27 Issue

The Professional Magazine

A monthly publication prepared by the Professional Research Team at Ali Al Nasser & Partners Certified Public Accountants and Consultants

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Introduction:

The Professional Magazine is a professional publication issued by Ali Ibrahim Al-Nasser & Partners, Certified Public Accountants and Consultants. In this twenty-seventh issue, we discuss the impact of tax and Zakat considerations on business, investment, and Organisational decisions. We also review some common professional mistakes and practices, most notably the failure to consider the market value of real estate when paying Real Estate Transaction Tax (RETT).

Key Updates and Developments

1. Issuance of the Minister of Finance's Decision to Extend the Initiative for the Cancellation of Fines and Exemption from Financial Penalties for Taxpayers

The Zakat, Tax and Customs Authority (ZATCA) announced the issuance of the Minister of Finance's decision extending the initiative to cancel fines and exempt taxpayers subject to all tax laws from financial penalties for an additional six calendar months, effective from 1 July 2026.

ZATCA explained that the initiative provides taxpayers with an exemption from late registration penalties under all tax laws, late payment penalties, late filing penalties under all tax laws, as well as the VAT return correction penalty.

ZATCA further stated that, to benefit from the initiative, the taxpayer must be registered with the Authority for tax purposes, submit all tax returns required to be filed with the Authority, pay the full principal amount of tax debt relating to the due tax returns, with the option to apply to the Authority for an instalment plan, provided that the application is submitted while the initiative is in effect, and comply with the payment of all instalments by their respective due dates in accordance with the instalment plan approved by the Authority.

ZATCA confirmed that the initiative does not cover penalties related to tax evasion violations, penalties imposed under Article (45) of the Value Added Tax Law, or penalties that were paid before the effective date of the initiative. It also does not cover penalties related to any tax return that was required to be filed with the Authority after 30 June 2026.

ZATCA also clarified that, if an extension of the initiative is deemed necessary beyond 31 December 2026, any subsequent extension will not cover penalties related to any tax return that was required to be filed with the Authority after 30 June 2026.

The Impact of Tax and Zakat Considerations on Business, Investment, and Organisational Decisions

Tax and Zakat considerations are fundamental factors that should be taken into account when making business, investment, and organisational decisions. Tax and Zakat implications are no longer merely a consequence that arises after a decision has been made; rather, in many cases, they have become a factor that directly influences the soundness of a decision and its economic viability.

A business or investment decision may be sound from an operational, financial, or legal perspective. However, failure to assess its tax and Zakat implications may alter its economic outcome, increase its cost, or give rise to liabilities that were not considered at the time the decision was made. Accordingly, overlooking these considerations may transform a decision that appears positive at first glance into a negative decision that, in fact, should not have been made or approved.

This becomes particularly important in major decisions made by businesses, especially medium-sized and large enterprises, such as entering into new investments, restructuring assets, establishing subsidiaries, transferring activities between entities, expanding outside the Kingdom, entering into significant contracts with non-resident suppliers, or adopting specific financing arrangements. Such decisions, among other major business decisions, do not affect only the commercial or organisational aspects of the business; they may also have a direct impact on Zakat liabilities, Income Tax, Withholding Tax, Real Estate Transaction Tax (RETT), Value Added Tax (VAT), and Transfer Pricing rules.

Based on the foregoing, the following examples and scenarios illustrate the practical and real-world application of these considerations:

A company may own an income-generating commercial complex directly, and its direct ownership of the asset may result in a specific Zakat treatment, including the possibility of deducting the asset from the Zakat base where the statutory deduction conditions are satisfied. However, if the company decides to transfer the asset to an investment fund and hold units in the fund instead of directly owning the asset, the Zakat treatment may differ significantly. An investment in the fund does not necessarily receive the same treatment as an asset held directly, and the investment may only be deductible from the Zakat base subject to specific conditions and considerations that differ from those applicable to direct ownership. This may have a significant and material impact on the Zakat cost. Accordingly, changing the form of ownership from direct ownership of an asset to an investment in an entity or fund may have a significant Zakat impact, even if the underlying economic asset has not fundamentally changed from the company's perspective. This demonstrates that the organisational or investment structure of a decision may affect its Zakat outcome and is not merely a legal, administrative, or organisational matter.

The importance of Zakat considerations is also evident in decisions relating to overseas investments and international expansion. The ownership or financing of foreign investments, or the manner in which such investments are held, may result in different Zakat implications depending on the nature and structure of the investment. The same applies to Murabaha arrangements and deposits. Although these instruments may be appropriate from a liquidity or cash management perspective, their Zakat implications may be significant, as they are generally among the items that are not deductible from the Zakat base. This requires their impact to be carefully assessed before making a decision to retain, increase, or allocate liquidity to such instruments.

Another important aspect is financing decisions, as the method of financing may have a significant impact on the Zakat base. Short-term financing may have different implications from long-term financing. Furthermore, the purpose of the financing and the asset financed may affect the Zakat treatment and the ultimate outcome of the financing arrangement. For example, a business may use financing to acquire an asset eligible for deduction, to fund operating activities, or to finance an investment that is not deductible. Each of these scenarios may have a different impact on determining the resulting Zakat cost.

Accordingly, a financing decision should not be assessed solely from the perspective of financing costs or cash flows. Its Zakat implications should also be considered, particularly for businesses that rely heavily on financing or have ongoing capital expansion programmes.

Restructuring decisions and the allocation of activities among group companies are also among the decisions that require careful tax and Zakat consideration in advance. A business group may decide to separate a particular activity into an independent company, transfer assets between subsidiaries, establish a holding company, or reorganise ownership interests and activities within the group. Although such decisions may be justified from a governance, management, or investor-attraction perspective, they may give rise to various tax and Zakat implications, including the potential recognition of taxable capital gains, the emergence of Real Estate Transaction Tax (RETT) implications, changes to the Zakat base at the level of certain companies, or differences in the treatment of related-party transactions, which may affect the Zakat cost or the application of Transfer Pricing rules.

This also applies to the nature of a business's suppliers and the contracts it enters into, particularly where non-resident suppliers are engaged to provide technical, administrative, consulting, or technology services. A business may assess such a contract primarily from the perspective of service cost or supplier efficiency. However, payments to non-residents may give rise to Withholding Tax implications, and the business may bear the resulting tax cost if the contract is not drafted clearly or does not specify which party is responsible for the tax. In large contracts, the impact of Withholding Tax may be material and significantly affect the actual cost of the contract.

The matter is not limited to the nature of the contract or the supplier; it also extends to the place where the company is incorporated, where it is managed, and where its executive decisions are made. A company may be incorporated abroad for investment or organisational purposes; however, if its central management or actual executive decision-making is located in the Kingdom, this may affect the determination of its tax or Zakat residency. In certain cases, this may result in the company being treated as resident in the Kingdom for tax or Zakat purposes, even though it was legally incorporated outside the Kingdom.

The Zakat impact may, in some cases, also extend to the timing of sales during the year. For example, if a real estate developer begins selling properties held for sale before the end of the Zakat year, the project may become ineligible for deduction because the prescribed threshold for qualifying for the deduction has been reached. This may have a material impact on the Zakat cost at year-end, compared with a situation where the developer begins selling at the start of the year and completes the liquidation and sale of the properties before year-end.

Based on the foregoing, business, investment, and organisational decisions should not be considered in isolation from their tax and Zakat implications. A professional assessment of these decisions conducted in advance may reveal significant implications that were not apparent when the business or organisational analysis was initially prepared. In some cases, such an assessment may lead to modifying the structure of the decision, changing the way it is implemented, or even abandoning the decision altogether where its Zakat or tax implications are found to undermine its economic viability.

In conclusion, awareness of tax and Zakat considerations is no longer a professional luxury or a subsequent compliance measure; it has become an essential part of decision-making within businesses. A sound business decision is one whose implications are assessed from all perspectives—including its tax and Zakat implications—before it is implemented, rather than after the resulting liability has already arisen.

Common Professional Mistakes and Practices

Common Mistake:

Failure to consider the market value of the real estate when paying Real Estate Transaction Tax (RETT).

Correct Procedure:

Verify the value of the real estate transaction and the market value of the real estate when calculating RETT, and do not rely solely on the value stated in the contract where such value does not reflect the fair market value of the real estate.

Explanation:

Some taxpayers may pay RETT based solely on the transaction value stated in the contract, without verifying whether such value reflects the fair market value of the real estate.

The impact of this mistake is particularly evident in transactions between related parties, transactions where the consideration is lower than the market value, or transactions involving non-cash consideration or special arrangements between the parties.

Accordingly, when paying RETT, the taxpayer must verify the value applicable for tax purposes and take into consideration the market value of the real estate where required, in order to avoid potential tax differences or subsequent penalties arising during a tax audit.

Common Mistake:

Failure to adjust input tax when applying the proportional deduction method.

Correct Procedure:

Adjust the input tax deducted on a proportional basis where the actual deduction percentage for the year differs from the percentage used in the periodic returns, which was based on the previous year's data, in accordance with Article (51) of the Implementing Regulations of the Value Added Tax Law.

Explanation:

Some taxpayers may carry out activities involving both supplies subject to VAT and exempt supplies, such as certain real estate or financial activities. This requires input tax that cannot be directly attributed to be deducted on a proportional basis.

A common mistake is for a taxpayer to apply an estimated or provisional deduction percentage throughout the year based on the previous year's data, as permitted under the Regulations, without making the required adjustment once the actual deduction percentage is determined based on the current year's data. This may result in the taxpayer deducting more or less input tax than the amount legally deductible.

Accordingly, taxpayers applying the proportional deduction method must review the input tax deducted and make the necessary adjustments in the final return of the year in accordance with the provisions of the Regulations. This helps avoid tax discrepancies and penalties that may arise during an audit, as well as ensuring that the taxpayer does not miss the opportunity to claim any additional input tax deduction to which they may be entitled.

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