

Introduction:

The Professional Magazine is a specialized publication issued by Ali Ibrahim Al-Nasser & Partners, Certified Public Accountants and Consultants. In this twenty-fourth issue, we address the Zakat base for insurance companies. This issue also highlights a number of common professional mistakes and practices, most notably the failure to disclose exempt supplies in Value Added Tax (VAT) returns, particularly real estate supplies.

Zakat Base for Insurance Companies

The insurance sector is considered one of the key and vital sectors, characterized by accounting treatments that differ in nature and presentation from those of typical commercial entities. Insurance companies rely on the International Financial Reporting Standard (IFRS 17) - Insurance Contracts, which sets out the measurement and presentation requirements for insurance contract accounts. The accounting treatments of insurance companies involve the recognition of a variety of provisions and reserves for the purposes of hedging and risk reduction. Accordingly, such treatments are distinguished by specialized applications that differ from those applied in conventional business activities. One of the most notable treatments is the aggregation of insurance contract assets and liabilities under a single line item, namely "Insurance Contract Liabilities", which is presented within the liabilities section of the statement of financial position. This item comprises a range of underlying assets, liabilities, and reserves arising from insurance contracts and is presented in the statement of financial position as a single aggregated amount comprising these items. Examples of items included within Insurance Contract Liabilities are as follows:

- Unearned premiums (liability)
- Claims payable to policyholders (liability)
- Outstanding claims reserve (reserve)
- Insurance premiums receivables (asset)

And other various and multiple items. The above examples demonstrate the diversity of items included within the Insurance Contract Liabilities line item, which consequently requires diverse Zakat treatments for such items.



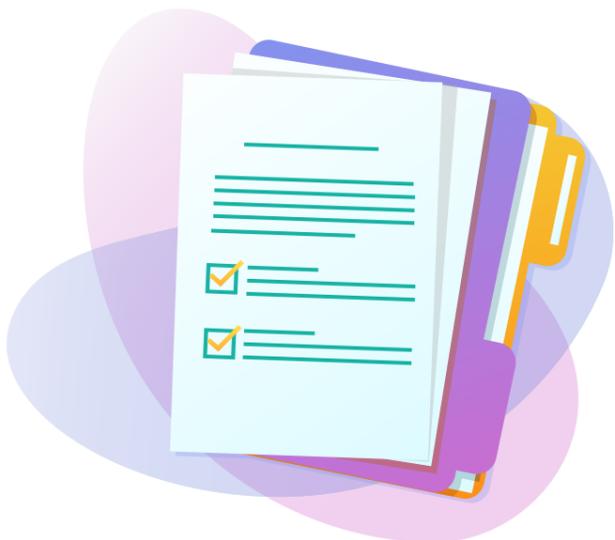
Furthermore, the financial statement presentation in insurance companies is characterized by the classification of assets and liabilities based on the liquidity of statement of financial position items, which necessitates additional analysis for Zakat purposes.

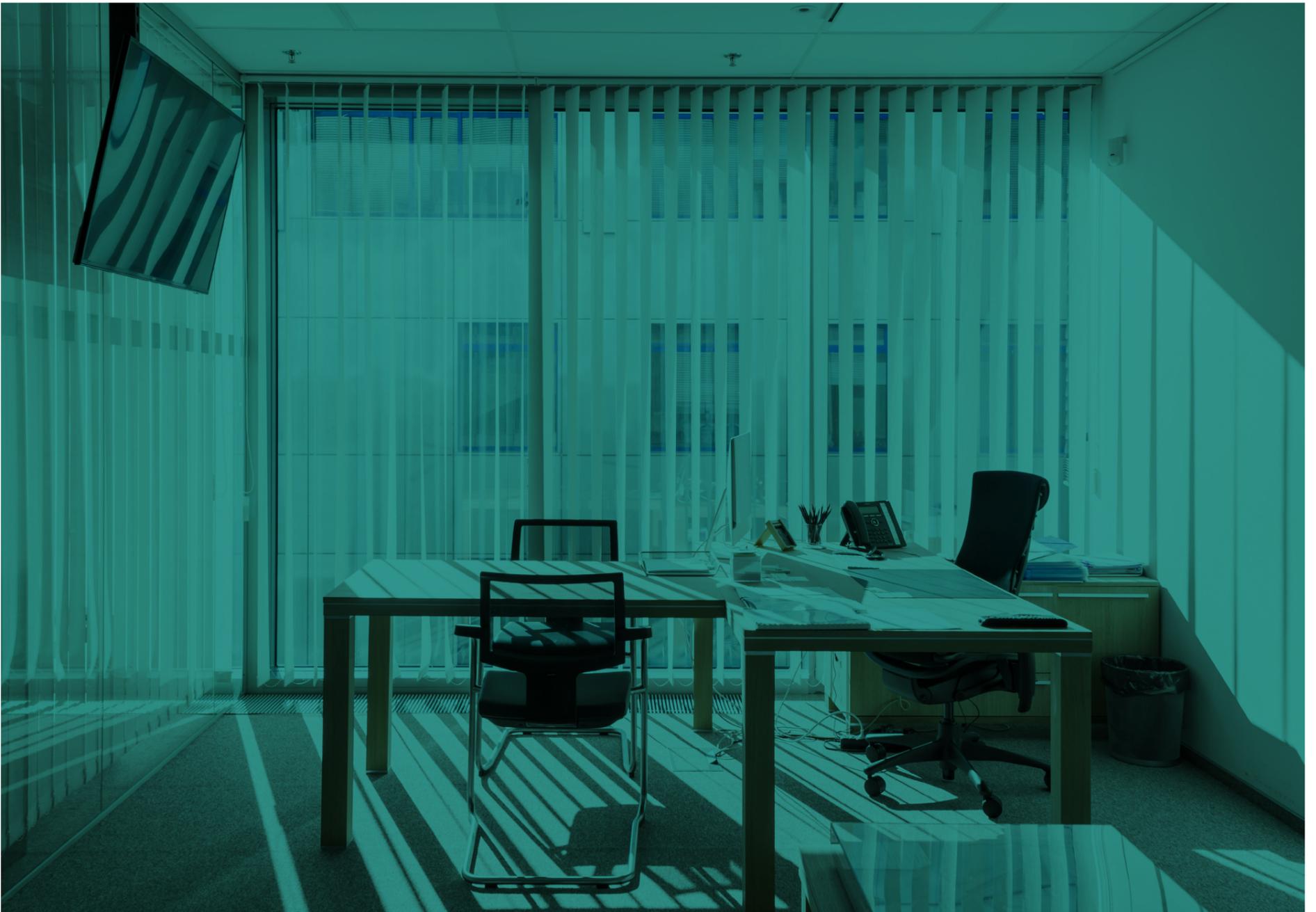
The Implementing Regulations for Zakat Collection address the Zakat treatment of the insurance sector under section Four of sub-section Seven (Special Provisions for Certain Taxpayer Activities). Article (81) sets out specific Zakat provisions applicable to taxpayers engaged in insurance activities, including the treatment of the following items:

- Statutory deposit with the Insurance Authority.
- Policyholders' share of the insurance surplus.
- Unearned premium reserve classified as non-current, in accordance with the Implementing Regulations for Zakat Collection.

The Regulations do not provide a comprehensive Zakat treatment for all items in the statement of financial position of insurance companies, particularly the specialized items presented in the statement of financial position of insurance companies:

- Insurance Contract Liabilities.
- Reinsurance contract assets arising from reinsurance transactions, including the related assets, liabilities, and reserves.





Accordingly, for Zakat purposes, the applicable approach is to refer to and apply the general provisions of the Regulations to the items of the statement of financial position of insurance companies. An exception applies to items for which specific treatments are prescribed under Article (81) of the Regulations.

Based on the foregoing, zakat payers engaged in insurance activities are required to treat equity, liabilities, and assets items in accordance with the provisions of the Regulations. As for aggregated items, namely Insurance Contract Liabilities and Reinsurance Contract Assets, these must be treated within the Zakat base based on a detailed analysis of their underlying items. These two items comprise various elements, including reserves, provisions, assets, and liabilities, which necessitates the preparation of a comprehensive and detailed analysis of these two items. The individual items should then be treated in accordance with the relevant provisions of the Regulations. For example, any reserves included within these items should be treated as part of equity items and their equivalents.

This requires the preparation of a detailed analysis of these items for examination purposes. The guideline issued by the Authority for zakat payers in the insurance sector stipulates the submission of a certificate issued by a certified chartered accountant in the Kingdom, which includes all detailed items underlying these two items, in addition to certain other requirements.

With respect to the presentation of assets and liabilities based on their liquidity, the Regulations address cases where financial statements are classified on a liquidity basis, for the purpose of determining current and non-current classifications. Financial statements prepared on a liquidity basis refer to those in which assets and liabilities in the statement of financial position are presented according to their liquidity, rather than being classified based on maturity into current and non-current categories.

Article (19) of the Regulations defines current items, for entities whose financial statements are prepared on a liquidity basis, as any asset or liability expected to be realized, recovered or settled within 365 days as a maximum after the end of the Zakat year, including but not limited to: Cash and cash equivalents, inventory, commercial receivables, and any asset owned by the Zakat Payer for the purpose of trading.

Accordingly, insurance companies are required to perform a comprehensive analysis of all asset and liability items to determine their maturities for Zakat purposes. This has a direct impact on the calculation of the Zakat base, as the treatments and assumptions applicable to current assets and liabilities differ from those applicable to non-current assets. Furthermore, many of the rules governing additions and deductions are directly linked to this classification.

Finally, the Zakat, Tax, and Customs Authority (ZATCA) has issued a comprehensive detailed guideline that includes both accounting and Zakat considerations for insurance companies, along with illustrative examples and detailed templates for calculating the Zakat base and the certified chartered accountant certificate mentioned above. This guideline is considered an authoritative reference for calculating the Zakat base for insurance companies in accordance with the provisions set out in the Implementing Regulations for Zakat Collection.



Common Professional Mistakes and Practices

Common Mistake:

Failure to disclose exempt supplies in the Value Added Tax (VAT) return, particularly real estate supplies.

Correct Procedure:

Disclose exempt supplies in the Exempt Supplies field, even if no VAT is due.

Explanation:

Some taxpayers overlook the disclosure of exempt supplies in the VAT return because they do not result in payable VAT. This is particularly evident in the real estate sector, such as in the sale of properties to third parties, which is considered a VAT-exempt supply.



Common Mistake:

Ignoring current assets and liabilities when calculating the Zakat base.

Correct Procedure:

Analyze the items of current assets and liabilities when calculating the Zakat base to verify their nature and determine whether they have any Zakat impact.

Explanation:

Current assets and liabilities may include items that affect the Zakat base. For example, on the assets side: Spare parts not held for sale, delayed government dues, partners' debit loans, advance payments for asset purchases. On the liabilities side: Partners' credit loans, certain types of provisions.

Therefore, taxpayers are required to analyze current assets and liabilities items to determine any potential Zakat impact of these items. Some taxpayers may limit the Zakat base calculation to the items of equity and non-current assets and liabilities, which may result in overlooking the Zakat treatment of certain current asset and liability items that have a Zakat impact.



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