

GOVERNMENT OF THE ISLAMIC REPUBLIC OF AFGHANISTAN

# MINISTRY OF FINANCE



## VALUE-ADDED TAX (VAT) IMPLEMENTATION PLAN



NOVEMBER 2017

DEAR TAXPAYERS,

Value Added Tax (VAT) will be a fundamental step in implementing an effective Tax system, in accordance with the best international Standards, to enhance the services of key sectors and the lives of the community. VAT plays a key role in achieving the leadership's vision of reducing the Donor dependency and building a sustainable knowledge Afghan Economy. This will contribute to advancing by providing additional sources of income for expansion of infrastructure projects of the Country. ARD



had an in-depth studies of VAT since 2010 which indicates that there would be no impact on the business sector and the investment environment in the Country. The VAT would, over time, replace the Business Receipts Tax (BRT). VAT is very similar in some ways to BRT, without the double-taxation and enforcement problems associated with BRT. Afghanistan has implemented the lowest Tax rate, with the aim of reaching the highest levels of happiness with the Afghan community. More than 145 countries around the world levy VAT. It is the most common form of a broad-based consumption tax. Countries with similar levels of development to Afghanistan have introduced VAT with good results. Afghanistan's immediate neighbors have implemented VAT with varying degrees of success. VAT will be introduced at a rate of 10% with some limited exceptions including basic food items, healthcare and education. ARD is planning a comprehensive awareness program for potential VAT implementation which will also have immediate effects on consumer behavior which gives opportunities for companies to assess their business direction and to plan strategically.

The VAT will have better economic effects by raising additional revenue necessary for the Government of Afghanistan to meet the needs of the country and its people. VAT is a relatively stable long term revenue stream. It is not as susceptible to fluctuations within specific industries as can happen with the BRT and income tax.

The VAT is designed so that businesses below the registration threshold will still contribute some tax towards the nation (on their imports and local purchases) but they are not burdened with administrative tasks. The current BRT is calculated and paid at each stage of production and thus accumulates in the costs of a business which are then passed on to the next stage. The result is taxes on taxes. The VAT system of tax credit removes this inefficient accumulation of taxes on taxes. The VAT is expected to decrease the share of the grey (informal) economy as the registered businesses will have a strong incentive to obtain proper invoices from their suppliers, showing the tax paid, because their tax paid on purchases can be offset as credit against their tax liability. VAT encourages exports because of the application of a zero rate to exports of goods and related services. This means that the prices of exported goods will not include Afghan VAT. The existing BRT system disadvantages Afghanistan businesses when competing on world markets because the BRT flows through to higher export prices. This anomaly provides a disincentive to current and future exporters. As a tax on consumption, VAT encourages saving and investment for the future benefit of the Afghanistan economy. VAT systems are widely understood in other countries and will be familiar to international investors.

Afghanistan has completed all legislative requirements to ensure that the implementation of its Tax system function best in region as a result I would like to take the opportunity to Thanks all my colleagues National and Internationals who dedicated their time and efforts to finalize the legislation and preparing the implementation plan phase of Value Added Tax.

Sincerely,

Deputy Minister of Customs and Revenue  
Dr. Najibullah Wardak

Dear Taxpayers,

The introduction of Value Added Tax (VAT) will play a key role in achieving the Afghanistan leadership's vision of building a sustainable, self-reliant economy and reducing donor dependency. The increase in revenue will also allow government to increase focus on much needed reforms in various key industries that will have a further positive impact on the lives of the Afghanistan citizenry that we serve.



The Government of the Islamic Republic of Afghanistan decided to introduce Value Added Tax (VAT), in Hamal 1395 (April 2016), by adopting the VAT Law (Official Gazette No. 1209). This law is scheduled to enter into force on 1 Jادي 1399 (December 2020), 3 years into the future.

The main difference between VAT and Business Receipts Tax (BRT) is that businesses can claim a credit for tax paid on their inputs, including investment goods. This makes the tax more business friendly than BRT. This is important because businesses are the engine of the economy. In particular, VAT ensures that the tax does not discriminate against products that go through many stages of production. Furthermore, the rate schedule of VAT is more neutral, with one standard rate instead of the differentiated rates of BRT. A number of essential commodities (wheat, flour, rice, sugar etc.; also coal, liquid gas and soap) will be zero-rated to reduce the burden of the tax on the lowest income group. Other products, like education and health-care, will be tax exempt. Exports will continue to be zero-rated, so that the tax will not harm international competitiveness. VAT is advantaging too for the efforts of the Afghanistan Revenue Department towards ensuring compliance. This will make the playing field for the private sector more equal, and will enhance government revenue through a reduction of tax evasion.

The rate of VAT will be 10%, which by international standards is moderate. This will apply to taxpayers above the VAT threshold, a turnover amount of 150 million Afghanis per year. BRT will continue to apply, but Taxpayers may apply for voluntary registration, in view of the mentioned advantages.

VAT on imports will be collected by the Afghanistan Customs Department, similar to the present collection of BRT.

Preparations have been made by drafting a VAT manual, designing forms, and training staff. Further preparations are under way, to ensure that requests for VAT refunds are scrutinized, and refunds are paid in time.

The introduction of VAT is an important step forward for the tax system of the country. VAT has become the standard worldwide, in both developed and developing economies. Afghanistan Revenue Department will continue to prepare for its implementation, in cooperation with the respected taxpayer community.

I would like to take the opportunity to express my gratitude to all my colleagues, both national and international, who dedicated their time and efforts to finalize the legislation and in preparing this Value Added Tax implementation plan. Your efforts are highly appreciated.

Thank you.

Abdul Habib Zadran  
Director General of Afghanistan Revenue Department

### Approval Statement

Value Added Tax Implementation, Transition and Communication Plans are reviewed and approved in principles. ARD is responsible for implementing above mentioned plans.

Abdul Habib Zadran

Director General of Afghanistan Revenue Department

Customs and Revenue Department

Ministry of Finance

Dr. Najibullah Wardak

Deputy Minister of Customs and Revenue

Customs and Revenue Department

Ministry of Finance



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## ABBREVIATIONS

ACD	Afghanistan Customs Department
ADB	Asian Development Bank
ARD	Afghanistan Revenue Department
ASYCUDA	Automated System for Customs Data
BRT	Business Receipts Tax
EU	European Union
GIRoA	Government of the Islamic Republic of Afghanistan
HHRR	Human Resources
ICT	Information and Communication Technology
IMF	International Monetary Fund
LTO	Large Taxpayer Office
MoF	Ministry of Finance
MTO	Medium Taxpayer Office
PMO	Project Management Office
SIGTAS	Standard Integrated Government Tax Administration System
STO	Small Taxpayer Office
VAT	Value-Added Tax
WB	World Bank

## PREFACE

The introduction of a Value-Added Tax (VAT) is a medium-term objective of the Afghanistan Revenue Department. A comprehensive plan is critical to overcome the challenges faced in previous efforts to implement VAT.

An initial VAT implementation plan was approved by H.E. the Minister of Finance in November 2011 and VAT implementation was originally planned for 2014. However, implementation was deferred to December 2016 and subsequently to December 2020.

The VAT Law was approved by the Parliament, signed by H.E. the President, and published in Official Gazette 1209 of 13 April 2016. The law was subsequently amended, with revised text published in the Official Gazette 1244 of 29 January 2017.

Under current legislation, VAT implementation will begin on the first day of Jada 1399 (21 December 2020) with a standard rate of 10%. The VAT implementation plan covers the period January 2018 to June 2021.



## PART I – INTRODUCTION

The plan is divided into six components (Initial actions, VAT legal framework, VAT system and procedures, organizational restructuring, VAT publicity and public education, and VAT operationalization). The plan identifies key activities associated with each work theme and assigns commencement and finalization dates for each activity. It is presented in two formats: a table of tasks and timeframes and a Gantt chart.

Designing the technical tasks and putting them into operation will require strong support from ARD and Afghanistan Customs Department (ACD) leadership and sufficient numbers of qualified staff.

A VAT Steering Committee, comprising senior ARD and ACD staff is appointed to oversee and support the VAT implementation effort. The main function of the VAT Steering Committee<sup>1</sup> is to take responsibility for the strategic issues associated with the VAT implementation. The VAT Steering Committee is responsible for providing direction and support to the VAT implementation teams to ensure project objectives are achieved as planned.

Additionally, a VAT Core Team is required to support implementation on a day-to-day basis. This plan calls for a core team situated in the ARD, led by a VAT Coordinator and supported by an international advisor and other required technical assistance as needed.

There will be major financial resource costs involved in the implementation of the VAT. Successful launch of VAT is dependent on the availability of donor funding and donor technical assistance for capacity building, public awareness and education.

### A. Background

The Government of the Islamic Republic of Afghanistan (GIROA) is committed to introducing the VAT in the 1399 solar year (2020 Gregorian Calendar). VAT is a key fiscal sustainability measure foreseen in Afghanistan's IMF Extended Credit Facility and in Afghanistan's EU State-Building Contract.

Domestic revenue mobilization has taken on increased urgency due to an expected decline in external grant financing. Based on 2012 projections, the VAT will mobilize revenues equivalent to 2.9 percent of GDP.<sup>2</sup> The Ministry of Finance projects that the introduction of VAT is not expected to be excessively burdensome to the market and should not adversely affect price levels.

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<sup>1</sup> The Steering Committee TOR have already been drafted and submitted for internal review.

<sup>2</sup> This estimation will be reviewed as the legislation becomes stable as the results of its changes.



## B. Overview of VAT in Afghanistan

The Afghan VAT system will have the following characteristics:

1. A unique 10 percent rate, with a zero rate for exports;
2. A unique threshold of Afn 150 million with an option for taxpayers below the threshold to voluntarily register if they conduct more than 75 percent of their business (by turnover) with entities subject to VAT or if more than 75 of their revenue is derived from exports;
3. Monthly or quarterly filing requirements;
4. An excess credit refund system to be determined and defined by VAT Regulations (i.e. outside of the VAT Law), coherent with other refund policies (e.g. for personal income tax);
5. Strictly limited exemptions.

A 10% VAT will be imposed on all imports (irrespective of whether the importer is VAT-registered) and on the sale of goods and services in Afghanistan by businesses registered for VAT. Initially, only the largest businesses (approximately 400 to 500) will be required to register for VAT. Voluntary registrations will not be permitted for two years after the commencement date. These measures are designed to align registrant numbers with administrative capacity while optimizing revenue collection.

The VAT will replace Business Receipts Tax (BRT) on all imports. Taxpayers who are registered for VAT will not be subject to domestic BRT. Taxpayers who are not registered for VAT will continue to be liable for domestic BRT if they meet the BRT legislative requirements.

The ACD will collect VAT on imports at the time and place of import. Most of VAT revenue will be collected from VAT on imports. The ARD will administer ‘domestic VAT’ – the VAT charged and collected by VAT registered taxpayers on domestic economic activity. Administrative activities will include registration, assessments, payments/refunds, taxpayer service, audit and enforcement.

The ARD is the lead agency responsible for managing VAT implementation. However, the ACD is a critical implementing partner. Failure to engage ACD appropriately is likely to lead to the failure of the VAT implementation effort. ARD and ACD will work closely and collaboratively to introduce and implement the VAT.

## C. Key assumptions

Experience from other developing countries suggests that the introduction of VAT is likely to pose significant political and institutional challenges. Some of the challenges include:

- preparing businesses, government and the public for the new tax, and
- ensuring the administration is ready for organizational and systems changes required to implement VAT.
- ensuring that both the ARD and ACD have sufficient capacity to ensure compliance with the VAT law.

This plan has taken these factors into account and certain assumptions have been made. Any change to these assumptions will impact the VAT implementation plan. The nature and significance of the change will determine the extent of the impact.

The below assumptions are provided as a base scenario – many constitute risks with a high likelihood of occurrence that will require ongoing revision of planning and resource allocation:

1. The VAT start date will be no earlier than 21 December 2020;
2. The Amended VAT Law will remain in force;
3. The Tax Administration Law will be the main law governing tax administration;
4. The Large Taxpayer Office (LTO) registration threshold will be the same as the VAT registration threshold (Afn 150 million) to align the number of initial registrants (approximately 400 to 500) with ARD administrative capacity;
5. The National LTO in Kabul will have responsibility for centrally administering VAT upon implementation through the VAT sub-directorate. This sub-directorate is already established under the Tashkeel, but will have strengthened capacity. In addition:
  - The client selection criteria for the three ARD market segments (LTO, Medium Taxpayer Office (MTO) and Small Taxpayer Office (STO)) will be reviewed and revised. The criteria will ensure a distribution of taxpayers which corresponds with the administrative capacity of each segment. At a minimum, taxpayers with a turnover of more than Afn 150 million will be re-allocated to the LTO;
  - Taxpayers will be transferred to the correct market segment in line with the reviewed criteria;
  - The Planning and Revenue Department will be involved to ensure that revenue targets are adjusted to correspond to taxpayer movements;
  - The LTO Director and the LTO VAT Sub-Director will be actively involved in VAT implementation activities;
  - As VAT administration stabilizes over time, the VAT registration threshold will be lowered, voluntary registrations will be permitted, and VAT administration will be devolved to other offices of the revenue administration according to taxpayer segment.
6. The LTO will be restructured and strengthened to increase the likelihood of successfully administering self-assessed VAT. Activities will include:
  - Creation of a single national LTO;
  - LTO reform and organizational restructure to support a modern computerized tax administration. Structural (organizational) changes will facilitate:
    - a. a focus on value-added tax activities (taxpayer registration, assistance, risk-based audit and filing/payment enforcement);
    - b. the introduction of a VAT credit verification/refund capability;
    - c. an enhanced data entry capability; and

- d. effective risk management and business intelligence capacity for risk analysis and profiling of VAT taxpayers to manage the specific compliance risks that VAT presents on imports, exports and domestic sales.
- Recruitment of additional staff; right people in the right positions at the right time via transparent, merit based recruitment processes;
- Delivery of a robust training programs (formal and on the job) with high levels of staff participation and engagement, which provide staff with the knowledge and skills to perform their jobs effectively and efficiently;
- The review, updating, enhancement and approval of the VAT policies and procedures and introduction of additional improved and streamlined business policies, processes and procedures, in particular, the refund policy:
  - a. reduced costs of administration for taxpayers and the ARD;
  - b. reduced opportunities for corruption;
  - c. facilitation of risk-based compliance activities.
7. Core tax administration processes (registration, payments/refunds, assessments and identification of late filers/payers) will be automated. The SIGTAS VAT modules will be reviewed, updated, tested and implemented on time and within budget. The VAT refund module has to be finalized and tested. Alternatively, new VAT tax administration software can be procured, customized, tested and made operational;
8. ARD staff accept and use SIGTAS (or new VAT tax administration software) to the full extent possible to administer VAT (no parallel or manual systems);
9. The VAT return filing system will be carried out exclusively through e-filing (Fast Track Filing);
10. Access is provided to potential VAT taxpayer files in Regional Revenue Directorates to facilitate verification and transfer of VAT client base to the National LTO and enable VAT registration. It is highly likely that access to cases in the Mustofiats cannot be achieved in the absence of a single national tax authority with direct reporting arrangements to the ARD;
11. VAT implementation is actively and publicly supported politically and by senior officials within the Ministry of Finance (MoF);
12. Adequate resources (financial, human and infrastructure) will be available at the right time to support pre- and post-implementation activities. The VAT team will prepare an adequate budget for the project implementation;
13. The ACD will work collaboratively with the ARD to ensure that it has the capability to collect the correct amount of VAT from importers from the VAT start date;
14. Any changes in the political environment, the economy and/or security do not significantly impact the implementation of VAT;
15. There is sufficient technical assistance to enable implementation as well as pre- and post-implementation activities to be supported and evaluated;
16. Macroeconomic stability improves, and the security situation remains stable.

## D. VAT Implementation Plan

Given the scale, complexity and nature of introducing VAT, implementation must be carefully planned and monitored. The VAT implementation plan is the high-level planning document that outlines the approach to be taken to implement VAT in Afghanistan. It is the 'roadmap' that outlines the project course.

## E. Development of the VAT Implementation Plan

This plan updates the implementation plans prepared in the past, which were collaboratively developed by the ARD and ACD. A VAT Steering Committee, chaired by the Deputy Minister of Revenue and comprising senior officials the ARD and ACD, oversaw the development of the plan, approved content, and facilitated Ministerial approval. The current update of the plan will also be approved by the VAT Steering Committee and the Minister of Finance.

Key milestones achieved towards preparation for VAT implementation include:

- Submission of Draft VAT law to Parliament (May 2013);
- Organizational restructuring exercise for VAT administration (commenced June 2013) with the approval for the establishment of a new VAT sub-directorate within the LTO Kabul. VAT Sub-Director has been appointed and limited staff recruited;
- Initial VAT awareness training of ARD and ACD staff, including provinces (2014-2015);
- Development of certain draft documents for VAT introduction (guides, manual, policies, training material and others);
- Publication of the VAT law in Official Gazette (April 2016);
- Amendment of the VAT law providing for new implementation date and 10% rate in Official Gazette (January 2017);
- Implementation of risk-based compliance model (2015-2017) by establishment of risk-based compliance sub-directorate with ARD, introduction of risk-based compliance practices and procedures within the LTO and rollout to other offices;
- Continuous automation of revenue and customs processes and procedures (SIGTAS and ASYCUDA);
- Gradual implementation of SIGTAS in ARD offices outside Kabul (since 2015 and still ongoing);
- Protocol for data exchange between SIGTAS and ASYCUDA (since 2016);
- Introduction of Fast Track Filing system (electronic declaration facilities for large taxpayers in 2017);
- Establishment of a call center to guide and help taxpayers to comply with their tax obligations (September 2017).

Ongoing activities and initiatives that impact VAT implementation include:

- Update of the strategic VAT implementation plan by a designated working group and its approval by the VAT Implementation Steering Committee and subsequently by the MoF by end-March 2018;

- Review of the LTO registration criteria and alignment of the LTO registration threshold with the VAT registration threshold;
- Development of strategic implementation plan for the establishment of a single national Large Taxpayer office and its approval by end-March 2018;
- Proposal for increase of staff in VAT sub-directorate with 1397 and 1398 Tashkeel;
- VAT client verification and identification that includes analyzing the ASYCUDA import data to identify potential VAT taxpayers currently registered at the MTO or STO or not registered at all, as well as taxpayers/traders understating turnover in comparison to import figures;
- Roll-out of SIGTAS (currently non-VAT module and subsequently VAT module) and preparation for full e-filing once the e-governance law is published (Fast Track Filing is currently operational);
- Design and implementation of new LTO organizational structure aligned with VAT implementation needs;
- Continuous efforts to ensure donor funding and technical assistance for VAT implementation;
- Ongoing and intensive training and development of ARD VAT staff as well as training of ACD post clearance audit, investigations and mobile verification teams;
- Basic VAT training for all other (relevant) ARD and ACD staff;
- VAT awareness for the general public and VAT education for future VAT taxpayers.

#### **F. Plan content**

The VAT implementation deliverables are grouped into six components. The nature and scope of the work within each component was identified by describing the major deliverables, the completion timeframes, and the persons responsible. These components are:

1. Initial Actions
2. VAT Legal Framework and Interpretation
3. Systems and Procedures
4. Organizational Restructuring and Resources
5. VAT Publicity and Public Education
6. VAT Operationalization

This plan focuses on timely preparation and mobilization of the capacity necessary to achieve the plan. VAT implementation will use project management practices and principles, with regular review and monitoring of all plans by the VAT Sub-Director with the oversight and support of the VAT Steering Committee. These activities will continue until Mid-2021, after which time the VAT Steering Committee will cease to exist and any remaining functions will be transferred to 'business as usual'.

## **G. Other project planning documents**

The VAT implementation plan is the master plan and other plans will be aligned with it. There are six subsidiary planning documents which address specific implementation challenges. These six documents are:

1. The Strategic LTO Reform Plan;
2. The VAT Implementation Risk Management Plan;
3. The VAT Stakeholder Management Strategy;
4. The VAT Communication Plan;
5. The VAT Change Management Strategy;
6. The VAT Compliance Strategy.

Establishment of a single national LTO and management of risk, stakeholders, change and compliance are critical to the overall success of the plan and to the VAT implementation in Afghanistan. The following paragraphs outline the purpose and status of each plan.

### **Strategic LTO Reform Plan**

The main initiative in rationalizing the organizational structure is the establishment of a single national LTO with centralized planning and management from the ARD. This means replacing the current reporting lines from Mustofiats to the Deputy Minister of Administration in the MoF.

This Strategic LTO Reform Plan will include the establishment of a unique threshold for LTO firms, independent of sector, as well as a transition plan with detailed schedule of implementation.

### **VAT Implementation Risk Management Plan**

The initial VAT Implementation Risk Management Plan was approved in December 2011. It has been updated to reflect the amendments in the VAT Law and intentions of the Government to introduce VAT in December 2020. It is a high-level document that seeks to identify and assess potential key project risks that may delay or derail the project if they materialize. The overall risk assessment for each identified risk is based on impact (what will happen if the risk occurs) and likelihood (how probable is it that the risk will occur).

The plan also outlines mitigation activities, or responses, to the risk, that will assist in managing the risks and reducing the risk level to a manageable level of acceptance. Over fifty risks were identified; each of which is aligned to a 'work theme' of the VAT implementation plan. The plan is monitored and updated regularly to ensure that the plan reflects project risks accurately.

### **VAT Stakeholder Management Plan**

The implementation of VAT will impact a wide and diverse range of people and organizations collectively known as 'stakeholders'. Project stakeholders include the business community, the general public, MoF staff and officials and other Government departments. This plan identifies stakeholders, the nature of their interest and proposes strategies to ensure



that the right people are communicated with at the right time with the right messages to assist with stakeholder ‘buy-in’ and support. The VAT Stakeholder Management Plan was initially approved in March 2013 and will be updated to reflect subsequent legal developments.

External stakeholder management activities will start as early as possible as the VAT law has already been enacted. This strategy will allow VAT registered businesses to be adequately informed about and prepared for the new tax. VAT Law amendment published in January 2017 provides for extended implementation date, namely by 21 December 2020, which will ensure three years for preparation of the government structures, taxpayers and the general public.

### **VAT Communication Plan**

A comprehensive VAT Communication Plan was developed in 2017 to outline how the ARD and ACD will develop key messages and communicate with stakeholders. The staffing and resource requirements for communications activities are outlined, and a preliminary set of Frequently-Asked Questions and a set of preliminary informational pamphlets has been developed for use across a variety of communication channels.

### **VAT Change Management Plan**

The introduction of the VAT will bring substantial organizational changes and challenges to the Revenue and Customs departments. Studies have shown that employee resistance and lack of training can be substantial hindrances to organizational change. Therefore, addressing the human aspects of change is a critical aspect of project planning and must be done early in the project cycle. The Change Management Plan is a proactive approach to planning and managing organizational change in a logical and strategic way to reduce employee resistance.

The plan components include:

- an explanation of the reasons for change;
- an outline of what is to be changed (structure/work processes/values and so forth);
- the identification of the people impacted by the changes; and
- a proposal of change management strategies.

An ARD-wide change management plan was developed in 2013. The plan will be updated to address all aspects of organizational change currently under the management of the DG ARD, including aspects relevant to successful VAT implementation.

### **VAT Compliance Plan**

A VAT Compliance Plan has been developed. The plan is divided into pre-implementation and post-implementation phases. Pre-implementation activities focus on the provision of taxpayer awareness and assistance activities to assist businesses to be VAT ready. Post implementation activities continue provision of taxpayer awareness and assistance, and include the commencement of compliance activities such as enforcement (debt and filing), audit and refund verification.

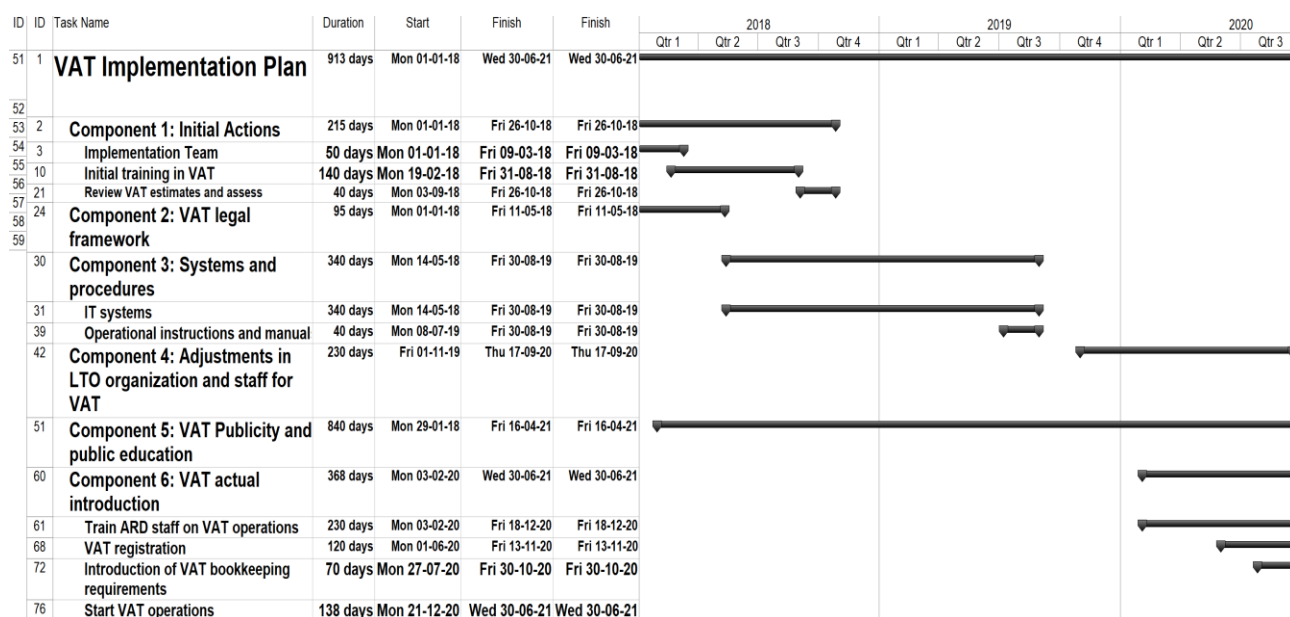


Significant features of the plan are the integration and alignment with existing ARD planning and strategy documents, based on the use of risk-based principles and reliance on an automated system, namely SIGTAS.

## Part II - VAT Implementation Plan

The present plan comprises six key components and features a detailed schedule for each. These components will be carried out from January 2018 to June 2021. According to the plan, VAT will start to be applied to imports and domestic sales on 21 December 2020. The plan describes each component, the resources needed for its development, the necessary input and the outcomes.

**Figure 1. Summary of the VAT implementation plan timetable**



The plan also features a risk analysis for each component, as well as suggest measures for mitigating each of the potential implementation risks detected. This document includes three annexes. The first is the general timetable for VAT introduction (Gantt Chart). The second is the project's timetable in a table format. The third is a note on VAT policy and administrative decisions.

### A. Project Governance

Successful implementation of the VAT will require high-level commitment and guidance as well as a strong core team of staff to carry out a significant program of work. For these purposes, a VAT Steering Committee and VAT Core Team will be formed.

## **B. The VAT Steering Committee**

The VAT Steering Committee (SC) will provide general guidance, approving implementation plans and providing overall supervision and ensuring stakeholder support. The SC will have the participation of the ARD Director General, and the Project Coordinator (who will act as SC Secretary), and of the Director General of ACD. When a long-term VAT expert is hired, he/she would be invited to participate in the SC meetings. The SC will be headed by the Deputy Minister of Revenue and Customs.

The SC will meet at least once a month to supervise the progress with VAT implementation according to the approved plans, to make the necessary adjustments, to assist in resolving stakeholders' issues, and to approve issues related with the tax policy. The SC will also be responsible for involving the private sector in the implementation of VAT and keeping their representatives informed. The SC will not be directly involved in any operational issues. The draft TOR for the Steering Committee have been prepared for MoF review.

## **C. The VAT Core Team**

The VAT Core Team should include professionals prepared to manage the various aspects of the project on a day-to-day basis. In addition to the project overall coordinator, the team should include a tax lawyer, an expert in domestic revenue, an expert on customs law, processes and controls, an IT expert, an expert in VAT compliance (VAT audit, VAT refund verification, enforcement and risk analysis and profiling) and an expert in communication and capacity building. The VAT Coordinator would be supported by a team of full-time support staff.

Some team members will have to work full time, while others may work part time. A core of at least 3-4 officers must be allocated full time. Others will be allocated according to the needs of the project (see the full project schedule in Appendix 1). In general, in addition to the VAT Coordinator, an ARD staff, a publicity and training person, and one or two administrative staff will work in a full-time basis.

A VAT international expert should be recruited for 20-30 months to assist the local team in implementing VAT. This expert would work in coordination with the National Project Coordinator, to whom he or she would report. In the specific case of Afghanistan, support from the ADB, EU and the World Bank in this area should be considered. The local team should also be assisted by short-term experts in the areas of communication, SIGTAS, ASYCUDA, and VAT audits and refunds.

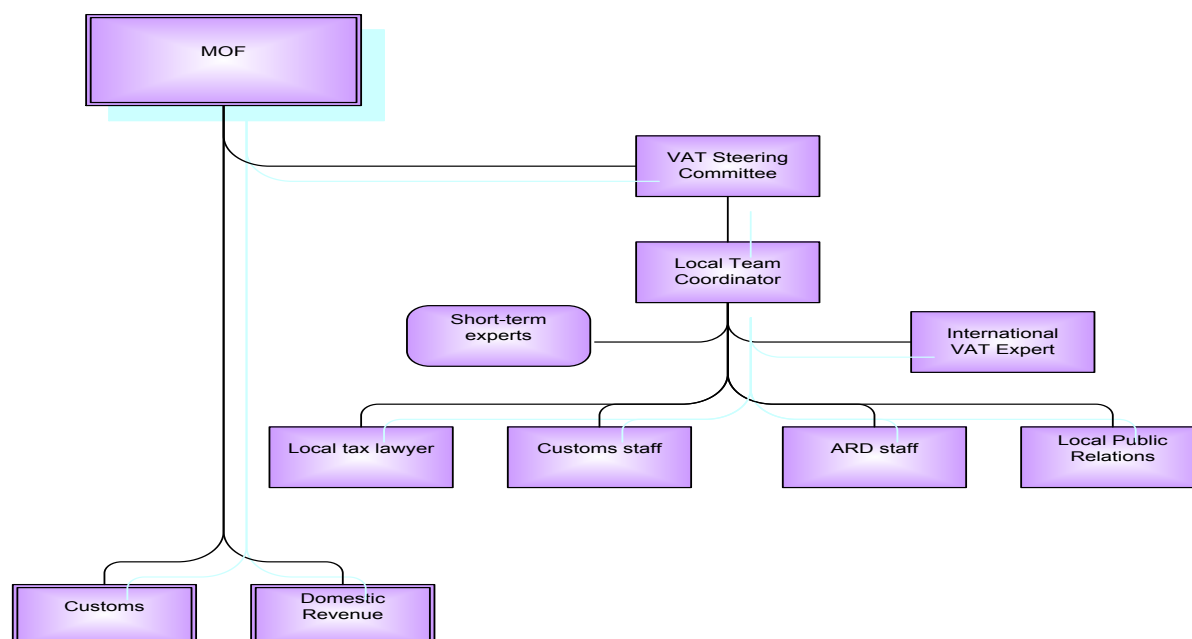
## **D. Budget for Implementing VAT**

A budget for implementing VAT is to be prepared to cover the costs of the project. The budget should cover the costs with the local team; the VAT international expert and other

experts; travel related with VAT implementation; publicity, public education, office space, and training on VAT; and the SIGTAS and ASYCUDA customization to process VAT.

A chart showing the relationship between the various parties in implementing VAT is presented below.

**Figure 2: Organizational Structure for Implementing VAT in Afghanistan**



## E. Key Components

The VAT project features six components: (1) Initial actions, (2) VAT legal framework and interpretation, (3) VAT system and procedures, (4) organizational restructuring and resources, (5) VAT publicity and public education, and (6) VAT operationalization.

The definitions of the six project components are presented below. The necessary resources for introducing VAT – both external and within MOF – were estimated. The key resources required by the project are:

### a. External

VAT introduction expert	(20-30 months)
VAT training expert for training instructors	(02-03 months)
VAT legislation specialist	(02-03 months)
IT business analyst (SIGTAS)	(04-05 months)
IT programmer (SIGTAS)	(04-05 months)
VAT risk and audit/refund verification expert	(02-03 months)

Communications expert	(02-03 months)
Economist for estimating VAT revenues	(01-02 months)
Economist for drafting VAT sensitivity studies	(01-02 months))
<b>Local</b>	
VAT Steering Committee	(entire project)
VAT introduction coordinator	(entire project)
VAT Coordinator PMO support staff	(entire project)
Local training specialist	(06-08 months)
Local legal specialist	(06-08 months)
ARD staff member	(18-21 months)
ACD staff member	(06-07 months)
Local communications expert	(10-12 months)

## F. Description of the Project Components

### Component 1: Initial actions

#### Outcome 1: VAT Core Team mobilized.

**Objective:** The team is ready to carry out the day-to-day work program for VAT introduction.

**Description:** The VAT Core Team should be established under the Minister of Finance to carry out daily tasks concerning the introduction of VAT. It will have the responsibility to ensure that the new modern systems and procedures implemented with VAT will be fully used by ARD staff. The team should be coordinated by a high-level professional – the VAT Coordinator. The key attributes of the VAT Coordinator are leadership, ease of access in relation to the country’s authorities, proven managerial experience and ability to innovate. In principle, the VAT Coordinator will be the ARD/LTO Deputy Director for VAT.

The VAT Core Team members should have responsibilities over the following areas: (1) tax legislation; (2) IT (in particular, SIGTAS); (3) taxpayer communication, training and education; (4) customs valuations, assessments and control over imports and exports; (5) taxpayer registration and assistance; (6) filing and payment processing; and (7) tax audit, refund verification and arrears collection. Although some countries allocated one staff member for each of these areas, the constraints in terms of human resources in Afghanistan make it acceptable for some team members to dedicate themselves to more than one area.

The VAT Coordinator and about 6 to 12 team members should be dedicated to the project on a full-time basis. Other members may work part-time, subject to the criteria set by the VAT Coordinator and prioritizing project activities. In addition, the VAT Coordinator should be

assisted by 2-3 support staff to manage plans and budget, monitor and track all activities, and support other team members.

At this point, it is extremely important to prepare an assessment of technical assistance (TA) needs. Fortunately, Afghanistan may use different sources of reliable TA: WB, IMF, EU, ADB etc. Once the needs are identified, it will be necessary to prepare the terms of reference (TOR) for the different activities.

It is highly recommended that the VAT Core Team include an international specialist with experience in introducing VAT.<sup>3</sup> This would prevent errors and accelerate the VAT introduction process. The specialist should be recruited for 20–30 months (within a 42-month time frame) to work alongside the VAT Coordinator. The specialist will assist team members in developing and implementing the tasks under their responsibility. Some short-term specialists may be required for conducting specific tasks such as drafting regulations, designing VAT risk systems (“risk engine” and risk criteria), audit programs or VAT refund programs, helping customize SIGTAS and ASYCUDA, etc.

A budget for introducing VAT should be drafted and approved by the Minister of Finance. This budget should cover expenses with personnel dedicated to the project, consultants, study trips to see VAT working in neighboring countries, expenses with office space, furniture, office equipment, training, communication material and transportation.

**Deliverables:**

- Core Team and VAT Coordinator appointed and mobilized.
- International specialist recruited to work alongside the project team.
- VAT project budget drafted and approved

**Outcome 2: ARD and ACD staff and trainers trained on basic, intermediate and advanced VAT**

**Objective:** Prepare a group of ARD and ACD staff to act as VAT instructors and to prepare staff from both departments to manage VAT.

**Description:** Capacity building is one of the key success factors when introducing new taxes. In the case of Afghanistan, this should start with the capacity building of the VAT introduction team and be extended to the ARD and ACD staff who will be involved in VAT

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<sup>3</sup> As mentioned before, the TA providers can help the VAT Team with the identification of an expert.

operations. Capacity building should start as soon as the team is allocated, and the VAT international expert becomes available. The first step will be identifying training needs and drafting a general VAT training plan. A particular aspect of this training will be the identification and training of local instructors (training of ARD and ACD trainers) who will be responsible for training their colleagues and new staff, under the supervision of the VAT Expert. During training on VAT, it may be necessary to recruit foreign VAT specialists to teach more specialized subjects. It will also be necessary to carry out high-level seminars for the authorities of MOF, ACD and ARD, as well as for Government decision makers. Also, at this point, professional attachments will start to neighboring countries that have VAT in operation.

VAT training packages have been developed to support the training of instructors and staff and should be reviewed and updated. These packages will be also useful for the regular training programs regarding ARD and ACD, once VAT is in operation.

**Deliverables:**

- VAT training material packages, including support texts, PowerPoint presentations and illustrative pamphlets.
- A seminar on VAT policy for high executives from the MOF, ARD, ACD, and for members of Parliament interested in VAT.
- Project team trained in VAT.
- ARD and ACD instructors trained.
- ARD and ACD staff involved in VAT duly trained in the VAT law, regulations, SIGTAS VAT modules, VAT policies and procedures.

**Resources needed:**

VAT Expert  
Potential local instructors (4-5)

**Input:**

Guidelines on VAT basic decisions on policy and administrative issues (see Appendix 3)  
“The Modern VAT”<sup>4</sup>

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<sup>4</sup> The Modern VAT - Liam P. Ebrill, International Monetary Fund, 2001

### **Outcome 3: Revision of the initial VAT revenue estimates and carry out a survey of the traders' ability to meet VAT bookkeeping requirements**

**Objective:** Review the VAT tax revenue and impact estimates, as well as assess the ability by potential VAT taxpayers to meet VAT requirements in terms of tax invoicing and bookkeeping.

**Description:** It will be necessary to prepare or review estimates on the impact of VAT. These studies will cover the possible impacts of VAT on the different economic sectors, on consumer prices, and on consumption of different consumer segments.

Lastly, there will be an assessment on the ability by potential VAT taxpayers to maintain the tax bookkeeping required by VAT. The assessment will focus on the current practices in terms of issuing invoices and sale tickets, use of ledgers and use of IT accounting systems.

#### **Deliverables:**

- Updated estimate on VAT revenues
- Study on the effect of VAT on prices; consumption; various economic sectors; and various consumer groups
- Report on the current tax bookkeeping practices by potential VAT taxpayers prior to introducing VAT

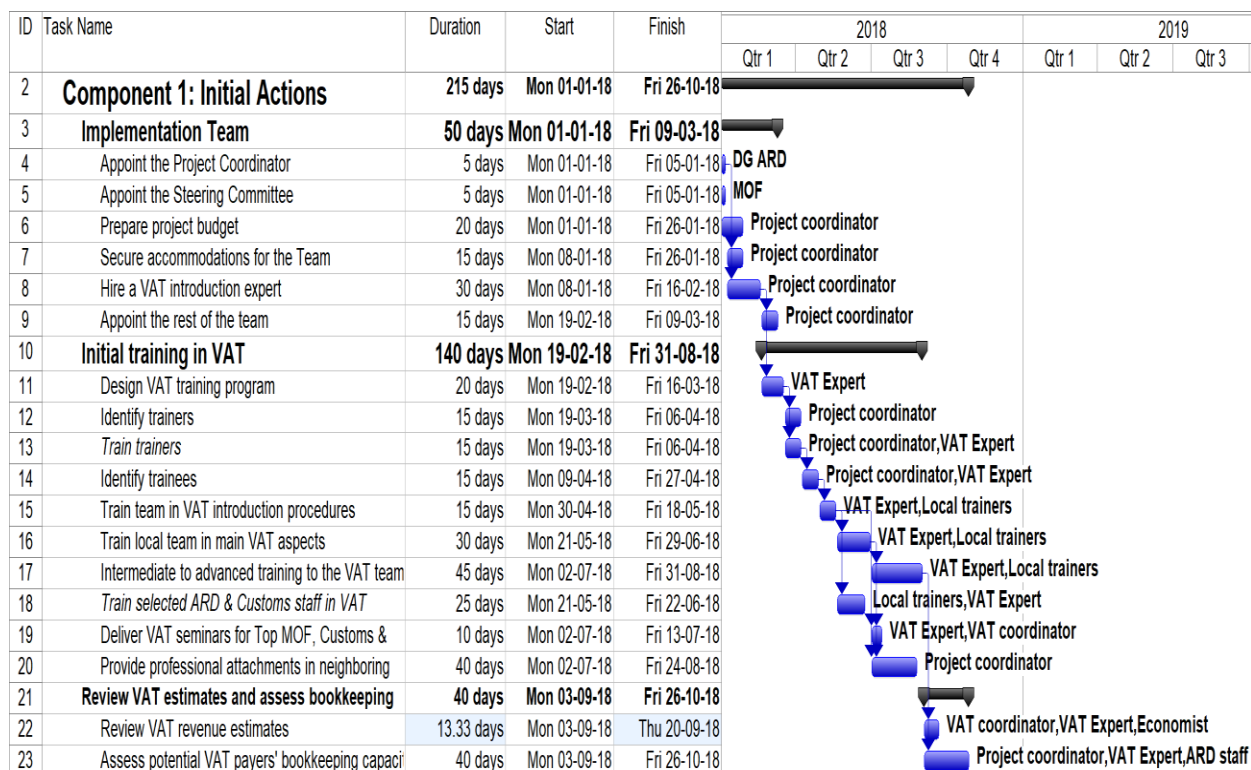
#### **Resources needed:**

- An economist for reviewing VAT revenue estimates
- An economist for preparing a VAT sensitivity study (could be the same)
- An ARD task force for assessing the current situation of tax bookkeeping by the potential VAT taxpayers, with support from the VAT expert

**Input:** Note on VAT decisions regarding policy and administrative aspects  
“The Modern VAT”



## Schedule:



## Component 2: VAT Legal Framework

### Outcome 1: VAT Law and regulation approved

**Objectives:** To have in place VAT regulations that includes features on tax bookkeeping as well as VAT rulings.

#### Description:

##### *Review VAT regulation*

The VAT law has been passed and now, it will be necessary to review the draft the VAT regulation as well as the initial VAT rulings. This task will require intense consultations with the stakeholders of Afghanistan.

It will be necessary to consider the impact of the new VAT legislation on the current legislation. Since VAT will replace the BRT for the taxpayers above VAT registration threshold, it will be necessary amend the BRT legislation. It is essential that the introduction of VAT coincides with the changes in those other legislations.

Additionally, the tax legislation specialists should review and update explanatory memorandum. This memorandum will help the parties to understand and discuss the VAT legislation and regulation.

#### Deliverables:

- VAT Regulations approved
- Initial VAT rulings published


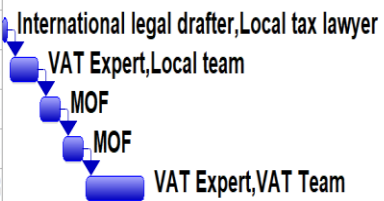
#### Resources needed:

- International tax legislation drafter
- Local legal specialists

#### Input:

- Decisions on the basic features of VAT policy and administration
- “The Modern VAT”
- ” Comments on VAT policy and administrative aspects”

### Schedule:

ID	Task Name	Duration	Start	Finish	2018			
					Qtr 1	Qtr 2	Qtr 3	Qtr 4
24	<b>Component 2: VAT legal framework</b>	95 days	Mon 01-01-18	Fri 11-05-18				
25	Review draft VAT regulation	5 days	Mon 01-01-18	Fri 05-01-18	 <p>International legal drafter, Local tax lawyer</p> <p>VAT Expert, Local team</p> <p>MOF</p> <p>MOF</p> <p>VAT Expert, VAT Team</p>			
26	Carry out public consultation	20 days	Mon 08-01-18	Fri 02-02-18				
27	Get Cabinet approval	15 days	Mon 05-02-18	Fri 23-02-18				
28	Get VAT regulation approved	15 days	Mon 26-02-18	Fri 16-03-18				
29	Prepare and publish the first set of VAT rulings	40 days	Mon 19-03-18	Fri 11-05-18				

### Component 3: Systems and Procedures

#### Outcome 1: SIGTAS and ASYCUDA adapted to process VAT

**Objective:** Adapt SIGTAS and ASYCUDA to process and monitor the VAT.

**Description:** The SIGTAS system should be customized to process and monitor the VAT. New e-forms will be included for VAT.

The ARD has a new IT system that can process any tax in an integrated and effective way. This includes VAT, income tax, wealth tax, rental tax, etc. In particular, it has applications for filing returns and making payments online, carrying out risk analyses and information crosschecking, and for processing VAT refunds. SIGTAS customization would be carried out in 2019 and 2020 with the modules for taxpayer service and taxpayer registration being implemented in June 2020 and the modules for return and payment processing by December 2020. The compliance control modules (stop-filing control, audit, arrears collection, refund processing and appeals) will be implemented during the first semester of 2021.

Customs ASYCUDA will be adapted to process VAT on imports. In addition, it should report on the import and declarations value and other details to ARD SIGTAS electronically, at least once a month. Customs also must provide ARD with monthly information on the details of all exports for refund control. It is important to indicate that the VAT tax base will include customs duties. ARD procedures will be changed to include VAT processing and monitoring.

On-line procedural manuals will be drafted for all VAT tax administration functions (taxpayer service, taxpayer registration, filing and paying taxes, controlling non-filers, audits, collection and appeals).

## Deliverables:

- ASYCUDA ready to collect VAT on imports
- SIGTAS ready to process VAT and to provide support to control over compliance with VAT legislation, including control over the printing and issuing of invoices and the processing of refund requests
- VAT operation on-line procedural manuals

## Resources needed:

- SIGTAS expert
- VAT expert
- Local specialist in domestic revenues
- Local specialist in ASYCUDA

**Input:** VAT law (or clean draft)  
VAT regulation (or clean draft)

## Schedule

ID	Task Name	Duration	Start	Finish	2018				2019				2020	
					Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2	
30	<b>Component 3: Systems and procedures</b>	340 days	Mon 14-05-18	Fri 30-08-19										
31	<b>IT systems</b>	340 days	Mon 14-05-18	Fri 30-08-19										
32	Assess changes need in SIGTAS and ASYCUDA	100 days	Mon 14-05-18	Fri 28-09-18										
33	Customize SIGTAS to process VAT	120 days	Mon 01-10-18	Fri 15-03-19										
34	Customize ASYCUDA to process VAT	60 days	Mon 10-12-18	Fri 01-03-19										
35	Test and approve SIGTAS changes for VAT	80 days	Mon 18-03-19	Fri 05-07-19										
36	Test and approve ASYCUDA changes for VAT	50 days	Mon 04-03-19	Fri 10-05-19										
37	Install ASYCUDA version for VAT	40 days	Mon 13-05-19	Fri 05-07-19										
38	Install SIGTAS version for VAT	40 days	Mon 08-07-19	Fri 30-08-19										
39	<b>Operational instructions and manuals</b>	40 days	Mon 08-07-19	Fri 30-08-19										
40	Prepare e-operational manuals and instructions	40 days	Mon 08-07-19	Fri 30-08-19										
41	Prepare e-operational manuals for audit and refund	40 days	Mon 08-07-19	Fri 30-08-19										

## Component 4: Organizational Restructuring

**Outcome 1:** ARD/LTO organization adapted to better manage VAT and equipped with the necessary human resources.

**Objective:** Adapt the structure of the ARD/LTO and recruit the number of staff members required to manage VAT.

**Description:** At outset, VAT will be operated by the LTO. It may be necessary to make some adjustments in the LTO structure and staffing for VAT operation. A Deputy Director should oversee VAT operations for the initial years. In the longer-term, VAT will be integrated in a functional structure in the LTO. Later, the VAT threshold will be lowered to incorporate new taxpayers from other local offices. At that time, these offices organizations will be reviewed to fit VAT operations.

The number of employees to support VAT administration will depend on the VAT threshold, and consequently, on the number of VAT taxpayers. It will also depend on the new procedures for operating. For instance, presently, ARD/LTO receives approximately 400 tax returns a year, including monthly and annual return. This number will change once VAT threshold is decided and a new configuration of the LTO taxpayers roll is implemented. Also, changes will be necessary in the organization due to mandatory use of e-filing for VAT.

Furthermore, it will be necessary to review work posts and to make the necessary adjustments in view of VAT implementation. It will also be necessary to adapt offices and work stations. Lastly, it will be necessary to train ARD staff on VAT operation and legislation.

### Deliverables:

- ARD/LTO structure adjusted to operate VAT
- Adequate number of staff allocated to VAT
- Adequate number of staff trained on VAT operation and legislation

### Resources needed:

- VAT Expert
- Domestic tax member
- SIGTAS trainers
- ARD trainers

### Input:

- VAT Law
- VAT regulation (or clean draft)

### Schedule

ID	Task Name	Duration	Start	Finish	2020						
					Qtr 4	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2
42	<b>Component 4: Adjustments in LTO organization and staff for VAT</b>	230 days	Fri 01-11-19	Thu 17-09-20							
43	Review the ARD/LTO organizational structure for VAT	60 days	Fri 01-11-19	Thu 23-01-20							
44	Estimate the number of VAT payers	20 days	Fri 27-12-19	Thu 23-01-20							
45	Estimate the need of new staff for VAT	20 days	Fri 24-01-20	Thu 20-02-20							
46	Review ARD/LTO job descriptions for VAT	40 days	Fri 21-02-20	Thu 16-04-20							
47	Refurbish ARD/LTO offices for VAT operations	50 days	Fri 17-04-20	Thu 25-06-20							
48	Appoint the necessary staff for VAT	50 days	Fri 17-04-20	Thu 25-06-20							
49	Train ARD/LTO staff in VAT legislation	60 days	Fri 26-06-20	Thu 17-09-20							
50	Train ARD/LTO staff in VAT operations	60 days	Fri 26-06-20	Thu 17-09-20							

### Component 5: VAT Publicity and Education

**Outcome 1: Raise the awareness of the Afghan population on VAT, its goals, its requirements, its operation and its effects.**

**Objective:** Develop and operate communication programs to publicize, as well as to educate taxpayers on their obligations regarding VAT.<sup>5</sup>

**Description:** As soon as the VAT policy and administration features are defined, it will be necessary to train potential taxpayers and to educate the public in the way that VAT will operate. Since this will be a considerable task, it is recommended that authorities make a public announcement concerning the introduction of VAT, to avoid public opinion distortions. Additionally, there should be created a publicity campaign, assisted by communication specialists, covering the period until VAT starts to operate. This publicity should focus on the introduction of VAT, the presentation of the general features of VAT, the VAT registration (or registration data updating) campaign, the start of VAT, and the first returns to be filed and payments to be made.

Publicity is a specialized area requiring experienced professionals who are specially recruited, to carry out the VAT publicity campaign. The VAT team will have a leading role in the program. It will be necessary to ensure that publicity covers as many people as possible and uses various media. Possibilities include: the use of a VAT website; telephone call centers for answering VAT related questions; an e-mail address for consultations;

<sup>5</sup> The authorities have already developed a draft VAT publicity and public education plan.

meetings; seminars; and presentations. Local team members will have frequent participation in radio and television programs to explain VAT and its main features. Many countries that implemented VAT created discussion forum with their business associations, chambers of trade and industry, etc.

The communication expert recruited for VAT should explore every available media. This includes internet, television, radio, newspapers, magazines and pamphlets, seeking to highlight the benefits of VAT.

### Deliverables:

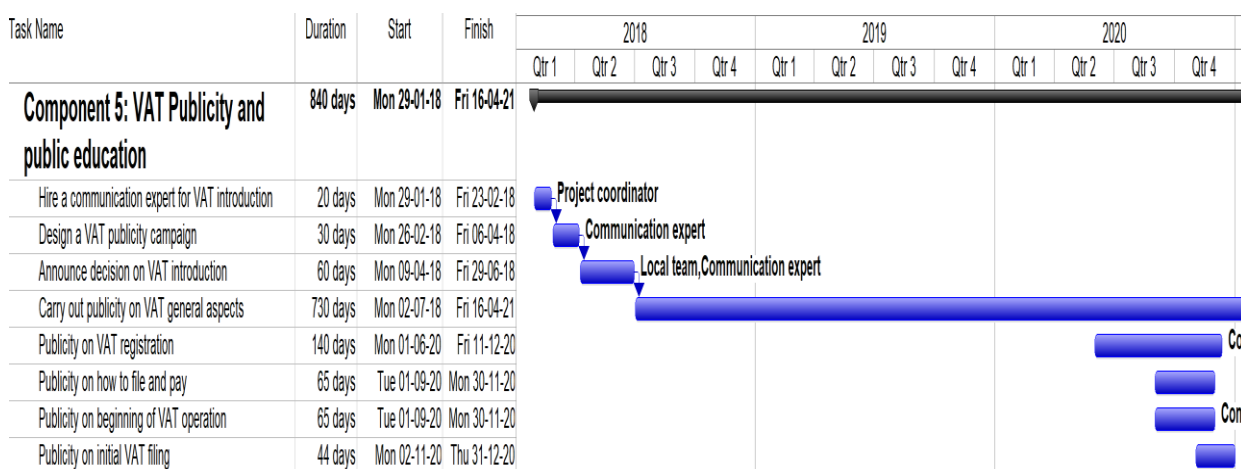
- Publicity campaign designed and carried out.
- Afghanistan taxpayers and population in general adequately informed on VAT

**Resources needed:** Local communication specialist  
Communication expert  
VAT expert

### Input:

- VAT law explanatory memorandum
- VAT Law and regulation (or clean draft)
- VAT rulings

### Schedule:





## Component 6: VAT Operationalization

### Outcome 1: Customs and ARD staff trained in VAT

**Objective:** Ensure that the ACD and ARD staff involved with VAT is duly trained in their tasks.

**Description:** ACD and ARD staff involved in VAT will be trained in VAT legislation and operation so that they can perform their new tasks properly. The VAT expert, the Customs and ARD VAT trainers, and the SIGTAS and ASYCUDA trainers will be responsible for this activity, which should include: taxpayer assistance, taxpayer registration, VAT collection on imports, processing of VAT returns and payments, VAT audits, VAT refund procedures, arrears collection and appeals.

#### Deliverables:

- Customs and ARD staff trained in VAT
- Group of local instructors prepared to repeat the courses

#### Resources needed:

- VAT expert
- SIGTAS trainers
- Training expert
- Project's IT expert
- ACD and ARD instructors
- ACD and ARD staff member to be trained

#### Inputs:

- VAT operational manuals
- Staff training manual (PowerPoint presentations, pamphlets, etc.)

### Outcome 2: All potential VAT taxpayers registered in the new IT system

**Objective:** Ensure that all businesses subjected to VAT are duly registered in ARD's SIGTAS and that their information is up to date.

**Description:** ARD will identify potential VAT taxpayers and issue them a notice requesting them to register themselves or to update their information in the taxpayer register. At this stage, ARD will not accept registrations from taxpayers whose sales are below the set threshold, but, wish to register for VAT. This will be accepted later (in approximately two years) as ARD gets more experience on VAT operation. Potential VAT taxpayers may be detected by way of their income tax returns, BRT returns, imports, exports, purchases or sales from/to large taxpayers' use of electricity, etc.

**Deliverables:**

- Taxpayer register with reliable information on all potential VAT taxpayers

**Resources needed:**

- VAT expert
- ARD staff member
- VAT registration function in the new IT system implemented and operational

**Input:**

- Legislation on VAT
- Registration e-manual

**Outcome 3: New tax bookkeeping regulation implemented**

**Objective:** Ensure that entities required to pay VAT have proper tax bookkeeping and comply with the tax bookkeeping regulation. This regulation includes rules on printing and issuing invoices or e-invoices and maintaining ledgers, whether in hardcopy or softcopy (e-invoice).

**Description:** ARD will require VAT taxpayers to adopt the new VAT bookkeeping system. At beginning, this will be done by submitting instructions and making advisory/educational visits. In a second stage, those who do not comply with the new requirements will be audited and sanctioned in accordance. The regulation on tax bookkeeping will include rules on the use of invoices and e-invoices, ledgers and electronic statements.

**Deliverables:** New VAT bookkeeping regulations operational  
Taxpayers and accountants trained in the new bookkeeping modality.

**Resources needed:** VAT expert  
ARD staff

**Input:**

- Tax bookkeeping situation survey
- Tax bookkeeping regulation
- VAT Law
- VAT regulation

**Outcome 4: A modern VAT system implemented**

**Objective:** Have a broad-based VAT operational

**Description:** The new VAT system will be implemented and will replace the current Business Receipt Tax. VAT will start being applied on imports on 21/12/2020 and the e-filing system will be available at the ARD website for e-filing or paper filing in the second half of January 2021. VAT returns and payments will be processed and a system for controlling non-filers will be implemented within the first three months of operation. This will be followed by audits, which will first be educational and later start to apply penalties. Lastly, the VAT refund and tax appeal systems will be implemented.

**Deliverables:**

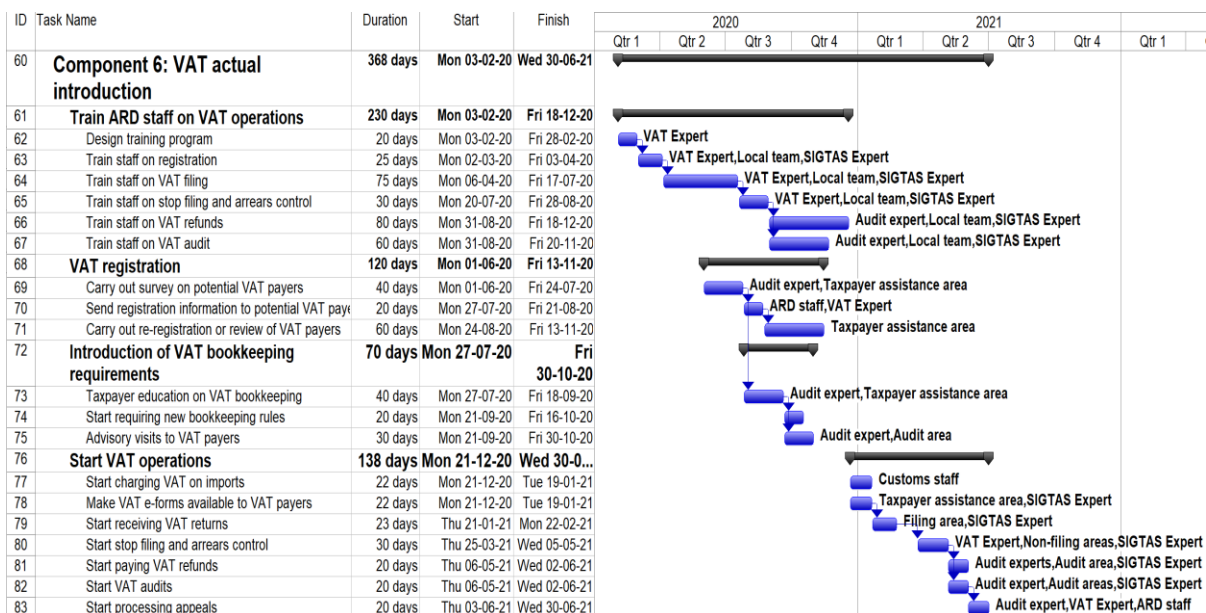
- VAT legislation in force
- VAT regulation in force
- Public properly informed about VAT
- Customs and ARD staff properly informed about VAT
- VAT in operation

**Resources needed:**

- VAT project coordinator
- VAT expert
- ARD staff
- SIGTAS and ASYCUDA adapted for VAT

**Input:**

- VAT law and regulations
- Operational online manuals on VAT



## VAT PROJECT RISK ANALYSIS

The project for introducing VAT and its success in terms of achieving its goals are subject to potential risks in each component. The table below shows some of these risks and indicates measures to mitigate their possible effects.

### Component 1 – Initial Actions

Risk	Suggestion on how to mitigate risks
Delay in appointment of the VAT team and its coordinator	The ARD should approach the authorities to discuss the problem and highlight the importance of these appointments
Delay in approving the VAT implementation budget	The VAT Coordinator should convince the MOF that the budget is crucial for the smooth VAT implementations and to accomplish with the December 2020 deadline
Delay in the selection of the VAT expert and short-term consultants to support the authorities in introducing VAT.	Request support from WB, IMF, EU, ADB and other international bodies in identifying and recruit VAT introduction specialists.
Delay in the approval of VAT policy and administration issues.	The VAT Coordinator should convince the authorities of the importance of an on-time definition of those issues, and should also request WB, IMF, EU, and ADB support on this.

### Component 2 – VAT Legal Framework

Risk	Suggestion on how to mitigate risks
Delay in the approval of the VAT regulations and rulings	The VAT Coordinator should require the VAT expert and Legal expert to finish the review of the VAT regulations and the preparation of the initial VAT rulings and/or approach the authorities to discuss the problem and highlight the importance of processing the regulations/rulings, if they are put on hold by them.

### Component 3 – Systems and Procedures

Risk	Suggestion on how to mitigate risks
Delay in adapting SIGTAS and ASYCUDA to VAT.	Ensure that the project secure SIGTAS business analysts and programmers with skills to customize SIGTAS and ASYCUDA for VAT

### Component 4 – Organizational Restructuring

Risk	Suggestion on how to mitigate risks
Delay in the allocation of resources to the ARD for operating VAT.	The VAT Coordinator should convince the ARD and MOF that the allocating of these resources is vital for the success of VAT.

### Component 5 – VAT Publicity and Education

Risk	Suggestion on how to mitigate risks
Delays in the recruitment of a communication specialist or firm to conduct the VAT communication and public education program.	Request support from development partners to identify and recruit VAT communication specialists. Try to find a Government communication staff with experience in public campaigns

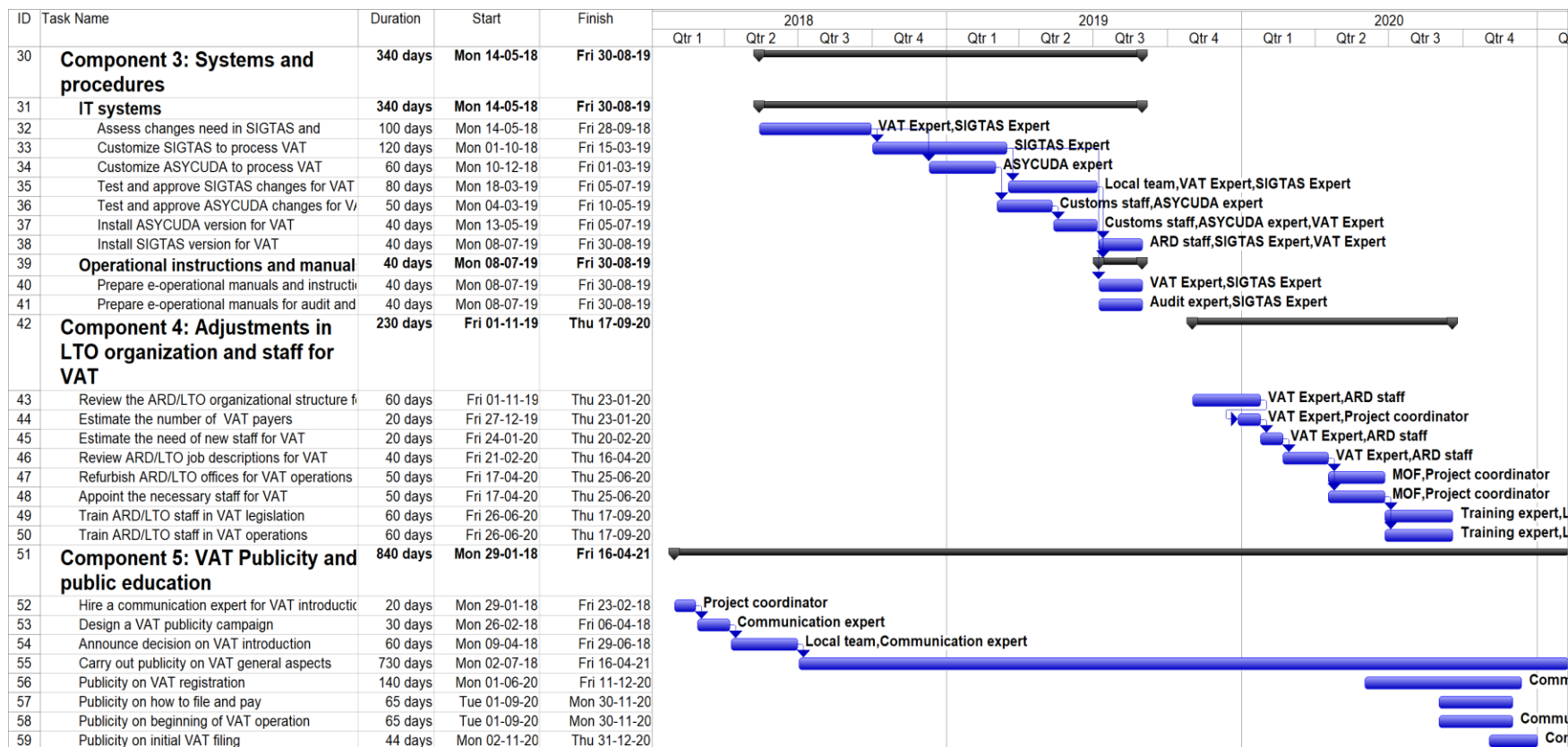
### Component 6 – VAT Operationalization

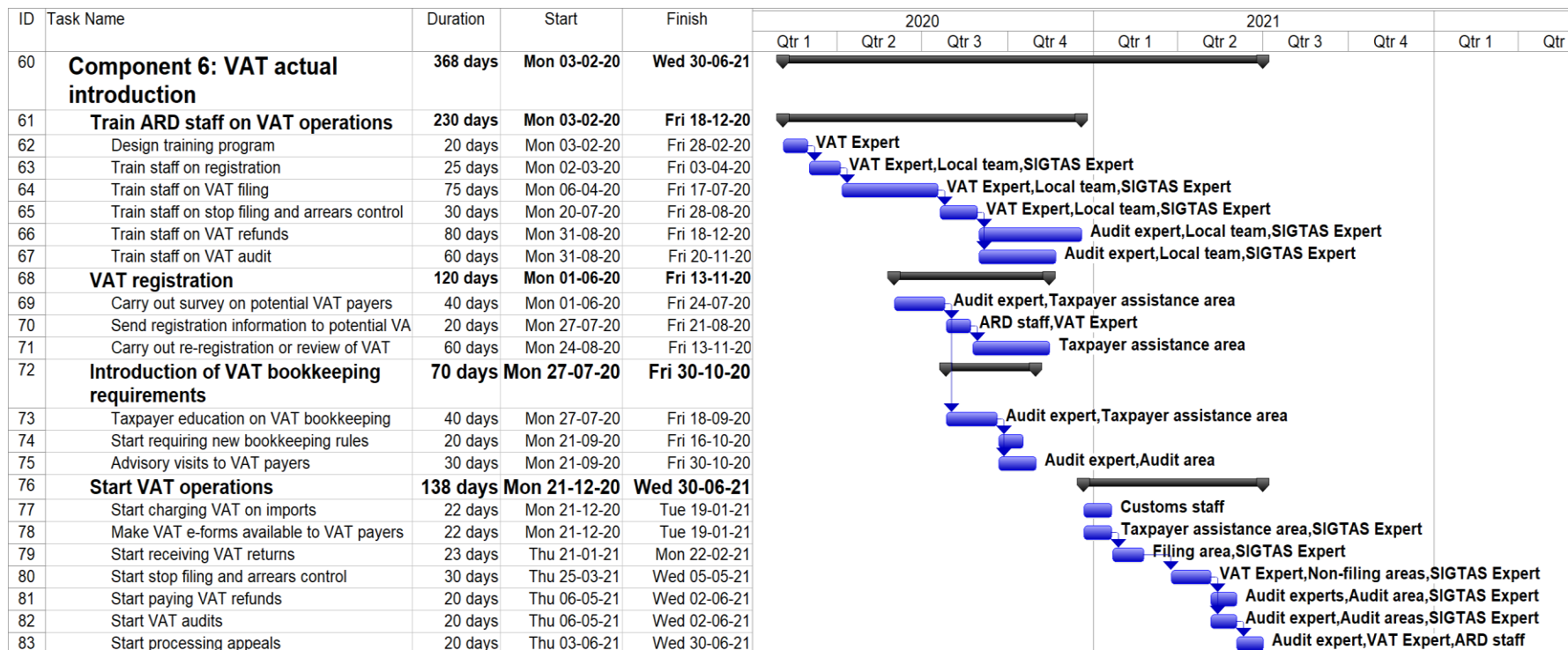
Risk	Suggestion on how to mitigate risks
In general, people do not appreciate new taxes. This behavior could affect the success of VAT operation in the country.	The VAT communication and public education program should handle this risk. Programs would focus on the importance of VAT for the development of Afghanistan. Taxpayers and community leaders, as well as opinion-makers, should be invited to VAT seminars to clarify their tax obligations.
Resistance by taxpayers in adopting the new VAT bookkeeping rules.	Intensive education of traders and accountants (component 5) and visits to explain the new rules. It is important to make use of the fact that the new tax bookkeeping rules will start around 6 months before VAT is introduced.

## Appendix 1 - Detailed implementation schedule

ID	Task Name	Duration	Start	Finish	2018				2019		
					Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2	Qtr 3
1	<b>VAT Implementation Plan</b>	913 days	Mon 01-01-18	Wed 30-06-21							
2	<b>Component 1: Initial Actions</b>	215 days	Mon 01-01-18	Fri 26-10-18							
3	<b>Implementation Team</b>	50 days	Mon 01-01-18	Fri 09-03-18							
4	Appoint the Project Coordinator	5 days	Mon 01-01-18	Fri 05-01-18							
5	Appoint the Steering Committee	5 days	Mon 01-01-18	Fri 05-01-18							
6	Prepare project budget	20 days	Mon 01-01-18	Fri 26-01-18							
7	Secure accommodations for the Team	15 days	Mon 08-01-18	Fri 26-01-18							
8	Hire a VAT introduction expert	30 days	Mon 08-01-18	Fri 16-02-18							
9	Appoint the rest of the team	15 days	Mon 19-02-18	Fri 09-03-18							
10	<b>Initial training in VAT</b>	140 days	Mon 19-02-18	Fri 31-08-18							
11	Design VAT training program	20 days	Mon 19-02-18	Fri 16-03-18							
12	Identify trainers	15 days	Mon 19-03-18	Fri 06-04-18							
13	Train trainers	15 days	Mon 19-03-18	Fri 06-04-18							
14	Identify trainees	15 days	Mon 09-04-18	Fri 27-04-18							
15	Train team in VAT introduction procedures	15 days	Mon 30-04-18	Fri 18-05-18							
16	Train local team in main VAT aspects	30 days	Mon 21-05-18	Fri 29-06-18							
17	Intermediate to advanced training to the VAT	45 days	Mon 02-07-18	Fri 31-08-18							
18	Train selected ARD & Customs staff in VAT	25 days	Mon 21-05-18	Fri 22-06-18							
19	Deliver VAT seminars for Top MOF,	10 days	Mon 02-07-18	Fri 13-07-18							
20	Provide professional attachments in	40 days	Mon 02-07-18	Fri 24-08-18							
21	<b>Review VAT estimates and assess</b>	40 days	Mon 03-09-18	Fri 26-10-18							
22	Review VAT revenue estimates	13.33 days	Mon 03-09-18	Thu 20-09-18							
23	Assess potential VAT payers' bookkeeping c	40 days	Mon 03-09-18	Fri 26-10-18							
24	<b>Component 2: VAT legal framework</b>	95 days	Mon 01-01-18	Fri 11-05-18							
25	Review draft VAT regulation	5 days	Mon 01-01-18	Fri 05-01-18							
26	Carry out public consultation	20 days	Mon 08-01-18	Fri 02-02-18							
27	Get Cabinet approval	15 days	Mon 05-02-18	Fri 23-02-18							
28	Get VAT regulation approved	15 days	Mon 26-02-18	Fri 16-03-18							
29	Prepare and publish the first set of VAT rulings	40 days	Mon 19-03-18	Fri 11-05-18							







## Appendix 2 - VAT introduction timetable (table format)

Task id	Task Name	Duration (Days)	Dates		Resource Names
			Start	Finish	
<b>1</b>	<b>VAT Implementation Plan</b>	<b>913</b>	<b>01-01-18</b>	<b>30-06-21</b>	
<b>2</b>	<b>Component 1: Initial Actions</b>	<b>215</b>	<b>01-01-18</b>	<b>26-10-18</b>	
3	Implementation Team	50	01-01-18	09-03-18	VAT adviser
4	Appoint the Project Coordinator	5	01-01-18	05-01-18	DG ARD
5	Appoint the Steering Committee	5	01-01-18	05-01-18	MOF
6	Prepare project budget	20	01-01-18	26-01-18	Project coordinator
7	Secure accommodations for the Team	15	08-01-18	26-01-18	Project coordinator
8	Hire a VAT introduction expert	30	08-01-18	16-02-18	Project coordinator
9	Appoint the rest of the team	15	19-02-18	09-03-18	Project coordinator
<b>10</b>	<b>Initial training in VAT</b>	<b>140</b>	<b>19-02-18</b>	<b>31-08-18</b>	
11	Design VAT training program	20	19-02-18	16-03-18	VAT Expert
12	Identify trainers	15	19-03-18	06-04-18	Project coordinator
13	Train trainers	15	19-03-18	06-04-18	Project coordinator,VAT Expert
14	Identify trainees	15	09-04-18	27-04-18	Project coordinator,VAT Expert
15	Train team in VAT introduction procedures	15	30-04-18	18-05-18	VAT Expert,Local trainers
16	Train local team in main VAT aspects	30	21-05-18	29-06-18	VAT Expert,Local trainers
17	Intermediate to advanced training to the VAT team	45	02-07-18	31-08-18	VAT Expert,Local trainers
18	Train selected ARD & Customs staff in VAT	25	21-05-18	22-06-18	Local trainers,VAT Expert
19	Deliver VAT seminars for Top MOF, Customs & Top ARD officers	10	02-07-18	13-07-18	VAT Expert,VAT coordinator
20	Provide professional attachments in neighboring countries	40	02-07-18	24-08-18	Project coordinator
<b>21</b>	<b>Review VAT estimates and assess bookkeeping capacity</b>	<b>40</b>	<b>03-09-18</b>	<b>26-10-18</b>	
22	Review VAT revenue estimates	13.33	03-09-18	20-09-18	VAT coordinator,VAT Expert,Economist
23	Assess potential VAT payers' bookkeeping capacity	40	03-09-18	26-10-18	Project coordinator,VAT Expert,ARD staff
<b>24</b>	<b>Component 2: VAT legal framework</b>	<b>95</b>	<b>01-01-18</b>	<b>11-05-18</b>	
25	Review draft VAT regulation	5	01-01-18	05-01-18	International drafter,Local tax lawyer
26	Carry out public consultation	20	08-01-18	02-02-18	VAT Expert,Local team
27	Get Cabinet approval	15	05-02-18	23-02-18	MOF

28	Get VAT regulation approved	15	26-02-18	16-03-18	MOF
29	Prepare and publish the first set of VAT rulings	40	19-03-18	11-05-18	VAT Expert,VAT Team
<b>30</b>	<b>Component 3: Systems and procedures</b>	<b>340</b>	<b>14-05-18</b>	<b>30-08-19</b>	
<b>31</b>	<b>IT systems</b>	<b>340</b>	<b>14-05-18</b>	<b>30-08-19</b>	
32	Assess changes need in SIGTAS and ASYCUDA for VAT	100	14-05-18	28-09-18	VAT Expert,SIGTAS Expert
33	Customize SIGTAS to process VAT	120	01-10-18	15-03-19	SIGTAS Expert
34	Customize ASYCUDA to process VAT	60	10-12-18	01-03-19	ASYCUDA expert
35	Test and approve SIGTAS changes for VAT	80	18-03-19	05-07-19	Local team,VAT Expert,SIGTAS Expert
36	Test and approve ASYCUDA changes for VAT	50	04-03-19	10-05-19	Customs staff,ASYCUDA expert
37	Install ASYCUDA version for VAT	40	13-05-19	05-07-19	Customs staff,ASYCUDA expert,VAT Expert
38	Install SIGTAS version for VAT	40	08-07-19	30-08-19	ARD staff,SIGTAS Expert,VAT Expert
39	Operational instructions and manuals	40	08-07-19	30-08-19	ARD staff,SIGTAS EExpert,VAT Expert
40	Prepare e-operational manuals and instructions	40	08-07-19	30-08-19	VAT Expert,SIGTAS Expert
41	Prepare e-operational manuals for audit and refunds	40	08-07-19	30-08-19	Audit expert,SIGTAS Expert
<b>42</b>	<b>Component 4: Adjustments in LTO organization and staff for VAT</b>	<b>230</b>	<b>01-11-19</b>	<b>17-09-20</b>	
43	Review the ARD/LTO organizational structure for VAT	60	01-11-19	23-01-20	VAT Expert,ARD staff
44	Estimate the number of VAT payers	20	27-12-19	23-01-20	VAT Expert,Project coordinator
45	Estimate the need of new staff for VAT	20	24-01-20	20-02-20	VAT Expert,ARD staff
46	Review ARD/LTO job descriptions for VAT	40	21-02-20	16-04-20	VAT Expert,ARD staff
47	Refurbish ARD/LTO offices for VAT operations	50	17-04-20	25-06-20	MOF,Project coordinator
48	Appoint the necessary staff for VAT	50	17-04-20	25-06-20	MOF,Project coordinator
49	Train ARD/LTO staff in VAT legislation	60	26-06-20	17-09-20	Training expert,Local team
50	Train ARD/LTO staff in VAT operations	60	26-06-20	17-09-20	Training expert,Local team
<b>51</b>	<b>Component 5: VAT Publicity and public education</b>	<b>840</b>	<b>29-01-18</b>	<b>16-04-21</b>	
52	Hire a communication expert for VAT introduction	20	29-01-18	23-02-18	Project coordinator
53	Design a VAT publicity campaign	30	26-02-18	06-04-18	Communication expert
54	Announce decision on VAT introduction	60	09-04-18	29-06-18	Local team,Communication expert
55	Carry out publicity on VAT general aspects	730	02-07-18	16-04-21	Communication expert,Local team
56	Publicity on VAT registration	140	01-06-20	11-12-20	Communication expert,Local team
<b>57</b>	<b>Publicity on how to file and pay</b>	<b>65</b>	<b>01-09-20</b>	<b>30-11-20</b>	
58	Publicity on beginning of VAT operation	65	01-09-20	30-11-20	Communication expert,Local team
59	Publicity on initial VAT filing	44	02-11-20	31-12-20	Communication expert,Local team

<b>60</b>	<b>Component 6: VAT actual introduction</b>	<b>368</b>	<b>03-02-20</b>	<b>30-06-21</b>	
<b>61</b>	<b>Train ARD staff on VAT operations</b>	<b>230</b>	<b>03-02-20</b>	<b>18-12-20</b>	
62	Design training program	20	03-02-20	28-02-20	VAT Expert
63	Train staff on registration	25	02-03-20	03-04-20	VAT Expert,Local team,SIGTAS Expert
64	Train staff on VAT filing	75	06-04-20	17-07-20	VAT Expert,Local team,SIGTAS Expert
65	Train staff on stop filing and arrears control	30	20-07-20	28-08-20	VAT Expert,Local team,SIGTAS Expert
66	Train staff on VAT refunds	80	31-08-20	18-12-20	Audit expert,Local team,SIGTAS Expert
67	Train staff on VAT audit	60	31-08-20	20-11-20	Audit expert,Local team,SIGTAS Expert
<b>68</b>	<b>VAT registration</b>	<b>120</b>	<b>01-06-20</b>	<b>13-11-20</b>	
69	Carry out survey on potential VAT payers	40	01-06-20	24-07-20	Audit expert,Taxpayer assistance area
70	Send registration information to potential VAT payers	20	27-07-20	21-08-20	ARD staff,VAT Expert
71	Carry out re-registration or review of VAT payers information	60	24-08-20	13-11-20	Taxpayer assistance area
<b>72</b>	<b>Introduction of VAT bookkeeping requirements</b>	<b>70</b>	<b>27-07-20</b>	<b>30-10-20</b>	
73	Taxpayer education on VAT bookkeeping	40	27-07-20	18-09-20	Audit expert,Taxpayer assistance area
74	Start requiring new bookkeeping rules	20	21-09-20	16-10-20	Audit expert,Taxpayer assistance area
75	Advisory visits to VAT payers	30	21-09-20	30-10-20	Audit expert,Audit area
<b>76</b>	<b>Start VAT operations</b>	<b>138</b>	<b>21-12-20</b>	<b>30-06-21</b>	
77	Start charging VAT on imports	22	21-12-20	19-01-21	Customs staff
78	Make VAT e-forms available to VAT payers	22	21-12-20	19-01-21	Taxpayer assistance area,SIGTAS Expert
79	Start receiving VAT returns	23	21-01-21	22-02-21	Filing area,SIGTAS Expert
80	Start stop filing and arrears control	30	25-03-21	05-05-21	VAT Expert,Non-filing areas,SIGTAS Expert
81	Start paying VAT refunds	20	06-05-21	02-06-21	Audit experts,Audit area,SIGTAS Expert
82	Start VAT audits	20	06-05-21	02-06-21	Audit expert,Audit areas,SIGTAS Expert
83	Start processing appeals	20	03-06-21	30-06-21	Audit expert,VAT Expert,ARD staff

## Appendix 3 - Guidelines on VAT basic decisions on policy and administrative issues

### Introduction

VAT is a multi-phased consumption tax. It is paid entirely by the final consumer, but collected along the way to the final consumer. VAT is applied on a broad range of domestic consumption expenditures. In order to raise revenues efficiently, with minimal distortions to the economy, its coverage of those expenditures needs to be comprehensive and uniform. A modern VAT applies at many points in the production and distribution chain, up to and including the retail sale. To avoid cascading (tax over tax), tax paid at earlier points is credited against tax due on the supply of taxable goods and services at each stage of the production/distribution chain. Both, VAT liabilities and VAT credits are based on invoices—from imports or primary production to the final retail sale to the consumers.

Provided that the crediting system can be administered effectively, the final consumer pays exactly the same tax on purchases of goods and services as he/she would have paid under a single-stage retail sales tax (RST). But the scope for avoidance and evasion is minimized for two reasons. First, if one supplier in the chain avoids or is exempted from paying the tax, the revenue loss can be made up, because the credit that is due at the next stage will be reduced by a corresponding amount. Second, although this tax may still be avoided at the final stage—as under the single-stage RST—the amount at risk will generally be much smaller, since most of the VAT will have been collected at earlier stages. This potential of an invoice-based VAT to minimize the loss of tax through avoidance or evasion is one of its fundamental advantages over an RST, and also that a VAT can eliminate all consumption taxes content from exports.

It is true that crediting the tax paid at earlier stages makes tax computation complicated. In addition, the VAT invoice-method requires the maintenance of proper records of sales and purchases. Furthermore, in order to take full advantage of the self-policing aspects of a VAT, it is essential that a VAT invoice be issued for each sale between registered businesses and that VAT credit be allowed only for those purchases covered by a VAT invoice issued by an authorized VAT payer. This is vital to the administration, as it creates an audit trail, and in addition, the need to furnish customers with VAT invoices encourages suppliers to register in the VAT.

#### i. VAT Base

Under VAT, there are three types of transactions: taxed, zero rated, and exempt. The first and most common, is an ordinary taxable supply made by a business that has been registered for the VAT.

The second type of transactions (zero rated) applies mostly to exports. Usually, exports are treated as ordinary taxable supplies, but are imposed a zero percent rate of tax on the sales (exports). Thus, exporters will always have input tax credits (credits for the VAT imposed on their inputs) that exceed the VAT on their outputs (their exports). In the normal course of events, a business that exports all its outputs will be entitled to tax refunds each tax period.

The zero-rate system for exports (sometimes called a VAT-free supply or an “exempt with credit” supply) is an important element of the VAT system. The effect of the zero rate is that no tax is imposed on an export sale because all tax embedded in the costs of the exporter are refunded to the exporter and therefore need not be passed on to the customer in the price of goods or services. In theory, there should be no trace of any consumption tax in exports. The elimination of tax on exports is important to the VAT as it ensures exports are cost competitive. Most countries follow the destination principle for VAT. Every country with a VAT under destination principle imposes VAT on imports and provides a zero-rate for exports. Thus, the only tax imposed on imported goods or services should be the tax imposed by the importing nation.

The third type of transactions is the exempt transactions. It is sometimes referred as “exempt with no credit” supply. An “exempt” transaction is exempt from output tax, meaning no explicit tax is payable on the supply. However, a business that makes an exempt supply is not entitled to any input tax credit for the cost of VAT that was included in the goods and services acquired by the business. It therefore has no choice but to include that tax in the price it charges to its customers—that is, every time a business makes an “exempt” supply there is actually tax embedded in the price.

Thus, unlike a zero-rated supply, the exempt transactions actually contain some VAT in the price. This is a great concern to business customers who would rather purchase a taxable supply than an exempt supply. If a business acquires a taxable supply, it can claim a credit for all tax included in the price. If it acquires an exempt supply, it will know it is paying some implicit tax embedded in the price, but it cannot claim a credit for it since the tax will not be shown in the invoice.

Exempt transactions are distorting and undermine the principles of the VAT. They are intended to provide reduced taxation for final consumption of goods or services the government wishes to subsidize relative to other types of goods or services. When exemptions are established, they may apply to a very tightly defined category of financial services, health or education supplies and some supplies of residential rental property or used residences. Because of their distorting effect, they are almost never used for supplies commonly consumed by businesses.



## ii. VAT Registration Threshold

A common characteristic of the tax system of most countries is that the bulk of the tax revenue is paid by a relatively small portion of the taxpaying population. Small businesses are usually large in numbers, but collectively yield little tax revenue. The threshold should be set sufficiently high to exclude these small taxpayers who often do not keep adequate accounting records and therefore are a burden on tax administration. In this respect, in setting the threshold, an important consideration is the capacity of tax administration to monitor and audit taxpayers.

Furthermore, a reasonable threshold will avoid the need for exempting specific sectors. For example, the great majority of the population engaged in farming, transportation, construction, and small traders will be exempt under the threshold. They will not be required to register for VAT, but will pay VAT on business inputs with no entitlement to a tax credit or refund. This means that the agricultural or transportation sectors need not, and should not, be exempted as such.

A common argument against excluding small businesses (through use of a threshold) is that it discriminates against larger ones. But in fact, some unregistered businesses face disadvantages, as registered businesses would prefer to purchase their inputs from registered suppliers in order to obtain credit for tax paid on business inputs. A small business that sells exclusively, or almost exclusively, to a registered enterprise is particularly disadvantaged, because it must pay the tax on inputs but cannot charge this on sales to the registered enterprise. The most effective way to overcome this problem is to allow voluntary registration of businesses even if their turnover is below the threshold. Because some small taxpayers may see registration as an opportunity to sell fake invoices or file fraudulent refunds, there should be strict conditions attached to voluntary registration, including:

- Capacity to keep proper accounting records;
- Permanent place of business;
- Possession of an account with a financial institution; and
- No deregistration for a period of time (two to three years for example).

## iii. Deciding on Zero-Rated and Exempt Supplies

In principle, only exports should be zero-rated, and only financial supplies should be treated as exempt supplies. One of the most important attributes of a VAT is its complete neutrality with respect to consumption choices by individuals. So long as the base is comprehensive, the tax will have no impact whatsoever on consumption choices—the same relative tax burden will be faced whatever is purchased.

Exempting supplies considered “necessities” leads to a number of problems. First, some of these supplies are acquired by businesses, not final consumers, and businesses will be in disadvantage, if they cannot recover the VAT embedded in the cost of these supplies. The embedded VAT will distort the pricing of supplies made in the jurisdiction and will undermine the competitiveness of exports that include these supplies.

Second, in some cases, it is very difficult to classify supplies in the large grey area between the extremes. Open heart surgery is clearly a medical supply, but is the flat screen TV in the private hospital room part of that supply? Or the doctor’s prescription to join an exclusive gym to work out and reduce the risk of heart attack? Even in the cases where specific supplies can be characterized, ever changing technology, social and commercial norms and practices necessitate continual review of every decision made. Drawing and then defending lines in the sand has proved to be an enormous administrative burden in all jurisdictions with exemptions.

Third, any distinctions that are drawn may cause unknown economic distortions elsewhere in the economy. If some supplies are made exempt and other substitute supplies are not, the shift by consumers from one mode to another will cause distortions in consumption and this will have flow-on effects that make the economy generally less efficient.

Fourth, and somewhat ironically, exemptions of necessities to help lower income persons often have a regressive impact, providing far more benefit to the rich than the poor. For example, exempting electricity would be a concession that provided far more benefit to the rich than the poor. The poor use electricity to power a minimal number of appliances; the rich run their air conditioners and swimming pool filters for months at a time. Similarly, exempting food would provide an enormous windfall to the rich who consume far more food than the poor.

The distortions and inefficiencies caused by exemptions are exacerbated by the fact that the lost revenue must be made up through a higher rate on taxed items.

#### **iv. VAT Multiple Rates**

Ideally, a VAT should have a single, positive rate with zero rating applying only to exports. Multiple rates are, of course, sometimes used to enhance equity. However, the gain in equity is often very limited and sometimes illusory. If, as likely, budget shares for goods consumption differ according to differences in income patterns then, in principle, it is possible to enhance equity by setting differential rates for indirect taxes. The scope for redistribution through indirect taxation depends on dissimilarities between spending patterns of the rich and the poor. However, for plausible degrees of dissimilarities, the amount of redistribution that can be achieved by indirect tax alone is very limited. This result arises from the fact that although the proportion of

income that the rich spend on, say, food (often a lower-taxed commodity) is low, the amount of food that they consume may be very large. The result is that a large part of the subsidy on food would benefit the rich. This is why, given other fiscal instruments for achieving social equity—such as expenditure policies—it is not advisable to use indirect taxation (including multiple rates under the VAT) to attain equity.

Also, multiple rates increase taxpayer compliance and tax administration costs because businesses are forced to incur increased record-keeping costs. Taxpayers must keep records of purchases and sales that consider different rates of tax. These records can also be prone to error. Using multiple rates adds to the cost of administration in two ways: (1) revenue accounting systems and procedures become more complex to consider the different rates; and (2) increased effort is required to control tax evasion through misclassification of taxable inputs and outputs, and to manage a larger number of refunds.

#### **v. VAT Rate**

To satisfy Afghanistan revenue needs, the VAT rate should be around 10 percent range. A rate lower than 10% would become inefficient since tax administration costs and taxpayers' compliance cost costs would significantly diminish the revenue collected.

#### **vi. Special Treatments Under VAT**

##### **A. Treatment of capital goods**

Because it is a tax on consumption expenditure, an invoice-based VAT should not tax capital goods. This result is achieved by allowing enterprises liable to a VAT a full credit for tax paid on capital goods. Denying full credit for tax paid on capital goods leads to tax cascading and distortions of relative prices. Taxpayers engaged in both taxable and tax-exempt activities, such as renting out both commercial (taxed) and residential properties (exempted), and using the same capital goods in both activities, should be permitted to recover the VAT in proportion to the use normally made of the goods in the taxable activity.

##### **B. Treatment of Government Purchases**

Under an invoice-based VAT, exemptions should be based on the nature of the good or service being supplied and not on the recipient of the supply. This ensures that an invoice trail is available through the production and distribution chain, thereby reinforcing compliance and facilitating administration of a VAT.

Providing relief based on the recipient of the supply, weakens the compliance-reinforcing benefits of an invoice system. Moreover, facilitates tax evasion by taxpayers reporting legitimate sales to government together with fraudulent nongovernment purchases.

### **C. Treatment of businesses purchases of Passenger Vehicles and Entertainment Expenses**

As a general rule, a VAT should allow a full credit for input tax on all business purchases. Some tax administrations make exceptions to the rule in the case of passenger vehicles and entertainment expenses. In many countries, these expenses are treated as final consumption by denying credit for input tax on them. This treatment eliminates the need to trace these expenses to ensure that they are not diverted to personal use.

### **D. Treatment of educational services**

Many countries exempt educational services at the primary and secondary level because governments often want to encourage their consumption. However, it should be kept in mind that private school services are generally speaking consumed by medium-high income people. In most countries, public schools are exempt; in any event there is not a big difference between taxing or not public schools taxed or not with VAT because they provide services for free. Another option, if the intention is to truly have educational services absolutely free of VAT, is to tax them at zero rate. In any case, the legislation should be very clear about what kind of educational services would be taxed, exempt or zero rated. For instance, dancing classes or cooking classes probably do not need to be exempt.

### **E. Treatment of Financial services**

Most countries exempt financial services because of the difficulty in identifying the element of service charge contained in loans, insurance, stocks, bonds, and foreign currency exchange. The value of services supplied by financial services is a spread that is often only a few base points in the total charge to the consumer. In general, it is difficult to estimate or find a proxy for the spread. It is also worth pointing out that the erosion of the tax base resulting from exempting financial services is small because the major portion of the output of this sector consists of inputs to other sectors and because financial enterprises pay non-creditable tax on inputs.

It is important that the definition of exempt financial supplies be tightly drafted. Not all supplies provided by a bank are financial supplies in the sense of being supplies of an intermediary. For example, in addition to taking deposits and making loans, a bank may rent safety deposit boxes or provide investment advice and charge for that advice, or charge for checkbooks, or charge for use of ATMs, etc. The rationale for exempt treatment of financial supplies does not extend to these types of supplies. It is the type of supply that is exempt, not the type of supplier.

## **F. Treatment of health services and medicines**

Basic medical services are normally exempt from VAT. These include services of doctors, dentists, hospitals, and medical clinics. However, tax is paid on their inputs and equipment, but no tax is charged on the services they provide. The treatment of pharmaceutical and medical products varies from country to country. The simplest approach is to tax all pharmaceutical and medical products. Any relief broader than medical services should be done by listing the medical products specifically exempted. To protect the revenue base, the products listed should be limited to prescription of generic drugs.

## **G. Treatment of residential buildings sales and rents**

Housing services are difficult to incorporate satisfactorily into a VAT system. In many cases residential housing services are self-supplied and have no easily observable market value. Most VAT systems tax housing services in an indirect manner. The better method is to charge VAT on the supply of new residential construction, while exempting any rent or lease payments on residential property, as well as the resale of used homes.

Short-term hotel accommodation should be subject to VAT, as should rental charges of commercial properties. Commercial business tenants should be entitled to a credit for any VAT payment paid on commercial rents. Although properties may be constructed by owners or by small contractors who fall below the registration threshold, these properties would still bear tax to the extent taxable building materials are used in their construction.

## **H. Treatment of tourist purchases**

As noted, VAT systems commonly zero-rate exports to eliminate all local tax on the exports, which will be subject to an import VAT at the destination. However, tourists cannot register and recover the tax on acquisitions. In theory, there is a case for establishing a system to refund to tourists the VAT on acquisitions they take out which are presumed to be consumed out of the country.

In addition, any special regime for tourists requires complex and costly administrative resources. To overcome these factors, countries that adopt tax rebate regimes for tourists generally set very high thresholds that might apply only to expensive manufactured goods. Adopting high threshold would leave almost all sales in the tax net in any case. In any case, there would be no advantage in Afghanistan to extending a zero-rate equivalent scheme to unregistered tourists.

## **vii. Refunds**

The VAT system only achieves its intended economic goals – the imposition of a tax on final consumption, if intermediate enterprises are able to recover the VAT on their inputs. In most cases, recover takes the form of a credit against the higher VAT liability from business' sales. In some cases, however, credits will exceed liability for "output" tax, i.e., the tax on sales. This will be the case, for example, with exporters and with start-up businesses that acquire expensive capital equipment to generate revenue over a long period. It will also be the case for short periods for cyclical businesses that incur expenses in the off-season in preparation for sales in the peak season.

A proper VAT system should provide prompt refunds to exporters. For this to work from an administrative perspective, two things are needed. First, there must be an administrative capability to verify and validate refund claims quickly. Second, the revenue accounting system must report VAT gross collections, refunds paid, and net collections (gross receipts minus refunds). Some countries establish a fund to pay VAT refunds which is funded with a percentage of the gross collection to avoid any shortfall in revenue that could delay refunds<sup>6</sup>. Refunds must be processed quickly, otherwise a significant cash flow penalty will be imposed on exporters and enterprises investing in new plants and equipment. Also, they should be paid through direct deposit in the taxpayer bank account to reduce risks of fraud. To reducing the risk of refunding inappropriately, without excessively delaying the verification process, a compromise approach is commonly used. Many countries establish a fast track refund system for proven compliant taxpayers – e.g., fully audited exporters – and make mandatory the carry-forward of excess credit for a number of months (e.g. 6 months) for non-exporters and non-startup companies

## **viii. Which organization is going to administer the VAT?**

Most countries prefer their VAT administered by their domestic tax department, the equivalent to the ARD in Afghanistan. Usually, the domestic tax staff's skills to enforce taxes based on financial records are higher than in Customs. And the ARD has considerable experience in administering the BRT. Customs administration will also play a significant role in collecting VAT. The main Customs involvement in VAT administration will be in relation to the collection of the VAT at import stage, verification of exports and the provision of information to the VAT area for audit and refund purposes. The customs declaration forms, procedures, and ASYCUDA will need to be reviewed for VAT implementation.

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<sup>6</sup> In the case of Afghanistan, it could be something between 5% and 10% of VAT gross revenue.

#### **ix. How frequently taxpayers should file and pay?**

Most countries require monthly filing and payment for the VAT. However, some administrations have decided in favor of monthly returns and payment only for medium and large taxpayers and quarterly returns and payment for smaller taxpayers. Nevertheless, longer filing and payment periods do have a negative effect because it takes longer to determine whether a taxpayer complies with filing and payment requirements. Also, information crosschecking has to cover a longer period. Due to the reduced number of taxpayers in Afghanistan, VAT should be filed and paid monthly.

#### **x. What the invoicing requirements should be?**

Invoices are a critical component of VAT. The correct use of invoices must be enforced by tax administrations. Tax practitioners often say that an invoice is like a check issued against the Treasury. Therefore, all precautions should be taken to ensure that they are adequately used.

Tax administrations have to decide on the contents of the VAT invoice. Usually, invoice information should include: the TIN of both the seller and the purchaser; the name and address of the seller; the name of the purchaser; the date the invoice is issued; the invoice number, a description of the goods and services supplied, indicating unit and total selling price; the amount of VAT resulting from that transaction; the total amount of the invoice, including the VAT payable, the date the invoice was printed, and the serial number of invoices printed in that batch. Special provision should be made for taxpayers who use computer systems to print their own invoices or use e-invoices, as well as for cash register receipts.

Compliance with invoicing requirements is another important issue. Countries have to decide how to control printing, issuing and the use of invoices. False or altered invoices are one of the concerns in VAT administration. Several countries have dealt with it through the introduction of strict invoicing regulations. Many of them require taxpayers to obtain tax administration authorization before printing invoices. Some countries have introduced systems to register the print shops that print invoices and require them to inform tax authorities of the TIN and range of the invoice numbers printed for a particular taxpayer.

Some countries have available web-based systems that allow print shops to get straight forward authorization and inform the invoice numbers printed to the tax administration. When the taxpayers use computerized invoicing systems and print their own invoices or use e-invoices, they should get authorization from the tax administration before printing/issuing the invoices. Tax administrations that have adopted these systems have all the necessary information on valid invoice numbers available to them.

It is critical to consider that in the near future many taxpayers will be using electronic invoices, which is a positive measure. The VAT system should be designed to accept and control e-invoices as well.