

Estimated Taxation Method in the Saudi Income Tax Law

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Abstract

The thesis delves into the complex realm of the Estimated Taxation Method within the Saudi Income Tax Law, offering a comprehensive analysis of this crucial aspect of taxation. The study aims to fill a significant gap in the existing literature by providing a detailed examination of the legal framework surrounding estimated taxation and the challenges faced by taxpayers in Saudi Arabia. Through a meticulous review of primary and secondary sources, including law review articles and academic documents, the thesis employs deductive reasoning to scrutinize the regulatory framework governing estimated taxation. By focusing on the specific context of Saudi Arabia, the research sheds light on the uncertainties and ambiguities introduced by the expansive discretion granted to the tax authority in imposing estimated taxation. The significance of this study extends beyond academic discourse, as it aims to provide valuable insights for foreign investors considering investments in the Kingdom of Saudi Arabia. It gives a preamble to foreigners seeking to invest in the fast-growing economy of Saudi Arabia. In other words, the research seeks to enhance clarity, consistency, and adequacy in the regulatory framework governing taxation. It achieves this by offering a nuanced understanding of the Estimated Taxation Method and its implications for taxpayers. Overall, this thesis contributes to the ongoing dialogue on tax laws and income tax, emphasizing the need for a well-defined regulatory framework that balances the interests of taxpayers and the tax authority. In sum, by addressing a novel aspect of taxation not

previously explored in published research, this study enriches the understanding of tax policies and their impact on economic activities in Saudi Arabia.

Keywords: Estimated Taxation Method, Saudi Income Tax Law, Saudi Arabia Taxpayers, Regulatory Framework, Taxation Practice.

1. Background of the Research

Taxes, throughout the ages, have represented a significant financial resource for the states. However, their importance has increased in contemporary times due to the expanding role of the state in economic activities, social conditions, and political affairs. Taxes are levied on the wealth of both natural and legal persons for the benefit of the state. Several theories contribute to the legal basis of taxation, including the general obligation and social solidarity theory.

Imposing taxes allows the states to play a crucial role in economic, social, and political life. It enables the financing of public expenditures that benefit both citizens and residents. Moreover, the government utilizes taxation as a tool within its financial policies to control economic activities. As citizens and residents benefit from public expenditures, taxation emerges as a vital instrument for governments to wield influence over economic activities.

The state's intervention in economic, social, and political activities varies from one country to another based on its internal regulations and domestic affairs. This diversity justifies the differences observed in the tax structures among states. Some countries emphasize direct taxes, while others focus on indirect taxes. However, virtually no tax system relies exclusively on one type, considering that each complements the other.

It is noteworthy that advanced countries tend to rely more on direct taxes, whereas developing countries lean towards indirect taxes, aiming to alleviate the burden on

their citizens. Direct taxes refer to taxes directly borne by the taxpayer and can not be shifted to another person. The Income tax is one of the direct taxes.

Saudi Arabia, according to its Vision 2030, is aiming to diversify its income sources, particularly by enhancing non-oil revenue. One of the main types of tax applied in KSA is Income Tax. The primary concept of the law is to tax the income accrued in KSA for non-Saudi taxpayers. Therefore, taxpayers are obliged to file a tax declaration with the Zakat, Tax, and Customs Authority, the government body responsible for collecting and managing taxes.

The law provides two main methods for calculating tax for taxpayers: one for those who maintain commercial books and another for those who do not. In certain instances, ZATCA may employ an estimated taxation method to determine the tax base for specific taxpayers. Given the limited studies on income tax, it is evident that there is a need for a comprehensive examination, clarification, and identification of this estimated taxation methodology. Additionally, exploring the circumstances of the application of estimated taxation and its scope is crucial. This includes investigating whether there are distinctions between large, medium, and small enterprises and determining whether the methodology remains consistent or undergoes variations.

A similar process exists in the Zakat system. The estimated way to calculate estimated Zakat is clear, with specific rules. However, when it comes to Income Tax, there appears to be some lack of clarity in the methodology and method of calculating estimated taxation. Therefore, the thesis attempts to study this issue, the current treatment of the estimated taxation, and whether there is a way to recommend and develop some suggestions.

2. Statement of Problem

Taxes are pivotal in economic management, influencing consumer behavior and investment decisions. Therefore, it is imperative to ensure that tax-related laws are clear and consistent, especially for foreign investors who scrutinize the legal frameworks of host countries. In Saudi Arabia, direct taxes are governed by two key laws: the Zakat Collection Law for Saudis and the Income Tax Law for non-Saudis. While the calculation methods for taxpayers maintaining commercial books and for estimated Zakat are well-defined, the methodology for estimated taxation lacks clarity and uniformity. The approach to calculating these taxes is ambiguous as the uniformity is sometimes tweaked to accommodate prevailing situations. This inconsistency leaves many economic activities without specified tax rates. It is also problematic as ZATCA is permitted to use estimation without clear guidelines on methodology and conditions.

The current ambiguity surrounding Estimated Taxation in the Income Tax Law poses risks and uncertainties for foreign investors, potentially impacting companies and the overall economy. There is a critical need for a comprehensive understanding of the existing challenges and potential improvements to address this regulatory gap and enhance investor protection. The legal framework can be strengthened to provide taxpayers and investors with a more transparent and predictable environment. Such can be achieved by clarifying the methodology and conditions for estimating the tax base. Therefore, this study aims to explore and propose developmental enhancements to the current legal framework. In doing so, it aims to mitigate risks, promote clarity, and foster a conducive business environment in Saudi Arabia.

3. Research Hypothesis

Financial obligations hold paramount importance, particularly for foreign investors. Consequently, the regulatory framework governing taxes should be unequivocal and

well-defined, with a specific emphasis on curtailing the unchecked discretionary authority wielded by the governing body over taxpayers.

The expansive discretion afforded to ZATCA in imposing estimated taxation introduces uncertainty and ambiguity in the application of provisions, thereby posing potential risks to the financial positions of taxpayers.

4. Research Objectives

The research aims to:

1. Identify the criteria and scope governing the application of estimated taxation in the Saudi Income Tax Law.
2. Analyse the existing gaps and challenges present in the regulatory framework of estimated taxation.
3. Explore and propose strategies to reform the current regulatory framework of estimated taxation to enhance clarity, consistency, and adequacy, aiming to improve the business environment and investor protection in Saudi Arabia.

5. The Importance of the Research

This research proposed holds significant importance in multiple aspects. Firstly, it offers an in-depth examination of the legal framework surrounding the Estimated Taxation Method in Saudi Income Tax law. Additionally, the research focuses on identifying and analysing the challenges and potential risks faced by taxpayers. These insights are crucial for foreign investors, providing them with the necessary information to make informed decisions regarding the feasibility of their investments.

This research holds academic significance as there are limited studies on income tax in the broader tax field, especially in income tax specifically. Without a doubt, no

existing study or book thoroughly explores my thesis topic. Therefore, this research aims to contribute to the academic discussion on tax laws and income tax.

6. Scope and Limitation of the Research

The primary constraint lies in its geographic scope, with the findings and conclusions specifically tailored to the context of Saudi Arabia. This research proposal aims to investigate the Estimated Taxation Method in the Saudi Income Tax Law, structuring the inquiry around three key aspects.

Firstly, an examination of the legal framework and features of the Estimated Taxation Method will be conducted, offering a detailed analysis of the regulatory and legal landscape governing it. This includes a comparative analysis with the same method in the ZAKAT law. Secondly, the research will delve into the challenges faced by taxpayers when the Estimated Taxation Method is applied. Lastly, the research will present a suggested vision to reform the current regulatory framework of estimated taxation, aiming to enhance clarity and consistency.

During my research, I anticipate encountering certain challenges. While I have identified a comprehensive literature review that will serve as a robust reference, obtaining sufficient data on Saudi income law may be a potential challenge. This is particularly pronounced in the case of ZATCA's internal policies, which are implemented but not publicly disclosed.

7. Conceptual Framework and Scope

The Kingdom of Saudi Arabia has adopted the Income Tax Law, Issued by Royal Decree No. M/68 dated 18/11/1431 H, which considered. The law and its regulations are considered the legal framework that govern the Income tax.

Based on the above, the main focus will be on the Law and its regulation; as they regulate the Estimated Taxation Method, and the terms used within the research shall

be defined as per the law and Regulation, unless otherwise mentioned. To go on board with this research, it is essential to discuss some of the terms and concepts tackled by the law and Regulation.

The following terms and phrases shall mean the description beside each of them according to the regulation, or according to the context of the research:

“**ZATCA**”: Zakat Tax, and Customs Authority.

“**Law**”: The Saudi Income Tax Law, Issued by Royal Decree No. M/68 dated 18/11/1431 H.

“**Regulations**”: The Implementing regulation of the law, issued by ministerial resolution No. 1535 dated 11/06/1425 H.

“**Taxpayers**”: Any person subject to Tax, in accordance with the law.

8. Literature Review

In the realm of income tax law within Saudi Arabia, several significant studies have contributed to understanding legislative provisions, tax principles, and the practical application of tax laws. One notable work is “The Determinants of Tax Compliance Intention in a Rentier Economy: The Case of SMEs in Saudi Arabia” by Abdullah Alghamdi. The doctoral thesis stands as a comprehensive and systematic overview of income tax law in the country. Alghamdi's work is particularly valuable due to his first-hand experience and involvement in researching tax regimes in Saudi jurisprudence. The study delves into dispute-settling mechanisms between taxpayers and ZATCA, the government authority responsible for tax collection. The thesis covers a wide range of income tax aspects, offering insights enriched by practical knowledge and real-world scenarios. Therefore, it contributes immensely to this study by offering a foundation for understanding the scope and applicability of the Saudi Arabian tax regimes.

Another noteworthy contribution to the field is Munir Ahmad's manuscript "Business and Tax Planning Considerations for Investment in Saudi Arabia." The author delves deeply into various facets of income tax, specifically focusing on its application to companies and businesses. The study explores tax principles, taxable entities, and exemptions. The various tax calculation methods and settlement scenarios vital to this current study are also found in Munir's work. The study contributes to closing the gap of ambiguities in the Saudi tax regime by thoroughly examining the complexities within the Saudi income tax system. While Munir's work offers valuable insights into income tax laws, it primarily focuses on the broader aspects of taxation. This means it may not delve extensively into specific areas, such as the Estimated Taxation Method, as intended by this study.

On the topic of taxation in Saudi laws, Altawyan Ahmed's 2022 study titled "Analysis of the Application of Income Tax Law to Income Generated Overseas by Capital Companies Located in the Kingdom of Saudi Arabia" sheds light on the concept of income tax applicable to capital companies. This study explores various tax types, distinctions between taxes on natural and legal persons, tax bases, and fundamental principles of tax imposition. The scholar provides foundational insights into the taxation of companies in Saudi Arabia. The study contributes to the larger scholarship on the Saudi tax system by offering a detailed examination of the legal framework governing corporate taxation. However, while this study contributes significantly to understanding tax laws, it may fail to address the specific gaps and challenges related to the Estimated Taxation Method identified in the current research problem.

Furthermore, understanding the legal foundation of the Saudi tax system and its underlying implications offers significant sagacity in exploring the topic of the Estimated Taxation Method. Another study shedding light on this aspect is Michael Leavitt's "Establishing an Enterprise in Saudi Arabia: A Focus on a Joint Limited

Liability Partnership, Contract Negotiating, Labor Laws, and Income Tax Consequences for Non-Saudis.” It goes deep into the legal guarantees provided to taxpayers within the Saudi tax system. This study addresses the inherent asymmetry in the relationship between governmental authorities and taxpayers. In doing so, the author highlighted the need to understand the rights and protections afforded to taxpayers. Michael's work offers valuable insights into the legal framework surrounding taxpayer rights. However, the scholar fails to tackle the challenges and uncertainty of the individual taxation method, making this study partial in offering background to the current research.

Moreover, Althunayan's 2020 study, “Tax and Religion: Saudi Arabia Tax System,” offers a comparative analysis of the provisions within the Saudi Income Tax Law and Islamic law. By examining the rights and obligations of taxpayers in their interactions with ZATCA, Althunayan's work provides a nuanced understanding of the legal framework governing taxation in Saudi Arabia. While this study sheds light on the rights and responsibilities of taxpayers, it ignores the specific challenges that clash between the two guiding frameworks of the Saudi tax regime. It also inadequately addresses the need for reform within the regulatory framework, which would make it align with the current research.

A different study offers a divergent perspective on the convergence of tax reporting regulations and their corresponding Sharia origins. Noor et al.'s “Zakat and Tax Reporting: Disclosures Practices of Shariah Compliance Companies” explores the accounting perspective of the Zakat base and its calculation. The study further compares results with Islamic law. This study offers insights into the intersection of Islamic principles and taxation practices in Saudi Arabia, providing a unique perspective on the calculation of taxes for companies. Although the scholars' work contributes to understanding the religious and cultural dimensions of taxation, it may not delve deeply into the technical aspects of the Estimated Taxation Method. It also

fails to discuss the implications of such intersections for taxpayers and regulatory authorities.

In the context of the tax methodologies and Saudi accounting standards, Nurunnabi Mohammad offers a compelling study titled “IFRS and Saudi accounting standards: A critical investigation.” Nurunnabi provides a detailed examination of various facets of income tax, including perspectives on tax imposition, exemptions, relief taxation cases, and tax calculation methods. The study further explores the possible settlement scenarios in line with the accounting standards as sources of tax system guidance. The scholar’s work offers a comprehensive analysis of income tax laws in Saudi Arabia, laying the groundwork for understanding the complexities of taxation for companies. Nonetheless, while Nurunnabi's study provides a valuable probe into income tax practices, it does not highlight how such accounting standard guidelines affect the various taxation methods. This creates the need to examine the specifics like in the current study.

Building upon the existing literature, the current research aims to fill the gaps in knowledge by focusing on the Estimated Taxation Method and its implications for taxpayers and regulatory authorities in Saudi Arabia. By examining the challenges and potential risks faced by taxpayers, the study seeks to provide a deeper understanding of the practical implications of the Estimated Taxation Method. It will then offer recommendations for enhancing clarity and consistency within the regulatory framework. The significance of this research lies in its potential to contribute to the academic discussion on tax laws and income tax, particularly within the context of the Estimated Taxation Method in Saudi Arabia. The research aims to provide valuable insights for foreign investors considering investments in the Kingdom of Saudi Arabia. It intends to achieve this by addressing the gaps in the existing literature and offering a detailed analysis of the regulatory framework.

In conclusion, the literature review highlights the diverse range of studies that have contributed to understanding income tax laws in Saudi Arabia. While these studies offer valuable insights into various aspects of taxation, there remains a need for further research to address the specific challenges and uncertainties associated with the Estimated Taxation Method. Undoubtedly, the studies mentioned above have significantly contributed to understanding income tax laws in Saudi Arabia. However, their shortcomings indicate the need for a more in-depth exploration of the Estimated Taxation Method. The current research aims to bridge this gap by comprehensively analyzing the Estimated Taxation Method and its implications for taxpayers and regulatory authorities. In doing so, the current study ultimately contributes to the advancement of knowledge in the field of tax law in Saudi Arabia.

9. Research Methodology

The research primarily applies a doctrinal legal methodology to Identify and assess the current estimated taxation in the Saudi Income Tax Law. Doctrinal research involves analysing legal propositions by examining statutory provisions and case laws using logic and reasoning. It contributes to the creation of law through legal reasoning and rational deductions, with a focus on authoritative sources for validation. Furthermore, it helps to understand the law in a better way as it offers logical exposition and analysis of such a law. Such an analysis also reveals a consistency in, and uncertainty of the law, and legal principles.

Also, it will utilize an analytical and comparative approach to assess and go into further detail regarding the current estimated taxation method. The chosen analytical approach evaluates the fundamentals, conceptual problems, and practical effects of the legal framework to identify gaps and opportunities for improvement. This method ensures a comprehensive examination of the law by combining the analysis of primary legal sources with an analytical perspective. Within the scope of this study,

national regulatory framework, legislation, laws, regulations, and the like will be investigated. Moreover, the research will compare Income tax with the Zakat system.

The researcher will utilize primary sources, including official legislation, regulations, articles, and online journals for consultation in this research. Primary resources offer a direct understanding of the legal framework and its practical applications, including:

1. The Income Tax Law and any related laws or regulations applicable in the Kingdom of Saudi Arabia.
2. The new draft of the Income Tax Law published in ISTITLA.
3. Case law and judgments issued by the court (s) in Saudi Arabia.

Also, secondary sources will be used, such as academic documents, including law review articles, papers, and books, that offer crucial background information, analysis, and perspectives which will improve the understanding of the primary sources. The secondary sources will be used along with relevant literature to employ deductive reasoning in examining the current regulatory frame of the estimated taxation.

10. Steps Forward and Conclusion

The criterion for resorting to the estimation method is either due to the inability to ascertain the tax base or the taxpayer's non-compliance with legal requirements leading to their punitive treatment through the application of the estimation method.

The current methodology faces various challenges that necessitate reform. To address these challenges effectively, the proposed methodology should differentiate between micro and small enterprises (MSEs) and medium to large enterprises (MLEs) when determining the tax base.

For MSEs, direct handling of tax calculations by the tax authority is recommended, eliminating the need for SMEs to file tax returns. Additionally, calculations should be based on sales rather than profits, aligning with the Commercial Books Law, which exempts MSEs with capital below a certain threshold from bookkeeping obligations.

Moreover, the determining tax base is a critical aspect that requires careful consideration. To establish the tax base accurately, reliance on sales or revenues reported in the taxpayer's VAT returns is advised. This approach provides a minimum baseline for determining the tax base. Any adjustments made by the tax authority should require them to provide evidence to support their decisions.

Furthermore, the distinction between MSEs and MLEs is crucial for equitable tax treatment. For MSEs, net profit rates should be determined based on periodic economic studies specific to each business sector, reflecting the average net profit within that sector. Conversely, in cases where MLEs fail to comply with tax obligations, such as timely filing of tax returns or maintaining accurate records, the tax authority may apply the estimated method as a punitive measure against tax evasion.

Consequently, net profit rates for MLEs should exceed the standard rates for MSEs, reflecting the punitive nature of enforcement actions. These measures aim to ensure fairness and efficiency in the taxation system, promoting compliance while deterring tax evasion.

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