TAX ALERT

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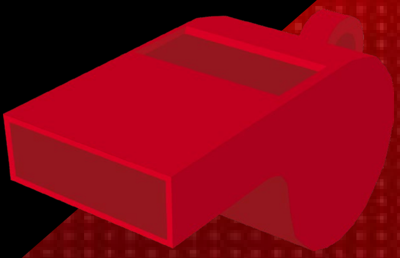

New Zakat Regulations in KSA

Introduction

The new Zakat regulations introduced in March 2024 represent a significant shift in the Zakat landscape in Saudi Arabia. It features several key changes that differ from the earlier regulations, these regulations mark a significant shift in how businesses are taxed, offering detailed guidance on Zakat calculation, exemptions, and compliance requirements.

Effective Date

The new regulations are mandatory from the fiscal year 2024. However, Zakat payer can opt to apply these rules to the 2023 fiscal year subject to specific conditions and if they submit a request within 60 days from March 22, 2024.

Exemptions for Non- Profit Companies

Non-profit companies and entities wholly owned by them are now exempt from Zakat collection, provided spendings on specific purposes do not exceed 10% of the company's revenues and are in line with their articles of incorporation. Further, expenses must be verified through audited financial statements or an accepted report from a licensed accountant in the Kingdom.

Cessation of Business Activities

- **Permanent vs. Temporary Suspension:** If a Zakat payer permanently ceases operations and notifies the authority within 60 days, Zakat collection stops. In contrast, Zakat continues for ongoing activities or temporarily suspended operations. The authority may set a different cessation date if sufficient evidence is provided.

- If the Zakat Payer stops some activities but continues others, Zakat collection will still apply to the ongoing activities.

- The Authority can set a new cessation date if the Zakat Payer provides sufficient proof.

Merge and Acquisition

For mergers creating a new entity, Zakat is calculated based on the fiscal year specified in the new entity's incorporation documents. Zakat calculations will be based on either one or two years (Hijri or Gregorian) depending on the length of the fiscal year. For mergers without forming a new entity, the acquiring Zakat payer continues the Zakat year from the date of the last declaration. Zakat does not apply to fiscal periods shorter than 354 days.

Financial Statement Reliance

Zakat calculations must now rely on the values appearing in financial statements at the end of the Zakat payer's Zakat year regardless of the origin date of the item.

Provisions and Liabilities

Provisions are treated as ownership rights and are added to the cash balance at the end of the Zakat year, except for certain items such as end-of-service benefits and annual leave allowances, which are treated as non-current liabilities. Zakat treatment of provisions varies by activity. Provisions related to accrued assets are handled differently, with some treated as non-current liabilities. The end-of-period balance is assessed based on its link to ownership rights or liabilities.

ZAKAT Computation New Vs Old rules

Old Regulation

Adjusted Net Profit = Net Accounting Income (or Loss) ± Adjustments (i.e., ± Provisions Allocated to Period Accounts ± Other Relevant Adjustments)

New Regulation

Zakat Base = Difference between book net profit and adjusted net profit+ Equity and the likes+ Non-current liabilities – Deductions

Let us dive deeper into the formula under new regulations

Equity and the likes:

Add – Closing balance of	Deduct – Closing balance of
Provisions (except End of Service Benefits and Statutory Vacation), Shareholder credit loans (under conditions), Realized and unrealized profit, Authorized profits for distribution, Retained Earnings and Reserves	Treasury stocks, Carried forward losses, Employee Equity stakes program, & Retained Losses.

Non- Current Liabilities

Closing balance of - Debts (Non-Current), Deferred tax liabilities, Contract liabilities (non-current), Provisions that represent a confirmed debt to non-shareholders, Negative derivative financial instruments (non-current), Shareholder credit loans (under certain conditions), Lease liabilities (non-current), End of Service Benefits provisions and employee-related provisions.

Current liabilities should not be included in the Zakat base unless a current asset is offset, in proportion as specified in Article 25 (see para on 'Attribution of Added Liabilities to Zakat Base'), or if ZATCA determines that a current liability is of a non-current nature.

Zakat Base Deduction:

- Raw materials not a part of the final product
- Non-saleable materials (e.g., spare parts)
- Deferred tax asset
- Shareholder debit loan (under certain conditions)
- Non-government Sukuk and bonds (under certain conditions)
- Investment in KSA (under certain conditions)
- Net fixed assets and intangible assets
- Employees Housing Support Program (under certain conditions)
- Assets under BOT, BOOT, BOO and AOT contracts (under certain conditions)
- Capital constructions and projects under construction (not intended for sale)
- Investment in funds (under certain conditions)
- Statutory Deposits and their equivalents
- Contract Cost (classified as Non-current)
- Right of Use Assets (for lessee)
- Investment properties (non-current and not held for sale)
- Late Government Receivables (under certain conditions) as prescribed in OECD guidelines.

Attribution of Added Liabilities to Zakat Base

Article 25 of the regulation details the concept of "attribution of added liabilities to the Zakat base", where the addition of liabilities to the Zakat base is adjusted when deducting a current asset or when not deducting a non-current asset.

- **Proportion attributable to a deductible current asset:** Ratio of the deductible current assets to the total current assets is applied to the current liabilities to arrive at the amount of current liabilities eligible to be added to the Zakat base.

- **Example:**

Description	Amount (SAR)
Current Asset	8,000,000
Total Current Assets	40,000,000
Total Current Liabilities	30,000,000

Zakat Treatment:
Proportion of Deducted Current Assets to Total Current Assets
= 8,000,000/40,000,000×100% = 20%

Current Liabilities Added to the Zakat Base: 30,000,000×20% = 6,000,000

- **Proportion attributable to a non-deductible current asset:** Ratio of the non-deductible current assets to the total Non-current assets is applied to the Non- current liabilities to arrive at the amount of Non- current liabilities which is not eligible to be added to the Zakat base.

- **Example:**

Description	Amount (SAR)
Current Asset	8,000,000
Total Non- Current Assets	40,000,000
Total Non- Current Liabilities	30,000,000

Zakat Treatment:
Proportion of excluded non-current assets to total current assets
= 8,000,000/40,000,000×100% = 20%

Non-Current liabilities not eligible to be added to Zakat base= 30,000,000×20% = 6,000,000

Non-Current liabilities eligible to be deducted = (30,000,000-6,000,000) = 24,000,000

Limitations: Ensure that the total additions or exclusions from liabilities do not exceed the value deducted from assets, according to the rules of addition and the minimum Zakat base.

The above calculation of Zakat base is subject to a minimum and maximum cap.

Minimum Zakat Base

Article 27 specifies that the minimum Zakat base which is determined based on the following:

Adjusted Net Profit vs. Zakat Base: If the calculated Zakat base is lower than what would be the adjusted net profit, follow these rules:

- if Non-deducted Assets + The difference between adjusted net profit and book Profit (the difference) < Adjusted Net Profit:

Zakat Base Calculation: Use the total non-deducted assets plus the difference between adjusted net profit and net book profit as the Zakat base.

- If Adjusted Net Profit < Non-deducted Assets + The difference:

Zakat Base Calculation: Use the adjusted net profit as the Zakat base.

Negative Results:
No Adjusted Net Profit: If the Zakat payer's results are negative and they don't have an adjusted net profit, there is no Zakat base to calculate. Essentially, no Zakat is due.

Positive Results Without Amended Net Profit:
Positive Base Calculation: If the Zakat payer's results are positive but they don't have an adjusted net profit, use the Zakat base (as calculated) directly to determine the Zakat due.

Example:

Description	Amount (SAR)
Adjusted Net Profit	150,000
Non – Deductible Assets	100,000
Book Profit	120,000

Difference between Adjusted Net Profit and Book Profit: SAR150,000 – SAR 120,000 = **SAR 30,000**

Calculation Steps:

Determine the Zakat Base:
Compare Non-Deducted Assets and Adjusted Net Profit:
Total of Non-Deducted Assets: SAR 100,000
Difference between Adjusted and Book Profit: SAR30,000

Check Values
If the total of non-deducted assets (SAR100,000) and the difference between adjusted and book profit (SAR 30,000) is less than adjusted net profit (SAR 150,000), use the following formula:

Total of Non-Deducted Assets + Difference = SAR 100,000 + SAR 30,000 = SAR 130,000

Compare with Adjusted Net Profit:
Since SAR 130,000 (Zakat base) is less than SAR 150,000 (adjusted net profit), use the Zakat base of SAR 130,000.

Final Calculation
Zakat Due = Positive Zakat Base SAR 130,000*2.5% = SAR 3,250

Maximum Zakat Base

Article 28 specifies that the maximum Zakat base is determined based on the value of ownership existing in the financial statements of the Zakat payer at the end of the Zakat year, plus the difference between adjusted net profit and book profit. This also includes items reclassified from liabilities to ownership rights.

Example:

Description	Amount (SAR)
Adjusted Net Profit	250,000
Value of Ownership in Financial Statement	500,000
Book Profit	230,000
Items Reclassified from Liabilities to Ownership Rights	30,000

- Calculate the difference between the adjusted net profit and the book profit, i.e. (SAR 250,000-SAR 230,000) = **SAR 20,000**
- Add the Difference to the Value of Ownership along with reclassified items
  = SAR 500,000+ SAR 20,000+SAR 30,000
  = **SAR 550,000**

Calculating Zakat for a Deemed-based Zakat Payer

A deemed Zakat payer is treated under specific regulations where the Authority may assess Zakat based on available financial statements, even if delayed, ensuring the Zakat base aligns with the scale of activities. A fixed Zakat percentage of 2.5% is applied, with a minimum threshold of SAR 500 and the use of a Tax Identification Number (TIN) for assessments. The Zakat base is calculated using a formula involving sales data, with adjustments possible based on market conditions or discrepancies found in VAT or other tax declarations. The regulations also allow for adjustments if the actual Zakat due is higher than the Authority's estimate.

Real Estate Projects under construction

- **Valuation of Properties Under Construction for Sale**: The value of properties under construction intended for sale is excluded from the Zakat base if they have not yet been offered for sale or if their cost of sales exceeds 25% of their apparent value in the financial statements.
- **Classification of Properties Under Construction:** Properties under construction classified as inventory or current assets are deducted from the Zakat base if they meet the specified criteria. Any related current liabilities must be added back to the Zakat base.

Provision for Insurance Activity

- **Deduction Elements**: Deposits with the insurance authority are deductible unless the Zakat payer is unable to invest them or if they are invested for the payer's benefit.
- **Addition Elements**: Additions include the policyholders' share of surplus insurance and the reserve for unearned premiums, classified as non-current liabilities according to Article 19.
- **Acceptable Deductions**: The reserve for unearned premiums and the reserve for outstanding risks for the Zakat year are acceptable deductions, provided they are returned to the Zakat base in the following year.

Amendment of Zakat Declaration:

To amend a Zakat declaration, the Zakat payer must submit a request through the authority's dedicated electronic system, ensuring all relevant documents and justifications are attached which must be approved by the authority. Once approved, the amended declaration must be submitted within 30 days. If the request pertains to deficiencies in the original declaration, it must be submitted before the Zakat assessment is issued and within the limitation period. Failure to comply with these requirements will result in the voiding of the approval, necessitating a resubmission.

Zakat Declaration Correction

The Authority has the right to issue a Zakat assessment, reassessment, or correct errors within five years of the Zakat declaration deadline if there are issues with the declaration or the application of regulations. This period extends to ten years if the declaration is submitted late, incomplete, non-compliant, or if Zakat payments are not made on time. In cases of intentional Zakat evasion, agreement for reassessment, or if the Zakat payer is unregistered, the Authority can reassess without a time limit. Additionally, the Authority can correct clerical or arithmetic errors within ten years without invalidating the declaration and may take legal action against those providing incorrect or deceptive information. Moreover, the Authority has the right to register an unregistered Zakat payer and conduct a Zakat assessment on them without being restricted by any time limit, ensuring that all Zakat payers are held accountable, regardless of their registration status.

Guidelines for Assumed Zakat Assessment

The Authority may estimate Zakat dues for an accounting-books Zakat payer if they fail to submit their Zakat declaration on time, do not provide requested documents within the specified period, or if the Authority finds additional information relevant to calculating the Zakat base. Before assuming Zakat, the Authority must send a warning and wait at least 60 days. This assumption is based on the information and data available to the Authority.

Submitting an objection request

Anyone affected by a decision from the Authority has the right to file an objection according to the rules set by the Committee for Resolution of Zakat, Tax, and Customs Violations. To have the objection accepted, the Zakat payer must first pay all Zakat dues related to the undisputed items and also pay between 10% and 25% of the Zakat dues for the disputed items or provide a financial guarantee for the same. The Authority may set additional regulatory controls for this process.

Dhruva comments

As the new rules take effect, companies must reassess their financial and operational frameworks to align with these updated Zakat obligations. By integrating these changes, businesses must adapt to the new regulatory environment to ensure compliance and optimize their financial strategies. The retroactive application provisions and detailed Zakat computation methods offer flexibility but also demand meticulous attention to detail to avoid potential pitfalls.

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