REPORT ON THE PROPERTY TRANSFER TAX REGIME IN AFGHANISTAN

Land Titling & Economic Restructuring in Afghanistan Project

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Cover photo: an informal settlement in the City of Kabul

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1. BACKGROUND

One of the most important goals of the LTERA Project is to make the recording of property rights in Afghanistan as efficient, transparent and inexpensive as possible. Comparative studies of land administration practices have identified the cost, complexity, and time involved in registering properties as the most important factor in explaining the low level of compliance with property registration systems. Afghanistan currently rates poorly in all three of these categories as compared with other countries (see Annex 1). Accordingly, the LTERA project is currently addressing all three of these obstacles.

High recording taxes and fees impose an impediment to the smooth functioning of property registration by 1) creating a disincentive to register property through the formal system, and 2) creating incentives for rent-seeking behavior by property registration officials.

This study is intended to accomplish the following objectives:

- document the amount of public revenue obtained through the current transfer tax system
- estimate the extent of compliance with the current registration system
- propose a revised system that will increase the level of compliance with a reduced level of taxation and produce a comparable amount of revenue.

Increased participation in the formal registration system will lead to a higher level of land tenure security for property owners, increased incentive to invest in improvement of business and residential property, and consequently, an accelerated rate of economic growth.

2. TRANSFER TAX REVENUES

Afghanistan's property transfer tax is based on the assessed value of the property, including both land and buildings. The tax is 7% or 8% of the assessed value and consists of the following elements:

- 1% collected by the national government;
- 1% collected by the municipal government; this component does not apply where the land is located outside a municipal area;
- 5% or 6% collected by the court system, depending on the assessed value; these revenues are deposited into the General Fund Account of the Ministry of Finance (MoF).

Total revenues from the transfer tax collected by all sources in 2004 were approximately $4.8 million[1], or slightly more than 1% of total domestically generated (tax and fee) revenues. These were collected as follows:

Transfer Tax Collections (2004)	
Governmental Entity	**Afghani**
National government	94 million
City of Kabul[2]	18 million
Other municipalities[3]	10 million
Court system[4]	117 million
Total	239 million

[1] Based on a 2006 exchange rate of 1 USD = 50 Afghanis.

[2] This amount represents 1.2% of total revenues collected by City of Kabul. Data from the Kabul Municipal Finance Department indicate that collections in the City of Kabul were AFG 18 million for 2004. This contrasts with our estimate for collections from Kabul Province by the Ministry of Finance during the same period (AFG 73 million). As the national and municipal governments should each receive 1% of total assessed value of property transfers in Kabul, there appears to be a substantial inconsistency, even after adjusting for the difference in the geographic area covered. The discrepancy is likely caused by differences in property assessment procedures. Our understanding is that the *mustofiat*, which assesses land for purposes of federal taxation, is much more aggressive than the municipal authorities in valuing property for taxation.

[3] Based on data from the Ministry of Finance.

[4] Of which AFG 54 million are from the City of Kabul.

Annex 2 shows provincial revenue collections by the Ministry of Finance in the first semester of year 1383 (2004), by province (including taxes other than the real property transfer tax). Total collections of provincial revenues for the first semester were 50 million Afghani (AFG); according to MoF, 94% of these revenues were from the transfer tax. Assuming the same level of collections in the second semester, an estimated 94 million AFG were collected from the transfer tax, of which transactions in Kabul Province constituted approximately 73 million AFG.

Annex 3 provides a breakdown by province of transfer tax collections by the Court system for the full year 1384 (2004). Transactions in Kabul Province represented approximately 63% of all transactions for which transfer tax was collected and 78% of the total transfer tax revenues collected by the Courts. Transactions in the City of Kabul represented approximately 44% of all transactions for which transfer tax was collected, and 46% of the transfer tax revenues collected by the Courts. The average amount of transfer tax collected by the Courts from transactions in the City of Kabul was 26,000 AFG, or $520. Outside Kabul Province, the average amount collected was 14,000 AFG, or $280.

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3. LEVEL OF COMPLIANCE

There are no hard data available to determine the exact level of compliance with official registration procedures. We have estimated the compliance level through use of various techniques. Our estimates show that the compliance level has declined substantially over the last 25 years.

There were 403,000 households in Kabul in 2005 according to data from the Ministry of Economy's Central Statistics Office. Assuming that half of these households live on an identifiable parcel and can claim ownership rights, and assuming an average turnover rate of once per 10 years, there should have been as many as 20,000 sales and inheritances recorded annually in Kabul in the last two to three years. However, the total number of deeds registered in Kabul Province during 2004 was only 3,032 (according to Court data). This indicates a registration compliance level of 15% - 20%. One direct observation provides confirmation of this estimate. A 2005 survey by LTERA Project in CD 1 of Kabul District 7 found that only 19% of properties had official deeds. An additional 38% of households had customary deeds (unregistered sale contracts).

In contrast, the average number of deeds registered annually during the period 1960 to 1975 was well in excess of 3,000 (see Annex 4). In 1975, the population of Kabul was approximately 1.5 million (180,000 households), indicating a registration compliance level of approximately 35% - 40%.

What would cause registration compliance behavior to decline so precipitously? The disruption associated with war and internal conflict was likely the major contributor to the breakdown in compliance from 1975 through 2001. However, with the advent of peace and increasing stability, the level of compliance should have rebounded to previous levels, absent other important influences.

A major reason for the continued low levels of compliance is the rapid escalation of land prices during the last five years. For example, the average sale price of one beswa (100 square meters) of residential land in Kabul, depending on specific location within the City, has increased from a range of $200 - $800 in

calendar year 2000, to a range of $4,000 - $30,000 in 2005. As the transfer tax is an *ad valorem* tax, the tax due for the same property transferred would also have increased by the same factor. By contrast, during this period, average household incomes in Kabul have been relatively stable in US Dollar prices. Similarly, the sale price of a jerib (2,000 square meters, or one-fifth of a hectare) of prime irrigated agricultural land in Afghanistan has increased from $100 in year 2000, to $2,500 in 2005. Cash incomes from farming have also been relatively stable during this period, as have prices of agricultural commodities. In essence, this means that the average tax cost for registering a given unit of land, whether urban or rural, has increased by a factor of approximately 25 times in the last five years, while the ability to pay the tax has not increased commensurately.

One could logically conclude that the transfer tax is no longer viewed as affordable by most inheritors and many purchasers of land. For example, assuming an annual household income of $4,000 in the City of Kabul, the average transfer tax per deed registered would represent approximately 29% of average annual income. Outside Kabul Province, assuming an annual household income of $2,000, the average transfer tax per deed would represent 24% of household income. In comparison, the average cost per deed transferred in the United States is approximately 5% of annual household income.[5]

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[5] Average transfer tax burden in the City of Kabul:
Average transfer tax collected by Courts in City of Kabul: $513
Average transfer tax collected by Kabul Municipality: $171
Average transfer tax collected by MoF in Province of Kabul: $480
Total tax collected = $1,164
Average transfer tax as percent of average annual household income = $1,164 / $4,000 = 29%

Average transfer tax burden outside Kabul:
Total tax collected = $486 (Courts $280; MoF $133; municipality $73)
Average transfer tax as percent of average annual household income = $486 / $2,000 = 24%

Average transfer tax burden in U.S:
Average transfer tax as percent of average annual household income = [1% x $300,000 (avg. house price)] / $60,000 (avg. household income) = 5%

INTERNATIONAL BEST PRACTICE

Real property transfer tax rates vary widely internationally (see Annex 5). In the United States, they vary by state, ranging mostly from 0.5% to 2.2% (combination of state and municipal taxes). The average across the states is approximately 1%. According to the World Bank publication, *Doing Business in 2005*, on average, higher income countries tend to have lower rates. In Europe and Central Asia, most countries have transfer tax rates in the 0 to 6% range with an average of 3.2%; in South Asia, the average is 6.1%; and in the Middle East and North Africa, 6.8%. Afghanistan's transfer tax rate (7% - 8%) is thus somewhat higher than the average for its region, but is not the highest.

4. RECOMMENDATIONS

The accumulated international experience is that modern, efficient registration processes with affordable costs for transactions result in most real property purchases and a large proportion of real property inheritances being officially recorded. This is clearly not the case in Afghanistan. In addition to its negative effects on participation in the formal property registration system, it could be argued that the tax rate in Afghanistan is not optimal from the point of view of revenue collection. Conversely, it is reasonable to assume that a reduction in the real property transfer tax rate to affordable levels, in combination with simplification of registration procedures and reduction in the amount of time required to register a property to internationally accepted levels, should lead to a restoration of the registration compliance levels to those of the 1960's and 1970's, and perhaps even higher. The potential base for the transfer tax in Afghanistan has increased manifold during the last five years as a result of the rapid escalation of prices. Thus, rate reduction over the long term could lead to increased revenue collections from the transfer tax.

It is logical that inheritors and purchasers of property would prefer to protect their legal rights through official recordation, so that they can invest in the property, as well as sell or bequeath the property in the future, without fear of challenge to ownership. All of the above argues for a reduction in the *ad valorem* rate to an affordable level, in order to bring most inherited and purchased property into the formal registration system.

As stated previously, the ultimate objective of transfer tax reduction is to improve long-term land tenure security, increase investment in business, and increase investment in improvement of residential property, leading to higher levels of economic growth and improvement in living standards.

We recommend that the following alternative approaches to reducing the transfer tax rate be considered:

Reduce the transfer tax rate to 3% of assessed value. This is slightly less than one half of the current combined rates. The proposed tax reduction measure has the goal of increasing the registration compliance level in the short term by a factor of at least 2, thus keeping the revenues to the government and court system from property transfers reasonably constant. Over time, an increased volume of sales of property, facilitated by the transfer tax reduction, should lead to additional increases in tax revenues collected.

Reduce the rate even further to 2% or 2.5%. This would be combined with imposition of a schedule of fees for property-related requests, such as title searches, copies of deeds, replacement of lost deeds, which would cover the cost of the transactions.

Implement a differential approach, splitting the transfer tax into several separate tax bases. This approach has the goal of obtaining maximum increase in participation with minimum short-term loss of revenues and could be organized as follows:

- Transfers of commercial property would continue to be taxed at the current rate;
- Transfers of private property would be taxed at a medium rate, perhaps 3% - 5%;
- Transfers of inherited property would be taxed at a low rate, e.g. 1%, or at a higher rate (e.g., 2% or 3%) when combined with a homestead exemption (e.g., $15,000).

This approach is based on ability to pay and aims at improving the registration compliance level among the population that is probably the most vulnerable.

ANNEXES

Annex 1 Obstacles to Registering Properties (2004)

Annex 2 Provincial Tax Revenue Collections by MoF in 1383 (2004)

Annex 3 Transfer Tax Collections by the Courts in 1383 (2004)

Annex 4 Number of Deeds Registered in Kabul Province (1961 to 2000)

Annex 5 Average Time and Cost of Registering Property

ANNEX 1
OBSTACLES TO REGISTERING PROPERTIES (2004)[6]

Country	Number of Procedures to Register	Time to Register (days)	Total Cost of Registration[7] (% of value)
Afghanistan	11	252	9.5
Algeria	16	52	9.0
Egypt	7	193	7.0
Morocco	3	82	6.1
France	10	193	5.8
Iran	9	36	5.0
Austria	3	32	4.5
Germany	4	41	4.2
Pakistan	5	49	4.2
Japan	6	14	4.1
United Kingdom	2	21	4.1
Albania	7	47	3.8
Turkey	8	9	3.3
China	3	32	3.1
Czech Republic	4	122	3.0
Oman	4	16	3.0
United Arab Emirates	3	9	2.1
Canada	6	20	2.0
Hong Kong	3	56	2.0
Kuwait	8	75	1.0
Armenia	4	18	0.9
Denmark	6	42	0.6
Azerbaijan	7	61	0.5
Estonia	4	65	0.5
United States	4	12	0.5
Saudi Arabia	4	4	0.0

Averages by region			
Sub-Saharan Africa	6.9	117.5	12.7
Middle East & North Africa	6.5	52.3	6.8
South Asia	6.9	124	6.3
East Asia & Pacific	4.6	62.2	5.0
Latin America & Caribbean	6.7	76.5	4.8
OECD: high income	4.7	32.2	4.8
Europe & Central Asia	6.5	127.1	3.0

Source: *Doing Business in 2005*, published by The World Bank

[6] These numbers have to be taken as averages and are dated, but can provide interesting comparisons.

[7] The table is sorted by the total cost of registration. Cost of registration (as % of property value) = sum of taxes, registration fees and notary charges divided by estimated value of the property.

ANNEX 2
PROVINCIAL TAX REVENUE COLLECTIONS BY MOF IN 1383 (2004)[8]

Province	Annual Tax Collected (000 AFG)	Percent of Total
Badakhshan	216	0.4
Badghis	0	0.0
Baghlan	533	1.0
Balkh	2,108	4.1
Bamyan	270	0.5
Daikundi	0	0.0
Farah	57	0.1
Faryab	294	0.6
Ghazni	406	0.8
Ghor	0	0.0
Herat	776	1.5
Hilmand	498	1.0
Jawzjan	268	0.5
Kabul	38,779	76.3
Kandahar	1,953	3.8
Kapisa	2	0.0
Khost	0	0.0
Kunar	0	0.0
Kunduz	450	0.9
Laghman	4	0.0
Logar	977	1.9
Nangharhar	955	1.9
Nimroz	858	1.7
Nuristan	0	0.0
Paktika	66	0.1
Paktiya	260	0.5
Panjshir	0	0.0
Parwan	75	0.1
Samangan	147	0.3
Saripul	26	0.1
Takhar	792	1.6
Uruzgan	0	0.0
Wardak	77	0.2
Zabul	0	0.0
Total	50,847	100.0
Total Excluding Kabul	12,068	23.7

[8] Approximately 94% of amounts shown are from real property transfer tax.

ANNEX 3
TRANSFER TAX COLLECTIONS BY THE COURTS IN 1383 (2004)

Province	Annual Number of Transactions	Annual Tax Collected[9] (000 AFG)	Percent of Total Transactions	Percent of Total Tax Collected	Avg. Tax per Transaction (000s AFG)	Avg. Tax per Transaction (USD)[10]
Badakhshan	23	514	0.5	0.4	22	447
Badghis	14	16	0.3	0.0	1	23
Baghlan	55	3,498	1.1	3.0	64	1,272
Balkh	401	3,078	8.3	2.6	8	154
Bamyan	3	0	0.1	0.0	0	0
Daikundi	0	0	0.0	0.0	0	0
Farah	5	12	0.1	0.0	2	48
Faryab	216	565	4.5	0.5	3	52
Ghazni	38	3,287	0.8	2.8	87	1,730
Ghor	160	32	3.3	0.0	0	4
Herat	0	0	0.0	0.0	0	0
Hilmand	0	0	0.0	0.0	0	0
Jawzjan	207	1,597	4.3	1.4	8	154
Kabul	3,032	91,888	62.6	78.4	30	606
Kandahar	0	0	0.0	0.0	0	0
Kapisa	83	150	1.7	0.1	2	36
Khost	4	364	0.1	0.3	91	1,818
Kunar	2	17	0.0	0.0	8	166
Kunduz	84	1,470	1.7	1.3	18	350
Laghman	24	403	0.5	0.3	17	335
Logar	5	977	0.1	0.8	195	3,910
Nangharhar	133	1,769	2.7	1.5	13	266
Nimroz	103	581	2.1	0.5	6	113
Nuristan	1	19	0.0	0.0	19	383
Paktika	0	0	0.0	0.0	0	0
Paktiya	0	0	0.0	0.0	0	0
Panjshir	0	0	0.0	0.0	0	0
Parwan	104	6,250	2.1	5.3	60	1,202
Samangan	92	452	1.9	0.4	5	98
Saripul	40	225	0.8	0.2	6	112
Takhar	11	60	0.2	0.1	5	109
Uruzgan	0	0	0.0	0.0	0	0
Wardak	2	24	0.0	0.0	12	240
Zabul	3	27	0.1	0.0	9	177
Total Including Appeal Courts	4,845	117,273	100.0	100.0	24	484
Total Excluding Kabul Province	1,813	25,385	37.0	22.0	14	280
Kabul City Only	2,107	54,066	43.5	46.1	26	513

[9] Real property transfer tax

[10] Based on 2006 exchange rate of 1 USD = 50 Afghanis

ANNEX 4
NUMBER OF DEEDS REGISTERED IN KABUL PROVINCE (1961 TO 2000)

Year	Deeds Registered	Year	Deeds Registered	Year	Deeds Registered	Year	Deeds Registered
1961	2,640	1971	2,702	1981	2,266	1991	1,953
1962	2,557	1972	3,549	1982	2,337	1992	1,630
1963	2,597	1973	3,046	1983	2,367	1993	1,654
1964	3,278	1974	3,325	1984	1,864	1994	1,445
1965	4,233	1975	3,753	1985	1,173	1995	1,177
1966	4,941	1976	2,238	1986	1,091	1996	1,285
1967	3,163	1977	3,260	1987	1,087	1997	1,861
1968	3,108	1978	2,640	1988	2,225	1998	683
1969	3,400	1979	2,426	1989	1,666	1999	1,181
1970	3,011	1980	2,756	1990	3,150	2000	1,781

Source: LTERA field study 2004

ANNEX 5
AVERAGE TIME AND COST OF REGISTERING PROPERTY

Region	Time to Register (days)	Cost to Register (% of value)
Sub-Saharan Africa	116	14.4
Middle East and North Africa	54	6.8
South Asia	56	6.1
Latin America and Caribbean	62	5.6
OECD and High Income	34	4.3
East Asia & Pacific	51	4.2
Europe and Central Asia	133	3.2

Source: *Doing Business in 2005*, published by The World Bank