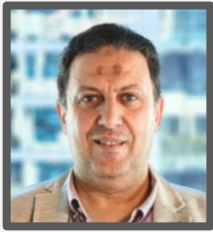




Reframing the Zakat Base: Analytical Insights into ZATCA's 2024 Amendments and Applications



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01. INTRODUCTION

The Zakat, Tax and Customs Authority (ZATCA) released an updated Guide on Zakat Adjustments and Treatments (1445H/2024) to accompany the Executive Regulations for Zakat enacted under Ministerial Resolution No. 1007, dated 19 Sha'ban 1445H (29 February 2024). This comprehensive framework replaces the 1440H regulations and represents a pivotal evolution of the Saudi Zakat system. It provides detailed guidance on exemptions, calculation methodologies, deductions, mergers, partner transactions, and compliance procedures.

These new rules apply to financial years beginning on or after 1 January 2024, with the first Zakat declarations in 2025. The 2024 framework aims to unify interpretations, enhance alignment with accounting standards (SOCPA and IFRS), and strengthen transparency and consistency across sectors.

This paper aligns directly with ZATCA's official guide and elaborates on its key technical clarifications.

02. KEY ADJUSTMENTS AND CLARIFICATIONS

2.1 Exemption for Non-Profit Companies

A significant innovation in the 2024 regulations is the Zakat exemption for non-profit companies, reflecting ZATCA's coordination with the Ministry of Commerce under the Companies

Law. Article 7(3) specifies that non-profit companies and their wholly owned subsidiaries are exempt from Zakat if the following conditions are met

Purpose Limitation

The entity's expenditures and activities must remain strictly within the non-profit objectives stated in its bylaws or articles of association. Any deviation may disqualify the exemption.

Compensation Cap

Total payments to any individual-including founders, shareholders, board members, or management-must not exceed 10% of total annual revenue. This includes salaries, benefits, allowances, and bonuses.

Audit & Verification

All expenditures must be supported by audited financial statements or a licensed auditor's report in Saudi Arabia. ZATCA may accept other supporting evidence at its discretion.

The exemption only applies to companies established under the Companies Law and its Executive Regulations. ZATCA evaluates each

case to ensure compliance with the non-profit definition and operational limits.

Example: A Saudi non-profit company earned SAR 12 million in 2024. It paid SAR 1 million (~8%) in combined board fees and management salaries. The company's financial statements were duly audited. Because its compensation ratio was within the 10% limit and its activities were consistent with its founding documents, it qualifies for exemption. If, however, total benefits exceeded 10% of revenue or the activities extended beyond stated purposes, Zakat would be due.

2.2 Cessation or Suspension of Activity

The 2024 guide distinguishes between permanent cessation and temporary suspension. Zakat liability ceases only when a taxpayer permanently stops activity and notifies ZATCA in writing within 60 days of cessation. Failure to notify results in continued Zakat liability until ZATCA receives the official notice.

Temporary shutdowns (e.g., plant maintenance or operational suspension) do not suspend Zakat liability. Since Zakat is based on ownership of wealth rather than income generation, ownership during inactivity remains subject to Zakat.

2.3 Mergers and Acquisitions

The updated regulations now define two distinct merger scenarios and clarify their Zakat implications:

- 1. Mergers resulting in a new entity:** When two or more companies merge to form a new legal entity, the newly formed entity is responsible for Zakat.
 - ✓ If its first fiscal year is shorter than 354 days, it is treated as a full Hijri year for Zakat purposes.
 - ✓ If it exceeds 354 days, Zakat is calculated for two full Hijri years.

Example: Companies A and B merged on 1 Rabi' al-Awwal 1446H to form Company C, whose first year ended on 30 Dhul Hijjah 1446H (10 months). Zakat is calculated for one full Hijri year, despite the shortened period.

- 2. Acquisitions (absorption mergers):** When one company acquires another, the acquiring company continues using its own Zakat year without resetting. The Zakat year of the merged entity follows from the last return filed by the acquirer.

ZATCA's approach emphasizes continuity and clarity, reducing interpretive disputes common under previous versions.

2.4 Zakat Rate and Long/Short Fiscal Years

The standard Zakat rate remains 2.5% for a full Hijri year. The guide confirms proportional adjustments for fiscal years that differ from the Hijri calendar:

Zakat Rate = $(2.5\% \div 354) \times \text{Number of days in financial year}$

ZATCA also clarifies application timing:

- **At the beginning of activity:** Fiscal years shorter than 354 days are subject to Zakat.
- **At the end of activity (e.g., liquidation or merger):** Fiscal years shorter than 354 days are not subject to Zakat.

Example: Company X's first fiscal year runs from 1 July 2024 to 31 December 2025 (549 days). Zakat = $(2.5\% \div 354) \times 549 = 3.877\%$. For a Zakat base of SAR 8 million, payable Zakat = SAR 310,160.

2.5 Reliance on Balance Sheet Values

A key clarification in the 2024 guide is that balance sheet closing values are now the sole reference for Zakat computation. ZATCA no longer allows average or adjusted valuations used under earlier practice. This ensures that all additions and deductions are determined strictly using the figures presented in the audited

Statement of Financial Position.

Example: A company purchases equipment for SAR 2 million and increases its share capital by SAR 1 million. Both are reflected at year-end. The machinery is deductible, while the share capital increase is added to the Zakat base.

2.6 Companies Presenting Financials on Liquidity Basis

ZATCA introduced special clarification for companies—such as insurers and financial institutions—that present financial statements on a liquidity basis rather than on a classified

current/non-current basis. For such entities, items are considered current if they are expected to be realized, recovered, or settled within 365 days from the end of the Zakat year.

Example: An insurance company reports its balance sheet based on liquidity. Investments classified as trading instruments with a maturity of less than 12 months are treated as current and included in the Zakat base; those exceeding 12 months qualify as non-current and may be deductible, subject to standard investment rules.

2.7 Offsetting Between Assets and Liabilities

The 2024 regulations formalize ZATCA's long-standing practice of offsetting assets and liabilities. Non-current liabilities offset non-current assets, and current liabilities offset current assets. Importantly, this offsetting applies regardless of which side arose first—timing no

longer affects treatment. Any remaining difference is absorbed through equity.

This reinforces a balance-sheet-based approach and ensures uniform treatment across entities using different accounting timelines.

2.8 Additions to the Zakat Base

The additions to the Zakat base form the foundation of how ZATCA defines a taxpayer's wealth subject to Zakat. Article 23 of the 1445H Regulations consolidates and expands these provisions, ensuring consistency and transparency in the way companies determine their final payable Zakat. The concept of "additions" reflects items representing

permanent capital or sources of funds rather than deductible, circulating assets. The objective is to align Zakat with its Sharia basis — measuring owned wealth and capacity to contribute — while maintaining harmony with accounting principles.

ZATCA's guide explicitly lists the following additions

01 Shareholders' Equity Components

Paid-up Share Capital and Capital Increases: Any increase during the year is added to the Zakat base from the effective date of registration. This includes both cash and in-kind contributions.

Reserves: All forms of reserves — statutory, general, voluntary, or other retained earnings — are treated as additions. Even reserves designated for expansion, contingencies, or asset replacement are included because they represent accumulated wealth.

Retained Earnings and Undistributed Profits: Profits not distributed to shareholders are added to the Zakat base, regardless of whether they have been appropriated for future use.

2. Adjustments Related to Long-Term Liabilities

- ✓ Financing of Deductible Assets: If long-term loans or credit facilities fund assets normally deductible from the Zakat base (e.g., inventories, trade receivables), the corresponding liability must be added back. This prevents double deduction (once through the liability and again through the asset's deduction).
- ✓ Non-Zakat Liabilities: Long-term obligations that do not represent true operational debt, such as shareholder or partner loans with no repayment schedule, are treated as capital and added to the base.

3. Profit Adjustments and Accounting Differences

- ✓ ZATCA requires reconciling between accounting profit/loss and adjusted profit/loss. Any difference resulting from non-deductible expenses or non-Zakat income (such as foreign dividends or tax-exempt gains) must be added to the base.
- ✓ Unrealized Gains: Gains arising from revaluation of assets, currency translation, or fair value adjustments are added if they increase equity or reserves in the balance sheet.
- ✓ Treasury Shares: If a company holds its own shares, their cost is not deductible unless sold; instead, their book value may be treated as an addition because they represent retained capital.

4. Partner and Shareholder Accounts

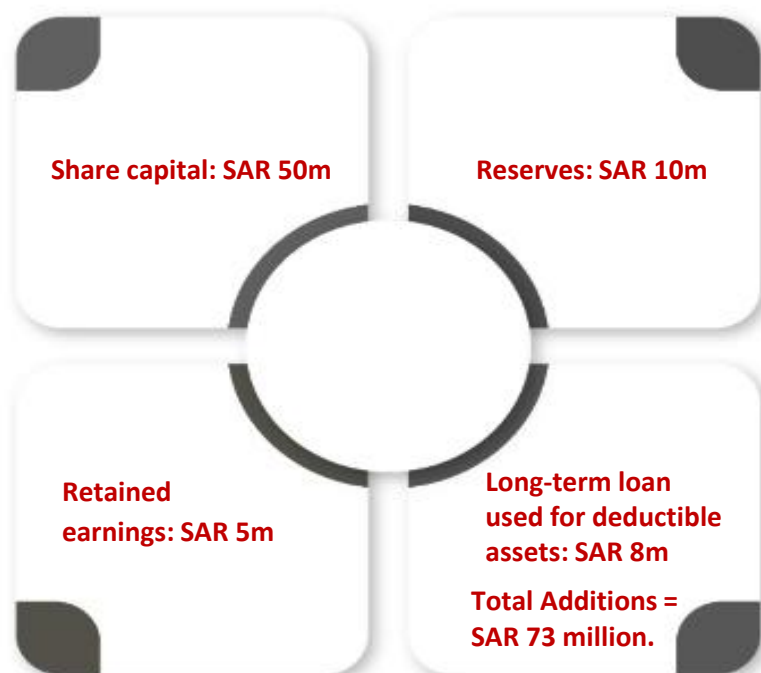
- ✓ Credit Balances: Partners' or shareholders' credit accounts (amounts owed to them by the company) are treated as part of the company's capital and therefore added to the Zakat base.
- ✓ Debit Balances: Conversely, debit balances (amounts owed by partners to the company) are generally deductible only when proven collectible and not representing disguised distributions.

5. Adjustments from Reclassifications or Valuation Differences

- ✓ When asset reclassifications occur during the year — e.g., from current to non-current or vice versa — ZATCA applies the balance-sheet position at year-end as definitive. If the reclassification increases equity or non-current assets funded by equity, the incremental value is added.
- ✓ Differences arising from foreign branch consolidations or deferred revenue are added when they represent retained or reinvested capital.

Illustrative Example

Company Y has SAR 50 million share capital, SAR 10 million statutory reserves, SAR 5 million retained earnings, and SAR 8 million long-term loans funding working capital. The Zakat base additions include:



If the same company had unrealized gains of SAR 2 million recorded in other comprehensive income (OCI), the total additions rise to SAR 75 million.

These detailed rules prevent manipulation through accounting classification or funding structure and ensure that the Zakat base reflects the true wealth available for contribution. ZATCA's move to codify these

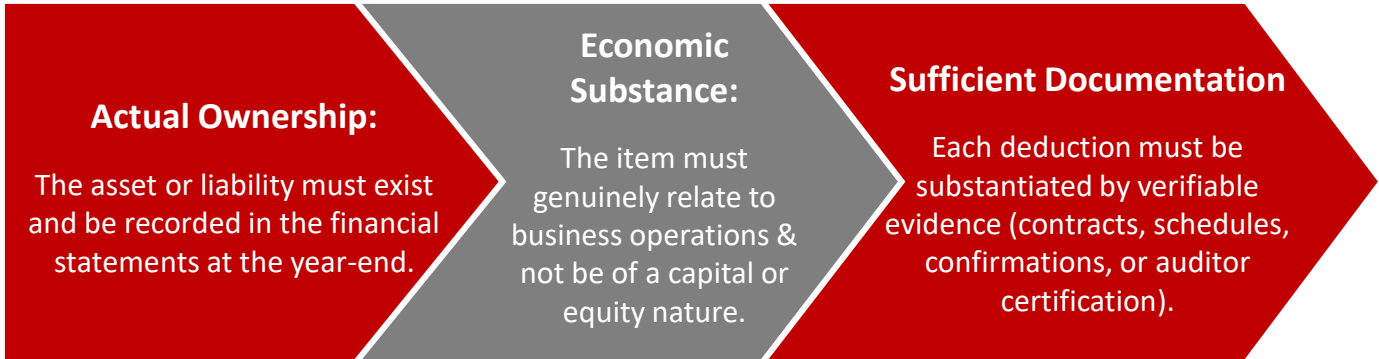
principles demonstrates its intent to standardize computations, minimize interpretive disputes, and strengthen alignment between Zakat law and modern financial reporting.

2.9 Deductions and Allowable Reductions

The deductions from the Zakat base are equally important to ensure that Zakat represents a fair and realistic measure of an entity's wealth. Articles 40–70 of the 1445H Regulations specify the permissible deductions that can be claimed against the gross Zakat base to arrive at the

final payable amount. The intention behind these deductions is to exclude assets or transactions that do not represent productive or owned wealth at the end of the Zakat year.

ZATCA's guide emphasizes that deductions must meet three cumulative conditions:



ZATCA categorizes deductions into several key groups

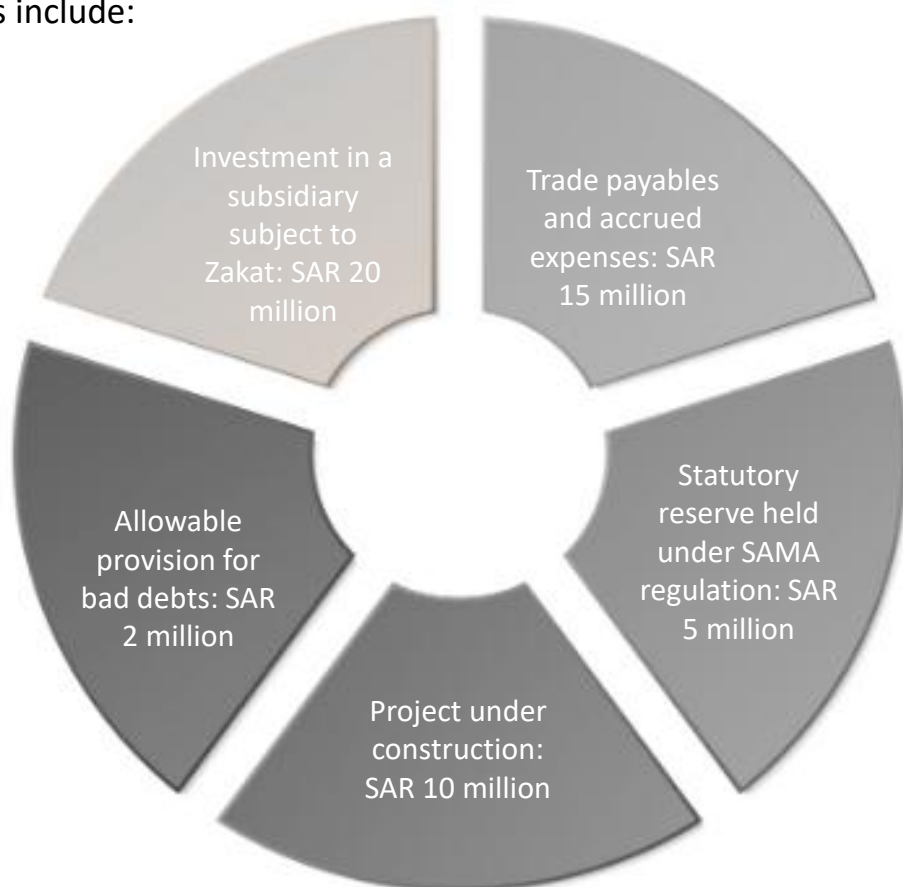
<p>1. Investments and Participations</p>	<ul style="list-style-type: none"> Investments in entities subject to Zakat or income tax in Saudi Arabia are deductible to prevent double Zakat. This includes subsidiaries, associates, or joint ventures taxed or zakatable under Saudi law. For foreign investments, deductions are permitted only where ownership corresponds to operational necessity and not capital placement.
<p>2. Trade and Operating Liabilities</p>	<ul style="list-style-type: none"> Current liabilities such as trade payables, accrued expenses, and short-term provisions directly related to deductible assets are allowable deductions. Deferred revenue is also deductible if it represents cash received in advance for services yet to be rendered.
<p>3. Regulatory Deposits and Statutory Reserves</p>	<ul style="list-style-type: none"> Deposits required by regulatory authorities such as the Saudi Central Bank (SAMA) or the Capital Market Authority (CMA) are deductible since these funds are restricted and not freely available for use. For insurance and finance companies, statutory reserves established under SAMA guidelines qualify as deductions when tied to liabilities arising from policyholder obligations or loan loss provisions.
<p>4. Projects Under Construction and Work in Progress</p>	<ul style="list-style-type: none"> Expenditures on ongoing projects are deductible until the project becomes operational or revenue-generating. Once operational, the project's value transitions to the Zakat base as a non-current asset subject to standard additions. This approach encourages capital investment without penalizing development stages.
<p>5. Provisions and Bad Debts</p>	<ul style="list-style-type: none"> Provisions for bad or doubtful debts are deductible if the debt is both overdue and substantiated as unlikely to be recovered. ZATCA requires written evidence such as correspondence, legal proceedings, or auditor confirmation. Recovered amounts in subsequent years must be added back to the Zakat base.

6. Partner and Shareholder Accounts	<ul style="list-style-type: none"> • Debit balances owed by partners or shareholders are deductible only when they represent bona fide business transactions and are expected to be collectible. • Non-collectible or personal loans to partners are not deductible and may be treated as concealed profit distributions.
7. Borrowings and Financing Liabilities	<ul style="list-style-type: none"> • Short-term loans used for operating purposes (e.g., purchase of goods, working capital) are deductible. • Long-term loans are deductible only when directly tied to deductible current assets. If used to finance fixed assets or capital expansion, they must be added back per Article 23. • Interest-bearing loans are deductible provided the financing conforms with Saudi banking regulations and the principal amount remains outstanding at year-end.
8. Zakat Paid in Advance or Overpaid	<ul style="list-style-type: none"> • Any Zakat previously paid or carried forward as a credit balance from earlier years is deductible to avoid duplication. • Refunds or adjustments approved by ZATCA should also be reflected in the deduction schedule.
9. Specific Industry Deductions	<ul style="list-style-type: none"> • For financial institutions, deductions may include client deposits, refinancing obligations, and restricted customer funds. • For insurance companies, technical provisions (unearned premiums, outstanding claims) are deductible under SAMA-approved methods. • For real estate developers, advance receipts from customers are deductible if contractual and not yet recognized as revenue.

Illustrative Example

Company Z has a preliminary Zakat base of SAR 100 million consisting of equity and reserves. Deductible items include:

- **Total Deductions = SAR 52 million.**
- Accordingly, the Net Zakat Base = SAR 48 million, subject to a 2.5% Zakat rate



Through this structure, ZATCA's 2024 framework ensures that only genuine, productive capital remains zakatable. By defining deductions with greater precision and documentation requirements, the new system strengthens consistency, minimizes disputes, and aligns fiscal enforcement with both Sharia principles and modern financial standards.

2.10 Minimum and Maximum Zakat Base

For the first time, the Executive Regulations introduce both minimum and maximum thresholds for the Zakat base. This ensures equity between taxpayers and prevents distortions caused by extraordinary accounting

entries or valuation changes. The minimum base guarantees a reasonable contribution even where accounting losses exist, while the maximum cap prevents excessive assessments beyond economic reality.

03. PROCEDURAL AND COMPLIANCE ENHANCEMENTS

ZATCA's guide expands procedural detail in several areas

- **Amendments and Revisions:** Taxpayers may amend Zakat returns within statutory deadlines; late corrections must follow formal approval.
- **Zakat Estimation:** ZATCA retains authority to estimate Zakat where discrepancies or missing documentation exist.

- **Communication and Audit Trail:** Taxpayers must retain comprehensive records supporting calculations, including reconciliations between Zakat base and accounting data.
- **Payment and Allocation:** Zakat proceeds are transferred to the Social Security Account, ensuring funds reach eligible beneficiaries in compliance with royal decrees.

04. PRACTICAL IMPLICATIONS FOR CFOs AND TAX LEADERS

The 2024 Zakat reforms carry far-reaching operational implications:

- **Accounting Alignment:** Companies must ensure IFRS and SOCPA reporting structures support Zakat computations directly from audited financial statements.
- **Internal Controls:** Establish clear processes for monitoring related-party transactions, partner loans, and investment structures.
- **Documentation Culture:** Preemptive documentation is essential, especially given

- ZATCA's increased scrutiny on merger accounting, profit adjustments, and Zakat base composition.
- **System Readiness:** ERP systems should be configured to extract Zakat data (equity, liabilities, reserves, provisions) automatically for faster compliance.
- **Governance:** CFOs should maintain periodic Zakat base reconciliations and ensure internal sign-offs before filing.

Conclusion

The 1445H Executive Regulations and accompanying ZATCA Guide on Zakat Adjustments mark a turning point in the institutional maturity of Saudi Arabia's Zakat framework. By embedding accounting precision, fiscal clarity, and procedural transparency, ZATCA has aligned religious obligation with modern regulatory expectations. For businesses, proactive adaptation—through system upgrades, training, and early engagement with

ZATCA—is essential.

Saudi Arabia's evolving Zakat landscape underscores a broader trend: the convergence of faith-based fiscal systems with global financial governance. As this integration continues, Zakat compliance will become not only a legal duty but also a cornerstone of corporate accountability and ethical financial stewardship.