed VAT taxes.<sup>27</sup> In our view, this indicates a fundamental misunderstanding of the current Afghan tax law because Afghanistan does not charge VAT taxes.

Similarly, our review of USAID's ten largest contract actions in Afghanistan during 2010 and 2011 also showed that the agency erroneously reimbursed contractors for taxes levied by the MOF from which the contractors should have been exempt. For example, in one USAID contract, the prime contractor was reimbursed nearly \$160,000 for sales tax. However, USAID's agreements specifically name sales tax as an exempt category. Under the same contract, the prime contractor was reimbursed over \$13,000 for "tax withholdings." This amount should not have been invoiced to USAID. Instead, these taxes should have been withheld from

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<sup>24</sup>These represent amounts USAID reported to State and do not include any taxes State may have incurred.

<sup>25</sup>The Afghan National Security Fund is referred to in later appropriations as the Afghanistan Security Forces Fund.

<sup>26</sup>SIGAR Audit 13-4, *Afghan National Army: Controls Over Fuel For Vehicles, Generators, and Power Plants Need Strengthening To Prevent Fraud, Waste, and Abuse*, January 24, 2013.

<sup>27</sup>We have referred this matter to our Investigations Directorate for further consideration.

subcontractors and not invoiced to USAID as an additional cost. Similarly, invoices for other contract actions showed smaller amounts charged to USAID in the broad category of “taxes, customs, and duties” even though these should have been ineligible for reimbursement by USAID. USAID officials responsible for reviewing and approving invoices told us that they were unaware that these invoices contained taxes that were passed on to USAID for reimbursement.

## Contracting Agencies Have Not Taken Sufficient Steps to Help Contractors Obtain Tax-Exemption Certificates

In order to qualify for tax exempt status, the MOF requires contractors to obtain a tax-exemption certificate for their contracts. To obtain the required certificate, U.S. contracting agencies must supply the contractor with a letter outlining the details of the contract—the contract number, value, and period of performance—they are supporting. Contractors provide this letter as part of their request to the MOF for a tax-exemption certificate.

Officials from the U.S. Army Corps of Engineers (USACE), a DOD contracting agency covered by the SOFA, stated that they have not had many issues related to contractor taxation. However, we found that USACE does not have procedures to help ensure that subcontractors are exempt from taxation. Officials at the Afghan Engineer District told us that the tax exemption process for their prime contractors requires the contractor to first obtain a letter of introduction for its work and then submit the letter to the U.S. Embassy Kabul Economics Office for certification and submission to the MOF. Upon approval, the MOF issues the contractor a tax exemption letter. USACE officials stated that they may be unaware of subcontractors’ tax issues because USACE has no contractual relationship with subcontractors.

Similarly, INL has developed a procedure for issuing letters of introduction on behalf of their contractors; but it does not have a similar procedure for the subcontractors working on its contracts. INL officials stated that they encourage their contractors to hire qualified Afghan subcontractors but do not advise the contractors on their tax responsibilities.

CENTCOM Joint Theater Support Contracting Command (CJTSCC) also operates as a contracting command for DOD in Afghanistan. Like USACE, CJTSCC’s operations fall under the protections delineated in the SOFA. Unlike USACE, CJTSCC has not developed any procedures to ensure that its contractors receive tax exemption. CJTSCC contracting officers we spoke with stated that they were unaware of how the taxation provisions in the SOFA and the Afghan tax code affect their contracts. They stated that they have refused to sign letters of introduction or assist contractors in the tax exemption process because they believe tax issues are beyond the contracting officers’ responsibility. But at the same time, DOD’s Office of General Counsel has stated that its policy is to resist providing advice to contractors because that is the responsibility of the contracting officers.<sup>28</sup> CJTSCC employs local Afghan business advisors to assist contractors in complying with local tax laws; however, a number of the Afghan advisors we spoke with incorrectly stated that contractors supporting U.S. government contracts were not tax-exempt.

CJTSCC maintains an Acquisition Instruction meant to provide guidance to its contracting personnel for the appropriate handling of common contracting issues in Iraq and Afghanistan. However, this Acquisition Instruction does not include any explanation of contracting personnel responsibilities or requirements for assisting in contractor taxation issues or tax-exempt status. While DOD’s Office of General Counsel has taken the position that each individual contractor should consult with its contracting officer on tax related matters,<sup>29</sup>

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<sup>28</sup>DOD Office of General Counsel Memorandum, *Contractors in Afghanistan and Iraq – Assistance in Responding to Questions Regarding Taxation under the Respective Status of Forces Agreements* (March 29, 2011).

<sup>29</sup>See *id.*

CJTSCC contracting officers told us that it was not their responsibility to ensure that contractors receive the proper tax treatment.

As a result of a preliminary brief of this audit's potential findings to the CJTSCC commander held on October 23, 2012, the CJTSCC commander drafted a proposed revision to the Acquisition Instruction that details steps and requirements for the contracting officer to take a more proactive role in helping contractors gain tax-exempt status. Additionally, the CJTSCC commander developed electronic training to help contracting officers gain a better understanding of their responsibilities to assist contractors in the tax exemption process.

To help ensure their contractors and subcontractors complete the tax-exemption process, USAID holds periodic conferences detailing the MOF's tax-exemption process. In addition, USAID issues letters to contractors providing verification that the contractor is implementing a USAID-funded program. The contractor must then provide this letter along with supporting documentation to the MOF and follow Afghan government procedures to receive tax-exempt status. Although USAID does not have a direct contractual relationship with subcontractors, it provides guidance to prime contractors, who are then to pass the information on to subcontractors. Contractors generally provide USAID with a list of all subcontractors they plan to use during the performance of the contract. The contractor also submits to the MOF a list of those subcontractors that will perform work in Afghanistan. Subcontractors then receive (1) a verification letter from the prime contractor identifying their partnership and (2) a copy of the letter acknowledging the prime contractor's partnership with USAID.

## CONCLUSION

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The fact that almost a billion dollars in taxes have been levied—sometimes erroneously—on contractors supporting U.S. operations in Afghanistan, should be a cause for action by all U.S. agencies involved. The U.S. agencies need to have assurance from the Afghan government that their assistance funding (that is, U.S. taxpayer's money used to build schools, roads, health clinics, water treatment facilities) and funds spent to secure the country are not improperly taxed. Agreements put in place to ensure that contractors supporting U.S. agencies' contracts are not taxed appear to be failing in their purpose. Despite requests from contractors for clarification on taxation issues, especially on the question of subcontractor tax exemption, U.S. government agencies, so far, seem unable to provide a definitive and unified response. Further, the U.S. government's lack of a unified position with regard to the taxation of contractors has allowed the Afghan government to exploit the inconsistencies in the terms of agency agreements and has created an uncertain business environment for contractors. The result is that after 11 years of reconstruction efforts, contractors and U.S. contracting officials alike are still unclear as to who (for example, prime contractors and subcontractors) and what activities are supposed to be taxed. The lack of clarity on these tax issues resulted in some personnel working on U.S. contracts being arrested, increased costs to U.S. government contracts, and may have interrupted contractor support to U.S. military operations. While we are encouraged by State planning to include contractor taxation issues in the bilateral security agreement, additional steps must be taken to address current taxation issues.

Furthermore, the 2003 Consolidated Appropriations Resolution and subsequent annual appropriations require that only certain taxes on specific appropriated funds are reported to Congress. Thus, the over \$900 million in taxes levied on the contractors in our sample were not required to be reported to Congress. If it is Congress' intent to know the amount of all taxes levied on all U.S. assistance in Afghanistan, then future appropriations acts should require agencies to report all types of taxes assessed by foreign governments.

## RECOMMENDATIONS

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To help ensure that contractors working with U.S. government agencies receive fair tax treatment, we recommend that the Secretary of State:

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.**

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:

2. **Determine if taxes reimbursed by INL and USAID were legitimate and recover any inappropriately reimbursed taxes.**

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 USACE; and the Commander CJTSCC:

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.**

## MATTERS FOR CONGRESSIONAL CONSIDERATION

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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.**

## AGENCY COMMENTS

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We received written comments on a draft of this report from CJTSCC, USACE, State, and USAID. CJTSCC and USACE concurred with our recommendations and described the actions they are taking to address them. For example, both agencies discussed CJTSCC's January 2013 bulletin to heads of contracting activities on the taxation of defense contractors in Afghanistan and the steps they are taking to incorporate this bulletin into a new acquisition instruction. Once the new acquisition instruction has been completed, existing training will be revised and expanded to educate new personnel about issues related to contractor taxation. CJTSCC's and USACE's comments are presented in appendices II and III, respectively.

In its comments, State questioned SIGAR's authority to examine issues related to the tax treatment of contracts, particularly those contracts supporting U.S. Embassy operations in Afghanistan. State commented that its Office of Inspector General and the "General Accounting Office"—now the Government Accountability Office—are the responsible inspection entities for the review of State's operations. We are concerned that State chose to focus initially on the bureaucratic question of which oversight agency is the appropriate one to examine this issue, rather than turning its attention to devising solutions to the problems we identified in this report. As we informed State officials on several occasions over the course of our audit, and as our draft report clearly noted, the audit did not assess the performance of contracts supporting Embassy operations or those funded with non-Afghanistan reconstruction funds. Nevertheless, our enabling legislation states that we may conduct audits and investigations of the:

“treatment, handling, and expenditure of funds appropriated or otherwise made available for the reconstruction of Afghanistan, and of the programs, operations, and contracts carried out utilizing those funds, including...the monitoring and review of the effectiveness of United States coordination with the Government of Afghanistan and other donor countries in the implementation of the Afghanistan Compact and the Afghanistan National Development Strategy.”<sup>30</sup>

U.S. contracting activity in Afghanistan is an intrinsic part of the effort to implement the Afghanistan Compact, the Afghanistan National Development Strategy, and subsequent agreements. Therefore, we have audit jurisdiction over issues, such as improper taxation, that affect the ability of contractors to support U.S. government implementation of those agreements. Furthermore, our audit was coordinated with State's Office of Inspector General, the Government Accountability Office, and other U.S. government oversight entities. None of these other oversight agencies questioned our authority or ability to conduct this audit.

With regard to our recommendations, State generally concurred with three of our recommendations to develop procedures to help contractors obtain appropriate documentation of tax exempt status, issue guidance and training to contracting officers on how to properly identify taxes in contracts and invoices, and ensure that contractors are reimbursed only for eligible tax payments. State commented that it is continuing to consult internally on how procedures can be improved to help its contractors take advantage of applicable exemptions and to ensure its contracting offices are able to identify and address specific tax issues that may be raised.

However, State did not agree or disagree with our recommendation to determine if taxes reimbursed by INL were legitimate and to recover any inappropriately reimbursed taxes. Instead, State requested that we provide a detailed breakdown and analysis of the taxes we identified in order to determine whether any reimbursement for taxes were legitimate. We provided State with specific information on the types of taxes we identified during our exit conference in January 2013. This information should be sufficient for State to implement our recommendation. Although we are willing to provide additional information on our analysis, we note that it is

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<sup>30</sup> Public Law No. 110-181, as amended.

State's responsibility to ensure that the taxes it reimburses are legitimate and to recover any inappropriately reimbursed taxes.

Moreover, while State did not explicitly agree or disagree with our recommendation to develop a consistent, unified position on what the U.S. government deems appropriate taxation of contractors supporting U.S. government efforts, it argued that such a unified position already exists and that it is inappropriate to suggest that there are inter-agency differences. We disagree. Our finding that contractors have repeatedly requested and failed to receive guidance on resolving different tax treatment by different federal agencies indicates that inter-agency differences do, in fact, exist. State suggests that our recommendation advocates that it seek a treaty or other agreement with Afghanistan exempting all U.S. contractors from taxation. However, State is incorrect and is misrepresenting our recommendation. We do not argue that all contractors should be exempt from host country taxation. However, we do believe that the U.S. government needs additional clarity on which activities are and are not exempt from taxation, that future bilateral agreements should reflect this unified position, and that this information should be provided explicitly and clearly to U.S. contracting activities and to contractors.

State also provided technical comments that we incorporated into our report, as appropriate. State's comments and our response are presented in appendix IV.

USAID also took issue with a number of our findings and recommendations. First, USAID stated that it has "exactly the sort of clear, comprehensive agreement in force with the Afghan government that U.S. law and policy demands." We agree that USAID has such agreements and our draft report discussed in detail the four Strategic Objective Grant Agreements with the Afghan government established in September 2005. These agreements allow U.S. foreign assistance to be used for development and civil society projects and state that the "assistance... is free from any taxes imposed under laws in effect in [Afghanistan]." The agreements further stipulate that non-Afghan contractors working on behalf of USAID are tax-exempt. Despite these agreements, however, we found some instances of taxes that had been reimbursed under USAID contracts. Contrary to USAID's comment, we do not dispute that there are some legitimate taxes levied by the Afghan government—for example, the withholding of income taxes on the salaries of Afghan national employees. Nevertheless, USAID is incorrect that withholding taxes do not constitute an added cost to the U.S. government. As our draft report noted, contracting agencies (including USAID), have issued modifications to reimburse contractors for withheld taxes. Moreover, multiple contractors told us that they increased their invoiced contract costs to account for withholding taxes. This clearly represents increased costs to the U.S. government. In our view, the vague nature of the Afghan government's tax assessments—and not our draft report as USAID argues—conflate legitimate taxes and activities that should be exempt from taxation.

USAID did not explicitly agree or disagree with our recommendations, but instead stated that they had already been implemented, were not applicable to USAID, or—in the case of our second recommendation to determine if taxes reimbursed by USAID were legitimate and to recover any inappropriately reimbursed taxes—lacked detailed analysis for the agency to implement the recommendation. As we noted in our response to State's comments above, our finding that contractors have repeatedly requested and failed to receive guidance on resolving different treatment of taxes by different federal agencies, including USAID, indicates that USAID's "well-established procedures" and "adequately trained" contracting officers are not as transparent or effective as the agency argues. Furthermore, with regard to having sufficient information to support our analysis, we provided USAID with a memorandum in January 2013, which detailed the breakdown of taxes on USAID contractors that were discussed in our report, as well as information from contracts and invoices that were erroneously reimbursed by USAID. Nevertheless, as with the State Department, it is USAID's responsibility to

determine that the taxes it reimburses are legitimate and to recover any inappropriately reimbursed taxes. Moreover, we have limited confidence in the USAID financial audits that the agency claims “will provide an added safeguard to ensure that no unallowable taxes were invoiced to USAID.” These financial audits, in a substantial number of cases, will not occur until many years after funds have been expended.<sup>31</sup> This elapsed time could increase the difficulty of recovering inappropriately paid reimbursements. Relying on audits after the fact is not a substitute for having robust processes in place to avoid spending taxpayer funds on illegitimate taxes.

USAID’s comments and our response are presented in appendix V.

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<sup>31</sup> In an April 2012 report, we found that nearly \$1.1 billion in funds disbursed by USAID since 2003 had not been subject to financial audits because of a significant backlog at the Defense Contract Audit Agency, which conducts these types of audits, and limited funding at USAID. See SIGAR Audit 12-09, *USAID Has Disbursed \$9.5 Billion for Reconstruction and Funded Some Financial Audits as Required, But Many Audits Face Significant Delays, Accountability Limitations, and Lack of Resources*, Reissued on May 2, 2012

## APPENDIX I - SCOPE AND METHODOLOGY

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The audit focuses on business income taxes and associated penalties that the Afghan government levies on contractors supporting U.S. government contracts in Afghanistan. Specifically, our objectives were to determine (1) the amount and types of business taxes and associated penalties the Afghan government assessed and the amount paid and reported by contractors supporting U.S. government contracts in Afghanistan, and (2) the extent to which U.S. government contracting agencies have taken steps to minimize the tax burden imposed by the Afghan government on these contractors. To accomplish our objectives, we reviewed relevant guidance, including the Federal Acquisition Regulation, relevant international agreements, Afghan tax law, and official guidance from U.S. government contracting agencies. We reviewed tax and penalty information for the period between January 1, 2002 and June 30, 2012.

Since no central database existed that identified business taxes and penalties paid by U.S. contractors conducting work in Afghanistan, we used several methods to obtain this type of information. We identified contractors who were likely to have been assessed taxes to the Afghan government by searching the Federal Procurement Data System (FPDS) database for contractors with operations in Afghanistan. FPDS is a searchable database of federal contracting actions, maintained by the U.S. government that allows for queries of contract actions using variables such as contractor name, contracting office, action date, and place of performance. Based on our review of the database containing over 145,000 contract actions, we identified the highest valued contracts that were likely to have been assessed taxes. We selected 222 companies and joint ventures to query using a questionnaire. The questionnaire was designed to obtain information on any tax-related issues pertaining to contract work in Afghanistan. We did not intend to project the results of this review to the universe of contract actions. In addition to obtaining information using the questionnaire, we also received information from an additional 29 companies that had either contacted the audit team or were identified through interviews as having tax issues associated with U.S. government contracts in Afghanistan. This resulted in obtaining responses from 72 companies. Of the 72 companies, 43 indicated they had paid taxes in Afghanistan and 29 indicated they had not paid any taxes. We used computer-processed information to identify U.S. contractors in FPDS and validated the information we obtained through interviews and the questionnaire. We determined that the data were sufficiently reliable to address our objectives.

To determine the extent to which steps were taken to minimize the tax burden, we reviewed DOD, State, and USAID procedures for contract awards and reimbursement. We also reviewed contract files representing the 10 highest valued contracting actions between 2010 and 2011, through the Department of State, USAID, CENTCOM Joint Theater Support Contracting Command (CJTSCC), U.S. Army Corps of Engineers (USACE), and stateside DOD contracting agencies. Additionally, we interviewed 14 contractors associated with contracting actions. We also asked the contracting agencies to provide contracting actions with known tax or penalty issues. Based on this request, we reviewed four additional CJTSCC contract actions and four additional contract actions from other DOD contracting agencies. After discussions with the Department of State's INL Bureau, we received four additional State contracting actions. We assessed internal controls in the process of reviewing contract files, award documents, requests for equitable adjustments or modifications to the contracts, and through our examination of 168 invoices.

We conducted our audit work in Kabul, Afghanistan, and Washington, D.C., from June 2012 to January 2013, 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 conducted this audit under the authority of Public Law No. 110-181, as amended; the Inspector General Act of 1978, as amended; and in accordance with generally accepted government auditing standards.

## APPENDIX II - CENTCOM-JOINT THEATER SUPPORT CONTRACTING COMMAND COMMENTS



CJTSCC-CG

HEADQUARTERS  
CENTCOM JOINT THEATER SUPPORT CONTRACTING COMMAND  
CAMP PHOENIX, AFGHANISTAN  
APO AE 09320



17 April 2013

MEMORANDUM FOR Special Inspector General for Afghanistan Reconstruction, ATTN: Ms Elizabeth Singer, Assistant Inspector General for Audits

SUBJECT: CENTCOM Joint Theater Support Contracting Command (CJTSCC) Comments on Draft SIGAR Audit 13-8, Taxes: Afghan Government Has Levied Nearly a Billion Dollars in Business Taxes on Contractors Supporting U.S. Government Efforts in Afghanistan

1. Reference. Draft SIGAR Audit 13-8, April 2013, subject: as above.
2. The C-JTSCC appreciates the opportunity to review and provide technical comments on the draft SIGAR report in Reference 1.
3. The C-JTSCC is responsible for planning, soliciting, evaluating and awarding contracts that support United States and Coalition forces participating in Operation Enduring Freedom. The contracts awarded by this command are governed by United States and Afghanistan Status of Forces Agreement (SOFA) which entered into force on 28 May 2003.<sup>1</sup>
4. The C-JTSCC concurs with the recommendations directed toward the command. In response to SIGAR's 23 October 2012 preliminary brief of the audit's potential findings, this command took aggressive action to develop procedures and conduct training to address the deficiencies noted by SIGAR. Key details are highlighted below.

a. **Recommendation 3:** Develop procedures to help contractors obtain appropriate documentation of tax-exempt status with the Afghan government. **Reply.** On 21 January 2013, the command published "Head of the Contracting Activity Bulletin 13-02 Taxation of Department of Defense Contractor in Afghanistan." This bulletin includes an information paper that summarizes the tax exemptions for Department of Defense contractors and subcontractors performing in Afghanistan under the SOFA and Military Technical Agreement (MTA) between the International Security Assistance Force and Afghanistan. The bulletin also includes letter templates to be signed by a senior DoD contracting official that allow contractors to seek the appropriate tax exemptions from the Ministry of Finance. The templated letters reflect input from the Ministry of Finance and have been used successfully by several contractors in obtaining recognition of their tax exempt status. The C-JTSCC Acquisition Instruction will be revised to include guidance that advises contracting officers of their responsibilities and the command's procedures in this area.

c. **Recommendation 4.** Issue guidance and training to contracting officer on how to properly identify taxes in contracts and invoices. **Reply.** On 4 and 5 November 2012, the

<sup>1</sup> Agreement regarding the Status of U.S. Military and Civilian Personnel of the U.S. Department of Defense Present in Afghanistan with Cooperative Efforts in Response to Terrorism, Humanitarian and Civic Assistance, Military Training and Exercises, and other Activities, entered into between the United States and Afghanistan [which was concluded by an exchange of diplomatic notes (U.S. Embassy Kabul note No. 202, dated September 26, 2002; Afghan Ministry of Foreign Affairs notes 791 and 93, dated December 12, 2002, and May 28, 2003, respectively), and entered into force] on 28 May 2003.

S:\SCO-A\6.1 NEW LEGAL FOLDER\ADMINISTRATIVE LAW\AUDITS, INSPECTIONS, INVESTIGATIONS\AUDITS\ SIGAR (13-08) Taxation of Contractors (APR-13)

CJTSCC-CG

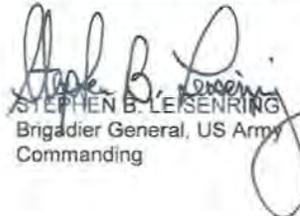
SUBJECT: CENTCOM Joint Theater Support Contracting Command (CJTSCC) Comments on Draft SIGAR Audit 13-8, Taxes: Afghan Government Has Levied Nearly a Billion Dollars in Business Taxes on Contractors Supporting U.S. Government Efforts in Afghanistan

command hosted a Regional Contracting Center/Regional Contracting Office Forum at Bagram Airfield. The chiefs and deputies of all subordinate contracting offices within the command attended that event and received training focused on the tax status of contractors under the SOFA and the MTA. In turn, the chiefs and deputies shared that training with their contracting officers. That training has been posted on the command's SharePoint Portal and discussed during internal, bi-weekly Acquisition Forums (i.e., conference calls) hosted by the command's Director of Acquisition Policy. On 16 November 2012, C-JTSCC drafted two tax clauses for inclusion in all solicitations and contracts issued and awarded by the command. The clauses inform contractors whether a contract action is subject to the tax provisions of the SOFA or the MTA. Those clauses are being reviewed by the Defense Procurement and Policy Office and will be included in the revised C-JTSCC Acquisition Instruction which will be published shortly. Finally, the command will revise and expand existing training to educate new personnel about issues related to contractor taxation.

c. **Recommendation 5.** Ensure through guidance and training that contractors are reimbursed only for eligible tax payments. **Reply.** The command's Acquisition Instruction requires all requests for equitable adjustments or claims, regardless of price, to receive a legal and policy review. That tiered review process ensures actions taken by contracting officers comply with law, regulation and policy. The command's acquisition policy analysts and attorneys have received training on the tax exemptions for Department of Defense contractors and subcontractors performing in Afghanistan under the SOFA and MTA.

5. Please note that draft report incorrectly refers to C-JTSCC as the Combined Joint Transition Security Contracting Command. References in the report should read: "CENTCOM Joint Theater Support Contracting Command."

6. My staff point of contact for this memorandum is the C-JTSCC/FUOPS, which can be reached at [REDACTED]

  
STEPHEN B. LEISENRING  
Brigadier General, US Army  
Commanding

## APPENDIX III - U.S. ARMY CORPS OF ENGINEERS COMMENTS

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REPLY TO  
ATTENTION OF

DEPARTMENT OF THE ARMY  
UNITED STATES ARMY CORPS OF ENGINEERS  
TRANSATLANTIC DIVISION  
255 FORT COLLIER ROAD  
WINCHESTER, VIRGINIA 22603

April 22, 2013

Internal Review Office

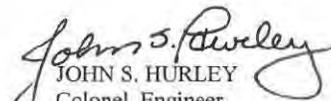
Mr. John F. Sopko  
2530 Crystal Drive,  
Arlington, Virginia 22202-3940

Dear Mr. Sopko:

Enclosed is U.S. Army Corps of Engineers, Transatlantic Division response to recommendations 3, 4, and 5 contained in SIGAR Draft Audit Report 13-08, Taxes: Afghan Government Has Levied Nearly A Billion Dollars in Business Taxes on Contractor's Supporting U.S. Efforts in Afghanistan.

My point of contact for these comments is Mr. George Sullivan, Chief, Internal Review at

Sincerely,

  
JOHN S. HURLEY  
Colonel, Engineer  
Deputy Commander

Enclosure

USACE Comments to SIGAR Draft Audit Report 13-8, Taxes: Afghan Government Has Levied Nearly A Billion Dollars in Business Taxes on Contractors Supporting U.S. Efforts in Afghanistan

USACE comments are provided for each recommendation as shown.

**Recommendation 3:** Develop procedures to help contractors obtain appropriate documentation of tax exempt status with the Afghan Government.

**USACE Response:** Concur. USACE will leverage the procedures outlined in [C-JTSCC-CG memorandum, dated 21 January 2013, subject: Head of the Contracting Activity \(HCA\) Bulletin 13-02, Taxation of Department of Defense \(DoD\) Contractors Performing in Afghanistan](#) across USACE contracting activities. This memorandum provides Contracting Officers (KO's) templates to assist contractors in obtaining the appropriate tax exemptions from the Government of Afghanistan.

**Recommendation 4:** Issue guidance and training to KO's on how to properly identify taxes in contracts and invoices.

**USACE Response:** Concur. USACE will apply the guidance outlined in the C-JTSCC-CG HCA Bulletin 13-02 across USACE contracting activities for actions in support of Operation Enduring Freedom. Upon publication of the revised CENTCOM C-JTSCC Acquisition Instruction (AI) to include foreign tax provisions for use in solicitations and contracts, USACE will update the USACE AI with similar information to provide standard processes aligned with the procedures provided by C-JTSCC. USACE will leverage the electronic training developed by the C-JTSCC commander to assist KO's gain a better understanding of their responsibilities to assist contractors in the tax exemption process. The electronic training will also be incorporated as part of the training curriculum provided by the USACE Deployment Center to KO's, Administrative Contracting Officers (ACO's), and Contracting Officer Representatives (COR's) deploying to Afghanistan.

**Recommendation 5:** Ensure, through guidance and training, contractors are reimbursed only for eligible tax payments.

**USACE Response:** Concur. The procedures and processes outlined in the C-JTSCC-CG HCA Bulletin 13-02 will be leveraged across USACE contracting activities. USACE will benchmark the procedures outlined in referenced HCA Bulletin to provide guidance and training to KO's, ACO's, and CORs relative to foreign taxes to ensure contractors are reimbursed for eligible tax payments.

## APPENDIX IV - DEPARTMENT OF STATE COMMENTS

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**United States Department of State**

*Washington, D.C. 20520*

*www.state.gov*

April 22, 2013

Elizabeth Field Singer  
Assistant Inspector General for Audits and Investigations  
Special Inspector General for Afghanistan Reconstruction (SIGAR)  
1550 Crystal Drive, Suite 900  
Arlington, VA 22202

Ms. Singer:

Thank you for the opportunity to provide the Department of State's comments on SIGAR draft Audit 13-8, "Taxes: Afghan. Government Has Levied Nearly a Billion Dollars in Business Taxes on Contractors Supporting U.S. Government Efforts in Afghanistan."

The Department supports SIGAR's Afghanistan Reconstruction oversight audits and investigations of amounts appropriated or otherwise made available for the reconstruction of Afghanistan as provided in the statute establishing SIGAR. As has previously been conveyed to SIGAR, however, the Department understands that our Inspector General (State OIG) and the General Accounting Office, and not SIGAR, are the responsible inspection entities for the review of the Department of State's world- wide operational platform, to include Afghanistan. We are referring, in particular, to contracts supporting Embassy operations that are funded from the State Department's Diplomatic and Consular Programs (D&CP), Embassy Security, Construction, and Maintenance (ESCM) appropriation or other operating accounts. We are concerned that, to the extent this audit covers the tax treatment of contracts pertaining to "non-reconstruction" funding, the audit extends beyond the scope of SIGAR's mandate. Particularly given the important distinction between foreign assistance and Embassy operations contracts as it relates to taxation by a foreign government, this audit should be limited to reconstruction funding.

SIGAR  
Comment 1

As SIGAR found while conducting its inquiry, the taxation of foreign contractors operating in Afghanistan, as it is in most countries, is often complex. One contractor may have contracts with multiple U.S. Government entities, as well as with foreign governments, international organizations, non-governmental organizations, and/or private entities. Not all work a foreign contractor performs in Afghanistan, including for the U.S. Government, is necessarily covered by an agreement with the Afghan Government providing for tax exemption.

Accordingly, concluding that "almost a billion dollars in taxes have been levied on contractors who should be exempt" is not supported by SIGAR's analysis (page 13). SIGAR acknowledges that it cannot characterize more than \$700 million in alleged taxes and penalties, (30% less than a billion dollars) (see Table 2). In addition, SIGAR nowhere in its analysis otherwise states that it can conclude that all contracts surveyed fall within the U.S. interpretation of the applicable bilateral agreements tax exemptions. Insofar as SIGAR's report suggests or assumes in its discussion that all U.S. Government contracts are, or should be, currently treated as tax exempt by Afghanistan, we urge it to correct such inaccuracies. Specifically, the report

SIGAR  
Comment 2

found that \$783 million in taxes were levied on contractors working for "multiple agencies." Based on that information, it is impossible for the U.S. Government to determine whether these taxes were assessed in violation of any bilateral agreement.

With respect to SIGAR's recommendations and identification of Congressional considerations:

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.

We appreciate and share many of the concerns that motivate SIGAR's recommendation that the Secretary of State develop a "unified" position on appropriate taxation of contractors. We believe that the United States has such a position already, on a global basis: the United States is opposed, for both legal and policy reasons, to paying host country taxes on economic, technical, humanitarian and related assistance, and therefore seeks exemption for these activities via specific bilateral agreements. In accord with this policy, the United States has entered into bilateral agreements with Afghanistan to exempt much U.S. assistance from otherwise applicable taxes. These include a 1951 General Agreement, four 2005 USAID agreements, and 2003 and 2006 INL agreements.

More generally, we believe it is inaccurate to suggest that there are inter-agency differences, or is a lack of unified position on appropriate taxation of U.S. contracts in Afghanistan under the relevant agreements containing exemptions. While there may be differences in the scope of exemptions in agreements that different agencies have negotiated, your report confirms that agencies share common understandings on the interpretation and application of the agreements in place, even as they are bound by different agreements.

SIGAR  
Comment 3

We do not have, and do not believe that we could successfully negotiate, a regime with Afghanistan under which all U.S. government contractors, regardless of for whom they are working or for what purposes, are provided with complete exemption from local taxation. We are unaware of any such treaty regime applicable to U.S. government contractors in any other country of the world. We have no indication, for example, that Afghanistan is interested in providing extraordinary privileges to Embassy operational contractors in Afghanistan. A touchstone principle with respect to the rules governing how a diplomatic mission is treated is reciprocity – nations extend to each other's envoys the treatment that they want their own to receive. The United States cannot easily provide contractors doing work for foreign missions in the United States with sales or income tax exemptions. Thus, we generally do not negotiate for that privilege from other states. We rely on the Vienna Convention on Diplomatic Relations (VCDR)'s provision of exemptions to the mission itself.

SIGAR  
Comment 4

Any exemption from taxes or customs duty in a country has to be negotiated, and the host country has to be willing to provide it. Afghanistan is no different, regardless of the security

environment. Consistent with U.S. law and policy, the USG seeks exemptions for all U.S. foreign assistance from host nation taxation in any bilateral assistance agreement. With respect to contracts supporting other types of U.S. efforts, which SIGAR's comment also may address, we note that reciprocity may undercut the U.S. government's negotiating position, that we have no particular argument that we are entitled under international law to an absolute exemption for all contracts, and we would be singling Afghanistan out for different treatment. We believe it is most fruitful to concentrate our efforts on resolving outstanding issues with respect to our foreign assistance contractors and grantees, and attempting to negotiate to fill gaps with respect to tax exemptions for our foreign assistance where issues of reciprocity do not arise.

The Department does agree that it is important to communicate with contractors. The Embassy maintains on its main website a document, including POC information, on **"Information and Resources Related to Possible Exemptions from Afghan Taxation for Projects Funded by U.S. Government Assistance."** The Country Commercial Guide, prepared at the U.S. Embassy by the Foreign Commercial Service, provides information to businesses operating in Afghanistan, including on the tax treatment of a range of U.S. agency contractors. The U.S. Embassy also consistently recommends that U.S. companies retain effective local counsel specializing in taxation matters.

2. Determine if taxes reimbursed by INL and USAID were legitimate and recover any inappropriately reimbursed taxes.

State neither agrees nor disagrees with the recommendation and would appreciate it if SIGAR could provide a detailed breakdown and analysis of the taxes that SIGAR identified with respect to INL, in order to determine whether any taxes potentially paid were legitimate and to recover any inappropriately reimbursed taxes.

SIGAR  
Comment 5

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.

While not all State Department contractors benefit from tax exemptions in Afghanistan, or elsewhere around the world, we do believe it is important that exemptions available under applicable international agreements are claimed for the benefit of the U.S. Government and tax payer. We agree that contracts should be clear about the allocation of responsibility for tax burdens, and that such allocation should be informed by an understanding of what taxes may need to be paid, as well as the scope of any applicable exemption. A/OPE, relevant legal offices, and INL are continuing to consult on how, we might improve procedures to help our contractors take advantage of applicable exemptions, and to ensure that our contracting offices are able to identify and address specific tax issues that may be raised in their administration of contracts,

and resolve them consistent with contractual provisions and applicable agreements with Afghanistan.

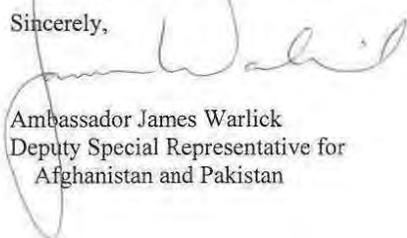
Department of State also provided technical comments that we incorporated into our report, as appropriate

Additionally, we note SIGAR's discussion of legislation penalizing taxation of U.S. foreign assistance funding. We very much appreciate the concern that prompts this legislative proposal. We believe that its goal is addressed by the existing annual appropriations act provision that seeks to ensure foreign assistance funding is exempt from taxation. We note the annual provision is worldwide in scope; we would have concerns that SIGAR's proposal would single out Afghanistan for less favorable treatment than we provide to other countries. We also would have concerns that the legislative proposal's requirement to expand the universe of assistance that must be cut would both hamper U.S. assistance efforts at a crucial time in Afghanistan, and may impose an artificial timeline on USG efforts to work with the Afghan Government to resolve outstanding issues with tax exemptions for foreign assistance.

SIGAR  
Comment 6

Thank you again for the opportunity comment, and we welcome any questions.

Sincerely,



Ambassador James Warlick  
Deputy Special Representative for  
Afghanistan and Pakistan

## SIGAR Response to U.S. Department of State Comments

- 1) As we informed State officials on several occasions over the course of our audit, and as our draft report clearly noted, the audit did not assess the performance of contracts supporting Embassy operations or those funded with non-Afghanistan reconstruction funds. Nevertheless, our enabling legislation states that we may conduct audits and investigations of the:

“treatment, handling, and expenditure of funds appropriated or otherwise made available for the reconstruction of Afghanistan, and of the programs, operations, and contracts carried out utilizing those funds, including...the monitoring and review of the effectiveness of United States coordination with the Government of Afghanistan and other donor countries in the implementation of the Afghanistan Compact and the Afghanistan National Development Strategy.”<sup>32</sup>

All U.S. contracting activity in Afghanistan is an intrinsic part of the effort to implement the Afghanistan Compact, the Afghan National Development Strategy, and subsequent agreements. Therefore, we have audit jurisdiction over issues, such as improper taxation, that affect the ability of contractors to support U.S. government implementation of those agreements. Furthermore, our audit was coordinated with State’s Office of Inspector General, the Government Accountability Office, and other U.S. government oversight entities and none questioned our authority or ability to conduct this audit.

- 2) A draft of this report contained this language, which we have clarified in the final report. The report does not suggest or assume that all U.S. government contracts are or should be tax exempt in Afghanistan; additionally, all \$921 million was assessed on companies directly supporting U.S. government contracts in Afghanistan. The exact amount of inappropriately assessed taxes is not determinable because of the vague tax assessments issued by the Afghan government. However, based on our audit work, we believe that much of the total assessed amount is likely illegitimate.
- 3) We disagree with State’s argument that a unified position already exists and that it is inappropriate to suggest that there are inter-agency differences. Our finding that contractors have repeatedly requested and failed to receive guidance on resolving different tax treatment by different federal agencies indicates that inter-agency differences do, in fact, exist. State asserts that we are recommending the department seek a treaty or other agreement with Afghanistan exempting all U.S. contractors from taxation altogether. However, State is misrepresenting our recommendation. We do not argue that all contractors should be exempt from host country taxation. Rather, we believe that the U.S. government needs additional clarity on which activities are and are not exempt from taxation, that future bilateral agreements should reflect this unified position, and that this information should be provided explicitly and clearly to contracting agencies and contractors.
- 4) See SIGAR response three. We agree that it would be difficult to negotiate a tax regime with Afghanistan that would exempt all U.S. government contractors from taxation, and we do not make such a recommendation. Our recommendation does not ask the State Department to seek exemption for Embassy operations. The recommendation suggests that the State Department develop a unified U.S. government position concerning which taxes are eligible for exemption and work to obtain agreement from the Afghan government.
- 5) We have provided and are willing to provide additional information on our analysis. However, it is State’s responsibility to reimburse only those taxes that are legitimate and to recover any inappropriately reimbursed taxes.
- 6) While we share the State Department’s concern about singling out Afghanistan for less favorable treatment, we proposed the matters for Congressional consideration to provide members of Congress with

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<sup>32</sup> Public Law No. 110-181, as amended.

greater clarity of taxes being paid in Afghanistan. Any decision as to the applicability of penalties should be decided by Congress in future legislation.

# APPENDIX V - U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT COMMENTS



## MEMORANDUM

April 26, 2013

**TO:** John F. Sopko  
Special Inspector General for  
Afghanistan Reconstruction (SIGAR)

**FROM:** Alex Thier, Assistant to the Administrator for Afghanistan and Pakistan

**SUBJECT:** Draft SIGAR Report titled, "Taxes: The Afghan Government has Levied Nearly A Billion Dollars in Business Taxes on Contractors Supporting the U.S. Government Efforts in Afghanistan" (SIGAR 13-8)

**REFERENCE:** SIGAR Transmittal email dated 04/01/2013

Thank you for providing USAID with the opportunity to review the subject draft audit report. Discussed below are our comments on the findings and recommendations in the report.

### PART I: COMMENTS ON SIGAR's FINDINGS

Based on the findings of your audit, your report should conclude three central points as regards USAID:

First, it is clear from this audit that USAID has exactly the sort of clear comprehensive agreement in force with the Afghan government that US law and policy demands.

SIGAR  
Comment 1

Second, there are some legitimate taxes levied by the Afghan government on implementing partners, e.g. withholding of income taxes on the salaries of Afghan national employees. Unfortunately, the audit report conflates legitimate and exempt taxes, thus fundamentally failing to differentiate successful implementation from problems and thereby confusing readers into thinking that legitimate tax assessments were levied and paid in error.

SIGAR  
Comment 2

Third, it is clear that USAID works assiduously with the Afghan government and its implementing partners to enforce our agreements, thus resulting in almost no examples of questionable taxation of USAID partners, despite the alarming title of the report.

SIGAR  
Comment 3

As a matter of principle, USAID takes the taxation exemptions negotiated with the Afghan government very seriously, and enforces them firmly. This is central to our duty to safeguard taxpayer funds and invest them effectively. Rather than levying vague allegations, we ask below that SIGAR provide us with actionable information resulting from their audit so that we may swiftly address any valid claim. USAID takes action to recover any funds that have been paid in violation of grant and contract agreements.

SIGAR  
Comment 4

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### Specific Points

1. **The Afghan government can require the withholding of income taxes for Afghan employees of contractors under Afghan law and USAID agreements and the withholding represents no additional cost to USAID.** Table 2 on Page 6 indicates that the total tax assessed by the Afghan Government on seven USAID contractors was \$5.223 million categorized under "Withholdings."

**USAID Response:** Under Afghan law and USAID's agreements, Afghan nationals or firms are not exempt from annual income taxes under Afghan law. Consequently, such withholding is not a tax on USAID assistance but rather on income earned by Implementing Partners' employees or subcontractors. Based on prior financial audits of costs incurred by USAID contractors, certain amounts are being withheld by Implementing Partners on behalf of the Afghan Government for taxes due on income earned by their Afghan employees or Afghan subcontractors. SIGAR Comment 5

Furthermore, the tax withholdings do not constitute additional costs to USAID projects. The amounts withheld form part of the salaries and wages, rental and other direct costs that are valid charges under USAID awards.

We request that SIGAR provide details of the \$5.223 million withholdings for further evaluation so that we may address this recommendation.

2. **Under Afghan law and USAID's agreements, Afghan firms are not exempt from annual corporate income taxes.** On Page 7, first paragraph, SIGAR states "*Similarly, despite the contractors' tax-exempt status, a contractor working with USAID, DOD, and INL was assessed more than \$27 million in Business Receipts Tax and Annual Corporate Income Taxes, and a USAID contractor was assessed over \$1 million in these taxes and incurred associated penalties for the 4 previous years.*"

**USAID Response:** USAID notes that under Afghan law and USAID's agreements, Afghan firms are not exempt from annual corporate income taxes. We request that SIGAR provide transaction details so that we can confirm validity of the tax assessment. In addition, this statement is not consistent with Table 2 on page 6 where zero business receipts and annual corporate taxes were reported for USAID. SIGAR Comment 6

3. **A single special case in 2009 does not indicate a trend.** On Page 7, second paragraph, SIGAR states "*Contractors we interviewed have filed for reimbursements from their contracting agencies to recover taxes paid to the Afghan government. One contractor we interviewed was granted a reimbursement by USAID for more than \$230,000 for taxes paid in Afghanistan; ...*"

**USAID Response:** This statement pertains to a one-time reimbursement of \$234,391 approved by USAID in September 2009 on an exceptional basis. USAID determined that it was appropriate to reimburse the Contractor for penalty charges for late payment of withholding taxes for the period April 2007 through May 2008. USAID's final determination was based on the fact that the contractor relied in good faith on erroneous advice provided by USAID in December 2006 that resulted in the contractor's incurrence of late penalty charges. No further penalty charges were allowed to be reimbursed after May 2008. USAID will provide supporting documentation upon request.

SIGAR  
Comment 7

4. **No supporting evidence from SIGAR.** On Page 11, second paragraph, SIGAR states "*Similarly, our review of USAID's ten largest contract actions in Afghanistan during 2010 and 2011 also showed that the agency erroneously reimbursed contractors for taxes levied by the MOF from which the contractors should have been exempt. For example, in one USAID contract, the prime contractor was reimbursed nearly \$160,000 for sales tax. However, USAID's agreements specifically name sales tax as an exempt category. Under the same contract, the prime contractor was reimbursed over \$13,000 for "tax withholdings."* –

**USAID Response:** USAID requests supporting documentation for the claim that a prime contractor was reimbursed nearly \$160,000 for sales tax and a further \$13,000 for "tax withholdings". Without this detail, it is not possible to comment and it is possible these withholdings were properly assessed.

SIGAR  
Comment 8

Rather than anecdotal evidence, this audit would benefit from a systematic review of data. USAID requests that SIGAR incorporate actionable data and information instead of isolated examples without supporting documentation.

## **PART II: COMMENTS ON SIGAR'S RECOMMENDATION**

*To help ensure that contractors working with U.S. government agencies receive fair tax treatment, we recommend that the Secretary of State:*

*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.*

**USAID Response:** USAID has clear agreements with the Afghan government regarding taxation, communicates this clearly to all contractors, and works to ensure that taxes levied are according to this agreement. The provisions on taxation under which USAID currently operates is part of the 1951 Agreement on Technical Cooperation between the Government of Afghanistan and the United States and is general in nature. USAID's Strategic Objective Grant Agreements, that implement the 1951 agreement, are much more specific and detailed. These agreements already contain provisions related to tax exemptions that are communicated

accordingly to contractors. With regard to the requirement for reporting taxes to Congress, a specific clause is already incorporated into USAID awards. Contractors' compliance with the annual tax reporting requirement is reviewed during audits. We therefore deem this recommendation not applicable to USAID.

SIGAR  
Comment 9

*2. Determine if taxes reimbursed by INL and USAID were legitimate and recover any inappropriately reimbursed taxes.*

**USAID Response:** SIGAR has not provided specific evidence or analysis of improperly reimbursed taxes; therefore it is impossible for USAID to implement this recommendation at this time. Once SIGAR provides a detailed analysis of the taxes that SIGAR reviewed, USAID can conduct such an analysis to determine if the taxes were legitimately reimbursed and to recover any inappropriately reimbursed taxes. USAID is very vigilant on this issue in Afghanistan. In an analysis that USAID performed of the awards that SIGAR reviewed, there was no evidence found that USAID had improperly reimbursed any taxes. The majority of taxes paid by the implementing partners (IPs) were withholdings which are allowable under Afghan law and USAID's agreements. The only tax-related payments reported by these IPs that were not allowable were those fees paid when tax returns were not filed in a timely manner in accordance with Afghan law, which requires entities to file a return regardless of whether any taxes are owed. In other cases, fees were paid when legitimate and allowable tax withholdings were not properly made. There was no evidence that these fees had been invoiced to USAID.

SIGAR  
Comment 10

In addition, 99% of funds currently under obligation in Afghanistan, other than funds provided to certain Public International Organizations (PIOs), are subject to USAID financial audits that will provide an added safeguard to ensure that no unallowable taxes were invoiced to USAID. The remaining 1% of the funds are obligated under fixed priced awards which during the evaluation of proposals the Contracting Officer would be responsible for ensuring that no budget is authorized for unallowable taxes.

*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 USACE; and the Commander C-JTSCC:*

*3. Develop procedures to help contractors obtain appropriate documentation of tax-exempt status with the Afghan government.*

**USAID Comments:**

We consider this recommendation to be fully addressed and therefore, not applicable to USAID. USAID/Afghanistan has well-established procedures in place for assisting implementing partners in availing themselves of appropriate Afghan tax exemptions. The USAID Regional Legal Office has two full-time staff who spend a substantial portion of their time addressing issue related to tax exemptions and assisting USAID partners on these matters already. The Regional Legal Office has held trainings for all contractors to address the proper procedures for ensuring that activities USAID funds are exempt from Afghan taxation as evidenced by the notice sent to Implementing Partners OAA-IP-2012-023.

SIGAR  
Comment 11

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*4. Issue guidance and training to contracting officers on how to properly identify taxes in contracts and invoices.*

**USAID Comments:** USAID Contracting Officers are already adequately trained to recognize the allowability, allocability and reasonableness of all award costs including taxes. Contracting Officers cannot be reasonably expected to be tax experts due to the complexity and ever changing nature of tax laws. However, Contracting Officers work closely with the Regional Legal Office to help determine the applicability or allowability of any taxes in contracts or invoices. Existing guidelines such as the Code of Federal Regulations (CFR), Federal Acquisition Regulations (FAR), AIDAR, ADS and other relevant guidance are deemed adequate; as such, no further USAID action is necessary.

SIGAR  
Comment 12

*5. Ensure thorough guidance and training that contractors are reimbursed only for eligible tax payments.*

**USAID Comments:** The cost principles applicable to assistance and acquisition awards -- as contained in pertinent OMB circulars, CFR and FAR provisions -- are specifically referenced in award documents. The applicable cost principles are discussed at post award briefings with USAID Implementing Partners (IPs). IPs are directed to refer specific tax questions to their cognizant CO/AO. As such, we consider this recommendation to not be applicable to USAID.

SIGAR  
Comment 13

## SIGAR Response to U.S. Agency for International Development Comments

- 1) We concur that USAID has agreements in place and our draft report discussed in detail the four Strategic Objective Grant Agreements with the Afghan government established in September 2005. These agreements allow U.S. foreign assistance to be used for development and civil society projects and state that the “assistance... is free from any taxes imposed under laws in effect in [Afghanistan].” The agreements further stipulate that non-Afghan contractors working on behalf of USAID are tax-exempt. Despite these agreements, and the processes USAID has put in place to gain tax exemptions for their contractors, we found some instances of taxes that had been reimbursed under USAID contracts.
- 2) Contrary to USAID’s comment, we do not dispute that there are some legitimate taxes levied by the Afghan government—for example, the withholding of income taxes on the salaries of Afghan national employees. Nevertheless, USAID is incorrect that withholding taxes do not constitute an added cost to the U.S. government. As our draft report noted, contracting agencies (including USAID), have issued modifications to reimburse contractors for withheld taxes. Moreover, multiple contractors told us that they increased their contract costs to account for withholding taxes. This clearly represents increased costs to the U.S. government. In our view, the vague nature of the Afghan government’s tax assessments, and not our draft report as USAID argues, conflate legitimate taxes and activities that should be exempt from taxation.
- 3) See response one.
- 4) Upon request from USAID, we provided a memorandum on January 31, 2013, detailing the breakdown of taxes on USAID contractors that were discussed in our report, as well as information from contracts and invoices that were erroneously reimbursed by USAID. While we are willing to provide further information, it is USAID’s responsibility to determine actionable conclusions from the information, or—ideally—prevent inappropriate charges from the beginning.
- 5) The withholdings cited in the Table 2 are not restricted to employee wages of Afghan nationals, but include amounts withheld from subcontractors and landlords as well. We are familiar with the contention that withholding taxes do not constitute an added cost to the U.S. government; however, as we point out in the report, contracting agencies have issued modifications to reimburse for withheld taxes and multiple contractors have stated that they have increased their invoices to account for withholding taxes. Furthermore, we have previously provided USAID with specific information regarding the \$5.223 million in withholdings.
- 6) None of the contractors cited in USAID’s comment operate as Afghan companies. We have previously provided USAID with information concerning the contractors. We have revised Table 2 to accurately reflect our data.
- 7) The point we make in using examples of USAID (and other agencies) reimbursing contractors for taxes paid to the Afghan government was to illustrate the larger problem that taxes may have been erroneously reimbursed.
- 8) See response four.
- 9) The recommendation is directed toward the Secretary of State and is not applicable to USAID.
- 10) We have previously provided USAID the documentation requested in this comment. While we are encouraged that most of USAID’s funds obligated to Afghanistan undergo financial audits, we have limited confidence in the USAID financial audits that the agency claims “will provide an added safeguard to ensure that no unallowable taxes were invoiced to USAID.” These financial audits, in a substantial number of cases, will not occur until many years after funds have been expended. This elapsed time could increase the difficulty of recovering inappropriately paid reimbursements. Relying

on audits after the fact does not substitute for having robust processes in place before payment of scarce funding on potentially illegitimate taxes.

11) As we noted in our response to State's comments above, our finding that contractors have repeatedly requested and failed to receive guidance on resolving different treatment of taxes by different federal agencies—including USAID— indicates that USAID's "well-established procedures" and "adequately trained" contracting officers are not as transparent or effective as the agency argues.

12) See response one.

13) See response one.

## APPENDIX VI - ACKNOWLEDGEMENTS

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This audit report was conducted  
under project code SIGAR-060A.

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- improve effectiveness of the overall reconstruction strategy and its component programs;
- improve management and accountability over funds administered by US and Afghan agencies and their contractors;
- improve contracting and contract management processes;
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