

Introduction:

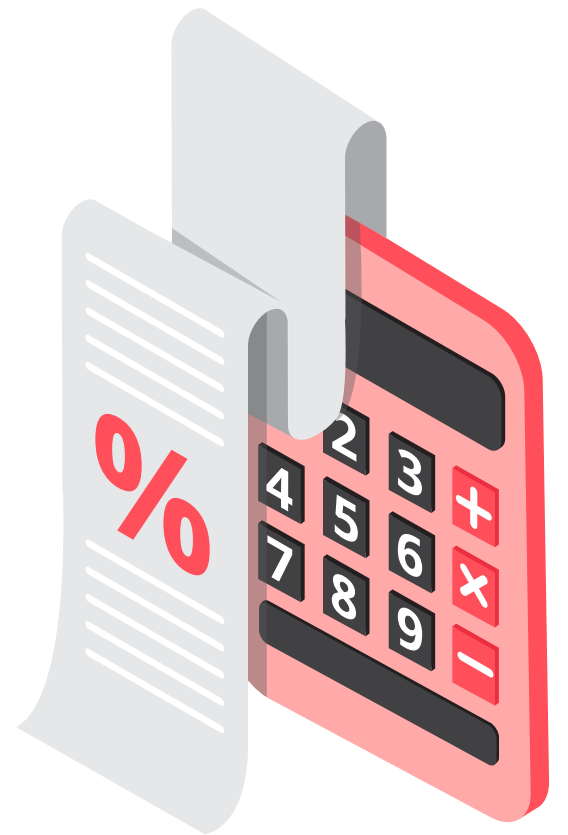
The Professional Magazine is a specialized publication issued by Ali Ibrahim Al-Nasser & Partners, Certified Public Accountants and Consultants. In this twentieth issue, we discuss the legislative hierarchy governing the treatment of debts in the Zakat base. This issue also highlights a number of common professional mistakes and practices, most notably the failure to issue tax invoices for deemed supplies, as well as the failure to declare Value Added Tax on the receipt of advance payments.

The Legislative Hierarchy for the Treatment of Debts in the Zakat Base of the Taxpayer

Debts are considered among the most significant items affecting the Zakat base of taxpayers, as they represent one of the main sources of external financing that influence the Zakat base. The inclusion of debts in determining the Zakat base is based on the applicable jurisprudential opinion adopted in this regard, depending on whether such opinion considers debts to reduce the Zakat base, not to reduce the Zakat base, or to reduce the Zakat base subject to specific controls and considerations.

The treatment of debts under the direct method for calculating the Zakat base requires either the deduction of debts from the Zakat base or their non-deduction, depending on the adopted opinion regarding the treatment of debts. Conversely, under the indirect method, the treatment of debts requires adding such debts to the Zakat base for the purpose of capturing and subjecting to Zakat the Zakatable assets financed thereby, or refraining from adding them to Zakat in order to avoid subjecting assets financed through such debts to Zakat, on the basis that debts reduce the Zakat base, depending on the opinion adopted in this regard.

Another significant challenge in the treatment of debts within the Zakat base of commercial establishments is the difficulty of tracing debts as sources of funds to the assets financed thereby. This makes it challenging to conclusively determine whether debts have financed Zakatable assets or non-Zakatable assets, due to the volume of transactions within establishments, the commingling of funds, and the multiplicity of funding sources, which are not limited solely to debts.



The Zakat treatment of debts within the Zakat base has evolved through successive Zakat collection regulations, reflecting differences in recognized jurisprudential opinions, as well as the underlying bases and assumptions upon which the Zakat treatment was established. Accordingly, the Zakat treatment varied across the issued Zakat regulations, which may be summarized as follows:

1. The Implementing Regulations for Zakat Collection issued by Ministerial Resolution No. (2082) dated 01/06/1438H, applicable to the year 2018 and prior years.
2. The Implementing Regulations for Zakat Collection issued by Ministerial Resolution No. (2216) dated 07/07/1440H, applicable to the years from 2019 to 2023.
3. The Implementing Regulations for Zakat Collection issued by Minister of Finance Resolution No. (1007) dated 19/08/1445H, applicable to the year 2024 and subsequent years.

The Zakat treatments of debts have varied across the Implementing Regulations for Zakat Collection mentioned above. This necessitates careful consideration when dealing with different years in the submission of Zakat returns or objections by taxpayers, as a taxpayer may file an objection relating to a previous year. Accordingly, the objection and its underlying regulatory basis must be prepared in accordance with the regulations applicable to that year. The key updates regarding the treatment of debts in the aforementioned regulations can be summarized as follows:

1. The Implementing Regulations for Zakat Collection issued by Ministerial Resolution No. (2082) dated 01/06/1438H:

The 1438H Regulations were the first comprehensive Zakat regulations issued, consolidating all treatments from the Zakat resolutions applicable at the time. These regulations treated debts as not reducing the Zakat base under any circumstances, meaning that all debts are added to the Zakat base once a lunar year has elapsed (Hawl). Debts for which a Hawl has not yet elapsed are added only if they have been used to finance deducted assets.

The regulations take into account the completion of the Hawl (lunar year) on the sources of funds, which means that debts added during the year that have not yet completed a Hawl are not added to the Zakat base. This also reflects that the regulations require tracing the sources of funds, so that if it is determined that debts have financed deducted assets, such debts are added even if a Hawl has not yet elapsed.

The regulations do not set any limit on the addition of debts to the Zakat base; all debts and liabilities are added once a Hawl has elapsed, irrespective of their accounting classification, whether current or non-current. This necessitates a detailed analysis of all liability items to identify debts that have completed a Hawl, while also considering the portions that financed deducted assets, if applicable.

2. The Implementing Regulations for Zakat Collection issued by Ministerial Resolution No. (2216) dated 07/07/1440H:

These regulations introduced a new approach to the treatment of debts by setting a limit on the addition of debts, such that they do not exceed the assets deducted from the base. This results in a difference in the Zakat treatment between equity items and liability items, as no limit is applied to the addition of equity items, whereas the addition of liabilities is limited to the extent of the deducted portion of the Zakat base.

Furthermore, under these regulations, the addition is generally limited to non-current debts, while current debts are added only in specific cases, such as financing deducted assets or scheduled loans.

Another important update in the treatment of debts under these regulations is that the completion of a full Hawl is no longer considered an absolute condition for addition. Debts added during the Zakat year that have not yet completed a Hawl are added proportionally based on the date of addition, unless they have been used to finance deducted assets.

It is also noteworthy that the regulations treat all provisions as equity items, meaning they are added to the Zakat base in full without any limit, regardless of the type or nature of the provision.

3. The Implementing Regulations for Zakat Collection issued by Minister of Finance Resolution No. (1007) dated 19/08/1445H:

These regulations maintain the approach of the previous regulations by generally limiting the addition to non-current debts, except in specific cases. However, they introduce a fundamentally different perspective in the treatment of debts from three influential aspects:

First aspect: Debts are added to the Zakat base at their end-of-period balance, regardless of the date of addition and without consideration of the completion of a Hawl, as they are treated as acquired funds.

Second aspect: The regulations adopt the principle of equality between assets and liabilities, which determines the placement of debts—whether added or not added—to the Zakat base in specific cases in addition to eliminating all procedures for tracing debts and the assets they financed, as additions are made according to the equality principle without tracing what the debt financed. Under this principle, liabilities are matched with assets based on the assumption that non-current liabilities shall be equal to non-current assets, and current liabilities shall be equal to current assets. Additionally, it is assumed that, by default, non-current assets are considered fully deducted unless proven otherwise, while current assets are considered non-deducted unless proven otherwise. Accordingly, non-current liabilities are added to the Zakat base as they are equal to deducted assets, while current liabilities are not added to the Zakat base as they are equal to non-deducted assets.

Accordingly, if a current asset is deducted, the corresponding non-added current liabilities must be added to the Zakat base. Conversely, if a non-current asset is not deducted, the corresponding non-current liabilities added to the Zakat base must be excluded. This is carried out in accordance with the procedures specified in the regulations.

Third aspect: The regulations adopt a reclassification procedure, treating certain specified liability items as equity items based on specific considerations. This includes provisions, partners' credit loans, and profits under distribution. At the same time, certain provisions—such as end-of-service and leave provisions, or similar items—are treated as debts.

Accordingly, the addition is limited to debts classified as non-current. The financing of deducted assets by debts has no effect on the addition of debts under the equality principle. Current debts may be added to the Zakat base in specific cases, such as in placement scenarios, provided that the addition of debts does not exceed the limit, which is represented by the assets deducted from the Zakat base.



Common Professional Mistakes and Practices

Common Mistake:

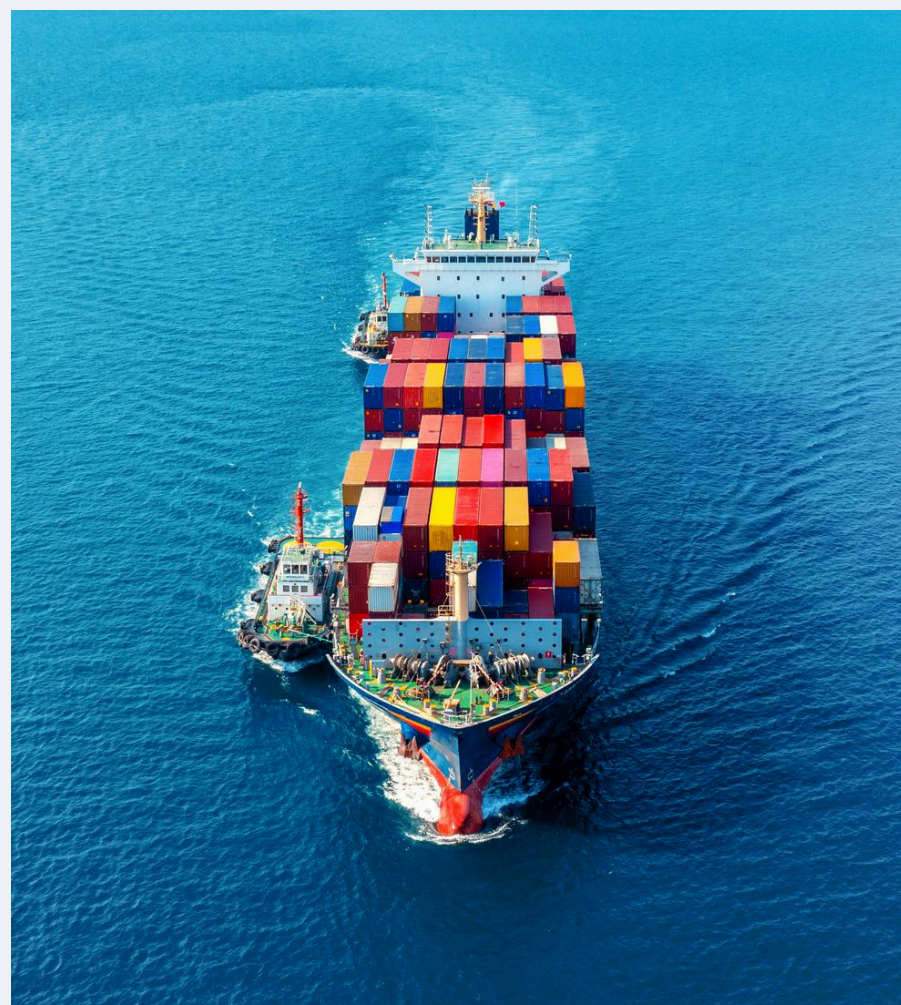
Failure to declare advance payments in Value Added Tax (VAT) returns.

Correct Procedure:

Advance payments must be declared in the VAT return, VAT must be paid thereon, and tax invoices must be issued in respect of such payments.

Clarification (Example):

Value Added Tax must be declared in the correct tax period, in accordance with the occurrence of the taxable event as set out in the relevant VAT provisions. This includes the receipt of advance payments from customers, as the receipt of an advance payment constitutes a taxable event for VAT purposes where the payment is received prior to the issuance of the tax invoice and prior to the supply of the goods or services. In such cases, a tax invoice must be issued upon receipt of the advance payment in accordance with the provisions governing the issuance and timing of tax invoices.



Common Mistake:

Failure to issue tax invoices for deemed supplies.

Correct Procedure:

Tax invoices must be issued in cases of deemed supplies.

Clarification (Example):

Some establishments may undertake certain types of deemed supplies as provided for under the Unified VAT Agreement of the Gulf Cooperation Council (GCC), including the supply of services without consideration. In accordance with the VAT provisions, such transactions obligate the establishment to issue a tax invoice in compliance with the requirements of the Law, as deemed supplies are treated, for this purpose, in the same manner as regular taxable supplies. It has been observed, however, that some establishments do not take this into account, which constitutes a violation of the provisions of Value Added Tax.



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