ZAKAT

هيئة الزكاة والضريبة والجمارك
Zakat, Tax and Customs Authority

Guide

For Modification of the Activity Result for Zakat Purposes for Zakat Payers holding Legal Accounts

Version one | 2023

The Zakat, Tax and Customs Authority ("ZATCA", "Authority") issued this guide for the purpose of clarifying certain treatments concerning the implementation of the statutory provisions in force as of the Guide's issue date. The content of this Guide shall not be considered an amendment to any of the provisions of the Laws and Regulations applicable in the Kingdom.

Furthermore, the Authority would like to highlight that the clarifications and indicative tax treatments, where applicable, shall be implemented by the Authority in light of the relevant statutory texts. Where any clarification, interpretation or content provided in this Guide is modified - in relation to unchanged statutory text - the updated indicative tax treatment shall then be applicable prospectively concerning transactionss made after the publication date of the updated version of the Guide on the Authority's website.

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1. Introduction

1.1 About Zakat

Zakat is the third pillar of Islam, and one of the great financial rituals, consequently, it was mentioned repeatedly in the Holy Qur'an. Allah Almighty has associated it with prayer in more than (80) verses. It is one of the key pillars that distinguishes the Muslim community, and a manifestation of the supremacy of Islamic legislations. It represents a successful way to fight poverty, and alleviates the suffering of the needy, leading to the achievement of social solidarity.

1.2. Collection of Zakat

One of the evidence indicating the great regard of Zakat in Islam is assigning its management and supervision to the State. In fact, the State is the entity, which is responsible for collecting Zakat on funds and disburse it on those entitled, by assigning some personnel (Zakat Employees) to visit the owners of funds throughout the Islamic State, calculate and collect the amount of their Zakat, and supervise the disbursement and distribution of it to the beneficiaries.

ZATCA is currently responsible for the collection of Zakat, where it undertakes all procedures related to Zakat payers, starting with registration, and passing through the process of filing Zakat declarations, the issuance of Zakat assessments, payment procedures, examination of submitted data and information, and verification of them through human competencies and contemporary automated technologies of the Authority, and ending with the issuance of the final Zakat certificate, and any other procedures thereafter related to studying the objections of Zakat payer to the Authority's Zakat assessments.

1.3. Zakat Collection in the Kingdom of Saudi Arabia

Collecting and disbursing Zakat to those entitled thereto are among the basic tasks stated in the Basic Law of Governance in Article 21, stating as follows: "Zakat shall be collected and spent for legitimate expenses". Furthermore, Article 7 included evidence of the State's attention to the Sharia duties and commitment thereto in general, stating as follows: (Governance in the Kingdom

of Saudi Arabia derives its authority from the Quran and the Sunna of the Messenger, both of which govern this Law and all the laws of the State).
In witness thereof, the Royal Decree No. (17/2/28/8634), dated 29/06/1370 AH, corresponding to 06/04/1951 AD, which included the order to collect Zakat was issued during the era of the founder King Abdulaziz. Following this Royal Decree, a number of royal decrees confirming it, ministerial resolutions implementing it, and statutes and circulars explaining and clarifying it, were issued, including Royal Decree No. (M/40) dated 02/07/1405 AH, and the Implementing Regulation for Zakat Collection issued under the Ministerial Resolution No. (2082) dated 01/06/1438 AH, corresponding to 28/02/2017 AD, and the Implementing Regulation Zakat Collection issued under the Ministerial Resolution No. (2216) dated 07/07 1440 AH, corresponding to 14/03/2019. Such regulations will be applied for the zakat years commencing starting from January 1, 2019 for all Zakat payers, except for those who are charged by the discretionary method according to Section (IV) of the Regulation, the Regulation applies to their declarations submitted after 31 December 2019. Therefore, the Implementing Regulation for Zakat Collection issued on 07/07/1440 AH shall not apply to the fiscal years prior to such date; however, such years shall be treated in accordance with the regulations and instructions prior to such date.
The Implementing Regulation for Zakat Collection paid much attention to explaining the provisions for Zakat collection with regard to commercial and professional activities, and alike to the exclusion of any other zakatable wealth, and specifying the requirements for filling the Zakat Declaration, the procedures of assessment, examination and payment, as well as their respective time limits.

The Zakat proceeds collected by ZATCA are received and deposited in the Social Security Account, which is responsible for disbursement to the poor and needy in accordance with Royal Decree No. (1/5/16) dated 05/01/1383 AH, corresponding to 28/05/1963 AD. Paragraph (1) thereof provides for: "Zakat shall be collected in full from all joint stock companies, and others, and individuals who are subject to Zakat." In addition, Paragraph (2) stipulates: "All amounts collected shall be returned to the Social Security Fund"

1.4 The Zakat, Tax and Customs Authority (ZATCA)

ZACTA is a Saudi government authority established pursuant to the Council of Ministers' Resolution dated 23 Ramadan 1442 AH, corresponding to 04/05/2021 AD, following the Resolution to merge the General Zakat and Income Authority, the previous name, with the General Customs Authority to be one authority; the Zakat, Tax and Customs Authority.

1.5 ZATCA's Tasks

The Statute of ZATCA defines the tasks of ZATCA in Article (3) thereof, and it includes the following:

1. Collecting zakat, taxes. and customs duties from Zakat payers according to the relevant laws, regulations, and instructions.
2. Providing high-quality services to the Zakat payers to enable them to fulfill their duties.
3. Following up on Zakat payers, and taking the necessary measures to ensure collection of dues payments.
4. Raising awareness of Zakat payers, strengthening the level of their voluntary commitment and ensuring their compliance with ZATCA's rules and instructions.
5. Utilizing modern technology in implementing, monitoring and facilitating ZATCA's activities, and in enhancing the security role in combating customs smuggling.
6. Cooperating with the private sector to carry out and manage supporting activities.
7. Developing the necessary plans to organize, manage and invest the facilities of the customs port, in coordination with the relevant agencies.
8. etting performance indicators for assessing ZATCA's activities and plans to ensure the development of its performance and services. ZATCA may, for such purpose, coordinate with the relevant agencies to its mandates.

9. Cooperating and exchanging experience with regional and international bodies and organizations, and specialized consultancy firms within the Kingdom and abroad, subject to ZATCA's mandate.

10. Representing the Kingdom in relevant regional and international organizations, bodies, forums and conferences.

1.6 About the Manual on the modification of the activity' result

This Guide provides essential guidelines and information with regard to the modification of the activity result for the purpose of calculating Zakat and helps to form a crystal-clear vision and provide guidelines in relation to the practical application about the modification of the accounting profit for Zakat purposes.

This Guide presents ZATCA's concept and explanation regarding the application of the Implementing Regulation for Zakat Collection issued under the Ministerial Resolution (2216) dated 07/07/1440 AH.

For any guidelines regarding any transactions, visit the official website of ZATCA (ZATCA.gov.sa), which containing a large set of tools and information specifically developed to help the Zakat payer, including video guidelines and all relevant data, as well as answers of the FAQs.

2. Modification of Activity Result

2.1 Introduction

This Guide provides clarifications and explanations for the provisions of Articles 8 and 9 of the Regulation, by addressing the most prominent clauses by which the result of the activity of Zakat payers is modified for the purposes of zakat calculation, by adjusting the accounting net profit to reach the adjusted net profit for zakat purposes.

Through this Guide, ZATCA has studied, analyzed and collected the most prominent clauses in this Guide with illustrative examples to inform the Zakat payers, bring their points of view closer, and reduce disputes and disagreements between the Zakat payers and ZATCA.

2.2 Definitions and Relevant Terms

ZATCA or Authority: The Zakat, Tax and Customs Authority

Regulation: The Implementing Regulation for Zakat Collection issued under the Ministerial Resolution No. (2216) dated 071440/07/ AH and any amendments thereto.

Kingdom: Kingdom of Saudi Arabia

GOSI: The General Organization for Social Insurance

Zakat payer: A natural or legal person who carries out an activity that is subject to zakat in accordance with the provisions of Article 2 of the Regulations, whether it is a sole proprietorship, corporate, or a person engaged in a business activity under a license issued by a competent authority in the Kingdom.

Zakat Declaration: A form prepared by ZATCA, which includes several elements and items. It must be filled out and submitted by Zakat payer or representative. The purpose of the declaration and its submission is to indicate the amount of the Zakat base and the due Zakat that must be paid by the Zakat payers.

Net profit (loss): The result of the company›s business in terms of book profit or loss, which is calculated under the generally accepted accounting principles and approved accounting standards for a specific financial period.

Adjusted Net Profit (Loss) for Zakat Purposes: Net accounting profit (loss) after being adjusted with clauses in accordance with Articles 8 and 9 of the Regulation.

Activity Result: Net book profit (loss) as per the Zakat payer's audited financial statements.

VAT: Value-Added Tax as per the definitions and terms set forth in the relevant applicable laws in the Kingdom.

Excise Tax: The Excise Tax as per the definitions and terms set forth the relevant applicable laws in the Kingdom.

RETT: The Real estate transaction tax as per the definitions and terms set forth the relevant applicable laws in the Kingdom.

2.3 Modification of the activity's result

Subject to the Regulation, the activity result is considered one of the basic components of the Zakat base for Zakat payers holding regular accounts, besides additions to the Zakat base, which were mainly addressed in Article "4" in the Regulation, and the deductions from the Zakat base addressed in Article "5" in the Regulation. The alternative Zakat base shall be developed if the result of the previous base was negative, as per the provision of Article "6", Paragraph (1).

The term "result of activity" refers to the results of the Zakat payer's business based on its financial statements during the zakat year, represented by the revenues achieved as a result of practicing the licensed activity, less the expenses and other costs incurred to reach the net profit or loss.

In terms of zakat, the Regulation stipulates controls and conditions when determining and modifying the result of an activity. In general, the Regulation in articles 8 and 9 is consistent with the basic assumption that all expenses are considered deductible under controls, with a specific exception to the items that are not deductible under an explicit context mentioned in Article "9" in the Regulation.

In this Guide, the provisions of the above-mentioned articles will be reviewed and clarified according to the order mentioned in the Regulation. Moreover, this Guide addresses the zakat treatment of some other items that may affect the result of the activity for the purposes of calculating the adjusted net profit for zakat purposes.

2.4 Deductible Expenses

2.4.1 Ordinary and Necessary Expenses for the Activity

In consideration with the provisions of Article "9" of the Regulation regarding non-deductible expenses, Article "8" thereof stipulates that all ordinary and necessary expenses for the activity, whether paid or due, are considered deductible, if the controls and conditions stipulated in Article "8", Paragraph (1) thereof are met as follows:

I: The expense must be actual and supported by documents and evidence accepted by ZATCA and maybe validated, even if they were related to previous years

With the assumption that all expenses involved in determining the result of the activity are deductible expenses in nature as they are necessary for the activity.

However, the next basic standard for accepting the deduction of expenses for Zakat purposes is to be supported by verifiable supporting documents. The purpose of these documents is (for example but not limited to):

1. tbooks in conformity with the applicable accounting standards in the Kingdon (for example, not to be of a capital nature). Refer to clause (III).
2. These expenses are related to the activity of the Zakat payer.
3. Verifying that they were borne by the Zakat payer. For example, the Zakat payer must submit supporting documents for such expense.

II: It must be linked to the activity of the Zakat payer, and not related to personal expenses or other activities that do not relate to the Zakat payer

When determining the result of the activity, in principle, all expenses should be directly related to the activity of the Zakat payer and required to be incurred as a condition for allowing these expenses to be deducted from the result of the activity.

Consequently, for the purposes of zakat, the result of the activity must not include any expenses that are not related to the activity of the Zakat payer, including personal expenses of the owner or partners in the establishment.

The following are examples of non-activity related expenses:

- Personal expenses belonging to the owner or partners in the establishment, for example, expenses related to the maintenance of the owner›s house, which were recorded in the expense account at the establishment.
- Depreciation expenses related to an asset that is not used in the activity of the Zakat payer or of personal use by the owner or the partners. This also includes other expenses incurred that are related to the same asset, such as maintenance, insurance, etc.

III: Not to be of a capital nature

Capital expenses are expenses directly related to capital assets, such as fixed assets (including real estate, machinery, equipment, etc.) that aim to increase the production capacity of the capital assets and contribute to achieving revenues in the long term.

In versus to such expenses, there are the "operating expenses", which are spent to achieve revenues for the year and recorded as period expenses in the statement of income.

These expenses are called "capital expenses " because they are capitalized on the value of the asset and are not recognized as period expenses in the statement of income.

Accordingly, if the results of the Zakat payer›s business include such expenses, it is expected that the establishment will recognize them as part of the expenses of capital assets and depreciate them over their useful life if they are depreciable assets. The same applies to expenses related to non-depreciable assets, such as land.

These expenses that may be part of a capital or fixed assets, in addition to the asset›s purchase price, may include as an example, but not limited to:

- Site preparation costs to prepare the asset for use.
- Loading and handling.
- Non-refundable duties and taxes such as customs duties, VAT, and non-refundable RETT.
- Shipping costs.

Substantial maintenance costs that increase the useful life of the asset, which must be capitalized for the value of the asset.

In the cases where it is clear that the Zakat payer has reversed these expenses and recognized them in the statement of income, this must be modified in the result of the activity in order to reach the adjusted profit (loss) for zakat purposes or the result of the modified activity, as well as adding it to the asset value and depreciate therewith.

Example

The following statements are for a company that carry out business of selling electronics in the Kingdom, which represent a list of some expenses incurred and recorded by the company under its activity's result in the FS of 2022:

Expense	Amount	Additional details
1. Hospitality expenses	100,000	This expense is paid against the employees' Iftar event during the holy month of Ramadan in one of the Kingdom's hotels as part of the program to enhance internal communication between the company's employees.
2. Entertainment expenses	20,000	This expense is paid in exchange for tickets purchased and granted by the company to employees to attend a sporting activity, as part of the company's employee loyalty program.
3. Maintenance of company vehicles	500,000	This expense is paid for replacing engines for the company's vehicles used by sales representatives.
4. Insurance	10,000	This expense is paid for an insurance policy for the (personal) vehicle of the company›s general manager.

Assuming that all the above expenses are sufficiently supported by documents, what is the zakat treatment for the above expenses under the provisions of the Regulation, and should the result of the activity be modified for these items?

The Answer

<table>
<tr><th>Expense</th><th>Analysis</th><th>Treatment - Explanation</th></tr>
<tr><td>1. Hospitality expenses</td><td>They are expenses related to the activity of the Zakat payer</td><td rowspan="2">It is not required to modify the result of the activity with it if proven to be important to the taxable activity.
For example, such activities are necessary as a program to support and motivate the company›s employees, which helps and enhances the employees' loyalty and productivity.</td></tr>
<tr><td>2. Entertainment expenses</td><td>They are expenses related to the activity of the Zakat payer</td></tr>
<tr><td>3. Maintenance of company's vehicles</td><td>It is expected that this maintenance may increase the useful life of the vehicles, since the maintenance that was carried out is essential to increase the production capacity and the useful life of the asset.</td><td>The result of the activity must be modified by adding it to reach the adjusted net profit for Zakat purposes. However, these expenses must be added to the book value of the vehicles and the depreciation premium must be recalculated for the year and subsequent years.</td></tr>
<tr><td>4. Insurance</td><td>They are not expenses related to the activity, but rather non-deductible personal expenses.</td><td>The result of the activity must be modified by adding it to reach the adjusted net profit for Zakat purposes</td></tr>
</table>

2.4.2 Salaries and Allowances of the Owner registered with GOSI and Remuneration of Board Members

Paragraph (2) of Article 8 stipulates that among the deductible expenses for identifying the net result of the activity are the following: "Owner's salaries and allowances registered with General Organization of Social Insurance (GOSI) and the remuneration paid to Chairman, deputy chairman and directors, provided that the remunerations should not exceed those paid to independent persons."

In this matter, this item must be analyzed in two parts:

First: The owner›s salaries and allowances registered with GOSI

The salaries, allowances and other benefits allocated to the owner of the establishment or the partner in the company, which the establishment discloses to GOSI and registers for statutory purposes, including:

1. Calculating the monthly insurance contributions according to the applicable laws in the Kingdom, which require (in general, for example) the calculation of contributions based on the basic salary and housing allowance, for example, and not other allowances and benefits.
2. For the purposes of the Wage Protection System applicable in the Kingdom, which requires recording all the employee's earnings (whether an owner, partner or other employee in the establishment) under his contract to monitor that the salary registered in the GOSI with all its allowances and benefits have been settled and monthly paid (i.e., transferred) to the employee.

Accordingly, by way of interpretation of the provisions of this Article, the salaries and allowances of the owner registered with the GOSI are considered among the deductible expenses without specifying a limit therefor, provided that the following are available at least for ZATCA to allow this item as deductible expenses:

- A regular employment contract between the owner or partner and the establishment.
- These salaries and allowances stipulated in the contract must be registered with the GOSI and subject to the Wages Protection System in the Kingdom.

Moreover, ZATCA may request additional justifications and supporting documents to verify the reasonableness of the above process.

Example

Essam, a partner/ owner in the Arab Trading Company, receives a monthly salary of SR 60,000 = SR 720,000 yearly, including all allowances, according to a regular employment contract registered and disclosed with the GOSI. The employment contract was concluded with Essam in his capacity as the General Manager of the company and the supervisor of its operations.

On a monthly basis, the company pays Essam the monthly salary with the rest of the company's employees in accordance with the applicable laws in the Kingdom.

In this case, the salary paid to Essam is a deductible expense to determine the result of the activity.

Example

If we assume in the previous example that the salary paid to Essam is not registered with the GOSI and is not subject to the Wages Protection System in the Kingdom.

In this case, the salary is not considered a deductible expense to determine the result of the activity, and it must be modified.

Second: Remunerations of the Chairman, deputy chairman, or other members of the Board

It is common in companies, especially joint-stock companies in the Kingdom, that their articles of association provide for a method of paying remunerations to the board members, whether as a fixed amount or on other bases such as an allowance for attending board meetings, in-kind benefits, etc.

The Implementing Regulation for Zakat Collection considers these remunerations as deductible expenses when determining the result of the activity without regard to the size of the remuneration due and paid to the members of the Board, including the Chairman and his deputy. Nevertheless, the Regulation set an important control, representing in considering these remunerations to be fair and in line with the common transactions between independent parties.

2.4.3 Bad Debts

Bad debts are defined as the debts that are confirmed to be uncollectible, requiring the company to write them off directly when it is confirmed that they haven't been collected from its books. This item is considered among the items that do not necessitate the modification of the activity result in the event that the Zakat payer takes direct action and writes off the debt when confirmed that it has not been collected, such as the sudden bankruptcy of the customer. Accordingly, this item is charged as an expense on the statement of profits or losses, as part of the activity result, with consideration of the following controls as mentioned in the Regulation:

- It must have been previously declared within the revenues in the year when the revenue is due.
- The debts must be resulting from the exercise of the activity.
- The Zakat payer must submit a certificate approved by a chartered accountant licensed in the Kingdom stating that these debts have been written off by a decision of the authorized person, upon required by ZATCA.
- The debts should not be owed by parties related to the Zakat payer.
- The Zakat payer shall declare the debts collected within his income upon collection.

These are examples of supporting documents to be kept in support of deducting the debts as expenses:

Conditions	Support (for example but not limited to)
• It must have been previously declared within the revenues in the year when the revenue is due. • The debt must be resulting from the exercise of the activity	Supporting document for the receivables based on revenue invoices previously issued to the customer and evidence of their recognition within revenues based on the account statements in the year of revenue realization.
Writing off the debt from the books	A certificate from a chartered accountant licensed in the Kingdom stating that these debts were written off by a decision of the authorized person.
The debt should not be owed to a related party	The Zakat payer is obligated to prove that the customer is not a party related to the Zakat payer as a partner, owner, or other establishment belonging to the same owner or a sister company, etc., according to the disclosures approved by the chartered accountant in the audited financial statements, as well as legal and other documents such as the structure of the group companies proving that the customer is not a related party to the Zakat payer.
The Zakat payer must declare the debts collected within his income	• No specific document is required. • Non-compliance may lead to amendments by ZATCA during the zakat examination.
	ZATCA may request such evidence to verify the validity of the Zakat payer's procedure.

Example

On December 31, 2022, there was SR 4,000,000 among the debtors' balance for a company operating in the commercial sector.

At the end of the fiscal year, it was confirmed that the debt was not collected from the debtor as a result of its bankruptcy.

Based on the studies carried out by the company, it was found that there is no possibility for collecting the debt under the current circumstances. Accordingly, the company has written off the debt directly and charged it as an expense on the statement of income.

Requirement: Explain the zakat treatment of items amending the result of the activity (if any)?

Answer:

Based on the above information, the company treats this expense resulting from the writing off of the debt as deductible expenses that do not require the modification of result of the activity, provided that the controls stipulated in the Regulations are met.

Example

Back to the previous example, during the year 2024 and after successful efforts, the company was able to collect the debt from the customer.

Requirement: Explain the zakat treatment of items modifying the result of the activity (if any)?

Answer:

The above-mentioned Zakat payer must re-recognize the collected revenues in his books and subject it to zakat as part of the activity result.

Example

In the previous example, if the customer is a related party to the company within the same group that has business transactions.

Requirement: Explain the zakat treatment of items modifying the result of the activity (if any)?

Answer:

Based on the above information, the Zakat payer may not deduct the written-off debt as expenses, and he must modify the result of the activity for SR 4,000,000, as it belongs to a related party.

2.4.4 Expenses of Assets Depreciation and Amortization

The term "depreciation" or "amortization" is often related to fixed assets or intangible assets (respectively), except lands. These assets are measured and reported in net value in the statement of financial position according to their historical cost following an adjustment as per the reduction in the value of the asset due to its use, obsolescence, or other circumstances. This reduction in the value of an asset over time is known as "depreciation" in accounting, indicating therein the asset at the expiration of its useful life.

Therefore, depreciation is defined as the allocation of the cost of assets over their useful life span in order to identify the reduction in the value of the asset in each accounting period due to various factors, whether subjective related to the asset itself such as usage and maintenance or non-subjective, i.e., not related to the asset itself such as obsolescence and lapse of time.

Companies usually identify depreciation rates of their assets based on the nature, production efficiency, and useful life of the asset in accordance with the depreciation methods. In this regard, the applicable depreciation methods (e.g., the straight-line or declining-balance method) are considered, and identified by each company based on the type of assets it owns.

Example: When guided by the International Accounting Standards (IAS) applicable in the Kingdom for fixed assets, some enterprises use a depreciation rate of 5% for stationary buildings; 25% for plants, machinery, hardware, software, and equipment, including passenger and shipping vehicles; and 10% for all other tangible and intangible assets of a consumable nature not covered by the previous categories (such as furniture, aircrafts, vessels, locomotives, and goodwill).

Regarding Zakat, Article (8) of the Regulation provides that the depreciation of fixed assets shall be considered deductible expenses. The same applies to the amortization of intangible assets, such as software, patents, or goodwill. The Regulation fail to identify a standard or guideline for deprecation or amortization rates. However, the Regulation leave the matter to the zakat payer to calculate and recognize the deprecation expense as part of the activity result without adjustment, as long as the deprecation rates are not exaggerated. On the other hand, ZATCA shall have the right to revise the said rates during the review of the zakat payer's zakat declaration.

The above-mentioned expression "not exaggerated" means the zakat payer's use of depreciation rates that entail a higher than reasonable depreciation expense exceeding accounting guidelines.

2.4.5 Donations

Donations are the amounts paid by the zakat payer against any possible aid to another entity for charitable purposes in order to promote community cohesion and support the overall objectives of community development. Donations may also be paid to a non-profit organization to support the charitable purpose for which the said organization is established in order to develop the community.

The donation may be in cash in the form of Sadaqat, services or in kind, including food, clothes, toys, etc.

In terms of Zakat, clause 8.5 of the Regulation provides that donations shall be considered deductible expenses under the following conditions:

- **Donations shall be actually paid**

They are not recorded under an accrual item or a deferred payment provision.

- **Supported by documents**

The Zakat payer must submit a certificate approved by a chartered accountant licensed in the Kingdom stating that these debts have been written off by a decision of the authorized person, upon required by ZATCA.

- **Paid to an entity authorized to receive donations within the Kingdom**

For example, charities and public education institutions, such as universities, schools, etc., providing that the purpose of such entities under the laws is being authorized to receive donations. Cases permitted to receive donations include entities that act as an intermediary to deliver donations to individuals in need (e.g., the National Platform for Charitable Work) in the Kingdom.

Example

According to the financial statements of a zakat payer, it is found that the donation expense amounting to SR 2,000,000, including the following for the year ended on 31 December 2022.

Amount	Donation's Recipient
500,000	Miscellaneous Sadaqat and donations not supported by documents and distributed by the establishment to people in need. Supported only by an internal payment voucher from the company.
800,000	Donations and contributions to charities paid abroad.
300,000	Donation reported under an account payable expense (not paid) to an entity authorized to receive donations inside the Kingdom.
400,000	Donations made to a charity authorized to receive donations inside the Kingdom supported by documents.

In light of the above information, the donation expense shall be treated as follows for the purposes of calculating the adjusted net profit (loss) for zakat purposes:

Amount	Donation's Recipient	Deductible Expense	Grounds
500,000	Miscellaneous Sadaqat and donations not supported by documents	No	Sadaqat and donations not supported by documents
800,000	Donations and contributions to charities paid abroad	No	Donations paid abroad
300,000	Donation reported under an account payable expense (not paid) to an entity authorized to receive donations inside the Kingdom	No	Donations not actually paid. They will still be allowed on the year of payment
400,000	Donations made to a charity authorized to receive donations inside the Kingdom and supported by documents	Yes	Donations satisfy the deduction requirements set forth under the Regulation and supported by documents

In-Kind Donations:

The in-kind donations for mosques and equivalent, such as schools and public hospitals, are deemed included under the Paragraph (5) of Article "8" of the Regulation, whenever such donation is proved by documents with providing a statement indicating the receipt of the assets or in-kind donations provided by the supervisory entity on the establishment or alike, such as the mosque's Imam, headmaster or hospital manager, appointed officially by competent authorities.

2.4.6 Created during the zakat year from the unearned premium reserve and the reserve for current risk in insurance and/or reinsurance companies

These are reserves reported by insurance and reinsurance companies as a regulatory requirement for the sector.

The unearned premium reserve is the part of premiums collected or recorded in the business books covering risk related to the zakat year or subsequent zakat years.

The reserve for current risk is the amount of compensations for claims received or reported during the zakat year with not completed procedures of disbursement during such year.

These reserves are allowed as deductible expenses for the purposes of identifying the activity's result, provided that such reserves:

- **Be returned to the zakat base in the following year; and**
- **Be determined in accordance with the professional standards used in this type of activity and in accordance with the applicable laws, regulations and rules related to the above-mentioned activity.**

2.4.7 School Tuitions paid for Children of the Zakat Payer's Employees

It has become a common practice for most enterprises to adopt various types of allowances and benefits to which the employee is entitled from the employer under their employment policies.

Education allowances are one of the most prominent allowances to which an employee may be entitled due to working for the employer.

Clause (8.7) of the Regulation provides that school education allowances shall be considered deductible expenses under the following conditions:

- **They shall be paid to a licensed educational institution within the KSA**

It means the institutions licensed to provide education services provided by schools, whether public, private, or international; and regulated by the Ministry of Education in Saudi Arabia or the Ministry of Human Resources and Social Development, such as nurseries.

For the purposes of this Paragraph, the zakat payer shall consider deducting education expenses for services rendered by the aforementioned educational institutions up to secondary education.

- **These benefits shall be provided for in the employment contract or the company's bylaws**

This evidence shall be a preliminary document for the employee's entitlement to such benefits provided for in the employment contract or the company's bylaws and employment policies, which shall provide that these allowances are payable to the employee, whether generally or according to the job grade of the employee.

In practice, the company's bylaws may provide for this benefit in one of the following methods:

1. A direct compensation on the basis of paying the education allowance as a lump sum to the employee.
2. An indirect compensation where the employee is compensated for his payments to the educational institution.

In both cases, the method of compensation shall not affect the deductibility of the expense while taking into account the other deduction conditions.

- **These expenses shall be supported by sufficient documents supporting the entitlement and payment of this allowance**

Such documents may include, but not limited to, a contract with the educational institution and a regular invoice issued by the educational institution in line with the instructions of invoicing in the Kingdom with a proof of payment to the employee or the educational institution directly

Example

The Mediterranean Company's policy compensates employees for education costs. In this regard, the Company's policy pays education costs to the employees indirectly where the tuitions are settled should the employee pay the tuitions and claim them from the company.

In light of the above information, the amount paid to the employee as a compensation for education expenses paid by the employee shall be considered deductible expenses, provided that the following is retained:

Company's policy or the employment contract indicating that these allowances and benefits are paid.

These expenses must be paid to a licensed educational institution in the Kingdom.

A contract, an invoice or a receipt indicating the company's name, the employee's name, or the name of the employee's children.

2.5 Non-deductible Expenses

This section covers items addressed under the provisions of Article (9) regarding non-deductible expenses, by which the activity's result should be adjusted.

2.5.1 Expenses and costs not related to the activity

Clause (8.1) of the Regulation provides that expenses and costs not related to the zakat payer's activity shall not be deducted. For example, the inclusion of the personal expenses of owners or employees within the company's expenses, gifts, hospitality and entertainment expenses; and awards and presents granted to the employees.

Example

The Company "X" has included the expense of purchasing a vehicle for an owner in the zakat declaration of 2023.

Based on the above information, what is the adjustment to the net profit for zakat purposes?

The accounting net profit is adjusted for zakat purposes by adding the expense of purchasing the vehicle, as such expense is considered a non-deductible expense.

2.5.2 Expenses that cannot be documentary supported by the zakat payer

In accordance with the previous section, no expenses shall be allowed for zakat purposes if they are not supported by documents, even when the said expenses are of a deductible nature from the activity result.

Accordingly, in principle, each expense must be recorded in the books under supporting documents to prove its nature as related to the activity; thus, satisfying the provisions of paragraph (1), Article "8" of the Regulation.

Generally and in principle, an expense should be recorded in the zakat payer's books under sufficient documents supporting the zakat payer's incurrence of the expenses for the purposes of the activity.

In the event that the supporting documents are insufficient, ZATCA shall have the right to disallow the deduction of the expense disclosed in the zakat declaration; consequently, modify the activity result.

Example

Al Qalam Company Ltd. has recorded the rent expense of the company's building within the expenses in the zakat declaration of 2022.

Upon ZATCA's review of the declaration, the zakat payer was able to provide the lease only.
In light of the above information, the lease shall be considered as a document under which the rent of the period may be determined, even of such rent is not paid, as long as it has been verified that the building is owned by the Company.

In such cases, the zakat payer shall provide further evidence, such as an invoice issued by the lessor at least.

2.5.3 Due or Paid Zakat and Tax

Zakat and income tax are not considered deductible expenses from the net profit, as they are considered a use of the income, not an expense. Therefore, zakat and tax shall not be deducted, whether paid or due inside the Kingdom or abroad, nor shall any penalties or fines related thereto.

Zakat represents the amount calculated as per the Regulation, which is recorded by the zakat payer in his books as deemed zakat for the zakat year. This term may also refer to the zakat charged (as a provision) as a result of existing cases and objections that may be filed by the zakat payer as per the Department's estimates, which require modifying the activity's result if recorded under expenses in the statement of income.

On the other hand, the term "tax" refers to the income tax and VAT due under the provisions of the Income Tax Law and Value-Added Tax Law in the Kingdom. Furthermore, the "tax" term does not include the withholding tax borne by the resident zakat payer on behalf of the non-resident service provider under a contract so authenticates.

Example

A non-resident provider has provided a technical service to a resident Zakat payer against SR 100,000. Upon the completion of the service, the zakat payer paid the dues of the resident provider without deducting the tax. During the inspection process, the zakat payer has been requested to pay and paid the non-deducted tax, and such tax was added to the expenses.

In the light of this example, the withholding tax paid by the zakat payer is not considered within the deductible expenses in this case, as the tax is due on the non-resident service provider as not agreed to otherwise.

Example

A non-resident supplier a person related to the zakat payer provided technical services to a resident zakat payer against an amount of SAR 170,000. Both parties agreed that the zakat payer shall bear any taxes and duties that may be applicable within the Kingdom. Accordingly, the zakat payer is required to pay the amount of SR 170,000 to the non-resident supplier for the service.

Upon the completion of the service, the zakat payer has paid the dues and withholding tax to ZATCA, and this dues were added to the cost with amount of 170,000 × 15%= SAR 25,500.

In light of the above example and in this case, the withholding tax is a part of the service cost as agreed with the non-resident supplier and shall be approved within the costs, provided that the withholding tax shall be re-calculated. Furthermore, the tax percent is 15% as the entity is related to zakat payer, therefore, the amount subject to the withholding tax and the withholding tax shall be re-calculated as follows:

Withholding tax (170,000 ÷ 85%) × 15% = SAR 30,000
The withholding tax becomes (SAR 30,000) not (SAR 25,500).

Example

The company has submitted the zakat declaration to ZATCA as a mixed company and paid zakat by amount of SR (100,000) and income tax amounting SR (150,000). After inspection and assessment, zakat variances were found to be due on the company amounting SR (25,000) and variances in income tax amounting SR (30,000), in addition to delay penalty in paying the income tax amounting SR (7,200). The company paid the variance of zakat and income tax as well as the penalty, and all was added within the expenses in the statement of income.

As per the above example, variances of zakat and income tax, as well as the delay penalty of income tax are not considered within the deductible expenses, and their profits shall be modified.

Example

The company contracted with non-Saudi employees. The contract conditions included that the company shall pay the due income tax in the employees' countries on the salaries paid to those employees, in consideration that the country imposes an income tax achieved by its citizens abroad.

In light of the example, this tax is considered one of the employees benefits stated in the contract entered by and between the employee and the company. Accordingly, this paid tax on salaries is considered within the deductible expenses.

2.5.4 Employee Share in Pension Programs and Provident Funds

Some companies run provident, pension, savings, or other funds for their employees, where a part of the employee's salary is withheld (employee's contribution) and a part is contributed by the company (company's contribution). This goes to the benefit of employees participating in the above-mentioned programs.

The employee's contribution is considered a non-deductible expense from the net profit for zakat purposes. In the event that the accounting net profit includes the employee's contribution, the activity's result shall be modified accordingly.

Example

A company operating in the Kingdom has established a pension fund for their employees and has included an amount of SR 230,000 under administrative and general expenses as employees' contribution in the pension fund for the employees' interest.

Employees' contributions in pension funds are disallowed, as they are considered non-deductible expenses for zakat purposes, unless when the company's policy or employment contract provides that the company shall bear the employees' contributions to pension and provident funds. In this case, the expenses are allowed, and the activity's result is not modified.

2.5.5 Provisions and Reserves created during the zakat year

The provision created during the year

These are potential expenses recorded by the zakat payer against liabilities expected in future, but this expense shall remain uncertain in terms of the time and amount.

Furthermore, accounting standards applicable in the Kingdom define the provision as a liability with uncertain timing and amount.

A provision differs from other liabilities payable to suppliers or other accrued expenses, where the latter arise for the provision of actual goods or services to the establishment with at least a certain amount or timing in the future. On the other hand, the provision is characterized by uncertainty in terms of the amount and timing.

In terms of zakat, a potential expense with uncertain timing and/or amount is considered non-deductible expense. When allowed, the expense is deducted within the limits of its actual formation and treatment.

These are non-exclusive examples on the provisions that fall within this item:

1. Provision for employee benefit plan liabilities.
2. Provision for doubtful debts or the so-called provision for credit losses.
3. Provision for slow moving inventory.
4. Provision for cases and lawsuits.
5. Provision for product maintenance guarantee or provision for warranties.
6. Provision for returning the site to its original condition (related to fixed assets).

Accordingly, whereas the provision does not present an actual expense upon its formation, it shall not be accepted as a deductible expense for zakat purposes because it is uncertain. Hence, net book profit (loss) shall be adjusted accordingly, in accordance with Article (9.5) of the Implementing Regulation.

The unearned premium reserve, and the reserve for current risk in insurance and/or reinsurance companies (technical reserves), provided however that such reserves shall be returned to zakat base in the following zakat year, and determined in accordance with the professional standards in this regard.

Example

The statements of income and financial position for one of the businesses included the following information for 2022:

Expense in the Income Statement	Corresponding Calculation in the Financial Position Statement	Particulars
1. Doubtful debts expense	Provision for doubtful debts	Represents the management estimates in respect of doubtful debts for the FY 2022
2. The portion created from provision for slow moving inventory (sold inventory cost)	Provision for slow moving inventory (in stock)	Represents the management's estimates in respect of the obsolete inventory in the warehouses for the FY 2022

3. Employees' incentives	Registered as employee's accruals for the financial year	Represent employees' accruals of the annual incentives after the management's approval on such incentives. These amounts were paid to the employees within the salaries and wages cycle of May of the following year.

In light of the above information, the zakat payer is required to modify the activity's result with only the following expenses as they fall under the provisions item:

- **Doubtful debts expense**
- **Provision created for slow moving inventory (sold inventory cost)**

Regrading professional services expense (and) employees' incentives, they shall be considered of the actual expenses (not provisions) that may be deducted as expenses as per the Regulation, provided that the supporting documents and other evidence mentioned in the Regulation shall be maintained, in addition to ZATCA subsequent requirements in the inspection phase of zakat declaration.

- **Reduction of the provision during the year**

In certain cases, the justification or reason for which the establishment considered creating a provision for an expense may disappear. Then, the provision is reversed to the statement of income whereby it becomes an accounting revenue (provisions no longer needed).

Example

The provisions movement for one of the businesses during 2022 has been reported as follows:

Provisions	Opening Balance	Additions during the year	Utilized amount of the Provision	Closing Balance
Provision for end of service benefits	91,769	11,900	8,500	95,169
Provision for depreciation of securities	3,450	-	-	3,450
Provision for depreciation of real estate prices	-	3,220	-	3,220
Provision for doubtful debts	501,579	185,000	15,000	671,579

So, if you knew:

- The utilized portion of the movement above represents that portion of the provision, which is no longer needed. Hence, it was reversed by recognizing the same within other revenues in the statement of income.
- The company's net profit of the above year amounted to SR 10 million.

Requirement: Calculate the adjusted profit for zakat purposes, assuming that no other adjusted items for the activity result.

10,000,000 Net accounting profit

Added thereto:

11,900 Provision for end of service benefits after reducing the same by the utilized amount thereof

3,220 provision for non-deductible depreciation of real estate prices

185,000 Provision for doubtful debts after reducing the same by the bad or reversed debts.

10,200,120 net adjusted profit for zakat purposes

2.5.6 Increment in the price of materials or services provided by related parties or who have the ability to impact on the acts or decisions of the zakat payer directly or indirectly compared to the prices utilized between independent parties in accordance with the applicable relevant laws, regulations and rules.

This item is directly related to those transactions with the mentioned parties against transactions that have an impact on the activity result, which may be conducted by the zakat payer for the purposes of reducing the activity result, and hence reducing the zakat payable.

It is noteworthy to mention that Transfer Pricing Bylaws issued by ZATCA pursuant to Board Resolution No. [196-1-] dated 251440/05/ AH corresponding to 312019/01/ AD, stipulated detailed definitions and clarifications in addition to controls, terms and conditions to consider that transactions had been conducted between related parties or those parties to which other parties have an effective impact.

In principle, commercial transactions, whether between related or unrelated parties, should have a commercial substance without having a purpose that would reduce tax or zakat burden contrary to the laws and regulations.

This matter also applies to the zakat aspect under the above paragraph, assuming that all transactions between the related or associated parties as if conducted between independent parties. If proved otherwise, the activity result shall be modified if proved that the transaction is not overshadowed by the commercial substance.

Therefore, in those cases involving overpriced transactions or not in line with the market having impact on the activity result of the zakat payer, the zakat payer shall consider the nature of transaction and modify the activity result accordingly.

Example

Company "X" and Company "Y" are falling within the definition of related persons.

Company "X" is a non-resident company incorporated in another country, and its profits are not subject to any taxes or fees, while Company "Y" is a resident company incorporated in the Kingdom and carries on business and supplies a type of goods for customers inside the Kingdom.

Company "X" is a supplier of a group of suppliers that Company "Y" deals with to purchase goods before aggregating and supplying them to the market of the Kingdom.

During 2022, Company "X" supplied goods amounting to SR 1800 to Company "Y". Through the transaction supporting documents, it was found that the price of goods is SR 1800, while the prevailing price in the market compared to the local market and other markets; where the price rate of the same goods is SR 1,000.

In such cases, the previous transaction will impact on the books of Company "Y" regarding the sold goods cost (the expense), and thus impacting the activity result through reduction.

Accordingly, modification of the activity result of the zakat payer will be taken into consideration unless an acceptable justification is provided about the essence of the transaction above.

Example

Company "X" and Company "Y" are falling within the definition of related persons. They are resident companies in the Kingdom subject to the provisions of zakat collection in the Kingdom.

Company "X" is leasing its owned building to several companies, including Company "Y".

Upon perusal of the both companies financial accounts, it was found that Company "X" charges rental expense amounting to SR 1,000,000, which is a value higher than the remaining lessees for the same property's area and specifications by SR 700,000.

In light of the above information, the transaction between Company "X" and Company "Y" has an impact on the activity result, which should be examined with identifying the impact on it. From Company's "Y" accounts, this had an impact on the activity result through reduction, while increase for Company "X".

However, it is necessary to identify the impact and modify the activity result in the event that both zakat payers ("X" and "Y") do not provide justification and evidence for the essence of this transaction since it has an impact on the zakat account for the current year and/or subsequent years.

2.5.7 Import Differentials

Import differentials may arise from comparing import amount reported in the zakat payer's declaration under foreign purchases item and the import amount recorded in Customs declaration.

These differentials usually arise either in excess (the amount recorded in the declaration is higher than the amount recorded in the Customs declaration) or decrease (the amount recorded in the declaration is lower than that the amount stated in the Customs declaration).

In either case, the zakat payer shall maintain supporting documents and settlements supported by evidence to justify these differentials. In the absence of such documents justifying the differentials, then, ZATCA shall have the right to conduct its assessment by one of the methods mentioned in the provision of Article (9.7) of the Regulation.

At the outset, it is necessary to highlight certain key reasons that may lead to the customs differentials:

- **Capital Purchases**

Companies may import fixed assets that are legally cleared; however, these assets appear within the fixed assets in zakat payer's books, and not within the equation of inventory cost in its books or within the foreign purchases, specifically in the declaration. This transaction (assuming there are no other import transactions) will show a value for customs imports higher than the recorded amount as per the zakat payer's books.

Such transactions should at least be supported by the following:

1. Fixed assets record showing such additions.
2. Foreign supplier invoice, which is identical in terms of the underlying value (purchase value), added thereto the other costs supported by documents, such as the customs duties, etc.
3. Any other documents that ZATCA may require subsequently during inspection process.

- **Imports on behalf of other Persons**

Such transactions might be common between zakat payers who carry out international shipping activity of goods, which, subsequently, these companies may have imports that are not primarily related to their activity, but fall under the item (imports on behalf of others).

Such transactions will also show imports according to customs declarations with an amount higher than the amount recorded as per zakat payer's books or declaration.

This matter requires clarification and supporting documents that prove that the transaction above is nothing but imports on behalf of others or company's customers. These include, but not limited to:

a. Purchase order issued by the customer as a request for such imports and shipping the same by the zakat payer on customer's behalf.

b. Supplier's invoice directed to the customer, which is in conformity with the specifications mentioned in the customs declaration.

c. Third party's certification of the imports amount conducted on his behalf.

d. Any exhibits or documents that ZATCA may require for verification of the above transaction.

- **The Timing Differentials of Imported Goods Registration**

There could be a difference in terms of timing of recognition of the foreign purchases according to zakat payer's books compared to timing of registration of the transaction with ZATCA. For example, goods may be cleared on the last days of the financial year, while they are registered in the books in the subsequent year when they actually entered the company›s warehouses and delivered.

On other circumstances, the goods may arrive and the zakat payer registers them in the books upon the receipt of the invoice form the foreign supplier. This may cause a difference in the timing of goods recognition and registration.

In such cases, the zakat payer shall maintain the supporting documents and justifications of the above transactions, in addition to the necessary settlements and other evidence that may be required by the ZATCA.

- **Purchases Returns**

In such cases, and after the goods have been cleared from customs, the zakat payer may need to return the goods to the foreign supplier because they are not in conformity with the specifications or are damaged, justifying failure to register these goods in the zakat payer's books, while ZATCA has previously recorded them in its system, which causes a difference in the foreign purchases between the two records; zakat payer's and ZATCA's records.

In this case, the zakat payer shall maintain the supporting documents for the transaction above as follows (for example, but not limited to):

- If the purchases were returned to the supplier as purchases returns, its necessary to maintain the abroad re-export statements, which prove that the imported goods are in conformity with the particulars of the re-export process, while maintaining other documents that reflect the transaction such as the credit note.

- If the purchases were maintained and if it was agreed with the foreign supplier that the goods are not in conformity with the specifications or are damaged (not valid for use or resale), it's required to maintain at least a credit note from the foreign supplier to reflect the transaction above.

In all of the above cases supporting the differentials in foreign purchases between the declaration and the books, ZATCA may require further documents, which provide extra level of credibility to the statements submitted by the zakat payer, which may be mainly the chartered accountant certificate to grant a confirmation according to the relevant standards regarding import differentials.

ZATCA's procedures in case import differentials were not settled

In case the supporting documents of import differentials mentioned in the above examples and any other examples were not available, ZATCA shall have the right to take the following procedures:

Case	Procedure Followed by ZATCA
In case that imports amount as per Zakat declaration is higher than the amount as per customs declaration	The differential is not allowed in the overcharged import expenses, through adding it back to the net profit of the year (added).
In case that imports amount as per Zakat declaration is lower than the amount as per customs declaration	ZATCA shall subject the differential in the expense to a profit, in accordance with the procedures determined by ZATCA at a rate not less than the gross profit rate of the declaration to the activity revenues, consequently, thereby modifying the activity result.

Example

Upon ZATCA's review of the zakat declaration of 2022 of Company "X", it has noted that the foreign purchases amount recorded was SR 2,500,000, while imports amount as per customs declaration for the same year was SR 4,000,000, it has also requested the zakat payer to provide a settlement and the supporting documents of the differentials above, but the zakat payer did not submit the same.

Requirement: What is the adjustment on the net profit by ZATCA?

Whereas the imports amount according to the customs declaration is higher, and since the zakat payer failed to submit the supporting documents of the differentials, then, ZATCA shall has the right to calculate a profit for the differential according to the procedures determined by ZATCA not less than the gross profit ratio of the return to the activity's revenues. Consequently, modifying the activity result.

With the assumption that the profit rate of the declaration is 10% and ZATCA has calculated a deemed profit at 15% of the differential between foreign purchases, which are not recorded in the zakat declaration (4,000,000 - 2,500,000 = SR 1,500,000) (1,500,000 × 15% = SR 225,000)

Example

The import amount of one of the companies as of 31 December 2019 was SR 80,000,000 according to the company's books.

Noting that the import per customs declaration was SR 100,000,000.

Assuming that the rate determined by ZATCA not less than the gross profit ratio of the declaration to the activity's revenues is 15%

Requirement: How does this differential is treated in the imports amount in the following cases:
First case: Import differential resulting from fixed assets additions
Second case: Charging imports on the financial position items or statement of income items.
Third case: Import on behalf of other companies.
Fourth case: Timing and registration differentials.

Case	Procedure Followed by ZATCA
First case: Import differential resulting from fixed assets additions	• In this case, import differentials are not calculated if the zakat payer submitted a statement of the fixed assets added during the zakat year, while providing ZATCA with invoices for the purchases of such assets that are in conformity with the invoices of purchases as per customs declaration. • In case there were differentials not supported by documents, this differential; amounting to (SR 20,000,000) shall be returned. In addition, an estimated profit shall be calculated at a rate determined by ZATCA not less than the gross profit ratio of the declaration to the activity's revenues, consequently, modifying the activity result as follows: (Import differential × the rate determined by ZATCA not less than the gross profit rate of the declaration to the activity's revenues × 2.5% = zakat value) 20,000,000 × 15% × 2.5% = SR 75,000

Case	Procedure Followed by ZATCA
Second case: Charging imports on the financial position items or statement of income items.	• If the zakat payer reconciled the closing balance of the inventory as per the declaration with the financial statements, and it is found that part of his purchases is charged on the production phases, which appear within the inventory items in the statement of financial position. As such, no import differentials shall be calculated, without prejudice to ZATCA's right to request necessary samples to verify the validity of these differentials. • In case there were differentials not supported by documents, this differential, amounting to (SR 20,000,000) shall be returned. In addition, a profit shall be calculated for this differential at a rate determined by ZATCA not less than the gross profit rate of the declaration to the activity's revenues, consequently, modifying the activity result as follows: (Import differential × the rate determined by ZATCA not less than the gross profit rate of the declaration to the activity's revenues × 2.5% = zakat value) 20,000,000 × 15% × 2.5% = SR 75,000

Case	Procedure Followed by ZATCA
Third case: Import on behalf of other companies.	• The company will be required to submit a statement of these differentials, represented in its importation of a subsidiary, further it will be required to provide ZATCA with the names of these companies and their certificati-ons on these balances. Accordingly, it shall be examined and verified that these companies have registered the imports within their statements and zakat declarations. • In case there were differentials not supported by docu-ments, this differential, amounting to (SR 20,000,000) shall be returned. A profit shall be calculated for this differential at a rate determined by ZATCA not less than the gross profit ratio of the declaration to the activity's revenues, consequently, modifying the activity result as follows: (Import differential × the ratio determined by ZATCA not less than the gross profit ratio of the declaration to the activity's revenues × 2.5% = zakat value) 20,000,000 × 15% × 2.5% = SR 75,000
Fourth case: Timing and registration differential.	The zakat payer will be required to submit the imports statement that were registered at the end of the year with Customs and appeared in the Company›s books at the subsequent year. He will be further required to provide ZATCA with the invoices and records of their registration in the books for the subsequent year. Accordingly, the documents submitted will be verified and reversed in the subsequent year›s financial statements, and the invoices of purchases will be reconciled with the Customs declaration without calculating import differentials.

Example

The imports amount of one of the companies as of 31 December 2019 was SR 100,000,000 according to company›s books, noting that the import as per Customs declaration was SR 80,000,000.

Requirement: How does this differential is treated in the following cases:

First case: Differential resulting from import on behalf of other companies

Second case: Differential resulting from the difference in timing and registration

Case	Procedure Followed by ZATCA
First case: Import on behalf of other companies	• Upon examination, the company has submitted a statement for these differentials, represented in another subsidiary company that imports on the main company's behalf. The company is requested to provide ZATCA with the names of these subsidiaries and their certifications on these balances. Accordingly, it shall be examined and verified that these companies did not include these imports in their statements and declarations. • In case there were differentials not supported by documents, this differential, amounting to (SR 20,000,000) shall be returned and added to the net profit.
Second case: Timing and registration differentials	The zakat payer has submitted a statement for imports that was registered at the beginning of the subsequent year with Customs, and they were appeared in the company's books of this year, while providing ZATCA with the invoices and records of their registration in the books for this year. Accordingly, the submitted documents will be verified, and the invoices of purchases will be reconciled with the Customs declaration, and thus, import differentials shall not be calculated.

2.6 Other considerations for non-exclusive items affecting the activity result and its zakat treatment

2.6.1 Difference in salaries and wages between those registered in books and declared before GOSI

Salaries and wages are an integral part of expenses incurred by an establishment to perform its activity. Normally the establishment is contracting with the employees by virtue of legal employment contracts registered before competent authorities. Contracts' nature is summarized with the agreement with employees to receive a salary and other allowances for performing their job duties.

These allowances are varied according to some factors such as the establishment's work nature and activity, in addition to the job grade of the employee and other factors.

Legally, a company contracting with employees working under its umbrella should disclose all employees' contracts and register them at GOSI to calculate the subscriptions in the pension fund at GOSI. Registering at GOSI means that the establishment shall disclose all compensations received by the employees such as the salary and various allowances as stated in the employment contract.

Furthermore, these salaries and allowances will be subject to other laws such as Wages Protection System, which obligates the establishment to pay the subscriptions registered at GOSI.

As per the related provisions in Social Insurance Law, it is not necessary that all compensations paid to the employee shall be subject to GOSI subscriptions. For instance, only the basic salary and housing allowance are generally subject to subscriptions calculating basis. However, for zakat purposes, it is not necessary for other allowances to be considered of a non-operational nature or not related to the activity. They rather are supposed to be based on the establishment's work nature for example, and the job position of the employees to decide its deductibility as an expense for zakat purposes.

Accordingly, the compensations general paid to the employee, such as salary and allowances are considered deductible expenses, provided the following (for example, but not limited to):

- Legal employment contract between the establishment and the employee.
- Registration with GOSI and related systems, such as Wages Protection System.
- There shall be a clear internal policy for the company for any other allowances not subject to GOSI.

ZATCA has the right to request any additional documents and settlements it may need upon examining the zakat payer's declaration. This includes the settlements with respect of the details recorded in the zakat payer's books and zakat declaration and those disclosed at GOSI as per GOSI's certificate that indicates salaries and wages subject to GOSI subscriptions.

2.6.2 Change in exchange rate of financial statements' items that are recognized at income statement (profits or losses statement)

The zakat payer in the context of practicing its operational activity in some transactions or contracts may contract with other parties in foreign currencies, other than Saudi Riyal. These operations include sales, purchase, money transfer, etc.

For example, in the event the zakat payer contracted to purchase goods amounting to EUR 100,000 from a non-resident foreign supplier, the zakat payer shall record the purchase operation in its books and recognize accounts payable (accrual of foreign supplier) in the above value after exchanging it to Saudi Riyal as the reporting currency, using the exchange rate at the operation's date. After payment's date, and due to the Euro rate's fluctuations, the zakat payer will exchange the same contracted amount in Euro using another exchange rate at the date of such exchange. Difference between the foreign currency rate at the operation of purchase date and its recognition in the books and same currency's rate at the date of exchange will result in a profit or loss as a result of the change in the foreign currency exchange rate.

On the other hand, and using the same above information, with the assumption that the amount due to the supplier remained with the zakat payer until the end of the financial year without settlement, in this case, zakat payer shall consider calculating the unrealized currency's differences between the original operation's date (purchase date) and financial reporting year end date. This will result in changes in the exchange rate causing unrealized profit or loss.

In both cases, realized or unrealized profits or losses resulting from changes in the foreign currency exchange rate against local currency are recognized in income statement (profits or losses statement).

From zakat side, the abovementioned events in addition to other similar cases do not require a modification of the activity result.

2.6.3 Utilized amount of the provisions previously added back to adjusted profit subject to zakat in the year of its creation

As per paragraph (5), Article "9", modifying the activity result regarding the provisions is limited to the its part that is created during the year and recognized in the income statement as it is considered as non-deductible expenses for the purposes of calculating adjusted net profit (loss) for zakat purposes.

Regarding other provisions' elements, their zakat treatment is limited to adding opening balance carried forward from previous years less the part utilized during the year pursuant to Article 4 (6) of the Regulation.

Zakat treatment for the provisions can be summarized as follows:

Details	Zakat Treatment
Opening balance of provisions (1)	Additions to zakat base.
Created during the year (2)	Modification of activity result
Paid/ utilized during the year (3)	Deducted from item No. (1)

Therefore, zakat payers shall comply with the following zakat treatment:

1. In case of zakat assessment where the base is higher than net adjusted profit: utilized part of the provisions are deducted from the zakat base.
2. In zakat assessment cases where net adjusted profit is higher than the base: the utilized part is deducted from the net adjusted profit considering it as deductible expense, provided that net profit after deducting the utilized part shall be compared with the base, after cancelling the effect of the utilized part of the provisions from the base, and considering whichever is higher.

Example

Movement of slow moving goods provision for a business for the year ended on 31 December 2022 was as follows:

Item	Amount
Opening balance	1,000,000
Provision created during the year	200,000
Utilized part during the year	(100,000)
Closing balance	1,100,000

Requirement: How does this differential is treated in the imports amount in the following cases:

Item	Amount	Amount
Additions to the zakat base	Opening balance (-) utilized part of the provision during the year	900,000
Modification of the result of the activity	Created during the year	200,000

Example

Declaration's result for a business for the year ended on 31 December 2021 was as follows:

Item	Amount
Net adjusted profit for zakat purposes	500,000
Zakat base	(100,000)

When ZATCA has reviewed the zakat declaration for the above year, it was evident that the declaration included amendments to the activity's result amounting to SR 10,000 regarding an amount utilized from doubtful debts provision because profit adjusted for zakat purposes is higher than zakat base.

Item	Amount
Opening balance	50,000
Created during the year	20,000
Utilized during the year	(10,000)
Closing balance	60,000

In such case, zakat payer's modification is accepted as the zakat base is the net adjusted profit for zakat purposes whether before or after deducting the utilized part of the provision.

2.6.4 Company's share in business results of investee company via equity method

In the cases where investor owns shares in establishments within the Kingdom or abroad in form of equity instruments, while investor has an important control or effect on these companies, the measurement of these investments as per the accounting standards is included under one of the following classifications:

Investee company classification	Reasoning
Subsidiary	Control over the investee company
(or) affiliate	Important effect of the investee company
(or) joint venture	Mutual control with other party over the investee company

For further information on the aforesaid, kindly refer to the Guide of (Investments in equity for zakat payers holding statutory books)

In general, accounting standards applicable in the Kingdom require recognition and measurement

This method is summarized by measurement and accounting recognition of investment as follows: of these investments in zakat payers books by (equity method).

Investment cost upon initial purchase (1)
Add (less): investee company share in business results of subsidiary, affiliate, or joint venture of profit or (loss) (2)
Less: its share of year profits in subsidiary, affiliate, or joint venture (3)
Closing investment balance (4)

The above method is applied upon the end of each financial reporting period for the investing company by taking the book balance as in the previous year end and amending it with the above items (2 and 3)

Example

On 012022/01/ AD, the Arabian Company had investment balance in a subsidiary amounting to SR 500,000. The subsidiary has achieved net income amounting to SR 100,000 during the year. It has also paid dividends amounting to SR 50,000.

The Arabian Company uses equity method to account for its investments in the subsidiary. The ownership percentage of the Arabian Company in the subsidiary is 70%.

Classification	Details	Amount (Saudi Riyal)
Investment balance at the beginning of the year	Balance at 01/01/2022 AD	500,000
Add (Less): Arabian company share in net income (loss) of the subsidiary	100,000 × 70%	70,000
(Less): Arabian company share of dividends of the subsidiary	50,000 × 70%	(35,000)
Investment account balance in the subsidiary at the end of year		535,000

As previously noted, among items amending the above investment balance, the only item affecting the activity result is the investing company share in business results (profit or loss) of the subsidiary, affiliate, or joint venture, which is recognized in income statement (profit or loss).

This item's treatment is summarized with not modifying the activity result of company's share in business results of the mentioned investments whether of profit or loss, therefore:

Company's share in profits of investee companies is subject as a part of activity result.

The deduction of the company's share in the losses of the investee company is accepted by considering this share within the deductible expenses. Accordingly, it is not required to modify the activity result.

Example

Below is the comprehensive income statement for a company for the year ended on 31 December 2022:

Item	Amount (SR)
Revenues	10,000,000
Sales costs	(6,000,000)
Total profit	4,000,000
Administrative and general expenses	(3,000,000)
Interests revenue	50,000
Company's share in business results of a subsidiary	100,000
Company's share in business results of affiliates and joint ventures	(200,000)
Net profit (loss) before zakat provision	950,000

Clarifications:

1. Among the administrative and general expenses, there are expenses that don't meet the deduction conditions pursuant to the Regulation amounting to SR 300,000.

2. The Company's above investments are in resident subsidiaries and affiliates, and the company submits its declarations to ZATCA pursuant to the Regulation.

Requirement: Calculating adjusted profit for zakat purposes for the year 2022.

Item	Amount (SR)
Profit (loss) before zakat provision	950,000
Add: nondeductible expenses	300,000
Adjusted profit for zakat purposes	1,250,000

It can be noted form the example solution that activity result of the company's share in business results of subsidiary and affiliate has not been amended. Therefore, company's share in subsidiary's profits is subject to zakat and the share in affiliate's losses of expenses remains deductible.

It is noteworthy to mention that for the above-mentioned treatment to be applied, it is required for the investee company to submit zakat declaration and pay the due zakat or, in the event of investments outside the Kingdom, the company shall subject these investments to zakat according to Article 5 (5) of the Regulation which requires the following:

1. These investments are kept for non-trading purposes

2. Zakat calculation pursuant to a chartered accountant certificate.

3. Due zakat payment pursuant to the investing company's zakat declaration.

2.6.5 Profits or losses generated from selling investments recognized in other comprehensive income statement

In other cases where investor owns shares in establishments within the Kingdom or abroad in form of equity instruments, while the investor does not have control or important effect on these companies, the measurement of these investments as per the accounting standards is under fair value using one of the following classifications:

1. Fair value investments through profit or loss

2. Fair value investments through other comprehensive income.

Main differences between the above classifications can be limited in terms of the place of recognition of the generated income from these investments:

Investment type	Recognition place
Profit or loss generated from selling the investments in fair value through profit or loss	Income statement profit or loss statement
Profit or loss generated from selling the investments in fair value through other comprehensive income	Other comprehensive income statement

From the above analysis, it is clear that cases where profit or loss is generated from selling or disposal of investment recognized in the fair value through profit or loss statement, these profits or losses will be recognized as part of activity result. Therefore, they will be subject to zakat without adjustments on the net book profit or loss before zakat provision.

On the other hand, in the event of disposal or selling investments in the fair value through other comprehensive income, these generated profits or losses remain in other comprehensive income statement (i.e., after net book profit or loss). In such cases, to achieve fairness in treatment of the generated profit or loss as in the first classification, this requires modifying the activity's result as follows:

1. Recycling the profit generated from selling investments in the fair value through other comprehensive income and modifying their activity's result by adding the result to the activity.
2. Recycling the losses generated from selling investments in the fair value through other comprehensive income and modifying their activity's result by deducting it from the activity's result.

Zakat treatment for the above can be summarized as follows:

Investment type	Recognition place	Recognition place
Profit or loss generated from selling investments in the fair value through profit or loss	Income statement profits or losses statement	It does not require modification of the activity result as it is part thereof
Profit or loss generated from selling investments in the fair value through other comprehensive income	Other comprehensive income statement	It requires the modification of the activity result by adding profits generated for activity result and deducting losses generated from activity's result

Example

Financial statements for the Arabian company for the year ended on 31 December 2022 have shown the following information:

1. Net accounting profit before zakat provision: SR 1,000,000
2. The company has sold a part of its investments in shares of a company listed in the Saudi market. Selling process has generated profit amounting to SR 50,000. Furthermore, the company was keeping those investments for trading purposes, and are classified in the statements under investments in the fair value through profit or loss.
3. The company has another type of investments in other companies' shares that are kept for non-trading purposes. They were classified in the statements under investments in the fair value through other comprehensive income. During 2022, the company has sold a part of its investments in some companies to fulfill its need of cash liquidity. The above selling process has resulted in a loss of SR (20,000) that has been recognized in other comprehensive income statement in company's financial statements.

Requirement: Assuming that all other expenses are fulfilling the deduction's conditions pursuant to the Regulation, what are the items modifying the activity result from the above information.

Solution:

Item	Amount	Illustration
Net accounting profit before zakat provision	1,000,000	It is considered as the activity's result as per the financial statements of the zakat payer subject to modifications
Profit generated from selling investments in the fair value through profit or loss	Not require modifying its activity result	It is considered as part of the activity's result and has been previously recognized as part of net book profit
Loss generated from the disposal of investments in the fair value through other comprehensive income	(20,000)	It requires modifying its activity's result as it is recognized beyond the income statement and is not considered part of net book profit.
Adjusted net profit (loss) for zakat purposes	980,000	

2.6.6 Income from dividends from investee companies

To complement the stated in the above subsections, income from dividends received by the zakat payer as revenues from its investments in other companies' equities whether inside or outside the Kingdom can be considered as part of the activity's result (accounting profit before zakat provision).

In such cases, this item remains within the activity's result without modifying it and also subject to zakat as per the Regulation.

2.6.7 Profits or losses arising from remeasurement of employees' benefits plan

Starting from January 1, 2017, joint stock companies initially complied with transforming towards International Financial Reporting Standards (IFRS). Therefore, these companies became obliged to prepare their financial reports pursuant to these standards.

Among such IFRS is the international accounting standard (IAS) No. 19 "Employee Benefits". This IAS obliges companies in the Kingdom to calculate liabilities and expenses arising from employees' benefits, whether short-term benefits, after service, end-of-service benefits and other long-term benefits.

IAS obliged companies to estimate the final cost incurred by the company from benefits given to employees on basis of actuarial assumptions such as population variables, e.g., employee turnover rate and mortality rate, and financial variables, e.g., future increases at salaries and medical costs, which will affect the cost of such benefits.

At the end of every fiscal year, companies obliged by this standard remeasure their liabilities regarding the above. It may require a certified actuarial expert to perform such task. This requires the company to consider remeasurement's results of employee's benefits liabilities at the end of each financial report's year. For instance, the results of remeasurement of employees' benefits plan show the following:

Item	Amount	Classification in the statement
Employees' benefits provision	XX	Statement of financial position within non-current liabilities
Provision made during the year	XX	Income statement
Paid during the year	XX	Deducted from provision's balance in financial position statement
Actuarial profits or losses arising from remeasurement of employees' benefits plan	XX	Statement of other comprehensive income

According to the aforesaid, it is noted that actuarial revenues and losses are considered from employees' benefits liabilities components arising when the actual reality of local labor and wages system is different from the expected by using actuarial assumptions.

Actuarial loss is the increase in the unfunded actuarial liabilities of the plan at the date of measurement for the unfunded actuarial liability that would happen if all actuarial assumptions have been achieved. If the actuarial loss is less than zero, they are called actuarial revenues. For example, an actuarial revenue may happen if the plan's assets obtained 12% for the year, while assumed revenue rate utilized in the measurement was 8%.

Other reasons of actuarial revenues or losses include changes in actuarial assumptions and/or demographic changes in employee's identification file in the company.

In the accounting reality, such profits or losses are recognized within the statement of other comprehensive income, i.e., they are not considered part of book profit (loss). In contrast, these profits are reflected to another aspect of the equitation reflected on the remeasured liabilities provision as follows:

Item	Effect on employees' benefits plan liabilities provision
Actuarial profits	Decrease
Actuarial losses	Increase

To determine the effect of these profits or losses on the activity result, they shall not have an effect on it since they were recognized outside the income statement or after book profit or loss (profit or loss after zakat provision). Nevertheless, the effect of these items on the second part of the provision shall be considered as a liability and a component of zakat base.

As per Article "4' of the Regulation, opening balance of provisions, including but not limited to employees' benefits liability provision, shall be added after deducting the utilized during the year.

Therefore, since the items recognized in the other comprehensive income affect the provision according to the analysis mentioned above in inversely. In the event their activity is not amended, these items' effect will be compensated through the provision as follows:

Item	Effect on employees' benefits plan liabilities provision	Zakat treatment
Actuarial profits	Decrease	They are not included as a modification of the activity result and subjected to zakat as their zakat effect will be compensated as part of employees' benefits provision through decrease.
Actuarial losses	Increase	They are not included as a modification of the activity result as deductible expenses as their zakat effect will be compensated as part of employees' benefits provision through in excess.

Therefore, activity result is not required to be modified by actuarial profits or losses upon calculating zakat base for the zakat payer.

2.6.8 Value-added tax

The value-added tax is an indirect tax imposed on consumption and paid by the customer, and collected in each phase of supply chain phasis, starting from factory purchasing raw materials (for instance) ending at retail trader selling of the final product to the consumer.

Unlike other taxes, people subject to VAT will:

- Collect VAT from their customers for each selling process subject to tax as per the specified percentage.
- Pay the VAT to the suppliers from whom they received the goods or services (if any) for each purchase process subject to tax equals to the specified percentage.

When people subject to VAT sell a good or deliver a service, they shall impose the VAT applicable rate as per the applicable laws and regulations to the final selling price, provided that those people shall calculate the VAT rate they have received from selling process subject to VAT separately from their income to be paid latter to ZATCA. The VAT collected by people subject thereto for their sales is called output tax.

Similarly, purchases by people subject to VAT are treated, where VAT rate is added to purchases of goods and services delivered by people subject thereto with the assumption that standard rate is imposed on those supplies. VAT paid by people subject thereto to their suppliers is called "input tax".

On light of the above, VAT is imposed on goods and services supply processes. It shall be paid by the client (the consumer) to the trader or supplier in order for the latter to collect and provide it to ZATCA.

In some cases, the supplier is considered to incur the VAT either for the fact that it shall not be registered for VAT or otherwise.

In such case, as for the nature of the VAT as it is a tax on consumption, in cases where additional tax is incurred on supplies, it is considered as part of the good or service supply cost. Therefore, VAT shall be part of supply cost itself and considered as part of expenses to determine activity's result.

In other cases, supplier (seller) may incur a VAT on its supplies for clients. For example, the supplier may forget to impose a VAT on one of its supplies to the clients or it may happen due to imposing a VAT pursuant to an amendment performed by ZATCA resulting in VAT differences on its supplies, which, in turn, required to be incurred by the supplier. Since supplier is responsible to impose, collect and provide this tax to ZATCA, in the event this tax is incurred as an expense in its books, **it is not accepted to enter in the process of determining activity's result. Therefore, VAT is considered as non-deductible expenses and the activity's result shall be modified**.

Example

First Technology Company, a resident company established on 2022, has received legal services form a resident supplier against SR 115,000, inclusive of VAT.

The Company has recorded an amount of SR 115,000 (100,000 services value + 15,000 VAT) in professional services expense account, considering that the company is not registered in the VAT.

Through the above inputs, since VAT is being incurred as part of a supply or deductible expense (professional services expense), the amount inclusive of VAT is also considered deductible. Taking into consideration keeping other supporting documents such as the contract, the invoice, and other documents to support its deduction as an expense pursuant to the relevant regulation's provision.

Example

Referring to the same previous example, assuming that the company has incurred VAT on partner's flight tickets considering it as personal expenses not related to company's activity amounting to 1150 inclusive of VAT (1000 + 150 VAT).

In such case, as the expense (the supply) is one of the personal expenses that are not related to zakat payer's activity, it is not considered as deductible expenses pursuant to the Regulation. Therefore, the whole amount is not a deductible expense, including value added tax.

Example

Company "X" provides goods supplies to its clients in the Saudi market. The company is registered for VAT purposes before ZATCA and imposes tax on its supplies pursuant to the provisions of the applicable laws in the Kingdom.

During the year, the company has supplied a good to a client; however, it did not impose the VAT of 15% inadvertently, and was not able to collect the VAT amount from the client later. Accordingly, the company had to record the VAT amount as an expense in its records.

In this case, VAT amount is not considered as a deductible expense as this VAT is considered mainly a tax on consumption by the client not the supplier.

2.6.9 Real Estate Transaction Tax

RETT is the amount imposed on real estate transaction; the latter is known as any legal transaction transferring a real estate ownership or possession to own it or its utility. This includes, but not limited to, contracts that transfer usufruct or long-term rent right and other cases stated in RETT Implementing Regulations issued under the Ministerial Resolution No. (712) dated 15 Safar 1442 AH and subsequent amendments thereto.

RETT is imposed on a certain percentage of the real estate to be sold. The RETT charged on the real estate does not include any fines of any kind or reason.

Generally, RETT is considered as capital cost added to real estate value that might be incurred by the buyer (transferee) in addition to contractual value agreed (purchase price). Buyer's payment proof of RETT to the transacted and the latter's payment of tax are initial documents that prove buyer's bearing of the RETT. Furthermore, the buyer is responsible to record such RETT.

Assuming that RETT has been incurred by the buyer for an investment real estate to use it in the activity, this RETT should be incurred on the real estate value upon purchasing.

Accordingly, if zakat payer incurred RETT for purchasing a real estate used in its activity, it should not be recognized as an expense in income statement. It rather should be added to real estate value, whether the real estate is consumable (such as buildings) or consumable (such as lands). As such expenses are not administrative expenses related to asset's possession, **but they are necessary and direct costs to own the real estate. Accordingly, they shall be capitalized and this RETT becomes part of the asset's cost and can be deducted when transformed to become part of income statement (activity's result) upon selling it as part of asset's cost or upon consuming the asset in the event of keeping it to be used in zakat payer's activity.**

It must also be emphasized that the limit to be accepted as an expense is the amount of RETT incurred by the buyer only. Therefore, no fines related to this RETT when arising are accepted.

Example

Company "X" has purchased a building in 2022 amounting to SR 5,000,000. The building will be used as an investment real estate to be rented to others. The company has incurred RETT amounting to SR 250,000 and paid it to ZATCA as per the relevant laws. The company has also incurred other direct costs and duties amounting to SR 100,000 for the possession of the asset and transferring the legal ownership of the building to the company.

Using the above inputs, the company shall capitalize the costs incurred on the real estate value including RETT as follows:

Details	Amount
Contractual value of purchasing the building	5,000,000
RETT	250,000
Other direct fees of transferring the real estate	100,000
Investment real estate value	5,350,000

Therefore, the company is supposed to consume the building along with capitalized other costs during the expected useful life of the building and recognize the consumption as deductible expenses, considering consumption controls stated in the Regulation.

2.6.10 Excise Tax

Excise tax is an indirect tax and is being imposed on goods that have negative impacts on public health or the environment in varying percentages. These goods involve soft drinks, energy drinks, sweetened drinks, electronic smoking devices or tools and the like, liquids used in those electronic devices and the like, tobacco and its derivatives.

Excise tax is imposed on subjected goods with the following percentages:

Item	Excise Tax
Soft drinks	50%
Sweetened drinks	50%
Energy drinks	100%
Electronic smoking devices or tools and the like, liquids used in those electronic devices and the like, tobacco and its derivatives	100%

The following people are subject to excise tax:

People receiving excise goods: Beyond any situation outstanding the tax in the event the due tax thereon is not paid in full.

Manufacturers: Manufacturers disclose and pay the dues on the goods offered for local consumption.

Importers: At this phase, importers pay the tax on the excise goods in the phase of customs clearance of the goods before ZATCA.

From the accounting fact, people subject to the excise tax (whether manufactures or importers) are being accounted for due excise tax paid to ZATCA through charging it to the inventory value (i.e., it is considered as part of inventory cost). Therefore, manufacturer or importer will add the excise tax to the inventory cost for the purposes of accounting costs related to the inventory not as an expense within income statement.

Upon selling the inventory subject to excise tax, inventory cost including excise tax is incurred to income statement as part of sold goods cost.

Therefore, excise tax is considered as deductible expense to the extent that this tax is considered incurred on the sold goods cost that are recognized in the income statement. This is in the event it is not in a tax suspension situation. Noting that the importer who obtained a license of tax warehouse for inventory purposes has the right to clear the goods under a tax suspension situation while paying due tax after offering it for consumption (no longer under the tax suspension situation). In this case, the paid excise tax, after releasing the goods and becoming no longer in the tax suspension situation, is considered as deductible expenses as it is a part of goods cost upon selling that are incurred in the income statement.

There are further important considerations in the event of excise goods manufacturers, where the paid excise tax on inputs is required to manufacture goods subject to deductible and refundable excise tax pursuant to Excise Tax Law. Accordingly, it is worth noting that excise goods manufacturers are not entitled to deduct any deductible excise tax on their inputs as per Excise Tax Law. In addition, the failure of the manufacturer to use the deduction right given to it under the Excise Tax Law may not give him the right to deduct the excise tax within the deductible expenses for calculating adjusted profit for zakat purposes.

2.7 Practical examples

Practical example (1)

Income statement of Riyadh company showed the following financial statements for the financial year ended on 31 December 2022 as follows:

Income statement	2022
Revenues	42,000,000
Revenues' cost	(35,000,000)
Total profit	**7,000,000**
Selling and distribution expenses	(2,750,000)
General and administrative expenses	(250,000)
Operations' profit	4,000,000
Company's share in subsidiaries' business results	500,000
Dividends from investing companies	100,000
Financing costs	(500,000)
Profit of the year before zakat	**4,100,000**
Zakat	(200,000)
Profit of the year after zakat	**3,900,000**

Other information:

1. The company has organized an employees' camp as part of company entertainment policy supporting to its activities within the Kingdom and as a contribution to the community amounting to 21,000 incurred within the expenses in income statement.

2. The company has paid donations to an entity authorized to receive donations in the Kingdom amounting to SR 20,000 and 10,000 to a charity in the Arab Republic of Egypt.

3. The company has compensated the employees for school tuitions of their children in the Kingdom amounting to SR 100,000.

   Among expenses, there is an amount of SR 200,000 representing withholding tax expense and fines incurred by the zakat payer for payments to non-resident entities.

4. Among expenses, there is maintenance expense for the general manager house amounting to SR 200,000.

5. The company has purchased a real estate to use it as an administrative building. It purchased the real estate for an amount of SR 2,000,000 and included the RETT amounting to SR 100,000 within the expenses in income statement.

6. Regarding company's share in subsidiaries' business results, it represented company's share in general profits of a subsidiary in Kuwait. The company did not subject its investments in the said subsidiary to zakat.

7. The company has received dividends representing income from the distributions against its investments at companies, whose shares are traded in the Saudi market, noting that such dividends are derived from current year profits of investee companies.

8. The movement of the provision of the end-of-service benefits for the employees during the year was as follows:

Opening balance	Provision created during the year	Utilized during the year	Closing balance
150,000	70,000	30,000	190,000

9. The movement of provision of slow moving goods during the year was as follows:

Opening balance	Provision created during the year	Utilized during the year	Closing balance
100,000	50,000	20,000	130,000

Requirement: Calculating the adjusted net profit for zakat purposes?

Example solution:

From the above facts, activity's result shall be amended as follows:

Net accounting profit before zakat	4,100,000	As per the regulation
Add (less) the following:		
Donations paid abroad	10,000	Donations paid abroad in violation to the controls mentioned in the Regulation in this regard
Withholding tax and related fines expense	200,000	Due zakat and income tax are not considered from the deductible expenses
General manager house maintenance	200,000	Expenses not related to the activity
Provisions created during the year	120,000	Non-deductible (potential expense) provision
RETT	100,000	Capital expenses, added to the cost of the capital asset
Adjusted net profit for zakat purposes	4,730,000	

3. Appendix: Frequently asked questions

1. Does the part utilized from the provisions is considered from items that shall be included as modifications of the activity's result upon calculating net profit (loss) for zakat purposes?

* In case of the zakat assessment where the base is higher than the adjusted net profit, the used provisions are to be deducted from the zakat base.

* In case of the zakat assessment where the adjusted net profit is higher than the base, the used adjusted net profit is to be deducted as a deductible expense, provided that the net profit shall be compared to the base after deducting the used profit (after cancelling the effect of the base provision), and considering whichever is higher.

2. How can the VAT be treated if charged as an expense and formed part of the activity?

The VAT is mainly a tax on consumption, meaning that the client is the one who incur it not the seller. In the cases where the buyer incurred it on its purchases of goods and services and was recorded for the expense account, its treatment follows the supply, provided that it cannot be refunded within the declaration of the VAT, i.e., if the original supply is represented by a deductible expense, the tax incurred by the buyer (as the zakat payer) on that supply is also deductible.

3. What is the minimum of evidence and documents to prove the deductibility of the expense for zakat purposes?

The Regulation did not mention an inclusive list of these documents. However, zakat payer is expected to keep the minimum of these documents that can be represented by a contract, invoice, payment proof and other documents that support expense's incurring for the purposes of the activity.

4. In the event of differences in the external purchases between books and zakat declaration, what are the supporting documents to be kept proving the nature of this difference?

In such cases, zakat payer shall make the necessary settlements supported by documents and evidence to prove the nature of these differences. Therefore, zakat payer shall keep the said until the declaration is examined by ZATCA to prove the nature of this difference upon ZATCA's request. ZATCA has the right to assess the validity of the submitted settlements and documents upon examining the declaration.

5. Is there guidelines for the depreciation percentages of fixed assets for zakat purposes?

No, the Regulation left the matter for the zakat payer to depreciate the fixed assets and record depreciation expense in the books, while taking into consideration that depreciation expense shall be within the reasonable and customary limit in the practical and applicable reality in the market.

6. What is the zakat treatment of changes in the fair value of the statement of financial position items that are recognized within the activity's result?

In compliance with the Regulation's provisions, changes in the fair value shall be taken into consideration upon calculating zakat base. Accordingly, positive or negative changes in the fair value shall remain within zakat payer's activity result without modification.

7. In the event of receiving dividends from resident or non-resident, listed or unlisted companies, how they are treated for zakat purposes?

In the cases where zakat payer receives dividends from its investments in other companies that are recognized in income statement within the activity's result, this does not require a modification of such result. Therefore, these dividends are subject to zakat as part of the adjusted net income for zakat purposes.

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