



# The Tax Evasion Is A Serious Crime, and It Comes With Serious Consequences: A Study Based on Afghanistan

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## Abstract

Afghanistan has taken a number of measures to combat against tax evasion. These measures however, have not led to strengthening tax compliance in the country. This is because of social realities such as smuggling, corruption, black marketing, trading in narcotics and rejection of the state tax model of governance and its tax architecture by the local Afghan tribal leaders and the populace. This article argues that these problems present the greatest hurdle in Afghanistan's quest towards a tax compliant society. The article therefore, begins by highlighting the importance of the nexus between tax and development for Afghanistan. It then moves to examine the Afghan tax culture that results in loopholes that result in tax leakages. The article also closely considers strategic government led interventions to address the problem of tax evasion. Later, the paper proposes recommendations tailored towards mitigating some of the tax evasion practices.

**Key Words:** Combat, Tax evasion, Tax compliance, Smuggling, Corruption, Black marketing, Nexus, Loopholes, Tax leakage.

## 1. Introduction

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

Mohamddin, a resident of the district outside Kunduz city

Smuggling, corruption, black marketing, narcotics and rejection of the state model of governance and its tax architecture by the local Afghan tribal leaders has contributed to the decline of the Afghan economy. Further, a number of taxable activities remain untapped by the government as a result of high instances and dependency on cash and cash based transactions that are difficult to track. Furthermore, the lack of a formal system of documentation of self-employed persons and their activities has also led to tax leakages.

Almost all of the self-employed persons are involved in tax evasion and underground economic activities in Afghanistan. These facts have not only been confirmed by previous empirical studies carried out by Maimbo (2003), UNODC (2008), the Special Inspector General for Afghanistan Reconstruction (2012), Rosenberg (2013), Integrity Watch Afghanistan (2015) and Rai (2017), but also by the interviews<sup>2</sup> carried out as a result of this study. The burden of tax, the rise of the underground economy during the wars,

disdain towards regulation designed to curb market monopoly, the lack of loyalty towards public institutions and low tax morale are some of the determinants identified by the research as key contributors for tax evasion in present day Afghanistan.

Various scholars have argued that taxes play a very important role in the economic development of a country. Taxes support state sponsored welfare programs tailored towards improving citizen's living standards and in the distribution of wealth through the just allocation of resources. The process of tax collection is one of the most powerful lenses in political economy to assess the distribution of power in a polity.

Long ago Edmund Burke remarked: "Revenue is the chief preoccupation of the state. Nay more it is the state" (quoted in O'Brien, 2001: 25). Indeed, there is a long history of thinking in political economy and history that links the process of state-building with the capacity of rulers to collect taxation (Schumpeter [1918] 1954; Tilly, 1990). Taxation is also one of the few objective indices we have that measures the power, authority and legitimacy of the state to mobilize resources (Di John, 2010). Taxation and tax reform, therefore, is central to state-building in Afghanistan for several reasons.

First, the Afghan government needs to ensure sustainable funding for social programs, and for public investments to promote economic development. Second, taxation is the main nexus that binds state officials with and citizens. Not only can taxation enhance government accountability, it also provides a focal point around which citizens can mobilize to support, resist, and even propose tax policies. In other words, taxation is as constitutive of state formation as it is of citizen participation in budget making and delivery of social services. Third, taxation, particularly in the form of land and property taxes, customs and border collection can help increase the territorial reach of the Afghan state.

The diversity of the tax base is a telling indicator of the ability of the Afghan state to engage with different sectors and regions and is indicative of the degree to which the state's authority permeates society. Fourth, fiscal capacities are needed to build a legitimate state (Waris, 2016). Strong institutions and competent revenue authorities are therefore needed in order to ensure effective tax assessment and collection. It is therefore crucial to examine the tax collection capacity of the Afghan state in light of the fact that tax evasion practices in Afghanistan are now rampant.

Afghanistan is defined by the relationship between the kinship based solidarity of highlands and mountain range dwelling Afghans and the differentiated and hierarchical social organization of the city life and urban civilization. It is consumed by the culture of sedentary rural tribal Pashtun communities, non Pashtun groups (Hazaras, Tajiks) and Persians. Kabul and Kandahar have been places besotted with historical wars to present day hot beds for terrorist activities. Afghanistan traces its origins to a patrimonial state based primarily on coercion and conquest between warring tribes, and most recently, towards democracy.

Various governments have appeared and disappeared in Kabul during 1901-2001 – from the reign of Amir Habibullah to the fall of the Taliban regime. Pashtun political dominance invades all spheres of Afghanistan (see Barfield, 2011). Following its fragmented political structure, a definition of the Afghan state in terms of its revenue raising system is difficult because it incorporates a variety of different practices; tribal and community imposed taxes to government led taxation (Kakar 1979: 73-5). As it entered the 21st century, Afghanistan has still not completely shed the inheritance of its original imperial model. Hence, to various degrees, all Afghan governments have failed to successfully play a regulatory role among local communities.

Similar has been the stand with taxation. It has been difficult for the government to get communities to remit taxes. Consequently, this paper is based on 30 interviews conducted in Afghanistan with CSOs, NGOs, government officials, and community leaders to understand Afghanistan's tax structure and the instances that give rise to the rampant tax evasion practices there. The problem, however, is that there is hardly any data or sources that provide an indication on an estimate of the tax revenue that is lost to the Afghan state because of tax evasion practices; by individuals and corporations. Without evidence of these estimates and the identification of the tax evasion practices, the Afghan government will remain restricted in identifying, tracking and stopping such evasion.

The intention of this research is not to provide a comprehensive overview of estimates of every tax evasion component, nor of every tax evasion channel. Instead, it seeks to first, review existing legislation, regulations and policies on finance, taxation, corporations, banks and financial institutions including the Afghan Hawala markets and informal sector in order to understand the Afghan tax system. Second, to assess the level of compliance with global standards and recommendations on tax management. Third, to consider the effectiveness of the Afghan revenue authority and its competencies. Fourth, to assess the strengths and weaknesses of the departments and offices within the Afghan revenue authority to review the successes and challenges they face in collecting custom duties and taxes. Fifth, to examine the corporate tax structure in place for various industries such as the telecommunication, construction, trading and extractives sector. Sixth, to identify the key transactions corporations in those industries are involved in. Seventh, to review the remittance of taxes to the Afghan revenue authority where possible to assess source of income; and eighth, to generate data on the declaration of income by corporations, payment/non-payment of customs duties and smuggling of goods.

## 2. Structure of the study

This study considers and reviews the literature on tax evasion practices in Afghanistan. It begins by presenting the available information on tax evasion that is currently contained in policy papers, reports, newspaper articles, working papers, journal articles and books. It considers the information provided from interviews conducted with government sources, the civil society, and international organizations. The study then describes both the domestic and international initiatives taken by the Afghan government in curbing tax evasion. It then concludes by pointing out the current recommendations made by various domestic and international bodies that have conducted research relating to tax evasion in Afghanistan. This is in order to establish which of the recommendations the Afghan government has implemented, and which remain pending.

## 3. Tax evasion practices in Afghanistan

Afghanistan is cracking down on tax evasion to repair its finances as the country's economy struggles with renewed violence and the withdrawal of the huge coalition presence that fed business for years.

The departure of most foreign troops two years ago allowed the Taliban to take advantage of the security vacuum and escalate attacks on the government, hurting consumer and business confidence. Double-digit economic growth rates collapsed to almost zero a year after the withdrawal.

### 3.1. Unreported Transactions

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

The Global Financial Index (GFI) reports that Afghanistan's cumulative illicit outflows from 2003-2012 was USD 2.22 billion, with an average annual illicit outflow of USD 222 million per year. However, these figures are very conservative because GFI assigned a value of zero to Afghanistan's annual illicit outflows from 2007 to 2012. On the contrary, Integrity Watch Afghanistan (IWA) reports that the USD 222 million estimate does not pick up movements of bulk cash, the mispricing of services, or many types of money laundering. Afghanistan's rising IFFs linked to increased opium production and drug trafficking are also not captured in GFI's estimate. As such, the total amount of IFFs from Afghanistan is likely significantly higher than GFI's estimate of USD 222 million per year.

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

### 3.2. Lack of Regulation

A major challenge to disrupting the movement of illicit financial flows is the lack of regulation or control of the informal financial sector (hawala) which controls the vast majority (estimated at 90%) of financial flows within Afghanistan and transfers to foreign countries. Da Afghanistan Bank (DAB) has issued regulations to govern the informal money service provider (MSP) – hawala – sector; however, the majority of hawaladars operate without licenses and do not comply with DAB regulations. With little trust in the formal banking system, the Hawala emerged as the most convenient and reliable system for moving funds in and out of the country. Hawala, unlike any formal institution, is based on mutual trust and an extensive network of family and regional affiliations. Such a close knit community of money exchange dealers or hawaladars provide a reliable, timely and cost-effective alternative to the traditional banking and financial establishments which are otherwise perceived as inadequate and corrupt.



### 3.3. No Thresholds on Funds Transfer

There is no limit on the volume of funds transfers the hawaladars can transfer; individually or severally. Since the fall of the Taliban regime, the volume of financial flows through the hawala system has grown significantly. NGOs alone are estimated to have channeled at least US\$200 million in emergency, relief, and development funding through the hawala system. Single transactions in excess of US\$500,000, especially between Peshawar in Pakistan and Kabul, are not uncommon.

The larger international aid institutions and NGOs have made individual transactions of US\$1,000,000. Because there are limited storage facilities in Kabul for large sums of money, however, the majority of organizations remit funds through the hawala system in smaller amounts of US\$100,000 to \$200,000. The smaller organizations regularly remit US\$20,000 to \$30,000 to meet operational expenses. Internally, the funds remitted to the provinces tend to be smaller, ranging from US\$10,000 to \$20,000. Owing to security concerns, these hawala transactions are made only when the regional offices have ready invoices for payment.

### 3.4. Smuggling

Tax-motivated IFFs are a major challenge facing Afghanistan. According to a confidential assessment of Afghan finances by the International Monetary Fund (IMF), the Afghan government's financial woes in 2013 was caused by widespread tax evasion and smuggling abetted by government officials and the increasing theft of customs revenues by provincial governors. The UNODC (2008) reports that the financial flows in and out of Afghanistan linked to the drug trade and other illicit activities also occur via the hawala system. As the largest producer of opiate goods (includes heroine, morphine and other products) in the world, in the year 2008, the Afghan drug trafficking industry generated \$1.4 billion from opium exports alone. It offers a scrutiny free channel for money laundering which can be used to assist terrorist financing, illicit opiate industry and other criminal activities.

### 3.5. Weak Implementation of Reporting Standards

Weak implementation on the part of state authorities in establishing reporting and controlling standards allows several industries like the telecommunication, extractive and logistics to misappropriate their revenues. Several large scale of large misappropriation and under reporting of revenue across industries such as construction have been found, wherein the political elites consistently report no income. Similarly, the extractive industries from the regions of Badakshan to Nangarhar pay no royalties or taxes on mining activities for stones such as lapis and emeralds.

### 3.6. Absence of Information on Ownership

Afghanistan Investment Support Agency (AISA) probed an international logistics firm catering to American soldiers stationed in Afghanistan, which owed a total of \$6 million to the Afghani government in taxes. The Audit report of Special Inspector General for Afghanistan Reconstruction concluded that almost "43 contractors expanding US government efforts in Afghanistan" were found guilty of tax evasion, where a combined penalty of \$921 million was levied by the Afghan Ministry of Finance. Tax evasion by foreign companies in Afghanistan is often associated with the absence of information on operations and ownership. Though a total of 40,000 national and international companies are registered with the AISA, a large number of firms are still unaccounted for, and thus find it easy to evade taxes.

### 3.7. Trade in Narcotics

The UNODC reports that trade in narcotics is one of the most prominent sources of funds for IFFs in Afghanistan.<sup>17</sup> The Financial Action Task Force (FATF) categorizes Afghanistan as the origin country of drugs, with Kyrgyzstan and Tajikistan often acting as consumption and transit countries for the drugs to Europe, as well as an intermediary for handling finance. Consumers in Europe provide the funds back to Afghanistan. Pakistan operates as a consumption country and as a financial centre for drug money. Thompson, who has researched this process and conducted extensive fieldwork in Afghanistan, notes that Dubai operates as a central 'clearing house' for many of these transactions.

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

### 3.8. Corruption

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

Further, administrative bodies, such as customs and tax authorities, and law enforcement agencies, such as the border force and police, play a pivotal role in IFFs in most focus countries. Bribery and corruption are particularly prevalent on borders, such as the Afghanistan–Tajikistan border, where it is believed that some border guards, immigration and customs officials are directly engaged in the drug trade. It was reported by Lain et. al (2017) that in Afghanistan bribes are not necessarily seen as a corrupt act. Paying a bribe is often the path of least resistance to getting things done.

For example, the legal way to get things done on the border with Afghanistan is time consuming and expensive, and paying bribes speeds the process up, although only marginally. Pajhwok Afghan News (2017) statistics show that since fiscal year 2015 until May 2017, among every 10 middle level taxpayers, six evade taxes. Some of the taxpayers might have been evading tax while some might have been inactive. Pajhwok lists administrative corruption, misuse of authority or use of influence, power and lack of awareness about the law as the main reasons behind the nonpayment of taxes. Pajhwok quotes Yousuf Ghaznavi, an investigative officer at MoF, as saying that some business markets owned by parliament members or people who have close ties with government and tribal elders refused to pay taxes: “Some show them gun bullets and others offer bribe in order not to ask them for tax. They are so powerful that they can challenge our president and minister who according to them cannot ask them for tax.

### 3.9. Insiders

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

Funds had been embezzled from the bank by means of fraudulent insider loans and overpayments for goods and services, with much of the money transferred to Dubai. Ghani reopened the investigation into the Kabul Bank fraud by presidential decree two days after his inauguration. He had fought the election on an anti-corruption platform and the case was of symbolic importance, especially since Mahmood Karzai, the brother of Afghanistan’s former president, was among the alleged beneficiaries of the fraud. Save for Farnood and Ferozi, no other beneficiaries of fraudulent loans were convicted, although some of them were required to repay the bank.

### 3.10. Technology

Afghans have been moving money through money or value transfer services (MVTS) since the eighth century and the system is well established and used in all parts of the country. Its low cost, speed, convenience and accessibility are all factors that ensure that MVTS will continue to be popular, even in urban areas where there are banks. Although the volume of transactions that pass through the MVTS system in Afghanistan is significant, FinTRACA has only able to begin registering MVTS operators in 2007. By March 2012, the FinTRACA had registered and licensed over 640 MVTS operators that account for about 40% of the total volume of business. As of April 2014, over 1,000 MVTS operators were registered (compared to around 800 operators in the beginning of 2013).

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

### 3.11. Money Laundering

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

### 3.12. Informal Economy

Chief among the roadblocks, however, is the nature of Afghanistan's capital flows. Most of the country's economic activity is informal, and data provided by the Ministry of Finance suggest that only 35 percent of the financial flows within the country are legal. Unregulated cash transactions and remittances through the country's traditional money transfer system, hawala, are the rule. According to FATF, an international anti-money-laundering body, more than half of all transactions in Afghanistan involve hawala brokers. Ordinary Afghans do not have many other options: although the country's banking sector has grown significantly in recent years, most commercial banks are still concentrated in its cities. For many Afghans, hawala brokers, whose services often leave no paper trail, provide services that are cheaper and more convenient than their counterparts in the official banking sector.

Drug-related financial flows bear serious consequences for Afghanistan, including activities ranging from funding terrorism and supporting criminal enterprises to nurturing corruption, undermining the rule of law, impeding economic development and depriving the state of desperately needed revenue and resources, among others. Transgressing various division lines, these financial flows bring together in a single network state officials and insurgents, poor farmers and rich landlords, the fighters of competing insurgent groups and residents of competing regional and non-regional states. Thus, they form part of the Afghan and regional shadow economy, which remains non-transparent and poorly studied.

The Afghan Business (2012) cites an investigative report by 1TV in which it was reported that 15 out of 300 major companies in Afghanistan refused to pay taxes. The report claims that these companies have tried to evade tax by using diplomatic channels and relying upon the NATO command to pressure the government not to prosecute them.<sup>38</sup> The companies own a total of USD 7,307,000 in taxes, claims the report. It further adds that a number of foreign private security companies owe the government between USD 4-10mn each in taxes. This comes after the Afghan government alleged U.S. military's main food supplier in Afghanistan, Supreme Foodservice GmbH for operating in Afghanistan illegally and refusing to pay taxes to the government. Supreme, on the other hand, says it isn't engaging in any commercial activity in Afghanistan that should make it liable for taxes. According to the large tax department officials, Supreme is currently engaged in 50 contracts in Afghanistan, of which 15 are main contracts and exempted from tax. However, the remaining 35 contracts are subsidiary contacts that make the company eligible for tax payments to the government.

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

## 4. National and International Initiatives Taken to Curb against Tax Evasion

### 4.1. National Level Initiatives

Almost all state institutions had deteriorated or been distorted in Afghanistan prior to the ousting of the Taliban in 2001. This included the tax system. With the entry of the international community into Afghanistan, public finance was one of the first institutions to be addressed. Some of the first actions included reestablishing and staffing up the Ministry of Finance (MOF), introducing a new tax legislative framework, and building the Afghanistan Revenue Department (ARD) and hence the institutionalization of tax as a means to fund the state and public services.



#### 4.1.1. The Afghan Revenue Authority Starting in 2003 and 2004, the Afghan Government launched measures to build the domestic tax system.

These included introducing a number of simplified taxes, including a turnover tax (BRT) and withholding on wages. The BRT was considered more feasible than a modern corporate income tax, given the underdeveloped state of the economy and low capacity of the ARD. The ARD established an official presence in Kabul as well as in provincial offices (also known as Mastofiats) around the country but reporting to the director general of administration.<sup>41</sup> The ARD has established Large Taxpayer Offices (LTOs), Medium Taxpayers Offices (MTOs) as well as the Small Taxpayer Offices (STOs) in Kabul and the provinces of Herat, Balkh, Nangarhar, Kunduz and Kandahar. This taxpayer segmentation is meant to assist the ARD to better provide services to these taxpayers, encouraging voluntary taxpayer compliance. At the same time, the ARD has trained many staff in audit, taxpayer services, and general tax administration and has installed a new, commercial off-the-shelf IT tax administration system that supports streamlined processes and procedures.

#### 4.1.2. Fiscal Policy Unit

The MOF established a Fiscal Policy Unit, which is mostly focused on macroeconomic programs and medium-term budgeting, but is also responsible for monitoring and reviewing fiscal, including tax, policy and conducting tax analyses and developing tax policy reform recommendations.

#### 4.1.3. Income Tax, VAT and Tax Administration Laws

In 2009, Afghanistan enacted a comprehensive Income Tax Law, covering individuals and companies, which is much more consistent with international tax practice. The Afghan government also drafted a new VAT law to progressively replace the Business Receipts Tax through the lowering of the VAT registration threshold over time. The VAT law was enacted in the first quarter of 2015 with a start date of December 2016. In 2015, the Afghan government also enacted the Tax Administration Law.<sup>44</sup> A recent report compiled by Integrity Watch Afghanistan (IWA) over a 3-year period (2015, 2016 and 2017) shows the revenue collected by the six departments within the Afghan revenue authority. The report shows that the Small, and Medium Taxpayers Office accounts for the least revenue collected when compared to the other departments.

The most common income tax obligations for both for-profit and non-profit entities in Afghanistan under the Income Tax Law are:

- i. A monthly obligation to withhold and pay taxes from: employees' salaries (a progressive scale of 0-20%), landlords' rental income (0-15%) and payments to contractors (2-7%);
- ii. Corporate income tax rate is set at 20%;
- iii. A quarterly obligation to file and pay business receipts tax – a flat tax, usually four per cent – on gross revenue (non-profit organizations are exempt from this obligation);
- iv. An annual obligation to file a detailed tax return and pay 20 per cent tax on annual net profits (non-profit organizations and certain tax-exempt programs are exempt from the obligation to pay the 20 per cent tax, but not from the obligation to file returns). Taxpayers have a 10 to 15-days window at the end of each month to calculate and pay each monthly, quarterly and annual tax obligation and file the applicable forms, after which financial penalties may accrue. These financial penalties include:
  - ♣ A flat 10% penalty for late payment of withholding taxes.
  - ♣ A 0.1% per day penalty for late payment of any tax liability.
  - ♣ A per day penalty of 30 AFN per day (for natural persons) or 100 AFN per day (for legal persons) for failure to file “documents” including for example a withholding tax or business receipts tax form.

Grut (2017) in reviewing the Income Tax Law, the VAT law and the Tax Administration Law explains that these laws were implemented without consultation or warning and in effect operate retroactively. She contends that these laws have disrupted a stable, tried and tested system.<sup>48</sup> She gives the following example on the Tax Administration Law: “The Tax Administration Law, published in the official Gazette dated 18 November 2015, states that it will come into force after the date of publication. However, neither the Gazette nor a copy of the law were actually physically available until mid-December 2015.

Since most people are not in the habit of regularly checking the Gazette, many taxpayers were first notified of the law when they received a penalties bill for failure to comply with it, with penalties back-dated to 18 November 2015. A decree issued almost a year later, in October 2016, recognized that “companies were not aware” of the Tax Administration Law but, nonetheless, continued to allow for the penalty to be

applied back to November 2015 for all but one category of form (the fourth quarter 1395/2016 business receipts tax submission that was due on 5 January 2017”.

Grut (2017) also points out the fact that despite the enactment of the VAT Law in 2016 there was much confusion in the Afghan Republic in the subsequent months that followed as to whether the VAT law existed or not. This is because the law was passed without the public having been made aware of it. Further, she also argues that the Tax Administration Law is vague and lacking in detail. For example; Article 35(1) of the 2015 Tax Administration Law provides a daily late filing fee for failure to submit a tax return “or any other document,” words that did not appear in the 2009 Income Tax Law.

When the 2015 Tax Administration Law repealed this section (and many other sections) in the 2009 Law, by default, it also repealed the underlying regulations and rulings issued under those sections, but did not replace them. In total, approximately 60 pages of guidance and detail in the Tax Manual were deleted, not including other rulings and guidelines. It was this provision that led to the queues of people filing reams of documents, many of no consequence or relevance to actual tax liability, in early 2016: who were they to know what “any other document” referred to?

## 4.2. International Law Initiatives

### 4.2.1. Anti-Money Laundering Law

Afghanistan has taken a number of measures to combat against tax evasion. In 2004, Afghanistan passed the Anti- Money Laundering and Proceeds of Crime Law, on which the Financial Transactions and Reports Analysis Center of Afghanistan (FinTRACA), a financial intelligence unit (FIU), was created. Following long delays due to parliamentary inaction, suggesting weak rather than genuine political will, Afghanistan passed new AML/CFT laws in 2014, but the process of implementing regulations and actual enforcement practices remains slow.

The notable progress made with this legislation is that money laundering is properly criminalized and adequate provisions regarding the seizure and confiscation of crime proceeds are included. However, Integrity Watch Afghanistan (IWA) contends that the AML&CFT laws and regulations need to be further amended to increase compliance with FATF standards. IWA proposes tougher legal sanctions, and commensurate penalties for the following identified cases that are not effectively captured under the AML/CFT laws and regulations:

- Money laundering and the associated instances of corruption and other illegal activities (tax evasion, drugs trade, etc.).
- Money laundering sanctions and measures relating to politically exposed persons (PEPs) must also apply to family members or close associates of PEPs.
- Corruption.

In 2015, a new banking law was enacted; this law is expected to strengthen bank reporting and governance while also incorporating a framework for the declaration of cross-border cash transactions and bearer instruments.

The Afghan Business (2015) reports that a special commission which comprises the Ministry of Finance (MoF), the Ministry of Justice (MoJ) and the Attorney General’s Office has been formed to resolve disputes with large companies that owe taxes to the Afghan government. MoF’s treasury department head, Gul Maqsood Sabit, said three large companies owe roughly 15bn AFN in back-taxes to the Afghan government. Sabit said the special commission is formed to settle the issues the treasury department has with the various companies.

According to the official, 10% of the 500 large businesses registered with the Afghan government are alleged to be evading taxes to varying extents. Sabit added that the Ministry is facilitating installment-based payment plans to companies that lack the capacity to pay taxes right away, while those who are refusing to pay taxes due will face legal actions.

### 4.2.2. The Creation of FinTRACA following FATF Recommendations

FinTRACA is a semi-independent body administratively housed within the Central Bank of Afghanistan (Da Afghanistan Bank - DAB) and responsible for analyzing reports filed by private entities and data from other government agencies. Private sector entities are required to file reports on suspicious transactions and on large single or structured cash transactions.<sup>53</sup>This FIU is tasked with collaborating with other government entities, as well as foreign counterparts for international cooperation.

Afghanistan is a member of the Egmont Group and the Asia/Pacific Group on Money Laundering (APG), a Financial Action Task Force (FATF)-style regional body.<sup>54</sup> FinTRACA’s principal objective is to “deny the use of the Afghani financial system to those who obtained funds as the result of illegal activity, and to those who would use it to support terrorist activities.



” Although this objective is laudable and consistent with international standards, only meeting this goal may be counterproductive. Does the goal assist in the pursuit of other policy objectives, such as monitoring illegal transactions, facilitating investigations and prosecutions and improving asset tracing, freezing and recovery, among others? What if illicit flows are merely displaced to other channels less familiar or accessible to banks and government officials? These include informal value transfer systems such as hawala, import/ export manipulation, digital payments and even abuse of correspondent accounts.

The FATF has repeatedly noted Afghanistan’s need to address serious deficiencies by:

- a. adequately criminalizing money laundering and terrorist financing;
- b. establishing and implementing an adequate legal framework for identifying, tracing and freezing terrorist assets;
- c. implementing an adequate AML/CFT supervisory and oversight programme for all financial sectors;
- d. establishing and implementing adequate procedures for the confiscation of assets related to money laundering;
- e. establishing a fully operational and effectively functioning financial intelligence unit;
- and f. establishing and implementing effective controls for cross-border cash transactions.

As of October 2016, the FATF continued to list Afghanistan as a jurisdiction with strategic deficiencies: “in June 2012, Afghanistan made a high-level political commitment to work with the FATF and APG to address its strategic AML/CFT deficiencies. Afghanistan has taken significant steps to improve its AML/CFT regime, including issuance of a freeze order that automatically requires the implementation of changes to the UNSCR 1267 list. However, Afghanistan should provide additional information regarding the implementation of its legal framework for identifying, tracing and freezing terrorist assets. The FATF encourages Afghanistan to continue implementing its action plan to address the remaining AML/CFT deficiency.

“ Despite these measures that have been put in place, an interview with an agent of a private company revealed that all sorts of cash and other flows take place unmonitored and unchecked due to geography (especially the Afghanistan-Pakistan border), resource constraints, unclear customs rules on dealing with suspicious transactions and the country’s porous international borders.<sup>58</sup> The US Department of State Bureau of International Narcotics and Law Enforcement Affairs has also noted that even Kabul’s international airport does not have proper controls for all passengers: “In 2011, the Afghanistan-Pakistan Transit Trade Agreement (APTTA) expanded trade cooperation between the two countries and attempted to minimize smuggling by maximizing oversight and technical monitoring.

Yet the designated trade routes pass through key locations where insurgent and terrorist groups operate. It appears insurgents are finding creative ways to utilize APTTA’s new rule of being able to maintain control of a cargo truck from country of origin to cross-border destinations without having to risk unloading trucks at border crossings. In addition, since the initiation of the new APTTA agreement, it appears organized smuggling groups have increased their use of Iranian ports of entry. With the phasing-out of Iranian sanctions, this trend will continue to grow. The Afghan transit trade is used in trade-based money laundering, value transfer, and in counter-valuation or the process of settling accounts between hawaladars.”

Despite new laws and institutions to control money laundering, terrorism finance and other illicit flows having been introduced, they are proving ineffective. Similarly, Passas (2016) pointed out that “new laws drafted with foreign assistance constitute another layer in need of harmonization. However, efforts to fight financial crime and corruption in the country are inconsistent, ad hoc, and discriminatory. The normative dissonance resulting from this lack of coordination—along with the judicial exclusion of certain groups, dysfunctional governance, corruption, turmoil and insecurity in the midst of foreign involvement—have given rise to continued drug trafficking and terrorism.

” Overall Afghanistan’s economy has many features commonly associated with a low tax base; such as (i) extremely low level of development; (ii) a large informal sector implying a narrow tax base; (iii) the dominance of agriculture which is hard to tax; and (iv) capacity constraints hindering the ability of the Government to collect taxes and of taxpayers to comply with tax regulations. Revenue mobilization is further complicated by the large opium economy that cannot be taxed directly, the need to consolidate Government control throughout the country, and heavy reliance on aid funds that are exempt from taxation. In addition, Afghanistan historically has had very low domestic revenue mobilization — in the 1970s the tax to GDP ratio was around 7%, one of the lowest in the world. Afghanistan’s medium-term revenue potential therefore is likely to be toward the lower end of the 11-14% of GDP range.

## 5. Key Findings Following Literature Review and Interviews and their Proposed Recommendations

According to Integrity Watch Afghanistan a number of important ministries and institutions either do not view tax evasion as a significant challenge or are unaware of the extent of the problem in the country. Raising awareness and training governmental institutions, agencies, and relevant authorities on tax evasion issues and related measures must be a priority. In addition, the declaration system and money laundering controls for cross-border transportation of currency and bearer negotiable instruments need to be rigorously enforced.

According to SIGAR, approximately USD 4.5 billion in bulk cash left Afghanistan via the Hamid Karzai International Airport (KIA) in 2011. Despite the installation of bulk currency counters at KIA to counter the risk of money laundering and bulk cash smuggling, these machines are not used for their intended purposes. In the case of Very Important Persons (VIPs), the main customs screenings or use of bulk currency counters are completely ignored. Another needed change is the reduction in the limit on the amount of currency persons travelling outside of Afghanistan are required to declare from \$20,000 to \$10,000. Given the cash based nature of Afghanistan's economy, strict enforcement of the declaration system and antimoney laundering measures along Afghanistan's porous crossings is critical to curbing tax evasion.

Laws regarding establishing beneficial ownership have not been implemented and control of legal persons in Afghanistan is opaque. The Afghanistan Central Business Registry should be required to collect information on beneficial ownership of all registered business entities, trusts and foundations. Any organization not fulfilling such requirements of the Central Business Registry should be prohibited from conducting business, opening a bank account or to transfer funds within or outside of the country, by whatever means.

The Centre for Budget and Governance Accountability has noted that the absence of adequate state structures has led to the misuse of political influence along with the emergence of provincial governors, which facilitates tax collection in their respective regions, increasing the risk of revenue loss. Unregulated hawaladars have not been brought under the ambit of the financial system to track informal transactions through the hawala system and to curb tax evasion. A publicly accessible 'beneficial owner' registry would aid in establishing transparency standards for entities in Afghanistan.

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

The EastWest Institute has argued that it is worth considering ways to leverage hawala information nodes and willingness of participants to collaborate with authorities. Hawala is a headache for controllers and bank compliance officers, but it is also a resource for risk analysis, monitoring, intelligence gathering and investigations. Outreach and good connections within hawala networks provide unique and valuable insights into otherwise non-observable shady networks and operations. It is a problem but also a solution.

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

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

An interview with a freelance journalist<sup>66</sup> also revealed that digitalization had the scope to reduce tax evasion. The interviewee argued that ethnic leaders sometimes bully taxpayers and blackmail government, a modernized tax system would bypass these instances of intermediaries necessary to collect taxes. According to him 'there should be no talk of so-called paper money, if the tax cyst is digitized this would be better for the citizen to be able to hand over his tax at the earliest opportunity'. Another interviewee also confirmed the hostile approach taken by tribal leaders towards payment of taxes or charges. According to the interviewee "these leaders; both tribal as well as politicians, have been accused of even not paying electricity bills. Electricity bills worth millions of Afs have not been paid by political figures. Since they also engage in business, they are foremost in evading customs duties as well".

Reports prepared by an investigative journalist interviewed showed that tax collection from holding wedding parties which are by law required to remit 5% of the income received are not collected by the government. The duty lies with the Medium Taxpayers Office and corruption plays a significant role in the nonpayment of this tax.<sup>68</sup> An interview with another journalist also confirmed the high level of

corruption within the government that leads to the erosion of the tax base. According to this interviewee large scale tax evasion occurs within the customs department of which private sector companies are largely to blame.

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

An authorized representative of a company from the private sector during the interview discussed how government itself abuses the tax system. According to him "politicians wield their authority to evade tax payment. They import goods illegally and do not pay customs duty". Another interviewee from a different company interviewed also complained that the lack of punitive laws in punishing against payment of customs has resulted in its wide scale spread. According to this interviewee "most Afghans don't have positive opinions about tax. They don't have positive opinion due to a number of reasons. First reason is lack of confidence in government. For example, I see people and I talk to them and they ask about the 10% tax on telephone credit cards. Since SIM cards aren't registered, companies have more customers.

Due to lack of a proper mechanism, people are doubtful whether the 10% tax goes to the pockets of telecommunication companies or to the account of government to be spend for development. Lack of confidence in government is one of the main reasons. It has many reasons. Lack of awareness. Afghans have witnessed decades of war and they don't know where the money taken out from their pockets is spent. They should be given awareness. People should be given awareness by the government that the tax they are paying is spent for the future of their kids. People should pay taxes. They should willingly pay taxes.

Another reason is the poverty of people. Another reason is existence of corrupt officials among high ranking government officials. For example, Da Brishna Shirkat announces on its site that high ranking officials such as MPs don't pay their electricity bills. People think they pay their bills on time while their law makers violate the laws they make. They result in tax evasion and non-payment of taxes".

Accordingly, the proposed recommendations are as follows:

- ♣ Amend the relevant laws and regulations to increase compliance with international standards in combating IFFs.
- ♣ Train the judiciary and law enforcement authorities on AML/CFT rules.
- ♣ Enhance transparency of beneficial ownership and the control structure of legal persons/organizations.
- ♣ Provide support and technical assistance to DAB by resuming collaboration with the international community.
- ♣ Support FinTRACA and other relevant institutions
- ♣ Increase national coordination and cooperation among relevant ministries, agencies, and authorities to curb IFFs.
- ♣ Implement a more proactive tax examination regime; establish a high level task force between the Ministry of Finance and the Attorney General's Office to examine, audit and where appropriate take punitive measures against companies or organizations which are found to be evading taxes.
- ♣ Register/provide licenses for all MSPs (hawaladars), establish and apply appropriate regulations and ensure adequate supervision of this sector under DAB.
- ♣ Digitalization of the tax system.
- ♣ Punitive sanctions on evasion of customs duties.



## Conclusion

Tax evasion is a general term often used in cases where an individual or a company evades taxes all together in violation of a country's tax laws. Tax evasion can take many forms: individuals or businesses underreporting their income, or failing to report their income all together; companies and individuals also hide or evade obligatory tax withholding on rental income and rental payments, on business services, on dividends and on staff salary payments. Large-scale underreporting of profits in various sectors such as telecommunications, construction, trading and extractive industries, is also quite common.

Tax evasion is an activity widely practiced in Afghanistan by national and international companies, organizations and individuals. The willingness of a country's citizens to pay taxes and the ability of a country's government to collect taxes is a critical factor in improving the economic situation of a country, especially for third world countries such as Afghanistan which are suffering from terrorism, corruption and poor governance.

Taxes also play a crucial role in maintaining the existence of the state. Small firms, large firms and international companies and organization are required to pay taxes and the role of any government should be to establish procedures for the collection of taxes in order to support its public service sectors. For example, public health care, government employees' salaries, education, the work of the National Police and National Army, and the maintenance of public utilities which provide people and industries with energy and water – all such government expenditures rely, at least to some extent, on taxes.

Based on the information provided by various sources (Afghan Zariza & AISA) there are 40,000 local and international companies registered with Afghanistan Investment Support Agency (AISA) and investigations shows that some of these companies, especially foreign companies owe billions Afghanis (AFN) as tax to the Afghan government and some of them function without the obligatory business license.

Some of these foreign companies which are working in Afghanistan has continuously failed to clear the dues, despite repeated reminders from the Afghan government's Ministry of finance. There are various reasons for the tax evasion problem in Afghanistan. The fundamental problems are manifold, but include the lack of a strong political will, an overly bureaucratic system, poor government standards, loopholes in the rules, weak enforcement mechanisms, and a lack of resources and expertise.

Another reason relates to corruption, the payment of bribes and the use of political influence. Many Afghans who should be paying large tax bills, especially wealthy businessmen, are closely linked to senior officials and political figures. These "untouchables" do not always pay their full tax bill. In addition, customs revenues, which account for about half of Afghan government revenues, have been declining due to the theft of custom duties. (Rosenberg, 2013) Tax evasion determinants have not been investigated in Afghanistan, nor have any published studies fully examined the factors influencing tax evasion.

Thus far only a few media pieces have reported on occasional superficial cases of tax evasion with researchers referring to this issue in their studies or desk reviews. Research on tax evasion and tax avoidance is an urgent requirement to identify the actors involved and to highlight the revenue loss to the country. The proposed study will cover the matter comprehensively in two parts; 1) a literature review and some qualitative research will be conducted; 2) legal gap analysis research will be undertaken to find the gaps and to develop an accurate measure of tax evasion at the individual and corporation levels and identify the variables associated with tax evasion.

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