ZAKAT

هيئة الزكاة والضريبة والجمارك
Zakat, Tax and Customs Authority

Guideline

Manual of Transition to the International Financial Reporting Standards

and its impact on Calculating Zakat for Taxpayers Obligated to Maintain Statutory Accounts in the Kingdom of Saudi Arabia

IAS 20 "Accounting for Government Grants and Disclosure of Government Assistance" and IAS 41 "Agriculture"

Version One November 1 2021

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This Manual is indicative and constitutes the concept and interpretation of the Zakat, Tax and Customs Authority (ZATCA) with regard to the implementation of the Executive Regulations of Levying Zakat promulgated by the Ministerial Resolution No. (2216) dated 07 Rajab 1440 AH. It is not a statutory document, and its provisions are indicative, non- binding to ZATCA, and it does not eliminate the need to peruse the Executive Regulations for Levying Zakat and the relevant rules and resolutions.

This Manual is indicative, and includes a summary of the most important considerations with respect to application of International Financial Reporting Standards (IFRSs) approved in the Kingdom of Saudi Arabia. It is not a statutory document. The provisions thereof are guiding, and it does not eliminate the need to peruse to the International Financial Reporting Standards approved in the Kingdom of Saudi Arabia and other standards and publications approved by the Saudi Organization for Chartered and Professional Accountants. All diagrams and drawings contained herein are for illustrative purposes and may not include all requirements and exceptions to the standards. The Authority expressly disclaims any duties or obligations towards any person or entity that may result from using this attached Manual. Kindly also note that this Manual does not express any conclusion about the Proper Accounting Treatment based on specific facts and does not recommend accounting policies or treatments that the user of this Manual shall choose or apply.

Introduction

Purpose of Manual:

This Manual aims to provide a summary of the most important effects that resulted from the transition to International Financial Reporting Standards (IFRSs) at the expense of Zakat. It should be noted here that the mentioned standards were adopted by the Saudi Organization for Chartered and Professional Accountants to become applicable by companies listed in the Saudi Financial Market effective from the Fiscal Year January 1, 2017.

Further, this Manual is intended to contribute to raising awareness on changes in the accounting treatments contained in international standards, which may have changed the Zakat handling for some items. ZATCA aims that the Manual will also contribute to narrowing the gap between the understanding of taxpayers and the Authority's expectations concerning the mechanisms for estimating and calculating Zakat in light of the transition to these standards.

This Manual addresses the following international standards:

- IAS 20 "Accounting for Government Grants and Disclosure of Government Assistance"
- IAS 41 "Agriculture"

The Manual has been prepared based on the International Financial Reporting Standards approved in the Kingdom of Saudi Arabia (issued in 2020 AD).

Overview of the transition to the approved International Financial Reporting Standards in the Kingdom of Saudi Arabia:

International Financial Reporting Standards have been endorsed by the Saudi Organization for Chartered Auditors and Accountants to become applicable by companies listed in the Saudi financial market effective from the fiscal year 1 January 2017.

In the interest of the Zakat, Tax and Customs Authority to keep pace with this fundamental transition, the Authority has listed and formulated the most prominent effects of the transition on the account of Zakat for private sector companies and institutions in the Kingdom of Saudi Arabia.

1. Overview of IAS 20 and 41

1.1 International Accounting Standard No. (20)

1.1.1 Scope Summary:

This Standard should be applied when accounting for and disclosing the government grants and when disclosing other forms of government assistance.

1.1.2 Scope Summary:

Most Important Exceptions to IAS (20)	Applicable Standard	Standard Name
Special problems arising when accounting for government grants in the financial statements that reflect the effects of changing prices or in additional information of a similar nature	International Accounting Standard 21	IAS 21 "Effects of Changes in Foreign Exchange Rates"
Government assistances that are provided to a an establishment in the form of benefits that are made available in determining taxable profit or tax loss, or that are determined or reduced on the basis of the income tax liability. Examples of these benefits are: temporary exemptions from income tax, tax benefits for investments, permitted accelerated depreciation and reduced rates of income tax	International Accounting Standard 21	International Accounting Standard 12 "Income Taxes"

Government participation in the ownership of the establishment	International Accounting Standard 32	International Accounting Standard (IAS) No. (32) Financial Instruments.: Presentation"
Government grants under IAS 41 "Agriculture"	International Accounting Standard 41	IAS 41 "Agriculture"

The Saudi standard that replaced it

AS 18: Disclosure of Government Assistances and Grants

Effective Date

January 1, 1984

1.2 International Accounting Standard 41

1.2.1 Standard objective:

The objective of this Standard is to specify the accounting treatment and disclosures related to agricultural activity.

1.2.2 Scope Summary:

Most Important Exceptions to IAS (41)	Applicable Standard	Standard Name
Land related to agricultural activity	International Accounting Standard 16 International Accounting Standard 40	IAS 16: Property, Plant and Equipment IAS 40: Investment Property
Fruitful plants related to agricultural activity	International Accounting Standard 16	IAS 16: Property, Plant and Equipment
Government grants related to fruitful plants	International Accounting Standard 20	IAS 20: Accounting for Government Grants and Disclosure of Government Assistance
Intangible assets related to agricultural activity	International Accounting Standard 38	IAS 38: "Intangible Assets"

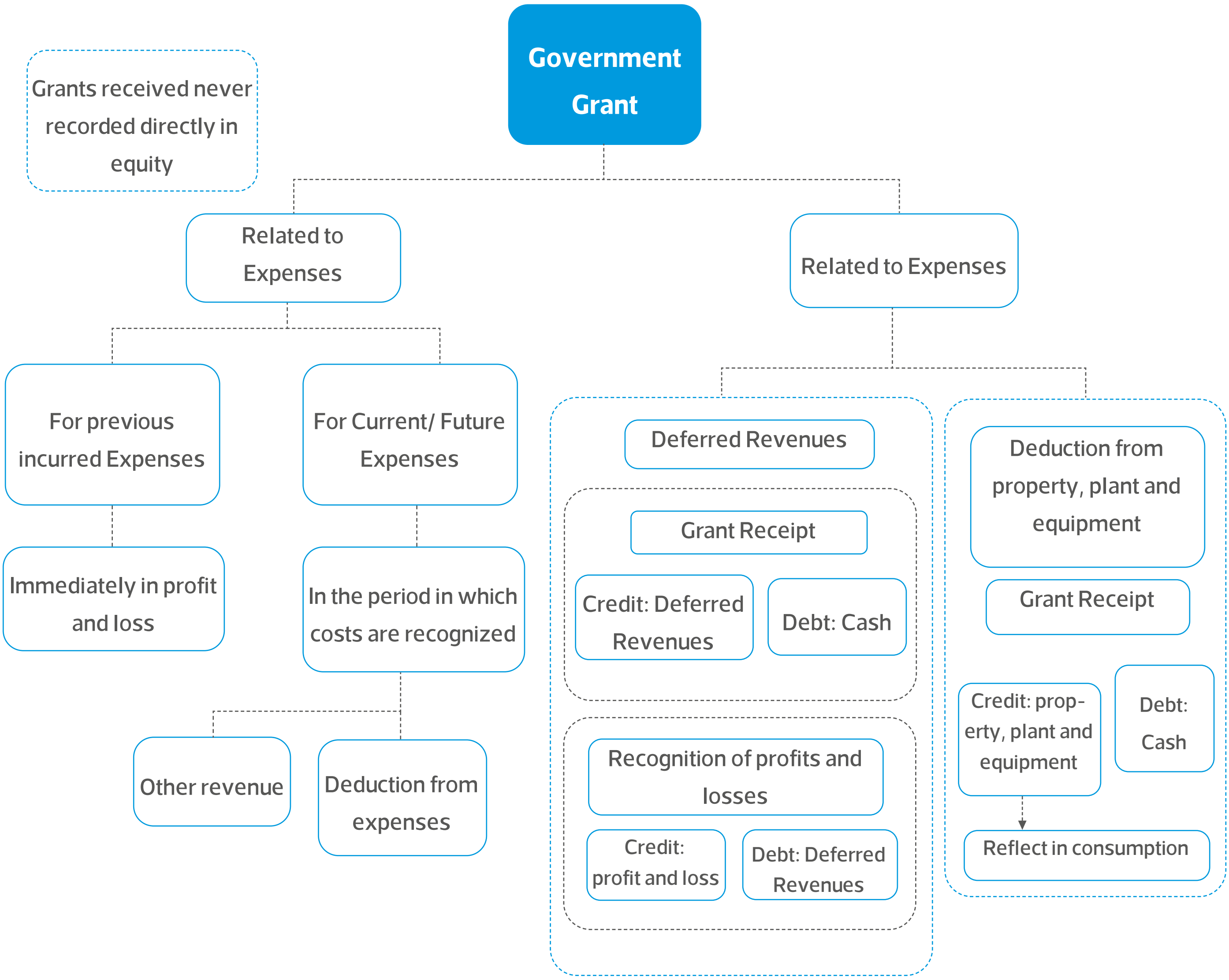
Effective Date

This Standard applies to the financial periods beginning on or after January 1, 2003

2. Recognition and Measurement Requirements

2.1 International Accounting Standard 20

2.1.1 How to calculate Government Grants



Government grants relating to assets, including non-cash grants at fair value, are presented in the financial position either by presenting the grant as deferred income or by deducting the grant to determine the book value of the asset. The options available under this Standard are:

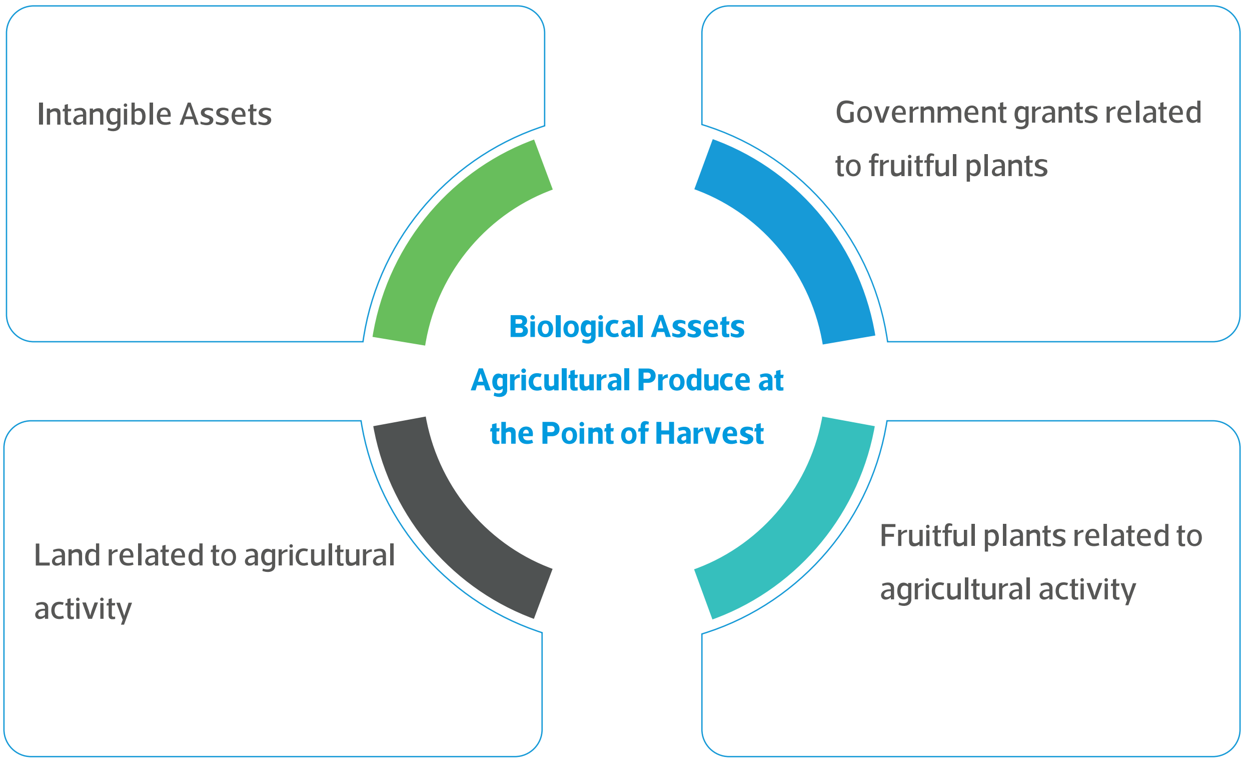
Option 1: Deferred Income

This method recognizes the grant as deferred income to be recognized in profit or loss on a regular basis over the useful life of the asset.

Option 2: Consideration of the Asset Book Value

This method deducts the grant while calculating the book value of the asset. The grant is recognized in profit or loss over the life of the depreciable asset as a reduced depreciation expense.

International Accounting Standard 14



Initial

An establishment recognizes a Biological Asset or agricultural product only when the establishment controls the asset as a result of past events. It is probable that future economic benefits associated with the asset will flow to the establishment, and the asset's .

2.1.2 Disclosure of Government Grants and Government Assistance

Government Grants

The following shall be disclosed: [IAS 20.39]

- The approved accounting policy for grants, including the financial position method
- The nature of the presentation and extent of grants defined in the financial statements
- Unfulfilled conditions and contingent obligations associated with recognized grants

Government Assistance

The grants don't include the grants which its value couldn't be reasonably measured, such as technical or marketing advice, [IAS 20.34] However, disclosure of benefits is required, [IAS 20.39(b)].

2.2 International Accounting Standard 41

2.2.1 Requirements of Initial Evidence of the Biological Asset or Agriculture Product

Measurement Requirements for the Biological Asset or Agriculture Product

Agriculture Product

Agricultural product harvested from the entity's biological assets shall be measured at its fair value less sale costs at the point of harvest. Such measurement being the cost at that date when IAS 2 "Inventory" or another applicable Standard is applied.

The gain or loss arising on initial recognition of the agricultural product at fair value less selling costs shall be recognized in profit or loss for the period in which it arises.

Biological Assets

Biological assets within the scope of IAS 41 must be measured at initial recognition and at subsequent reporting dates at the fair value less sale costs, except in the case where fair value cannot be measured reliably.

The gain or loss arising on initial recognition of a biological asset at fair value less sale costs, and those arising from a change in fair value less sale costs of a biological asset, shall be recognized in profit or loss for the period in which it arises.

2.2.2 Requirements for Recognizing Unconditional Government Grants received in connection with Biological Assets

- Unconditional government grants received in connection with biological assets measured at fair value less sale costs are recognized in profit or loss when the grant becomes receivable.
- If the grant is conditional (including when the grant requires the establishment not to engage in a particular agricultural activity), the establishment recognizes the grant in profit or loss only when these conditions are met.

3. Impact of Transition on Zakat Base

3.1 IAS 20

- The new standard allows recognition of government grants linked to assets under one of two options: Recognizing grants as revenue in the income statement (profit or loss statement or recognizing grants as a reduction in the asset value According to the two methods, there is no impact on the zakat base, including the minimum limit. As the amount of revenue recognized is linked to the useful life of the asset, and accordingly, the methods of distributing and recognizing the grant revenue will directly correspond to the amount of depreciation.
- One of the most prominent differences between the previous standard and IAS 20 for the recognition of government grants is that the previous standard, when recognizing revenue in the profit or loss statement, refers to the grant conditions. For example, in the case of loans based on the method of payment or the term of payment and is not linked to the useful life of the asset as in the new standard. However, this should not have an impact as a whole on the zakat base when looking at the affected items of the asset, deferred grant income (liability) and retained earnings along with the net profit (loss) for zakat purposes. However, in the case of calculating Zakat based on the minimum limit, and due to the difference in the timing of revenue recognition in comparison between the previous standard and the new standard, a difference will arise. Therefore, the minimum limit will be decreased in the event that the conditions of the grant will be achieved for a period shorter than the useful life of the asset and vice versa. However, this does not require an adjustment to the result of the activity if the zakat is calculated based on the minimum limit (net profit adjusted for the zakat purposes).

3.2 International Accounting Standard 41

In view of the differences between the previous standard and the practices followed before and after the transition for treatment of items under IAS 41, it is noted that these differences, whether they have a financial impact or not, will be dealt with according to the Articles of the Regulations currently in force for the purposes of calculating zakat, as follows:

- After the transition, there is an additional form that can be chosen for treatment of recognition and measurement of biological assets (fair value form). This affects the value of the asset by increasing or decreasing, but the corresponding effect will be recognized in the profit or loss statement and thus does not leave an impact on the zakat base as a whole. However, the value of the increase in the deduction as a result of the increase of the fair value will be offset by a recognition of the amount of increase in the profit or loss statement. Further, it will be subject to zakat in line with the provisions of the sixth paragraph of Article (6) of the Executive Regulations for the Levying Zakat.

- Regarding the maintenance costs, according to common practices before the transmission, they were recognized within the inventory items and will be transferred to an expense upon sale. After the transmission, there is an immediate necessary to recognize this expense within the statement of profit or loss. Based on the foregoing, it is noted that there is a difference between the timing of the recognition of the expense. However, this does not require an adjustment to the purposes of Zakat, based on the procedural verification in terms of the permissibility of deducting the expense, and accordingly verifying the possibility of modifying the result of the activity, in accordance with the provisions of the Regulations.

4. Theoretical Applications showing Effect of Transition on the Zakat Base

4.1 International Accounting Standard 20

Example 1 - Property investment-related grants:

A grant of SAR 40,000 to purchase a packaging machine, the cost of the machine is SAR 100,000 and its useful life is 8 years. The entity acquired the plant on January 1, 2012 AD, so that it is depreciated on a monthly straight-line basis.

According to the above example, the entity has two options for recognizing the grant either on the basis of deferred income or on the basis of withholding as described below:

Option 1: Deferred Income
The entity can approve the grant on the basis of deferred income and amortize it over the useful life of the machine in order to match the grant income to the relevant costs, which in this case are the depreciation value.

In 2012, the entity recognizes SAR 5,000 as income in profit or loss (calculated as a grant of SAR 40,000 divided over 8 years).

Description	Value	Debit	Credit
Grant Receipt	40,000	Statement of financial position - cash or bank account	Statement of financial position - deferred in-come
Recognition of profit and loss in 2012 AD	5,000 (40,000/8)	Statement of financial position - deferred income	Profit and Loss - Income from Government Grants

Option 2: Withholding

The entity can withhold the grant amount to reach the book value of the machine, then its recognition is reflected in the profit or loss automatically from the depreciation value.

Subsequently, the new book value of the machine upon initial recognition is SAR 60,000 (cost SAR 100,000 minus SAR 40,000) and the annual depreciation cost is SAR 7,500 (SAR 60,000 divided by 8) instead of SAR 12,500 (SAR 100,000 divided by 8).

Description	Value	Debit	Credit
Grant receipt (to be directly deducted from the relevant asset)	40,000	Statement of financial position - cash or bank account	Statement of financial position - property, machinery and equipment (packaging machine)
Recognition of profit and loss in 2012 AD (in the depreciation value)	7,500 (60,000/8)	Profit and loss - packaging machine depreciation	Statement of financial position - property, machinery and equipment (packaging machine) - accumulated depreciation

Zakat Handling according to Option 1 for Handling of Government Grants related to Assets:

Description	First Year	Second Year	Third Year	Fourth Year	Fifth Year	Sixth Year	Seventh Year	Eighth Year	Ninth Year
Profit or loss (grant income transferred to profit or loss)	5.000	5.000	5.000	5.000	5.000	5.000	5.000	5.000	-
Machine depreciation expense	(12,500)	(12,500)	(12,500)	(12,500)	(12,500)	(12,500)	(12,500)	(12,500)	-
Net effect on the base minimum	(7,500)	(7,500)	(7,500)	(7,500)	(7,500)	(7,500)	(7,500)	(7,500)	-
Deductions from the zakat base									
Deduct: net assets (book value of the machine)	(87,500)	(75,000)	(62,500)	(50,000)	(37,500)	(25,000)	(12,500)	-	-
Added: balance of deferred income that were financed deductible	35,000	30,000	25,000	20,000	15,000	10,000	5,000	-	-
Added: effect on recycled earnings		(7,500)	(15,000)	(22,500)	(30,000)	(37,500)	(45,000)	(52,500)	(60,000)
Total effect	**(60,000)**	**(60,000)**	**(60,000)**	**(60,000)**	**(60,000)**	**(60,000)**	**(60,000)**	**(60,000)**	**(60,000)**

Zakat Handling according to Option 2 for Handling of Government Grants related to Assets:

Description	First Year	Second Year	Third Year	Fourth Year	Fifth Year	Sixth Year	Seventh Year	Eighth Year	Ninth Year
Machine depreciation expense (after adjusting the asset value in the grant)	(7,500)	(7,500)	(7,500)	(7,500)	(7,500)	(7,500)	(7,500)	(7,500)	-
Net effect on the base minimum	(7,500)	(7,500)	(7,500)	(7,500)	(7,500)	(7,500)	(7,500)	(7,500)	-
Deductions from the zakat base								-	-
Deduct: net assets (book value of the machine)	(52,000)	(45,000)	(37,500)	(30,000)	(22,500)	(15,000)	(7,500)	-	-
Added: effect on recycled earnings	-	(7,500)	(15,000)	(22,500)	(30,000)	(37,500)	(45,500)	(52,500)	(60,000)
Total effect	**(60,000)**	**(60,000)**	**(60,000)**	**(60,000)**	**(60,000)**	**(60,000)**	**(60,000)**	**(60,000)**	**(60,000)**

It is noted from the above example that:

1. International standards allow the use of one of two methods for recognizing grants related to assets, either as deferred income or by reducing them from the asset account.
2. In view of the zakat handling, there is no effect on the zakat base, including the minimum.
3. There is no difference in both ways of recognizing the grant on the base.

Example 2 - Government Assistance:

A grant of SAR 10,000 to pay the employees' salaries during 2012-2015 AD, based on the assumption that the entity will spend SAR 3,000 annually for 2012, 2013 and 2014, and SAR 5,000 in 2015 (i.e. total of SAR 14,000 for four years).

This grant covers current and future salary expenses, and the entity needs to recognize income from the grant in the periods in which the relevant expenses are incurred. Accordingly, the income from the grant for 2012 is recognized in the statement of profit and loss on a pro rata basis as follows:

(SAR 3,000 for 2012 salaries) ÷ (total assumed expenses of SAR 14,000) x (grant amount SAR 10,000).

The accounting handling is shown below:

Description	Value	Debit	Credit
Grant Receipt	10,000	Statement of financial position - cash or bank account	Statement of financial position - deferred income
Recognition of profit and loss in 2012 AD	2,143 (3,000 ÷ 14,000×10,000)	Statement of financial position - deferred income	Profit and loss - income from government grants (or relevant expenses)

Zakat Handling:

- It is noted that the recognition of the grant as income is associated with the expenses incurred by the entity in each year until 2015 AD. Accordingly, the grant income will be subject to zakat (as part of the minimum), which is reflected on profits and losses in accordance with the distribution mechanism recognized in the standard.
- The balance of the grant liability is added to the zakat base as part of the additions in accordance with Article (4/3) of the Executive Regulations for the Collection of Zakat.

In light of the foregoing, the zakat handling can be summarized as follows:

Description	2012	2013	2014	2015
Grant income subject to zakat as part of the minimum (net profit for zakat purposes)	2,143	2,143	2,143	2,143
Adding the grant liability to the zakat base	7,857	5,714	3,571	-

Example 3 - Interest-free Loan from Government Entity:

Entity "A" obtains an interest-free loan of SAR 1,000 from a local government entity with a guarantee that the entity will invest in new equipment in its manufacturing plant. The loan is repayable after five years and interest-free. Entity "A" can withdraw the loan upon recognition that it incurred expenses of equipping property, machinery and equipment.

On initial recognition, the market interest rate for a similar five-year loan is 10% per annum. The initial fair value of the loan is the current value of the future payment of SAR 1,000, deducted using the market interest rate of a similar loan of 10% for five years, which is equivalent to SAR 621.

The government incentive for entity "A" to invest in its plant is SAR 379 and the difference between the total consideration received is SAR 1,000 and the initial fair value of the loan is SAR 621, and this difference is treated as a government grant.

Zakat Handling:

The fact that the preceding case is recognized as a government grant, it must be emphasized that the zakat handling for this grant is summarized as follows:

- The grant balance is added to the zakat base, recognized as a liability in the statement of financial position
- The liability that is reflected on profits and losses remains within the minimum base and is subject to zakat without adjustment

4.2 International Accounting Standard 41

First Example:

An entity has these balances in its financial records:

	One Million Saudi Riyals
Value of biological assets at cost on December 31, 2011 AD	600
Fair value surplus on initial recognition at fair value December 31, 2011 AD	700
Change in fair value to December 31, 2012 AD due to growth and price fluctuations	100
Change in fair value to December 31, 2012 AD due to growth and price fluctuations	90

Required Action:

Showing how these values will be included in the financial statements on December 31, 2012 AD.

Solution:

Statement of Financial Position (December 31, 2012 AD)	One Million Saudi Riyals
Biological Assets	600
Fair value assessment (included in profit or loss for the year ended December 31, 2011 AD)	700
Book value on January 1, 2012 AD	1,300
Change in fair value	100
Decrease due to the harvest	(90)
Book value on December 31, 2012 AD	1,310
Income Statement for the Year Ended (December 31, 2012 AD)	**One Million Saudi Riyals**
Change of biological assets in fair value	100
Decrease due to the harvest	(90)
Net profit	10

Solution (Continued):

Zakat Handling:

Year 2011 AD	One Million Saudi Riyals
Deduct: The value appearing in the financial statements after the re-valuation of the biological assets and deducted from the zakat base.	(1,300)
Not adjusting the change in fair value recognized in profit or loss.	700
Net effect	(600)
Year 2012 AD	**One Million Saudi Riyals**
Deduct: The value appearing in the financial statements after the re-valuation of the biological assets and deducted from the zakat base.	(1,310)
Not adjusting the change in fair value recognized in profit or loss.	10
Net effect	(1,300)

Example 2:

Examples of biological assets (including potential fruitful plants), agricultural products and products of post-harvest processing:

Biological Assets that may meet the Definition of Fruitful Plant	Biological Assets (including the Product grown on Fruitful Plants) (IAS 41)	Agricultural Product (IAS 41)	Products that are the Result of Post-harvest Processing (IAS 2)
	Sheep	Wool	Spinning, Carpet
	Trees in a timber farm	Cut trees	Boards, sawdust
	Dairy Cattle	Milk	Cheese
	Cows	Slaughtered Animals	Sausage, processed beef
Cotton Plants	Harvested cotton	Harvested Cotton	Threads and clothes
Sugarcane root	Fruitful sugarcane	Harvested Cotton	Sugar
Rubber trees	Latex	Harvested tree sap	Rubber products
Tea bushes	Leaves on tea bushes	Cut leaves	Tea
Grape vines	Grapes on the tree	Harvested grapes	Juice
Fruit trees	Fruit on trees	Harvested fruit	Processed fruit
Oil palms	Fruit cultivation	Harvested fruit	Palm Oil

Note: Some plants, for example, tea bushes, grapes, oil palms and rubber trees, usually meet the definition of a fruitful plant and fall within the scope of IAS 16. However, a product grown on fruitful plants, for example, tea leaves, grapes, oil palm fruit and tree sap, falls within the scope of IAS 41.

In view of the categories that fall under IAS 41 and mentioned in the preceding slide, the zakat handling of these items in accordance with Article (5) of the Executive Regulations for the Collection of Zakat is summarized as follows:

Category	Zakat Handling
Biological assets that meet the definition of a fruitful plant	Eligible to be deductible
Biological assets (including the product grown on fruitful plants)	Eligible to be deductible
Agriculture Product	Not eligible to be deductible
Products that are the result of post-harvest processing	Not eligible to be deductible

External document

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