

DoD Final Rule Clarifies Application of Afghan Taxes to Contractors

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On December 30, 2015, the **Department of Defense (DoD)** issued a [Final Rule](#) intended to clarify that U.S. defense contractors and subcontractors performing work in Afghanistan, including work on contracts below the simplified acquisition threshold and for commercial items, are not subject to Afghan taxes.^[1] The rule updates the tax provisions of the DFARS to reference the [Bilateral Security Agreement](#) signed by the U.S. and Afghanistan in 2014, which was much more explicit in its exemption of U.S. contractors from Afghan tax obligations than assorted prior agreements between various United States agencies and the Afghan Government, which arguably included similar exemptions.

This update provides much needed clarification for U.S. defense contractors working in Afghanistan, who have long had to deal with Afghan officials disregarding the less explicit exemption provisions of the prior agreements and requiring them to make tax payments. A 2013 [Special Inspector General for Afghanistan Reconstruction Audit](#) found that a sample of 43 contractors had been assessed \$921 million in taxes and associated penalties despite such prior agreements. Indeed, in several instances, U.S. contractors were required to pay taxes to the Afghan government even though they had been issued tax exemption certificates by the Afghan Ministry of Finance. The hope is that by referencing the more explicit September 2014 Bilateral Security Agreement, the revised DFARS and resulting contracts will provide contractors with better documentation and support when tax disputes arise with the Afghan government.

However, given past experiences, contractors should continue to expect some pushback from Afghan officials. This is particularly true for subcontractors embroiled in tax disputes regarding work performed before the Bilateral Security Agreement took effect at the start of 2015, as it has been the Afghan government's position that subcontractors were not exempt from taxation under prior agreements. When such disputes do arise, it is important for contractors to engage and work closely with their contracting officer to respond to any claims of tax liabilities and to address the cost impact that such assessments may have on the contract.

[1] It is important to note that contractors are still responsible for complying with Afghan tax law as it applies to any Afghan employees of the contractor,

and therefore must still withhold taxes from the wages of these employees and make required payments to the appropriate local taxing authority.

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