



Islamic Republic of
Afghanistan

*Ministry
of
Finance*

*General
Presidency
of
Revenue*

Income Tax: The meaning of “salary” and “wages”

Relying on this Ruling

This is a public ruling within the meaning of Article 96 of the Income Tax Law. Information in this ruling may be relied upon by taxpayers as the basis for determining their tax liability. This means that if a taxpayer has declared his or her tax liability on the basis of this ruling, the Ministry of Finance will not seek to reassess the taxpayer for a higher tax liability in respect of taxable income covered by the ruling, even if the interpretation accepted by the Ministry of Finance is later determined to be incorrect by a Court and the taxpayer’s liability to tax is higher under the alternative interpretation accepted by the Court. Similarly, the Ministry of Finance will not seek to impose penalties on any person who has declared his or her tax liability on the basis of this ruling.

Introduction

1. The Income Tax Law states that the taxable income of a person is the total of all receipts less those deductions authorised by the law (Article 13). Further, the law provides that receipts subject to income tax include salary, wages, fees and commissions, whether received in cash or otherwise (Article 14). However, salary or wages will be exempt from income tax in certain limited circumstances. For example, the salary or wages of an employee of a foreign government or international organisation will be exempt from income tax where the exemption is specifically provided for in a treaty or agreement with the government of Afghanistan.

2. It is the responsibility of persons who pay salary or wages to withhold tax from the salary or wages paid and to pay the amount withheld to the Government account (Article 63). Where tax has been correctly withheld from an employee’s salary or wages and the employee has no other source of income, the employee then has no other income tax liability in respect of that salary or wages (Article 68). If tax has *not* been correctly withheld from an employee’s salary or wages, the employee will be required to file an annual income tax form and declare income from all sources including the salary or wages from which tax has not been correctly withheld. In that case, the employee may claim a credit for any tax that has been deducted from salary or wages and paid to the Government account.

3. This Public Ruling discusses the general principles of salary or wages (Part 1), when a benefit is a reward *for* services (Part 2), when a benefit is a *reward* for services (Part 3), when the provision or

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reimbursement of food or accommodation will not be considered reward for services (Part 4), treatment of living-away-from-home allowances (Part 5), treatment of other expenses of employees living away from their ordinary place of residence (Part 6), and the Ministry of Finance monitoring of accommodation, food and other exemptions (Part 7). Finally, this Public Ruling provides a summary of the taxation of typical benefits where employees are required to live away from their ordinary place of residence in order to perform the duties of their employment (Part 8).

Part 1: Salary or wages – general principles

4. The terms “salary” and “wages” are not defined in the Income Tax Law. The Ministry of Finance takes the view that salary and wages include all types of payments and benefits that are a reward for services provided.

5. In most cases, salary or wages will be paid directly from an employer to an employee. However, an employee will be treated as receiving salary or wages that are received indirectly because, for example, they are reinvested or accumulated for the person’s benefit or dealt with on the person’s behalf, including payment to another person. Salary or wages will be treated as being dealt with on an employee’s behalf where the payment relates to the services provided by the employee.

6. For salary or wages to be subject to income taxation in Afghanistan, the principal requirement is that its source is in Afghanistan. Salary or wages will have its source in Afghanistan if it is earned or derived in Afghanistan typically from the provision of personal services by an employee who is located in Afghanistan. In that case, it is of no relevance whether the employer or employee is a resident of Afghanistan or not. Similarly, it is of no relevance whether the payment of salary or wages is made from within Afghanistan or not. Further, it is of no relevance whether the receipts of salary or wages by the employee occurs within Afghanistan or not.

7. Salary or wages will also be subject to income taxation in Afghanistan where an employee who is a resident of Afghanistan but providing personal services outside of Afghanistan receives salary or wages from an employer who is resident in Afghanistan. Although the salary or wages may be considered to have been earned or derived outside of Afghanistan, the fact that the employee is a resident of Afghanistan requires that the employee be subject to income tax on their income derived from all sources worldwide.

8. The scope of what constitutes salary and wages is broad. It is intended to include all types of remuneration without regard to its form or legal nature. It will extend to all benefits from an employer to

an employee subject to the requirement that the benefits must be provided as a “reward for services”.

9. There are two elements to the phrase “reward for services”. The first is the requirement that there be a connection between a benefit and the provision of services. The second is the requirement that the benefit amounts to a “reward” for an employee. Part 2 of this Public Ruling addresses the need for a connection between a benefit and the provision of services for the benefit to constitute wages. Part 3 of this Public Ruling explains when a benefit will be considered a “reward”.

Part 2: When is a benefit a reward *for* services?

10. For a benefit received by an employee to be salary or wages, the benefit must be a reward *for* services. The requirement that the reward be *for* services and not *for* some other reason means it must be possible to identify a connection between a benefit received by a person and the provision of services for the benefit to be salary or wages – in other words, the benefit must be a *consequence of* or the *result of* the provision of services.

11. Not all benefits provided by an employer to an employee will satisfy this connection requirement. For example, an employer may also be a friend of an employee and may make a gift such as a wedding gift in a personal capacity and not in the capacity of an employer.

12. Whether a benefit is made in consequence of a person’s provision of services to an employer or in consequence of another relationship between the persons is an objective question of fact. The subjective understanding of the employee will not determine the character of the payment.

13. A number of factors can be used to determine the character of the payment. One test is to consider whether the employer is an individual with a personal relationship with the person receiving a gift or a legal person or partnership. Only a natural person can have a personal relationship with another natural person -- it is not possible for a business entity such as a legal person or a partnership to have a “personal” relationship with a natural person. Accordingly, whether or not a benefit from a legal person (eg a company) or a partnership is labelled a gift by the parties, if the payment is made from an employer to an employee, it will be considered a reward for services.

14. Another test is to consider whether the benefit was provided on a once-only basis in consequence of a special event such as a wedding or graduation or whether it is a repetitive gift such as an annual Eid

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payment or Christmas gift. In the case of a repetitive gift, the employer is considered to regard the benefit a consequence of the continued employment of the employee. Even if the employer is a natural person and even if the parties claim the benefit is provided in consequence of a personal relationship between the two persons, because of its regularity, it will be seen as a consequence of the ongoing employment relationship.

15. Note that, as mentioned previously, if a gift (or any other benefit) would be salary or wages of an employee had it been made directly to the employee, it remains that person's salary or wages even if paid to another person.

16. A third test is to consider the employer's accounting treatment of the expense of the benefit. If the employer treats the expense of the benefit in any way as an expense of his or her business enterprise, it will not be a gift in consequence of a personal relationship between the parties but will be remuneration for services and accordingly will fall within the definition of salary or wages. By way of contrast, if the employer does not record the expense in any way that relates to his or her business but rather treats the expense solely as a personal expense, the benefit is likely to fall outside the definition of salary or wages, provided the other tests mentioned above are also satisfied.

Part 3: When is a benefit a *reward* for services?

17. Some types of benefits received in consequence of employment will be a "reward" or payment for services, while other types will not. The term "reward" implies a gain to the recipient; a payment that leaves the person in a better economic position because of the employment. The reward for services will typically be payment of salary or wages in the form of cash or deposit to a bank account. However, the reward for services may also take the form of payment of allowances. An example is an allowance paid in recognition of the personal achievements of the employee such as an education allowance, bonus or other gratuity. Another example is an allowance paid as compensation for the difficulty, danger or increased cost of living attendant with the location of employment.

18. A reward can be contrasted with a benefit that merely compensated a person for a loss or expense directly incurred by the employee in the course of carrying out employment responsibilities. This type of benefit would restore the person to the position they would have been in had they not been in employment and incurred an expense, but would not be a genuine gain or reward to them.

19. An example of a benefit that is in consequence of employment but is not a reward for services (because it is not an economic gain) is

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the provision of tools or equipment or special clothing such as protective gloves or boots required to carry out employment tasks. These are benefits to the employee and they are in consequence of employment, but they are not rewards in the sense of gain to the employee. If the person was not employed they would not need the tools or equipment. The provision of these items is therefore not a gain to them – it merely leaves them in a position to carry out their employment services. The benefits are used directly in the course of carrying out employment responsibilities.

20. This is equally true of a reimbursement of expenses directly incurred in the course of carrying out employment responsibilities. For example, if an employee purchases tools or equipment used in carrying out employment services and the employer reimbursed those expenses, the benefit would not be a reward to the employee because there is no gain to that person compared to their position had they not been in employment.

21. Provision of benefits used in the course of employment and reimbursement of expenses incurred by an employee directly in the course of carrying out employment duties must be contrasted with benefits that put a person in position to carry out employment but are not directly part of the employment process.

22. For example, if an employer provides food or clothing (other than special work or protective clothing) or accommodation to an employee or reimburses an employee's expenses for food or clothing or accommodation, the benefit or reimbursement will normally be considered a "reward" for services as it is a personal benefit or expense of the employee and not directly related to carrying out employment responsibilities. Everyone needs to eat, to wear clothes and to have accommodation in order to work. But these are not expenses directly related to carrying out employment duties since people would have these expenses even if they were not carrying out services for their employer. If the employer provides these benefits or reimburses the employee for the cost of these benefits, the employer is providing personal benefits to the employee and this is a reward or an economic benefit to the employee. It does not simply compensate the employee for expenses that he or she would not have suffered if the employee had not carried out employment responsibilities.

23. A similar situation applies to the cost of travel between the employee's home and their place of employment. Such expenses are not related directly to the carrying out of employment duties. If an employer provides transport for an employee to travel to and from the employee's place of employment or reimburses the employee for the cost of transport, the employer is providing personal benefits to the employee and this is a reward or an economic benefit to the employee.

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24. While the provision by the employer of meals or transport to an employee would normally constitute a benefit derived during the course of employment and therefore be subject to income tax, the Ministry of Finance accepts that in many cases this has become an accepted part of the employee's conditions of employment, is difficult to accurately cost, can be administratively difficult to monitor, and is of comparatively small value. Accordingly, where an employer provides no more than one meal a day to an employee and the cost is no more than US\$2 or transport for an employee to or from the employee's usual place of employment and the cost is no more than US\$1 per day, then these benefits will not be subject to income tax. This exception will not apply where an employer pays an allowance instead of provision of the benefit. That is, if the employer pays the employee an allowance of any amount for meals or travel to and from the employee's usual place of work, that amount will be considered to be salary or wages and therefore subject to income tax.

Part 4: When the provision of food and accommodation or the reimbursement of food and accommodation expenses will *not* be considered a reward for services?

25. In some particular cases, expenses that would otherwise be personal expenses of an employee may be expenses related to carrying out employment services *away from the employee's ordinary place of residence*. An example would be the provision of airfares to travel to and from employment in Afghanistan or the reimbursement of such expenses where the employee retains an ordinary place of residence outside Afghanistan and will return to the ordinary place of residence when employment services have finished. The benefit of an air ticket or reimbursement of the cost of an air ticket does not relate to anything in the actual course of carrying out employment responsibilities. However, it is necessary for the employee to carry out those responsibilities at somewhere other than the place of the employee's ordinary residence.

26. As noted, the provision of (or reimbursement of) food, clothing, travel or accommodation by an employer would normally be a reward for services. In exceptional circumstances, however, the reimbursement of accommodation expenses (or the provision of accommodation) will be compensation for an expense incurred only because of employment. This will be the case where an employee maintains a home or similar ordinary place of residence and is faced with the need for a second place of residence in Afghanistan to carry out employment responsibilities. For example, an employee may maintain an ordinary place of residence outside of Afghanistan but,

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because of employment responsibilities, is required to maintain a second home in Afghanistan. Similarly, an employee may maintain an ordinary place of residence in Afghanistan but, because of employment responsibilities, is required to maintain a second home elsewhere in Afghanistan. If the employee provides the employer with proof that the employee has a home or similar ordinary place of residence and has a need for a second place of residence in Afghanistan only because of the employment responsibilities in Afghanistan, the provision of accommodation or the reimbursement of accommodation expenses will not form part of the employee's salary or wages.

27. In circumstances similar to those described in the previous paragraph, a portion of a person's food expenses may also not represent a reward for services. While it is true that persons would incur food expenses if they worked in Afghanistan or not, where employees are staying in a second residence, they are likely to incur higher food expenses than they would if they were in their ordinary residence. This is because in most cases their second residence in Afghanistan is unlikely to have the same food preparation and storage facilities as their ordinary place of residence and higher food costs, particularly for prepared foods, may be experienced.

28. To the extent an employer provides meals or reimburses the cost of meals in excess of the cost an employee would incur for meals at the employee's primary place of residence, the benefit will not be a reward and therefore will not be considered salary or wages. The Ministry of Finance considers provision to an employee in Kabul of meals with a cost to the employer up to US \$35 per day or the actual reimbursement of meal expenses for such a person up to US \$35 per day to be compensation for the additional cost of meals to these employees and thus outside the meaning of salary or wages. The Ministry of Finance considers provision to an employee outside of Kabul of meals with a cost to the employer up to US \$25 per day or the actual reimbursement of meal expenses for such a person up to US \$25 per day to be compensation for the additional cost of meals to these employees and thus outside the meaning of salary or wages.

29. In some cases, employees with a home or similar ordinary place of residence will be provided with "room and board" – that is, accommodation and some or all meals and incidentals such as laundry services – by an employer in Afghanistan or will be reimbursed for the expense of staying in accommodation where room and board is provided. In these circumstances, the cost of room and board will be considered to be compensation for the additional costs to these employees and thus outside the meaning of wages.

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Part 5: Treatment of Living Away from Home Allowances

30. In some cases, rather than provide “second home” accommodation to employees or reimburse employees for the cost of maintaining a second place of residence in Afghanistan, employers will simply provide a “living away from home allowance”. If the allowance is not tied to actual accommodation or additional food expenses but can be freely spent by the employee on anything the employee chooses, it will normally be considered to be another type of reward for performing services and thus will be considered salary or wages. However, where the employee has provided the employer with evidence that the employee has a primary home or similar accommodation, it will be clear that some of the allowance will have to be spent on the additional cost of accommodation and the additional costs of meals in Afghanistan.

31. Where an employer pays an allowance to an employee in accordance with the previous paragraph, the amount will be treated as salary or wages and therefore subject to income tax. Provided that (a) an employer does not also provide accommodation or meals to an employee or reimburse those costs separately and (b) the employee has provided the employer with evidence that the employee has a primary home or similar accommodation, the Ministry of Finance will accept that some or all of the allowance is used to pay for additional cost of accommodation and meals and therefore will not be considered salary or wages. Where the employee provides to the employer receipts or other documentary evidence confirming expenditure on accommodation and meals, the employer may then, and only then, deduct those amounts incurred for accommodation and meals from the employee’s salary or wages that will be subject to wage withholding tax.

Part 6: Treatment of other expenses of employee living away from ordinary place of residence.

32. The Ministry of Finance takes the view that expenses paid or reimbursed by an employer will be subject to income tax where those expenses are a reward for services. In some cases, expenses that would otherwise be personal expenses of an employee may be expenses related to carrying out employment services away from the employee’s ordinary place of residence. The test is whether the payment or reimbursement is a “reward” for service or a benefit that merely compensated a person for a loss or expense directly incurred in the course of carrying out employment responsibilities.

33. The payment or reimbursement of airfares to travel to and from employment in Afghanistan is discussed earlier as being in this category. Also included in this category would be payment or reimbursement of relocation expenses, medical expenses and vaccinations required for a person to come to Afghanistan to carry out employment responsibilities. In these situations, the paid or reimbursed expense is not a reward for service and would not be included in salary or wages.

Part 7: Ministry of Finance to monitor exemption for accommodation, food and other expenses

34. As part of the Ministry of Finance's routine taxpayer audit program, the Ministry will also review employer/employee arrangements which involve employees directly or indirectly receiving amounts for accommodation, meals or incidentals which are claimed to be not liable for income tax.

35. Where as a result of checks in accordance with the previous paragraph, the Ministry of Finance believes direct or indirect payments by an employer to an employee have been changed to reduce the amount of wages that would be subject to income tax in accordance with this Public Ruling, and the employer cannot provide evidence to justify such changes, then the Ministry of Finance may re-characterize the arrangement and adjust the amounts that will be subject to income tax. In addition to the adjustments made by the Ministry of Finance, the Ministry may also impose penalty for understatement of tax or take prosecution action for evasion of tax.

Part 8: Summary of taxation of benefits where employee living away from ordinary place of residence.

36. For the reasons outlined in this Public Ruling, the following amounts are not considered to be salary or wages subject to income tax, where the employee has provided evidence to the employer that the employee has a primary home or similar accommodation that the employee is required to leave in order to undertake employment activities and intends to return to upon completion of employment:

- actual provision of accommodation by employer
- actual reimbursement of accommodation cost by employer

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- provision of meals and incidentals in Kabul up to a cost to the employer of US \$35 per day and provision of meals and incidentals outside Kabul up to a cost to the employer of US \$25 per day
- actual reimbursement of the cost of meals and incidentals in Kabul up to US \$35 per day and actual reimbursement of the cost of meals and incidentals outside Kabul up to US \$25 per day
- actual provision of room and board by employer
- actual reimbursement of the cost of room and board by employer
- actual provision of benefits or reimbursement of additional costs arising from the need for the employee to carry out employment responsibilities away from the employee's ordinary residence, where it does not constitute a "reward" for service e.g. actual provision of travel or reimbursement of travel expenses to commence and cease employment, actual provision of relocation or reimbursement of relocation expenses, and actual provision of medical treatment or reimbursement of medical expenses incidental to commencement and cessation of employment.

37. Payment of a living-away-from-home allowance to an employee will be treated as being subject to income tax. However the employer may deduct the amounts of accommodation and meal expenses incurred and supported by receipts or other documentary evidence from salary or wages that is to be subject to wage withholding tax.

38. Payment of a relocation allowance to an employee will be treated as subject to income tax. However the employer may deduct the expenses of relocation incurred and supported by receipts or other documentary evidence from salary or wages that is to be subject to wage withholding tax.

Date of Effect

39. This Public Ruling has effect from 23 September 2005 [1 Mizan 1384].

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References to Articles in the Income Tax Law:

Definition of taxable income	Income Tax Law, Article 13
Definition of income	Income Tax Law, Article 14
Withholding of tax from salary or wages	Income Tax Law, Article 63
Discharge of tax liability though taxes withheld	Income Tax Law, Article 68
Public rulings	Income Tax Law, Article 96
