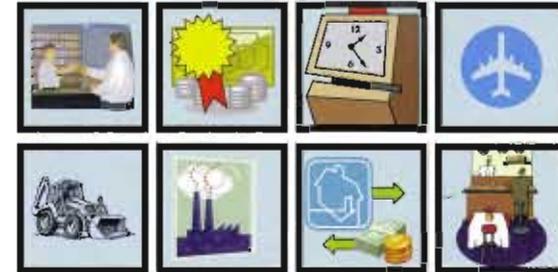




Guide 16 Deductible Business Expenses



Introduction

This guide outlines what business expenses are deductible and what expenses are not deductible for residents of Afghanistan. For tax issues for non-residents, please see Guide 23, Tax Issues for Non-Residents.

According to the Income Tax Law 2009, all ordinary and necessary expenses of the production, collection, and preservation of income of natural and legal persons are deductible against income, provided that these expenses have been incurred during the taxable year, or one of the three previous years, in accordance with the provisions of the Income Tax Law. (Article 18)

Note

There are no fees or charges payable to the Ministry of Finance or its Revenue Department for any Tax Guides or Forms or at any stage of the tax assessment, collection or enforcement processes.

The Income Tax Law 2009 provides for a penalty if a taxpayer fails to submit a tax return. This applies even if no tax is due for the period covered by the return. To avoid being penalized taxpayers therefore should submit returns even if no tax is due and state on the return that none is due.

What expenses are deductible?

Expenses and costs ordinarily incurred in the production of income are deductible from profit or income from that activity to determine the amount of taxable income. Article 18 of the Income Tax Law 2009 lists the ordinary and necessary costs and expenses that are deductible from receipts in determination of taxable income of



any business activity. Expenditures which are not ordinary and necessary expenses are not deductible.

Expenses and costs may be incurred which are not deductible for purposes of income taxation. Thus, the profit or net income of a business may be different according to the records of the owner than taxable income determined in accordance with the Income Tax Law.

Expenses and costs which are deductible are:

- 1 Any expense related to the cost of production or trade and business, such as insurance and freight expenses, etc.
- 2 The cost of supplies, materials, fuel, electricity, water, and other ordinary and necessary expenses used in the production of income, or in a trade or business
- 3 Wages, salaries, commissions, and fees paid for services rendered by employees in trade or business*
- 4 Interest paid on business loans*
- 5 Dividends paid in money by a legal entity organized under the laws of Afghanistan*
- 6 Rent paid on property necessary to and used in trade or business*

Note

*No deduction is allowed for dividends, interest, royalties, rents, commissions, wages, salaries, pay-ments to contractors and similar expenses if the taxpayer is required to withhold tax but has failed to do so.

- 7 Cost of repairs and maintenance of properties and equipment necessary to and used for purposes of the business or trade
- 8 Depreciation of movable and immovable property (except land) used in a trade or business or held by the producer for the production of income in accordance with the Income Tax Manual. The cost or value of assets used by the business cannot be taken as a one-time deduction but must be depreciated over the useful life of the property. (See Guide 20 – Depreciation of Assets for more information.) The total of deductions for depreciation of any item of property over a period of years shall not exceed its cost to the taxpayer
- 9 Any tax or charge that is a necessary expense of doing business, holding property for income, or of producing income, if paid or accrued during the taxable year. Taxes imposed by the Income Tax Law and taxes not

qualifying as necessary business expense are not deductible, except as otherwise provided by the Income Tax Law

- 10 Damages to movable or immovable property caused by fire, earthquake, or by or disaster of any kind, over a three year period, to the extent that the cost is determined and substantiated by records and the loss was not recovered by insurance
- 11 Losses in business or trade from bad debts according to the Income Tax Manual; and
- 12 Other expenses of doing business and of holding movable or immovable property for the production of income under relevant laws.

Wages and salaries include such items as regular pay, bonuses, over time pay, retroactive increases, and other considerations paid by the employer in money or other forms. Taxes withheld from the employee's pay and paid to the government are part of the employee's salary or wages.

Example: An employee works for a company for a monthly salary of AFN 20,000. In Qaus, he receives a promotion and his salary is increased to AFN 24,000, effective as of Mizan 1. At the end of the year, the company pays each employee a bonus of five per

cent of his salary. The company must include all of these items in reporting the employee's wages and can take a full deduction as wages expense as follows:

a. Salary (first 6 months) (6 x AFN 20,000)	<u>120,000</u>
b. Salary (second 6 months) (6 x AFN 24,000)	<u>144,000</u>
c. Total 12 months' salary	AFN 264,000
d. Five per cent of yearly salary at end of year (5% of AFN 264,000)	<u>13,200</u>
e. Total salary and bonus	<u>277,200</u>

Interest paid on business debts is deductible, but interest paid on personal debts is not. A personal debt is one incurred for purchase of goods and services or property for personal consumption and use. A business debt is one incurred in purchase of land, buildings, equipment, goods, etc., for leasing, resale, production of goods and services, and other business purposes.

Example: Aziz borrows money from his brother, Abdullah, to purchase a computer for personal use in his home. Abdullah charges Aziz 2 percent interest per year. Aziz cannot deduct the interest that Aziz pays to Abdullah.

Depreciation is not allowed unless the taxpayer has clearly established the cost of the property being depreciated. Any cost established for purposes of claiming depreciation expense is binding on the taxpayer for purposes of determining gain from sale of the same property. If an owner of a building is not able to clearly establish his cost basis and depreciation, the Ministry of Finance may not allow any deductions. If the owner provides acceptable documents regarding his cost basis and depreciation, then in this case, the deduction for depreciation will be allowed. For more information regarding depreciation deductions, see Guide 20 – Depreciation of Assets.

Taxes that you pay that are a necessary expense of doing business are usually deductible: for example, Business Receipts Tax and customs duties you paid in the course of your business and municipal taxes paid on property you rent to tenants are deductible expenses. Income taxes are *not* a deductible expense.

An employer can deduct the cost of certain *non-cash benefits* that it provides to its employees, provided that benefits are directly related to the employer's business.

Example: A construction company building a dam some distance from a town finds that it must provide transportation between the nearest town and the construction site each day to induce laborers to work at the project site. This is a legitimate expense of doing business and the company may deduct the cost of providing such transportation.

Note

If some of the employees drive their own cars to the project site, they cannot deduct the cost of traveling to and from work from their income when filing their individual income tax returns.

Loss of property (used for production, collection, or preservation of income) caused by fire, wind, earthquake, or disaster of any kind may be deducted to the extent that the loss was not reimbursed by insurance. To claim such a deduction, the owner must have kept records which clearly show the cost of the property lost. One third of the loss may be claimed in the year the loss occurred and one third in each of the succeeding two years.

Premiums paid for insurance of property used for the production, collection,

and preservation of income are a legitimate cost of doing business and are fully deductible. Receipts from an insurance company as the result of a loss are not taxable unless the amount of reimbursement exceeds the cost or depreciated value of the property lost. If the amount of reimbursement received exceeds the depreciated value of the property, the excess must be reported as income by the owner.

Bad debt A taxpayer will be allowed a deduction in a tax year for a bad debt if the following conditions are satisfied:

- a) The amount of the debt was previously included in the taxable income of the taxpayer
- b) The debt is written off in the accounts of the taxpayer during the tax year; and
- c) The taxpayer has reasonable grounds for believing that the debt will not be recovered.

This requirement will not apply to a bank entitled to a deduction for additions to reserves against losses in accordance with Article 56 of the Income Tax Law 2009.

Example: Ahmad Advertising Company provides advertising services for newspapers and radio. Ahmad Advertising Company has an

arrangement with Shiraz Restaurant where Ahmad Advertising Company places advertisements each month in the newspaper and on the radio and then sends an invoice for AFN 5,000 to Shiraz Restaurant for payment. One month, Shiraz does not make the payment. Ahmad Advertising Company cancels the arrangement. Ahmad Advertising Company, being required to account on the accrual basis and having provided the advertising services, has already included the amount of AFN 5,000 in its income. Ahmad Advertising Company attempts to collect the money. It makes phone calls and sends a letter to Shiraz Restaurant but no payment is received. Eventually, Shiraz Restaurant closes its business.

Ahmad Advertising Company has reasonable grounds for believing that the debt will not be recovered. It may treat the amount as a bad debt and claim an income tax deduction for the amount not received.

Note

If an amount is written off as a bad debt, but the debtor subsequently pays some or all of the amount written off, then this amount will be treated as income.

Note

If you have paid expenses in the form of services or property (moveable or immovable), you must deduct the allowable expense at the fair market value of the property or service on the date you incurred the expense or, for cash basis taxpayers, the date you transferred it.

Example: Wahid is a dentist who hired Aziz, a carpenter, to repair the roof of Wahid's office. Instead of paying for the work in cash, Wahid agreed to provide dental services for Aziz's two children. The dental services would normally cost AFN 10,000. Wahid may deduct AFN 10,000 from income on his tax return.

- by the owners or employees for personal or household purposes and not sold
- h. Cost of goods purchased but subsequently returned to supplier or manufacturer; and
- i. Cost and expense of providing benefits for the owners, officers, and management that are not necessary for the conduct of business.

Example 1: An individual owns a factory. From factory income, the business purchases a car for the individual's family. Such expenditure cannot be taken as a tax deduction by the individual.

Example 2: An individual owns a car dealership and purchases 10 cars for resale at a cost of AFN 160,000 each. He keeps two of these for his family's use and sells eight at an average price of AFN 200,000. If all purchases were allowed as a deduction, profit would be understated:

a. Sales receipt (8 x AFN 200,000)	1,600,000
b. Cost of purchase (10 x AFN 160,000)	1,600,000
c. Gross profit	0

Whereas the correct statement would be:

a. Sales receipt (8 x AFN 200,000)	1,600,000
b. Cost of purchase – less 2 automobiles for personal use (8 x AFN 160,000)	1,280,000
c. Gross profit	320,000

- j. Personal expenses including the following expenses are not deductible:
 - 1 Payments made to persons for his or his family's benefit and enjoyment
 - 2 Expenses and costs of maintenance, repair, construction, improvement, furnishing, and other expenses of the taxpayer's or his family's house or residence or any property devoted to his own personal or

- family's use
- 3 Interest on personal loans
- 4 Costs of commuting to and from work and cost of travel for personal purposes
- 5 Cost of life, accident, health, and liability insurance for the protection of the taxpayer and his family; and
- 6 Cost of insurance of any kind for the protection of property used for personal purposes.

Note

Afghanistan Revenue Department tax offices and Mustufiats provide forms, guides, and instructions to taxpayers free of charge, available both as printed and as downloadable versions from a new website <http://www.ard.gov.af>. The website also provides locations, contact numbers and hours of operation for Afghanistan Revenue Department tax offices and Mustufiats. Taxpayers also can download other useful information including various public announcements and rulings, questions & answers regarding wage withholding tax, the Income Tax Law 2009, and an Income Tax Manual. The manual discusses separately each article of the law, along with relevant regulations, often with helpful examples.

What expenses are not deductible?

Examples of non-deductible expenditures are:

- a. Gifts
- b. Illegal expenditures
- c. Donations
- d. Income taxes
- e. Additions to reserves for contingencies, bad debts and other similar purposes except for losses on loans by financial institutions
- f. Additions to reserves for losses on loans by financial institutions in excess of limit imposed by the Income Tax Law
- g. Cost of goods purchased but used