

INTERNATIONAL STABILITY OPERATIONS ASSOCIATION (ISOA) WHITE PAPER

TAXATION OF US GOVERNMENT CONTRACTORS IN AFGHANISTAN: THE CASE FOR A NEW, CONGRESSIONALLY-MANDATED MODEL IN TOTAL FORCE RELATIONS WITH HOST NATION GOVERNMENTS

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1. Purpose. This paper examines the current and historical scheme of unfair taxation of US Department of Defense (“DoD”) contractors¹ by the Afghanistan Revenue Department, Ministry of Finance, Islamic Republic of Afghanistan (“Afghanistan” or “AFG”), as an informative example of why a new, Congressionally-mandated, model for the interface between the host nation government and the US Total Force (including contractors), regarding taxation and “compliance” in the conflict and post-conflict expeditionary and contingency operations is urgently needed. By extension, the recommendations of this paper are fully applicable to Iraq and other current or future theaters of operations to which the US Total Force is deployed for expeditionary and contingency operations.²
2. Introduction

In the 14 May 2013 Audit Report 13-8, “Taxes: Afghan Government Has Levied Nearly a Billion Dollars in Business Taxes on Contractors Supporting U.S. Government Efforts in Afghanistan” (the “SIGAR Report”), the Special Inspector General for Afghanistan Reconstruction (“SIGAR”) detailed a pattern of unfair GIRoA³ taxation of DoD and other US Government (“USG”) contractors in Afghanistan, notwithstanding clear tax exemptions provided by the US Status of Forces Agreement (SoFA), Diplomatic Note 202 and other international protocols.⁴ Amongst other things, the SIGAR Report noted the disagreement of USG and GIRoA over tax exemption for non-Afghan DoD contractors, the need to have a whole-of-government approach vis-à-vis GIRoA in fighting such unfair taxation, to strengthen Congressional reporting of same, to off-set all foreign assistance to Afghanistan

¹ As used throughout this paper, the term “DoD contractors” refers to non-Afghan prime- and sub-contractors performing under and on projects and contracts of all sorts, for any organization, service, command, agency or authority within the US Department of Defense, namely the class of USG contractors entitled to the protections and tax exemption provisions of the applicable US-AFG status of forces agreement. In addition, NATO, and NATO member and partner state contractors are not immune from the GIRoA practices outlined here.

² See, e.g., Lardner, Richard, “Contractors accuse Iraq of shake downs to force tax payments”, Associated Press (“AP”) News, 25 Sept 2015, at: <https://apnews.com/5f7da8b9c1f34360b27b78fdf575d71f>.

³ Government of the Islamic Republic of Afghanistan.

⁴ “Agreement regarding the Status of United States Military and Civilian Personnel of the U.S. Department of Defense Present in Afghanistan in connection with Cooperative Efforts in Response to Terrorism, Humanitarian and Civic Assistance, Military Training and Exercises, and Other Activities” effected by exchange of notes September 26 and December 12, 2002 and May 28, 2003, and effective the latter date.

by the amount of such, and to ensure future bilateral agreements provide clarity on tax exemptions for DoD and other USG contractors involved in development, law enforcement and security assistance.

Since May of 2013, and despite robust and often herculean efforts by working-level USG officials (military and diplomatic) in Afghanistan vis-à-vis their GIROA (primarily MoF) counterparts, little enduring progress has been made in resolving such legacy taxation⁵ and the persistent problems encountered with leaving DoD contractors (to include subcontractors, “Subs”) to the predations of the host government, albeit a host government entirely dependent on US assistance of all sorts.⁶

Why little has changed and how comprehensive Congressional legislation is needed to effect an alternative, sustainable model for US Total Force relations with host governments, from Afghanistan to Iraq and beyond, is the subject of this White Paper.

3. Executive Summary

Congressional legislation is necessary to remove DoD contractors from the reach of GIROA tax and other “regulatory” officials and to more fully integrate DoD contractors into the Deployed US Total Force. The current situation under which Ministry of Finance officials routinely refuse to grant tax exemptions to contracts (including subcontracts) clearly exempt under the applicable Status of Forces Agreements (“SoFAs”), “double-taps” the American Taxpayer (either through charge-backs or pricing), facilitates and rewards improper behavior within a weak government. The overall effect aids the insurgency, undermines US sovereign control over its own force, and detracts from the US and Allied enterprise in Afghanistan.

GIROA tax officials should, instead, devote themselves to collecting legitimate tax revenues derived from the domestic economy, NOT American Taxpayer funded programs, projects and contracts. They must also address the real problem of domestic tax evasion, rather than directing their efforts toward illegitimate taxation of DoD and other USG contractors.

The US Total Force in Afghanistan numbers is about 11,000 military members, and an estimated 20,000 contractor personnel. With an anticipated increase of between four to five

⁵ Namely, taxation pertaining to the DipNote 202-era and before the effective date (1st January 2015) of the current SoFA, commonly referred to as the “Bilateral Security Agreement” or “BSA” (the formal title of which is, the Security and Defense Cooperation Agreement between the United States of America and the Islamic Republic of Afghanistan, 30 Sept 2014).

⁶ Indeed, at this writing, progress has been made in terms of the licensure, registration and tax-exemption for BSA contractors, including subcontractors (1st January 2015 onward). Moreover, a very small number of pre-BSA DoD Contractors have reported success in settling legacy tax issues.

thousand US troops, the number of contractor personnel and contractor provided services will also grow proportionally as the US enhances its military and security assistance.

Against this backdrop, GIROA is profoundly dependent on US military and development assistance. Yet, the Afghan Ministry of Finance continues to impose improper legacy taxes and penalties on revenue and income derived by DoD subcontractors (estimated to be 2,000+) and prime contractors clearly exempted by DipNote 202. The SIGAR Report estimates that the amount of taxes for a small sample of 17 DoD contractors, amounted to USD \$92,875,298.⁷ Given the passage of time since the Report and the tiny sampling of DoD contractors involved, the amount of unfair tax levies by the Ministry of Finance is actually far greater.

Paying these improper levies runs counter to USG policy and undercuts the USG’s position as to the provisions of DN 202. Caught between the two governments, the affected DoD contractors are being sanctioned by a series of knock-on effects: non-renewal of business licenses, non-renewal or issuance of visas, freezing of bank accounts, no-fly listing, freezing of company bank accounts, and other constraints on the liberty of DoD Contractor personnel. With Afghan business licensure and visas now a requirement for continued and future DoD contracting work, the temptation to simply pay these unfair levies is great.

Congressional action is urgently needed to set the parameters and essential provisions of any current or future SoFA, to include no taxation—real time, future or legacy—of DoD contractors (including subs) as well as to mandate and to formalize the structure, command and governance of a total force that is under US sovereign command and control, answerable to the combatant commander, subject to US government oversight, and not made vulnerable to an unfair host government. This is also applicable to the Iraq Theater of Operations and future theaters of expeditionary and contingency operations.

4. Questions Presented. This paper examines the following questions:

- a. Why and how is the status quo broken?
- b. Why have remedial efforts to date failed?
- c. What are the alternatives?
- d. Why is Congressional action required?

5. Background

Although the US entered into a SoFA in 2003 via the exchange of Diplomatic Notes, many DoD contractors, often under Contracting Officer instruction, did not register or obtain

⁷ For a total of 43 USG contractors, across DoD, USAID, State (INL) and “multiple agencies”, SIGAR estimated the amount at just under US\$1B (US\$921,397,213).

a business license from GIROA⁸, nor did they pay Afghan taxes (and often customs duties) of any sort, under the rubric of being “tucked-in” with US Forces.⁹

At the same time, unlike their USAID counterparts, DoD contractors, answered to a disparate array of contracting agencies¹⁰, almost all based outside of Afghanistan (primarily CONUS).¹¹ The vast array of contracts spread amongst these HCAs were administered by contracting officers (“KOs”), largely without any experience or knowledge regarding CJOA-Afghanistan¹², and generally unwilling or unable to assist contractors regarding any matter pertaining to host nation taxation, to include tax exemption. Indeed, only one HCA was resident in Afghanistan, namely the CENTCOM¹³ Joint Theater Support Contracting Command (“CJTSCC”)¹⁴, based at the now-abandoned Camp Phoenix in Kabul. CJTSCC had “coordinating authority”, but not directive authority over the other HCAs, but it was not until 21 January 2013, that it issued any substantive “coordinating” information to the other HCAs and, by extension, the DoD contracting community in Afghanistan.¹⁵ Even then, the dissemination of theater relevant information to HCAs was uneven and often unheeded.¹⁶

Left to their own devices, DoD contractors suffered an array of “enforcement” actions, often related to taxation or the Criminalization of Commercial / Civil Disputes (“CCD”). These coercive actions included entry of non-Afghan (principally American) staff onto No-Fly Lists (“NFLs”), seizure of passports, threat of, or actual detention and in some cases, physical violence, all of which could only be resolved on a government-to-government level.¹⁷

⁸ Specifically, through the now-defunct, Afghanistan Investment Support Agency (“AISA”), or the Ministry of Commerce and Industries (“MoCI”) which also issued such licenses in particular instances. Obtaining such a license is also the mechanism for obtaining a Tax Identification Number (“TIN”) from the MoF, an existential requirement for Afghan tax compliance.

⁹ This is in contrast with US Agency for International Development (“USAID”) implementing partners (contractors) who have long obtained GIROA business licenses.

¹⁰ Often referred to as Head(s) of Contracting Activity or “HCAs”. *See*, US Federal Acquisition Regulations (FARs) Part 2, “Definitions”.

¹¹ The Continental United States.

¹² Combined-Joint Operations Area-Afghanistan; *i.e.*, the Afghanistan Theater of Operations.

¹³ United States Central Command, headquartered at MacDill Air Force Base, Tampa, Florida.

¹⁴ CJTSCC redeployed to Qatar in 2014.

¹⁵ “Head of the Contracting Activity Bulletin 13-Q2 Taxation of Department of Defense Contractor in Afghanistan.” *See*, SIGAR Report, Appendix II, “CJTSCC Comments”.

¹⁶ This is both reflected in the SIGAR Report and is consistent with the author’s field observations and discussions with CJTSCC legal counsel throughout this period.

¹⁷ Prior to 2013, the Military Technical Agreement Branch (“MTAB” - named after the NATO SoFA) of Headquarters, International Security Assistance Force – Afghanistan (“ISAF”) regularly refused to assist DoD contractors afforded the protections of DipNote 202, insisting that MTAB’s remit was only to assist contractors in privity with a North Atlantic Treaty Organization (“NATO”) contracting agency, NOT that of NATO member (or partner) state. To

Over time, and in the negotiations and run-up to the BSA, which took effect on 1st January 2015, a “whole-of-government” effort emerged in Kabul, consisting of working-level American Officers within the cognizant US/NATO headquarters staff sections,¹⁸ and the American Embassy’s Economics Section (“ECON”). As part of the implementation of the BSA, which called for a US-AFG Joint Commission, a Technical Tax Working Group (“TTWG”) comprised of the above USG agencies and sections and MoF counterparts was formed, to include negotiations to resolve the legacy (pre-BSA) issues faced by hundreds of DoD contractors. The TTWG is chaired jointly by the CSTC-A EF-1 Director and the Director General, Afghanistan Revenue Department. The TTWG advises the Afghan Minister of Finance.¹⁹

Efforts of the TTWG to date have led to recommendations and an agreement²⁰ that would forgive legacy tax indebtedness (but not penalties) for an enumerated 31 American, DoD contractors (including some subcontractors), but in the GIRoA view, no others.²¹ Especially notable, is that MoF and its CRD steadfastly refuse to entertain any exemptions for non-Afghan (principally American) subcontractors whose contracts with DoD prime contractors fell entirely within or which commenced during the DipNote 202 era (2003-14).

Though widely heralded within certain CONUS-based USG and Congressional circles as a great success, it appears that the “Grand Bargain” agreed to by the Council of Ministers (the cabinet, chaired by the President of Afghanistan) has not been effective.²²

be sure, on an episodic basis, MTAB did successfully assist a number of imperiled NATO contractors, to include those whose staff were arrested or threatened with arrest, primarily in instances of CCD.

¹⁸ These staff sections include: the Legal Advisor / Staff Judge Advocate, the renamed, MTAB – now the International Agreements Branch (“IAB”), as well as within USFOR-A’s Combined Security Transition Command-Afghanistan (“CSTC-A”) Essential Function-One (“EF-1”).

¹⁹ Minister of Finance Eklil Ahmad Hakimi is either an American Citizen or Green Card holder, whose family resides in California, USA.

²⁰ As adopted by the Council of Ministers (Cabinet), chaired by the President of Afghanistan, through Decree 19 (minutes), dated 17/09/1395 (7th December 2016).

²¹ As this White Paper was originally being drafted, USG members of the TTWG were in an intractable stand-off with their MoF counterparts, as well as the entire Customs and Revenue Department taking the position that the “List of 31” is all-inclusive and exclusive, while the American side views it as only a representative sample of the whole of affected DoD contractors. On 31 October 2017, a senior MoF official informed the author that resolution of some legacy tax issues was awaiting a Memorandum of Understanding to be executed by the USG. Given the history of many apparent “breakthroughs” in the past, it is impossible to assess the veracity of this claim at this writing.

²² Even for the 31, it is largely uncertain and unknown as to how effective the agreement actually is. Firstly, there is no organized feed-back loop to USG stakeholders. So little is known, and what is known, is entirely anecdotal. Based on various field meetings attended by the author, no

6. Discussion

a. Why and How the Status Quo is Broken

The Status Quo with respect to the treatment of American and other non-Afghan DoD contractors in the face of an unfair host nation government is broken for the following ways:

- (1) There is no singular structure by which DoD contractors are integrated into the deployed US Total Force, as necessary to assure oversight, accountability, accurate and timely reporting of activities, to include encounters with the host nation government, discipline and performance. Rather, DoD contractors continue to have to deal with CONUS-based, KOs who are often ill-informed or disinterested in the intractable problems of doing business in Afghanistan that require active USG attention and engagement.²³ The status quo represents a breakdown of the principle of war “Unity of Command”, and undercuts the Combatant and Theater Commanders. It also assures that misbehavior by DoD contractors, which does occur from time to time, is not speedily detected and ferreted out, which results in reputational damage to both the DoD contracting community and US Forces.
- (2) One common USG policy level response to the woes of DoD contractors is to note there is no dearth of companies willing to take their place as measured by the response levels to DoD Afghanistan-related tenders. This misses the point of how the status quo hurts the American Taxpayer, damages both US and GIRoA credibility with the Afghan People, and incentivizes improper behavior by GIRoA officials. Further, it is an abrogation of the stewardship owed the American Taxpayer, the authority of the Combatant and Theater Commanders, and the force protection obligation of US Commanders to American DoD contractor personnel, many of whom are themselves US military Veterans.
- (3) There is a lack of reliable data and information about the extent of financial loss²⁴ and mission degradation resulting from the poor practices of GIRoA vis-à-vis

more than “eight or nine” at best are believed to have received any benefit. Moreover, as the SIGAR Report sets forth, the penalties for non-filing (which are not forgiven by the “Grand Bargain”), extending back as far as 2003 for some DoD contractors can involve millions of US Dollars for the Prime Contractors and hundreds of sub-contractors affected.

²³ Strict accountability for and of DoD contractors also suffers as a result.

²⁴ Based on the sampling of affected DoD contractors, in the SIGAR Report, there is little question that the amounts in question are hundreds of millions of US Dollars. A key point of this paper is that the USG, starting with DoD and the Department of State (“DoS” or “State”) must self-organize and collect the data, which is critical to assessing the impact on mission and US public resources.

DoD contractors. There is no clear reporting chain, mechanism or published assignment of an agency charged with fusing, aggregating, analyzing and reporting to the Combatant Commander, USCENTCOM, and all HCAs. This can best be overcome by integrating deployed DoD contractors into the deployed US Total Force and compelling timely and accurate reporting of all relevant activities, including encounters with the host nation government, and a reporting chain of properly trained KOs and Contracting Officer Representatives (“CORs”) within the deployed Force.

- b. Why Attempted Remedial Efforts Have Failed. Commendable but sporadic efforts, have failed and continue to fail for the following reasons:
- (1) The Absence of Conditions-Based Aid. Although GIRoA is almost entirely dependent on international donor funds, of which roughly 90% are derived from the American Taxpayer (including payment of GIRoA salaries), no appreciative funding, out of the hundreds of billions in defense funding alone for Afghanistan, has been withheld. In short, the Afghans do not take the US seriously at the negotiating table or in day-to-day interactions where corruption is addressed. The Afghans have not fixed the problem.
 - (2) A False Notion of Host Nation “Sovereignty.” The Islamic Republic of Afghanistan is existentially dependent on the US and has never been more so than the present. The existence of a nation- as opposed to a failed-state is entirely the result of US assistance of all sorts. The US has every right to maintain the sovereign control of its deployed Total Force, to include the governance, discipline, good order of, and sole authority over that Force. This is not inconsistent with Afghan sovereignty and is actually an important asset to it: by keeping US funded contractors beyond the reach of unfair tax and other GIRoA officials, US funds do not reward, facilitate or encourage the very corruption that undermines GIRoA’s credibility with its own population, and thereby aids and abets the insurgency.
 - (3) The Pretense and Distortion of the Host Nation Economy. GIRoA and MoF, in particular, have long been under intense pressure from the international community, most notably the International Monetary Fund, World Bank, European Union, US and UK Treasury Departments, to raise legitimate tax revenues. GIRoA and MoF officials, especially within the Afghanistan Revenue Department (“ARD”), have used this pressure to go after DoD and other USG contractors (especially, USAID implementing partners) for revenue and income derived from clearly tax exempt projects and contracts. Indeed, both nations want to see a flourishing, legitimately-sourced and used Afghan public purse, and a flourishing domestic economy and commercial sector to back it up. But US defense and development dollars are not part of the local economy and should not be utilized to create a false notion of a domestic economy. GIRoA tax revenues are low and insufficient because of

multiple factors that directly, or indirectly stifles the Afghan commercial sector and universally deters Foreign Direct Investment.

- (4) Weakness and Discontinuity in Bilateral Negotiations. As set forth above, personnel turbulence and the absence of conditions-based aid have undercut American bargaining power at the negotiations table. Of course, COMRS and the COM (currently a Special Chargé d'Affaires) are understandably preoccupied with fighting a war and re-building the country.
 - (5) Fear of Failure. The US Government's failure to impose and enforce conditions on billions of dollars of assistance. US assistance of all sorts has distorted the local economy, making some Afghans rich, while contributing to corruption that directly undermines the war effort. The current approach has gotten us to a situation where, as the current Secretary of Defense has noted, "we are not winning."
- c. Why Congressional Action is the Precondition for Fixing the Immediate Problem and Affecting a Long-Term Solution.

The efforts of mid- and working-level USG officials, both defense and diplomatic, in-theater, and in Washington, along with the periodic direct engagement by the Embassy's Chief of Mission and the US/NATO Commander in Kabul have been laudatory and at times, heroic. The recent memorandum from the Deputy Secretary of Defense that mandates tax relief for US contractors from all foreign entities is excellent progress. But more needs to be done by the Department of Defense to fully enact systemic changes that must be implemented, internally, as well as in the interface between the US Government and host nations where the US Total Force is deployed for expeditionary and contingency operations.

At the same time, corporate constituents and professional/industry associations such as ISOA and the Professional Services Council (PSC) have engaged individual Members of Congress and US Senators, and their staffs, resulting in letters from them to officials both within DoD and State Department. While this has been helpful to some degree, including a recent such inquiry which resulted in the tasking and drafting of an internal USG white paper to the COM and COMRS/USFOR-A on legacy taxes, it has not moved the dial on the systemic nature of this problem.

7. Stewardship: Respecting the American Taxpayer, Preventing "Double-Tapping" by Unfair Host Nation Governments, and Total Force Recognition
 - a. The US Government and their contractors will be empowered to treat American Taxpayer resources as they would their own.
 - b. The American Taxpayer is in effect, "double-tapped", since the additional taxes by the Host Nation Government is on top of the foreign assistance aid money provided to them by the US Congress.

- c. Taking Care of Our Own. Although various joint doctrinal publications and DoD instructions have made clear that DoD contractors are part of the forward deployed US Total Force²⁵, and the duty of commanders to safeguard and protect the total force, these mandates have not been fully implemented or actualized. It is time to make the “Total Force” real by integrating DoD contractors fully into the force. Contractors should no longer be left to their own devices in dealing with problematic HNGs; moreover, when they die or are wounded, those numbers should be reported up the military chain and to the American people, along with uniformed and civil service members. This is a moral duty to the Force and to the American People.
8. Recommendations. Robust, integrated legislation by Congress and action by DoD and DOS are required at this time and should include at a minimum:
- a. DoD shall track all tax assessments by foreign governments on U.S. security assistance.
 - b. DoD shall reimburse contractors for tax payments paid.
 - c. Permanent legislation implemented that would cut security assistance to foreign governments by 5 times that amount of the taxation to DoD contractors.
 - d. DoD and DOS shall resolve the remaining tax issues in Afghanistan.
 - e. DoD and DOS shall establish an Office of Contractor Support in DoD in-theatre to assist contractors for these and other similar issues.
 - f. DOS and DoD shall seek agreement of the following in future SOFAs or other bi-lateral agreements on U.S. military force presence:
 - (1) DoD contractors are to be treated similar to DoD civilians accompanying the force.
 - (2) DoD contractors and subcontractors are to be tax exempt and there is to be an agreed-upon mechanism for resolving disputes.
 - (3) DoD contractors and subcontractors are to be given AT&L-like protection from prosecution (for Acts on Official Duty), unless waived by the USG.

²⁵ As examples, DOD Instruction 3020.37 Feb 2010 includes contractors (contracted resources) as part of the Total Force and directs service components "shall use the most cost effective mix of the Total Force to meet mission." OSD Memorandum of Feb 21, 2013, "Total Force Management and Budget Uncertainty " clearly defines the Total Force as "active and reserve military, government civilians and contracted support." *See, generally*, Joint Publication 1-0, "Joint Personnel Support", 31 May 2016.