



Islamic Republic of
Afghanistan

Ministry

of

Finance

*Afghanistan
Revenue
Department*

Income Tax: Employee or independent contractor for the purposes of wage withholding tax.

Relying on this Ruling

This is a public ruling within the meaning of Article 113 of the Income Tax Law 2005. Information in this ruling may be relied upon by taxpayers as the basis for determining their tax liability.

Introduction

1. Article 58 of the Income Tax Law 2005 of Afghanistan requires all natural or legal profit and non profit persons, ministries, state enterprises, municipalities and other State departments employing two or more persons in any month of the year to withhold taxes from all salary and wage payments and to pay the amount withheld to the government account. The tax that is deducted from an employee's salary or wages is often referred to as 'wage withholding tax'. The Ministry of Finance interprets the wage withholding tax as applying to salary and wages payments in respect of employment in Afghanistan. The term "employment in Afghanistan" means the provision of personal services in Afghanistan in the course of an *employer* and *employee* relationship.

1. This Public Ruling explains three aspects of this position. The next (first) part of this Ruling explains what the provision of "personal services" means.

2. The second part of the Ruling explains when personal services are provided "in the course of an employer and employee relationship". This part documents three categories of factors that can be used to determine employment or independent contractor status.

3. The third part of the Ruling explains when services are provided "in Afghanistan".

4. The final part of the ruling is **Annex A** which is a table of the indicators that can be used to assist in determining employment status.

1. What are personal services?

5. The phrase "employment in Afghanistan" means the provision of "personal services". Personal services typically derive from a natural person's exertion or labour and are the first key element of employment.

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6. The clearest case in which a natural person provides personal services is where the person provides only personal exertion or labour for another person. However, much depends on the circumstances in which a person's exertion or labour is provided. In some cases, a distinction must be made between:

- the provision of personal services and a business structure;
- the provision of personal services and business assets; or
- the provision of personal services and the sale of an intellectual property right.

7. The distinction between personal services and a business structure may be illustrated with the example of a business that acquires accounting services from a natural person and another business that acquires accounting services from a large accounting partnership. In the former case, the natural person is providing *personal services* since the business contracted with that person to actually perform the accounting tasks required. In the second case, the business contracted for services from another business. The firm needing the accounting services does not care who actually does the work, so long as the accounting firm ensures it is done properly. By contracting with a firm, they are leaving it up to the firm to decide who will actually do the work.

8. The first case may give rise to an employment situation (subject to other tests discussed later in this ruling being satisfied) while the second case cannot give rise to an employment relationship between the business needing accounting services and the accountants who work for the accounting firm. The accountants may be employees of the accounting firm but they will not be employees of the first business since it has acquired services from a business structure rather than personal services.

9. The second distinction is between cases involving the provision of labour and equipment. In some cases, the labour portion is predominant, while in other cases the equipment portion is predominant. The former is a provision of personal services, while the latter is the provision of equipment.

Example 1:

Café Deluxe contracts with Rahim to deliver lunches and drinks to its customers. The contract requires Rahim to supply his own bicycle to use to deliver the food and drink. While the bicycle is necessary for the delivery, the service provided is a personal service since the pay provided to Rahim is mostly for his services, not for the cost of the bicycle.

Example 2:

Kabul Building Company has won a contract to rebuild three bridges. It contracts with Rafi, who owns a large earth mover and a large semi-trailer he uses to transport the earth mover to construction sites. Rafi personally drives the truck to transport his earth mover and operates the earth mover. While the payment made to Rafi is partly for his operating skills, most of the payment is for the use of the specialised and expensive equipment. As the labour component of the payment is not as great as the equipment part, Rafi is providing a service other than a personal service. Since he is not providing personal services, his status will be that of a contractor but not an employee.

10. The third distinction is between cases where a natural person provides labour that leads to the creation of property and where a person actually provides the property. The former is the provision of a personal service, while the latter is the provision of property.

Example 3:

Farilla receives a commission from a large bank to paint a large mural on a canvass to be hung inside the bank. Farilla is told she may work to her own design. From the time it is started until completion, the painting belongs to the bank. Farilla is only providing the labour to produce the final product. Farilla is providing personal services to the bank and may be an employee of the bank if the other conditions for employment discussed below are satisfied.

Example 4:

Najib worked for one month to produce a large sculpture. When he completed the sculpture he invited representatives from several businesses to view the work. He sold the sculpture to the bank, which sat it underneath the mural created by Farilla. As there was no commission from anyone to create this work, Najib created his property independently of any particular client. He provided property to the bank, not a personal service. While the property was the result of his personal labour, the labour was provided before the bank acquired any interest in the product of the labour. He is a vendor to the bank but he would not be an employee of the bank.

2. When are personal services provided “in the course of an employer and employee relationship”?

11. Even if it is decided that a person is providing personal services, payment for those services will constitute wages only if the person is providing the services "in the course of an employer and employee relationship". The actual nature of the relationship between the person providing services and the person receiving the services will determine whether the relationship is one of employee and employer or is one of independent contractor and customer. The form of the contract between the parties will not necessarily determine the character of their relationship. That is, if the relationship amounts to an employee and employer relationship, the fact that the parties may have called the arrangement a contract for independent contractor services will have no effect on the actual character of the relationship for tax purposes.

12. The relationship between an employer and an employee is a contractual one between two parties. It is often referred to as a *contract of service* and typically contains at least two things, namely, the services to be rendered and the remuneration to be paid (mutuality of obligation). The focus is on effort or labour (productive capacity) and the personal service to be rendered, not on a specific result. The employee's labour enables the employer to achieve a result. Such a relationship is contrasted with the principal/independent contractor relationship that is referred to as a *contract for service*. An independent contractor typically contracts to achieve a certain specific result. It is not the services as such which are the object of the contract, but the result as a whole.

13. The concept of an employee and employer relationship is used in many areas of law. In tax law it is used to determine whether the remuneration paid to a person is a wage and subject to wage income tax. In labour law it is used to determine whether the person providing services is entitled to various rights and subject to various obligations of employees set out in the labour law. And in negligence law it is used to determine vicarious liability – that is, to decide whether a negligent person is an independent contractor and is personally liable to compensate the victim of negligence or whether the person is an employee, in which case the person's employer may also be liable to compensate the victim. While there are similarities between the tests used to determine the nature of a personal services relationship in these three different areas of law, each seeks to characterise the relationship for different reasons and caution must be

exercised when applying tests from one area of law to another area of law.

14. As mentioned, in tax law the "employer and employee relationship" is used to determine whether the remuneration paid to a person is a wage and subject to wage income tax. If the relationship between the parties is that of independent contractor and customer rather than employee and employer, the remuneration paid to the person will not be subject to wage income tax. Instead, the person providing the services will be responsible for paying income tax on the income.

15. Wage income tax is normally collected by means of a withholding tax subtracted from the wages paid to an employee and delivered by the employer. Income tax is paid by the recipient of income, the person who provided personal services. A key difference between the wage income tax and the income tax is the fact that wage income tax is levied on gross payments with no deductions allowed for expenses that might be incurred to earn the income. Income tax, by way of contrast, is levied on net income, after deductions for expenses incurred to earn the income.

16. There are many other factors which need to be taken into consideration when determining whether a relationship is one of employment or independent contractor. The Ministry of Finance considers that the following factors are important and have divided these factors into three categories according to the degree of importance. The test that is to be applied in any case is the 'dominant impression' test. That is, having taken into account all relevant factors and the relative weight of those factors, is the dominant impression that of employment status or independent contractor status.

Three Categories of Relevant Factors to Determine Employment Status:

Category 1 – Near Conclusive Indicators

17. Control of Manner of Working: Control is the ability, authority or right of a payer to exercise control over a worker concerning the manner in which the work is done and what work will be done. An employer controls the manner in which work is done either by detailed instructions, by procedures, by policies, by training, by requesting that prior approval be sought, or by instituting disciplinary steps in the event of unacceptable performance by the worker. Control means control as to which tools or equipment to use, which raw materials to use and where to obtain them, which routines, patents or technologies to use etc. All of these are elements of commanding and directing and operation to achieve a particular business result.

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The employee must be subject to a certain degree of control by the employer although control need not be exercised in practice. The determination of degree of control can be difficult when examining the employment of professionals such as a ship's captain, doctors, engineers and so on. It is the right of the payer to exercise control that is relevant, not whether the payer actually exercises that right.

18. Payment Regime: A worker can be paid with reference to a result or to effort. Payment without material reference to a result indicates employee status, because the worker is then being paid for effort. Payment at regular intervals (whether at a fixed rate per time interval or a fixed rate per hour) without material reference to output or result for that interval, indicates that there is an acquisition of a worker's effort (productive capacity) as opposed to a result of effort.

19. Person Who Must Render the Service: An employment contract is one of personal service (i.e. the employee is at the "beck and call" of the employer). Where the employer has a right to insist on the personal service of a worker or to object to substitution (eg. the worker substitutes his or her own employee for herself or himself), or if the worker may not freely hire, fire, pay or supervise his or her own assistants, an employer-employee relationship is usually present. A contractual right to substitute is usually indicative of an independent contractor status.

20. Nature of Obligation to Work: A contract where the obligation to work is delineated by time and not result, indicates an employer-employee relationship because it amounts to the acquisition of productive capacity or effort. An obligation to work "full-time" indicates an employer-employee relationship as it means the exclusive acquisition of the worker's productive hours or capacity. The existence of an obligation to be present and available to work, regardless of whether work is available, indicates the acquisition of productive capacity was the employer's foremost consideration. An independent contractor is not normally required to be present at the payer's work location if no work is available whereas an employee is required to be in attendance during the agreed hours.

21. Employer (Client) Base: The contractual right to deny a worker the opportunity to service other clients amounts to acquisition of exclusive use of the worker's productive capacity. The independent contractor is free to seek out business opportunities or sources of income, is entrepreneurial, has a multiple and concurrent client base and is not economically dependent on one employer. The typical employee is bound contractually (at least in his job function and during business hours) to an exclusive relationship with the employer and may not work for a competitor or any other employer. The employee is restricted in developing a client base, and typically has no client base.

22. **Risk, Profit or Loss:** An exposure to risk (opportunity to enjoy profit or suffer loss) may indicate a degree of economic independence or non-exclusive acquisition of productive capacity, which is consistent with an independent contractor and inconsistent with an employee-employer relationship. Where a person is not directly exposed to performance or market risks, this may indicate an employee relationship. An employee is generally paid regardless of defective workmanship, while an independent contractor may only be entitled to a reduced fee or possibly no fee. An employee receives a fixed salary regardless of inefficiency, wastefulness, time and cost over-runs occasioned by him or her while an independent contractor might agree on a fee or price and bear the risks if performance costs exceed that fee or price. Employees do not bear the risk of injury in the performance of work or of increases in raw materials or transportation costs while the business owner does.

An independent contractor is free to make business decisions which directly affect profitability (levels of inventory, staffing, pricing, financing) while an employee does not make such decisions (unless mandated to do so by the employer on behalf of the employer).

Category 2 – Persuasive Indicators

23. **Instructions/Supervision:** The employer controls the work done and the environment in which the work is done by giving instructions as to the location, when to begin or stop, pace, order or sequence of work. etc. Such “supervision” is typical of most workplaces or employment relationships, and may indicate employer measures to control what it has contractually acquired (productive capacity). The greater the degree of supervision and control the greater would be the indication of employee status. The degree of such control must be measured against that level of supervision which the nature of the work requires. It is sufficient for the right such control to be contractually present, even if it is not exercised in practice.

Independent contractors usually enjoy autonomy as regards the order and sequence of work. Supervision in the sense of mere monitoring of performance (without the right to intervene) is unlikely to be relevant.

24. **Reports:** A reporting regime indicates that a measure of supervision exists. The existence of a reporting regime, depending on factors such as content, detail, regularity and obligation can be persuasive in favour of an employer-employee relationship. A reporting regime that amounts to control of the manner in which work is done is sufficient to satisfy the near conclusive “control” indicator in paragraph 18 of this ruling.

25. **Training:** The typical independent contractor invests in his or her own training, and is free to choose his or her own production

techniques. Typically, an employer might provide training to an employee but not to an independent contractor. Training can serve as a technique of supervision (ensuring coordination), or of control (ensuring that the employer's techniques are followed to control the manner of working).

26. **Productive Time:** Where the worker has contracted away his or her right to control their time, even for only a portion of their productive hours, there is at least a persuasive indicator in favour of an employee contract. Ordinarily, an independent contractor can choose which client/employer he services on a particular day or in a particular period of the day. Therefore, clauses controlling "work periods" (work hours, work days, sick or vacation days) reflect the acquisition of control of the period in which work is done. An employer's exclusive entitlement to all of a worker's productive hours is a near conclusive indicator of an employer-employee relationship.

Category 3 – Relevant Indicators

27. **Tools, Materials, Stationery etc:** An independent contractor typically possesses (i.e. has invested in) his or her own tools or equipment, production or office materials, business stationery etc. and provides other necessary raw materials. Therefore, provision by the employer of office equipment or tools, stationery etc. tends to indicate a degree of dependence and lack of investment, hence the existence of an employer-employee relationship.

28. **Office or Workshop:** An independent contractor characteristically operates from his or her premises (owned or leased) and is only temporarily or sporadically present at the client's premises. Where the client provides an office/workshop or the work continually and invariably occurs at the usual place of business of the employer, there is an indication of dependence, control, lack of investment, and hence an employer-employee relationship.

29. **Integration/Employer's Usual Work Premises:** Where a person is integrated into and operates in or from the employer's usual place of business, (particularly if the person cannot sustain his or her activities other than at the employer's usual work premises) there is a degree of dependence and symbiosis that is inconsistent with an independent contractor relationship.

30. **Integration/Usual Business Operations:** An independent contractor is in essence another employer running a separate business. Therefore, where a person is engaged in activities which are integral, accessory or ancillary to the employer's business operations, this may indicate an employer-employee relationship, particularly if economic survival of the person as an "entrepreneurial entity" is not possible outside the employer's normal business operations, or if the person's

function is ordinarily and continually critical to the employer's processes.

31. Integration/Hierarchy & Organization Chart: An independent contractor is typically independent and therefore not integrated into any one client's organization, nor reflected on any one client's organization chart/structure. They have not become "part and parcel" of the employer's organization. Where the person has a job title, job description and a position in the employer's hierarchy, this may be an indication of employee status and an indication of how the parties perceive the relationship.

32. Duration of Relationship: In general, where the parties contemplate an open ended or indefinite relationship (rather than one limited with regard to a result), an employee relationship may be indicated. An employee contract is usually indefinite and can be terminated on notice, while an independent contractor contract is terminated on achievement of a result or production of the item.

33. Termination and Breach of Contract: The threat of termination is a form of control normally associated with an employee relationship. Where the employer has the right to dismiss and/or the person has the right to resign prior to the completion of any task or before any result is achieved, without being in breach, this may be an indication of an employer-employee relationship.

34. Significant Investment: Where the operation of a business requires investment, it is normally the employer who makes this investment (an employer of an employee normally provides the premises, tools, raw materials, office stationery and equipment, support services and other inputs), while the employee normally has no significant investment in any of these inputs. Conversely, the typical independent contractor has normally made a significant investment in his or her business and bears the cost of replacement, repair and insurance.

35. Employee-type Benefits: The presence in a contract of employee-type benefits is a good indicator that an employer-employee relationship exists. Typical benefits include vacation pay, sick pay, pension schemes, provision by the employer of a vehicle, free parking space, canteen facilities etc. A contract of employment may also contain access to a grievance procedure and the worker may be subject to disciplinary procedures. However, the fact that a contract does not contain provisions for employee-type benefits will not, in itself, be an indicator of a principal/independent contractor relationship.

36. Bona Fide Business Expenses: Typically an employee incurs no "business expenses" and is reimbursed or granted allowances for expenses on behalf of the employer, while an independent contractor

incurs business expenses and builds these into the fee or contract price. The employee usually bears no financial risk as their expenses are reimbursed and they don't have any fixed on-going costs. However, independent contractors can have financial risk and incur losses because they usually pay fixed monthly costs whether or not work is currently being performed.

37. Viability on Termination: A person who is not viable on termination of that person's current contractual relationship may be regarded as being an employee. A person may be said to be "viable on termination" when the person is economically independent of the client such that the person can survive the termination of the contractual relationship as they have a wider customer base.

Summary: Whether a worker is an employee or an independent contractor depends on a range of factors, but the final opinion is not reached by adding up the number of factors pointing towards employment and comparing that result with the number pointing toward independent contractor status. It is a matter of evaluation of overall effect, which is not necessarily the same as the sum total of all of the individual details. Not all details are of equal weight or importance in any given situation. When the detailed facts have been established, the right approach is to stand back and look at the picture as a whole. The totality of the relationship between the parties must be considered. The grid in **Annex A** sets out 21 of the more common indicators (in differing significance or weight) in tabular form and is not meant to be exhaustive. The application of the indicators will point to whether the dominant impression gained is that of employee or independent contractor.

3. When are personal services provided in Afghanistan

38. The term "employment in Afghanistan" means the provision of personal services *in Afghanistan*. "Afghanistan" means the land territory of Afghanistan recognised as belonging to Afghanistan under international law or treaties.

39. Personal services are provided in Afghanistan where the work is carried out in Afghanistan. The place of performance of the work is independent of where payment is made or where the contract for the provision of services is made. The phrase "the provision of personal services in Afghanistan" focuses on where the actual personal services are provided, not on remuneration arrangements or legal contractual arrangements.

Example 5:

MMG, an India based film studio, asks Indira Ghani, a famous Indian actress, to star in a new movie to be filmed entirely on location in Afghanistan. It signs a contract with Ghani in India.

Under the contract, MMG agrees to pay Ghani a lump sum payment of US \$20,000 for acting in the film and an additional US \$5,000 for providing technical advice on the making of the film. In theory, the technical advice could be provided anywhere but as it turns out, it was provided entirely while Ghani was in Afghanistan.

The agreement between MMG and Ghani requires MMG to make the payment into the Swiss bank account of Ghani Services Co, a company incorporated in Switzerland and owned by Ghani.

In this case, all the personal services performed by Ghani under the contract are performed in Afghanistan. Ghani is performing those services in the capacity of an employee as she is providing services in a work environment controlled and provided by the employer. The fact that the contract was signed in India or that she has directed payment to be made to her company's bank account in Switzerland does not affect where the services are performed.

Date of Effect

40. This Public Ruling has effect from 25 July 2006.

Director-General of Revenue, Ministry of Finance
25 July 2006

References to Articles in the Income Tax Law:

Public rulings	Income Tax Law, Article 113
Wage withholding tax	Income Tax Law, Article 58

ANNEX A

Table of Indicators for Dominant Impression Test

	Indicator	Suggests Employee Status	Suggests Independent Contractor Status
Near Conclusive	Control of manner of working	Employer instructs (has the right to) which tools, equipment, staff, raw materials, routines, patents, technology	Person chooses which tools, equipment, staff, raw materials, routines, patents, technologies are to be used
	Payment regime	Payment at regular intervals but regardless of output or result	Payment but with a reference to results, or payment by output
	Person who must render the service	The worker is obliged to render the service personally, hires and fires only with approval	Worker, as employer, can delegate to, hire & fire own employees, or can subcontract
	Nature of obligation to work	Person is obliged to be present even if there is no work to be done	Person only present and performing work if actually required, and chooses to
	Employer (client) base	Person bound to an exclusive relationship with one employer	Person free to build multiple concurrent client base
	Risk/Profit or loss	Employer bears risk (pays despite poor performance/slow markets)	Person bears the risk (price hikes, poor workmanship, time over-runs)
Persuasive	Instructions & supervision	Employer instructs on location, what work, sequence of work, etc. (or has the right to)	Person determines own work, sequence of work etc.
	Reports	Control through oral/written reports	Person not obliged to make reports
	Training	Employer controls by training the person in the employers methods	Worker uses/trains in own methods
	Productive time (work hours, work week)	Controlled or set by employer/Person works full time or substantially so	At person's discretion
Relevant	Tools, materials, stationery, etc.	Provided by employer, no contractual requirement that the person provides	Contractually/necessarily provided by the person.
	Office/workshop, Admin/Secretarial etc.	Provided by employer, no contractual requirement that the person provides	Contractually/necessarily provided by the person
	Integration/usual premises	Employer's usual business premises	Person's own/leased premises
	Integration/usual business operations	Person's service critical/integral part of employer's operations	Persons services are incidental to the employer's operations or success
	Integration/hierarchy and organization chart	Person has a job designation, a position in the employer's hierarchy	Person designated by the profession or trade, no position in the hierarchy
	Duration of relationship	Open ended/fixed term & renewable, ends on death of worker	Limited with regard to result, binds business despite worker's death
	Threat of termination/ Breach of contract	Employer may dismiss on notice, worker may resign at will	Employer in breach if terminates prematurely. Person in breach if fails to deliver product/service
	Significant investment	Employer finances tools, premises, raw materials, training etc.	Person finances premises, tools, raw materials, training etc.
	Employee type benefits	Person receives employee-type benefits	Person not eligible for benefits
	<i>Bona fide</i> business expenses	No business expenses, expenses are reimbursed by the employer	Over-heads built into contract prices.
	Viability on termination	Person obliged to seek new employment	Person has other clients, continues trading