Saudi Arabia: ZATCA's policies and procedures regarding the most debatable Zakat, Tax and VAT matters

May 2023

“The aim of this guide is to clarify the Zakat and tax treatment for some of the most debatable items and it also provides more clarity which develops and enriches the tax environment in the Kingdom in line with Vision 2030.”

In brief

The Zakat, Tax and Customs Authority (‘ZATCA’) has released guidelines during May 2023 highlighting ZATCA’s Policies and Procedures “P&Ps” regarding the most debatable Zakat, Tax and VAT matters along with the suggested list of documents, information…etc. that are required by ZATCA to accept favourable treatment for the Zakat / Taxpayers. The content of the guidelines is not considered an amendment to any of the provisions of the laws and regulations in force in the Kingdom.

Further, the provided P&Ps may be applicable to the cases under dispute with no final ruling issued yet.

In detail

The guidelines aim to provide insights related to prominent Zakat, Tax and VAT items which are commonly debatable between ZATCA and Zakat / Taxpayers. Currently the guidelines are available only in Arabic language.

Some of the debatable items and corresponding ZATCA’s policies and procedures are summarised hereunder:

VAT

Transitional “Grandfathering” rule for applying zero rate on supplies related to long term contracts before the introduction of VAT

In addition to the requirements provided in the VAT regulations and available guidelines, ZATCA is of the view that the contract must also be executed prior to the adoption and publication of the GCC VAT Framework dated 12 April 2017.

Input VAT recovery on meals/catering

Taxpayers may claim input VAT related to meal expenses for workers located in remote locations provided that the taxpayer can prove that the meals are required to be provided under the KSA labor law

WHT

WHT on Deemed Dividends resulted from applying income tax on estimated profit

Deemed Dividends are not subject to WHT except in certain cases which includes the following:

- Actual dividends payment / deemed payment (offset) to a non-resident.
- Filing CIT return on a deemed profit basis.
- Non-disclosure of revenues or contracts.
- Not maintaining accounting records.
- Not filing the CIT return.
- Not having banks accounts in Kingdom.
- Tax evasion or avoidance cases.
- Written approval by the taxpayer or his official representative.

Zakat and Tax

Deductible expenses

➢ **Salaries in excess of what is reported as per GOSI certificate:** They are allowed as a deductible expense, provided that the are supported by documents such as:

- Monthly payroll sheets.
- Bank statements.
- Approved employment policy covering the allowances.
- CPA salaries' certificate.

➢ **Vacations and Air Tickets Allowances:**

In case they are expensed to the P&L, they are allowed as deductible expenses provided that they meet the expenses' deductibility criteria.

In case they are classified as provisions, they will be subject to the provisions' treatment

➢ **Life Insurance expense:**

It is allowed as a tax deductible expense provided that it meets the expenses' deductibility criteria as per Tax and Zakat regulations.

➢ **Bad debts:**

Providing a court ruling is not mandatory although it's a valid supporting evidence. In case of fulfilling the criteria as per Article (9 - Para.3) of the Income Tax By-Law and providing a persuasive evidence that the appropriate legal procedures have been taken regardless the case along with a proof that the bad debt is not collectable, the bad debt is deductible expense.

Foreign Purchases Differences between tax return and Customs Bayan

Following the consideration of the imports related to fixed assets, the Zakat / Taxpayer should be granted an enough period to provide a reconciliation of the differences supported by documents, in case of not providing the required reconciliation, ZATCA may assess tax and Zakat differences by disallowing the differences or in case of unreported purchases assessing a deemed profit at 15% for tax and mixed companies and 10% (up to 2018) and 15% (from 2019 onwards) for Zakat payers.

Disregarding the accounting records in case of delay in issuing the audited FS

Delay in issuing the audited FS is not an evidence for not maintaining accounting records, nevertheless, the principle is to pay Zakat / Tax based on the audited FS and not following this principle should be justifiable.

Assessment and Reassessment after 5 years

➢ **Zakat:**

- It's not allowed if it was based on available information or information that could have been obtained by ZATCA during the statutory period of 5 years.
- In case of evasion or not filing the return or the approval of the Zakat payer, ZATCA has the right to reopen the assessment according to Zakat Regulations.

Zakat and Tax (Cont'd)

Assessment and Reassessment after 5 years(Cont'd)

➢ **Tax:**

- ZATCA has the right of assessment or reassessment within 10 years from the statutory date of filing the return in case of not filing the return within the statutory period or in case of the tax evasion.
- ZATCA has no right of assessment or reassessment after 10 years in whatsoever case.

Statutory period to appeal against ZATCA's assessment

The period start counting from the following day to ZATCA's notification date.

Tax

The independence of the pension and insurance funds and its similars

This should not go to the extent of assessing the influence of owners or the management or whoever in the decisions of the fund, the main objective is to ensure that the contribution has been actually incurred by the taxpayer and he has no authority to benefit from the contribution or the income of the fund.

Allowing the contribution as a deductible expense is associated with the deductible amount of the salaries cost.

Zakat

Debtors' loans, support or additional funding

➢ **Zakat assessments up to 2018:**

Loans provided to investee are deductible from Zakat base capped to the ownership percentage of the investor in the investee's capital subject to certain criteria, some of the most important criteria are listed below, all criteria all listed in the guidelines:

- They should be classified as an investment or non-current assets in the investor's financial statements and classified as equity or long term liabilities in the investees' financial statements.
- They should not be resulting from commercial transactions between investor and investee.
- It should be an interest free loan not for a commercial or interest earning purposes.

➢ **Zakat assessments from 2019 onwards:**

Non-deductible according to the provisions of Article (5 - Para.4) of Zakat By-law, except for those classified within the equity of the investee and subject to Zakat in the investee without cap to the deductibles from the Zakat base.

Investment in BOOT contracts in books of the lessor

- Only the Saudi share of the non-current balance of the net investment in BOOT contracts and its similars is deductible.
- In case the entire investment is classified as current assets according to the accounting standards, only the due amount within the next year is non-deductible.
- In all cases, the entire financing source of this investment should be added to the Zakat base

Zakat (Cont'd)

Real Estate Under Development "REUD"

➢ **Zakat assessments for 2017 and 2018:**

- The intention of the Zakat payer regarding the sale of the REUD is determined based on the item movement in the subsequent year.
- Developed RE and rented in the subsequent year are deductible during the period they were REUD.
- Sold REUD in the subsequent year due to urgency or need for liquidity (along with the supporting evidence of not changing the intention) are allowed as deductible item from Zakat base

➢ **Zakat assessments from 2019 onwards:**

- Deductible from Zakat base subject to the criteria as per Article (5-Para 9) of Zakat By-law.

Investments in investment funds

Investments not held for trading purposes are allowed as deductible items from Zakat base subject to the following criteria:

- The fund should calculate and pay its due Zakat independently.
- The investor should calculate and pay Zakat on his investment in that fund according to the approved calculation mechanism by ZATCA.

Utilised provisions for Zakat purposes

- In case the Zakat base is higher than the net adjusted profit, the amount of the utilised provisions to be deducted from the Zakat base.
- In case the net adjusted profit is higher than the Zakat base, utilised provisions to be deducted from the net adjusted profit , then the net Zakatable profit to be compared with the Zakat base (after eliminating the impact of the utilised provisions on the Zakat base) and whatever is higher will be subject to Zakat

Considering the net adjusted profit as the minimum Zakat base

The net adjusted profit should not be considered as the minimum Zakat base, provided that Zakat due should not be less than the calculated Zakat as per the submitted Zakat returns for the years before 2017.

Dividends from the profit of the year

In case Zakat is calculated on the Zakat base but not of the net adjusted profit, the paid dividends will be deducted from Zakat base even they are more than the opening balance of the retained earnings, provided that they have been actually distributed.

Noting that these dividends should not be part of the Zakatable profit of the dividends' recipient.

The takeaway

The document provides additional insights as to how ZATCA intends to apply its laws and regulations related to zakat, tax and VAT.

If you wish to find out more about the document, feel free to reach out to us for support.

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Let’s talk

For a deeper discussion of how this issue might affect your business, please contact:

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Thank you