

CHAPTER 2

AN OVERVIEW OF MALAYSIAN TAX AND ZAKAT ADMINISTRATION

2.1 Introduction

This chapter discusses the Malaysian tax and zakat system. Sections 2.1 and 2.2 will discuss the tax and zakat administration in Malaysia, respectively. Next, Section 2.3 will provide a summary of tax and zakat from the perspective of *fiqh*, followed by a discussion on the integration of tax and zakat in the tax system in Section 2.4. This section will also illustrate the zakat rebate calculation on individual income tax. Finally, Section 2.5 will provide a summary of the chapter.

2.2 Tax Administration in Malaysia

Taxation is an important part of fiscal policy that can be used efficiently and effectively by governments to stabilise the economy of their countries. In many countries, taxation has often been used as a tool for promoting growth for national development. Funds collected from tax source have become a major contributor to the development of a country while benefitting its people. Shahrudin et al. (2012) viewed that countries and tax are complementary to each other, and one cannot survive without the other.

In Malaysia, the taxation system was introduced in 1947 to the Federation of Malaya by the British under the Income Tax Ordinance 1947 (Singh, 1998). The Income Tax Ordinance 1947 was subsequently repealed and replaced by the Income Tax Act

(ITA) 1967 which came into effect on 1 January 1968. The ITA 1967 consolidated three laws on income taxation then existing in Malaysia: The Income Tax Ordinance 1947 which was applicable to Peninsular Malaysia, Sabah Income Tax Ordinance 1956, and Sarawak Inland Revenue Ordinance 1960. After the formation of Malaysia in 1963, the separate taxation systems of the three territories continued in existence until the introduction of the ITA that has been used by the government until now (Kasipillai, 2015).

The Malaysian government imposes two types of tax, namely direct and indirect tax. In the case of the direct tax such as income tax, real property gains tax, and petroleum tax, it is directly paid by the taxpayers to the government whereby the burden cannot be transferred to others. These types of tax are administered by the IRBM. On the other hand, indirect tax is indirectly paid through another party by the taxpayers to the government (Kasipillai, 2015). Excise duties on production, customs duties and service tax, are examples of indirect tax. These types of tax are administered by the Royal Malaysian Customs Department.

In the early 1970s, the Malaysian government relied heavily on indirect tax compared to direct tax as a source of revenue for the country (Kasipillai, 2002). However, since 1999, the direct tax has become the major contributor to government revenue. The IRBM has made all the efforts to ensure the total direct tax collection every year is in line with the country's economic growth (IRBM, 2017).

2.3 Zakat Administration in Malaysia

Zakat is the third of the five pillars of Islam, which attracts the attention of Muslim economists nowadays. According to Yusoff (2006), zakat helps the economy

by encouraging people to invest because zakat is levied on wealth that remains idle for a year. This wealth, if put into proper use, has the potential to grow and improve the economic condition of society.

In Islam, there are two types of zakat which are zakat *al-mal* (on wealth) and zakat *fitr*. Zakat on wealth (*al-mal*) is divided into several sub-categories, namely zakat on income, zakat on savings, zakat on gold, zakat on business, zakat on the Employees Provident Fund (EPF), zakat on shares, zakat on livestock, and zakat on agriculture. Zakat on wealth is an annual payment based on the amount of wealth owned by a Muslim individual or organisation. This payment is obligatory upon any Muslim individual or organisation that has completed the requirement of *Nisab* and *Haul*.

Meanwhile, zakat *fitr* is obligatory on all Muslims and is paid during the fasting month of Ramadan (Haron et al., 2010). *Fitr* can be described as the purification of the person who fasts, redressing wrong deeds and undesirable words uttered during fasting. All Muslims are obliged to pay zakat *fitr*, regardless of their age, status, or wealth. Zakat *fitr* payment can be made throughout the month of Ramadan but must be before the start of *Eidul Fitr* prayers. If the payment is made after the *Eidul Fitr* prayers, then it becomes an ordinary act of charity.

Zakat institutions in Malaysia come under the jurisdiction of the individual State Islamic Religious Council (SIRC) of the thirteen states and Federal Territories. There are 14 SIRCs in Malaysia where 13 of them belong to the states and one to the Federal Territories. The first institution that was established to perform the task of collecting zakat is the Zakat Collection Centre, which is for the Federal Territories, and it was corporatized in 1991. Selangor, Pahang, and Penang followed the footsteps of the Zakat Collection Centre of the Federal Territory in 1995. Next were the states of Melaka and

Negeri Sembilan in 2006, while the corporatisation of Sarawak Baitulmal Fund started in 2001 and the latest was Pusat Zakat Sabah in 2007 (Ahmad Razimi et al., 2016). The main purpose of the SIRC's establishment is to centralise all the Islamic religious activities at the state level.

The corporatization of zakat institutions in Malaysia is to enhance the capability and effectiveness of zakat collection and distribution by the SIRC's. Each state uses a specific computer software system to allocate the eight *asnafs* and keep their information in a database. The system reduces the bureaucracy that might slow down the zakat distribution process. The efficiency of the zakat system and its operation influences people to pay zakat directly to the zakat institutions, and it portrays the good image of the management of zakat institutions in Malaysia (Makhtar & Ahmad, 2010).

2.4 Tax and Zakat from the Perspective of *Fiqh*

Fiqh is an Arabic term meaning "full comprehension" or "deep understanding". *Fiqh* can also be explained as the Shariah Islamic Law based on al-Quran and Hadith. It deals with the preservation of rituals, ethics, and social law in Islam. From the Islamic perspective, al-Qardawi (1973) stated that zakat is a Quranic term, and it is considered as religious worship because zakat is a religious obligation for all Muslims and is the third out of the five pillars of Islam. The term *zakat* appears 30 times in al-Quran (Shariff et al., 2011). One of the verses referring to zakat in al-Quran is verse 43 of Surah al-Baqarah:

وَأَقِيمُوا الصَّلَاةَ وَآتُوا الزَّكَاةَ وَارْكَعُوا مَعَ الرَّاٰكِعِينَ

“And establish prayer and give zakah and bow with those who bow (in worship and obedience.)”

(Al-Quran, Al-Baqarah 2: 43)

From the perspective of *fiqh*, al-Qardawi (1973) discussed the major similarities and differences between zakat and tax according to several bases. Examples of similarities between these two items are the elements of obligation and compulsion that exist in both zakat and tax. Besides, both zakat and tax are paid to a public entity, either a local or national institution. These two items also have the same objectives encompassing social, economic, and financial objectives.

Meanwhile, the differences can be grouped into the categories of religion, moral, and social. Under the religion category, the payment of tax symbolises a relationship between the payers and the local or national authorities of the state. If the tax collection is delayed by the government, the payers have no reason to pay the tax and cannot be blamed for insufficient tax collection. Meanwhile, zakat payment represents a relationship between the payers and Allah SWT. In Islam, Muslims need to fulfil their obligation to pay zakat to the needy. The payment of zakat is a symbolic religious duty for Muslims to seek the pleasure of Allah SWT. Even if the zakat institution of each state does not collect zakat, individual Muslims are still required to fulfil this duty.

Next, the differences can be categorised based on moral and social aspects. According to these aspects, paying tax is a social responsibility of the people to their country. The payment of tax will raise the revenue for government expenditures and become a major contributor to the development of the nation for the benefit of its people.

With the zakat payment, zakat payers can create balance in society and never let the poor and those in need suffer or die. In this way, the zakat payers can overcome poverty

and other social evils within society. Zakat purifies their wealth as it goes into the hands of the poor from the rich and ensures that each person benefits from the wealth.

Four conditions allow imposing taxes in addition to zakat, which are true need, just distribution of burden, lawful use of funds, and approval of the *shura* body of the state (al-Qardawi, 1973).

For instance, there should be a real need for the services tax to be imposed in an Islamic country. It is unlawful to violate this condition except when tax proceeds are direly needed for the country's development. If such necessity does not exist or if the government has other financial resources, it is not lawful to impose taxes.

Second, the condition to impose taxes in addition to zakat is for a just distribution of burden. The burden of tax must be distributed justly among the people so that no one is over-burdened while others are exempted without rational reasons. The authorities must set specific criteria for distributing the tax burden among the rich members of society.

Third, tax can be imposed if it is aimed at serving the nation. Thus, tax proceeds must not be used for the whims and desires of the rulers and their inner circles, or to fulfil private purposes or individual ambitions. If such a collection is used solely to meet the needs of a party, it is not lawful to impose taxes.

Finally, the imposition of tax in addition to zakat requires the approval of the *shura* body, as any levy on individuals must be approved by the consultative body of the state. It is not sufficient that the ruler alone or his administrative commissioners make such a decision.

A study by Al Matar (2015) also viewed zakat and tax from the perspective of *fiqh*. She conducted a study on the social justice issue and redistribution of wealth from zakat and tax collection. She stated that zakat falls on the annual accumulated wealth of the zakat payers, while tax falls on the income of taxpayers. The author argued that this difference between zakat and tax makes zakat fairer than taxation as it falls more heavily on the rich people than on the poor. Thus, zakat achieves more social justice compared to tax. She also explained that zakat helps to reduce income inequality by narrowing the gap between the rich and the poor, whereas tax seems to give more benefit to the government expenditure and the people as a whole.

Besides that, some authors have examined the arguments of the orthodox school and those of some contemporary scholars on alternative methods of computing business zakat (Obaidullah, 2016). The study found that the issue of zakat payment always arises due to the lack of harmonisation between zakat accounting and taxation. Obaidullah (2016) also provided useful recommendations to policymakers who are concerned about the wide gap between the actual and potential zakat collection and are recognising tax reforms for incentivising business zakat mobilisation. The researcher stated that the gap could be eliminated by making changes in the taxation method, such as providing a tax deduction or tax rebate.

To summarise, despite the presence of several integrations of zakat and tax in the context of administration, al-Qardawi (1973) still emphasised the importance of knowing the differences in terms of religion, moral, and social categories between these two obligations. It is because zakat is clearly a religious obligation, while tax is the obligation of the people towards the government.

2.5 Integration of Tax and Zakat in the Tax System

In Malaysia, the tax authorities fall under the jurisdiction of the Federal Government while the zakat institutions are under the jurisdiction of the thirteen states and Federal Territories. Even though the administration is executed under two different systems, there is integration between tax and zakat in the Malaysian tax system.

According to Section 7 of the ITA 1967, every individual in Malaysia is regarded as a tax resident if he/she meets any one of the following conditions.

Table 2.1: Conditions for Individuals to be regarded as a Tax resident in Malaysia

No	Conditions	Section
1	<i>The individual is in Malaysia for 182 days or more in a basis year</i>	7(1)(a)
2	<i>The individual is in Malaysia for less than 182 days in a basis year</i>	7(1)(b)
3	<i>The individual is in Malaysia for 90 days or more in a basis year.</i>	7(1)(c)
4	<i>The individual is not in Malaysia or in Malaysia for less than 90 days in the basis year.</i>	7(1)(d)

A resident individual must report all earnings derived, including gains or profits, to determine the total taxable income, including from businesses, payroll, dividends, interests, rents, royalties, and pensions. The total of all these incomes will then be deducted with various reliefs including for the individual, wives, children, education,

and medical expenses. After all the reliefs have been deducted from the annual income, the total chargeable income of the resident individual for the basis year will be obtained.

Each resident individual also needs to know the tax rates provided by the IRBM that are applied as percentages of the chargeable income. The more chargeable income earned by an individual, the higher the tax rate imposed on that individual. The tax rates calculation for the year of assessment 2017 are included as Appendix A.

The government also provides tax rebates for resident individuals, which are stated in Section 6A (2) of the ITA 1967, to reduce the amount of tax payable. Meanwhile, Muslim resident taxpayers are provided with an additional rebate, which is the zakat rebate, as stated in Section 6A (3) of the ITA 1967. The rebate will be granted for the year of assessment to Muslim resident taxpayers on the payment of zakat, zakat *fitr*, or any Islamic religious payments. The rebate system is implemented by the government to relieve Muslim resident taxpayers' obligation from complying with both responsibilities to pay zakat and tax. Table 2.2 shows the tax rebates list for resident individuals.

Table 2.2: Tax Rebates for Resident Individuals

Types of Rebate	Section
Individual's chargeable income does not exceed RM35,000	6A (2)
If husband and wife are separately assessed and each chargeable income does not exceed RM35,00	

If husband and wife are jointly assessed and the joint chargeable income does not exceed RM35,000	
Rebate for zakat, zakat <i>fitr</i> , or other Islamic religious dues paid	6A (3)

2.5.1 Conditions for Claiming the Zakat Rebate

The zakat rebate will only be granted when an individual Muslim meets certain conditions. First, each Muslim resident taxpayer must pay zakat directly to a state zakat institution, such as Lembaga Zakat Selangor or Pusat Zakat Negeri Sembilan. It means all the zakat payments made directly to the *asnaf* are not eligible for the zakat rebate. Second, the original receipts of the zakat payments issued by the zakat institutions must be in the name of the individual, except for the receipt for zakat *fitr*.

Third, the types of zakat eligible for the rebate are all types of zakat that must be paid by the individual in a basis year, such as zakat *fitr*, zakat on business, zakat on silver, zakat on EPF savings, zakat on agriculture, and zakat on livestock. Fourth, zakat payment receipts must be kept by the individual for seven years, as stated under Section 82 of the ITA 1967.

Lastly, the amount of zakat rebate is limited to the total income tax for the year of assessment. The balance cannot be brought forward to the following year. The higher the amount of zakat payment made, the less the amount of tax payable. If the amount of zakat paid equals to or exceeds the tax payable, then the Muslim taxpayers do not have to pay their income tax.

2.5.2 Illustration of Zakat Rebate Calculation on An Individual's Income Tax

All the rebates are stated in Sections 6A (2) and 6A (3) of the ITA 1967 in row B13 of the BE form. The scenario provided below shows an example of how to calculate the zakat rebate calculation on an individual's income tax according to the format of the BE form 2017. The BE form 2017 by the IRBM is attached in Appendix C.

Mr Nazri is an accounting manager in a private company. In 2017, his salary was RM8,600 a month including the payment to the Employees Provident Fund (EPF) of RM730 and a monthly tax deduction of RM250. Mr Nazri has a house in Kota Damansara which he rented out since January 2017. The net income of the rent is RM750 a month. His wife is unemployed, and they have three children who are still in school. Throughout 2017, he made various payments, including:

- a) Zakat fitr to Majlis Agama Islam Selangor (MAIS) amounting to RM35
- b) Zakat on income to the Lembaga Zakat Selangor (LZS) of RM550 per month through salary deductions.
- c) Zakat paid directly to a poor person amounting to RM350
- d) Zakat on gold paid to LZS amounting to RM100

Mr Nazri keeps the receipts for all the zakat payments made to the LZS. Mr Nazri has no business income, and hence, he must submit the BE form for 2017. The tax payable and zakat rebate calculation for Mr Nazri for 2017 is shown in Table 2.3

Table 2.3: Tax Computation Payable and Zakat Rebate Calculation by Mr Nazri

based on BE Form 2017

NO	STATUTORY INCOME, TOTAL INCOME, TAX PAYABLE, AND TAX POSITION	AMOUNT (RM)
B1	Statutory income from employment (RM8,600 × 12)	103,200
B2	Statutory income from rental (RM750 × 12)	9,000
B3	Statutory income from benefits, discounts, royalties, premiums, pensions, annuities, other periodic payments and any other revenue or surplus	-
B4	AGGREGATE INCOME (B1 + B2 + B3)	112,200
B5	Less: The amount of approved donations and gifts	-
B6	TOTAL INCOME (SELF) (B4 – B5) (Fill "0" if negative value)	112,200
B7	TOTAL INCOME TRANSFERS FROM HUSBAND / WIFE * for joint assessment	-
B8	TOTAL CONSOLIDATED INCOME (B6 + B7)	112,200
B9	Reliefs: P1: Individual : RM9,000 P2: Wife : RM3,000 P3: Children below the age of 18 years old (RM 2,000 × 3) : RM6,000	

	P4: Employees Provident Fund (EPF) ($RM730 \times 12 = RM8,760$) *maximum of RM6,000: RM6,000 P5: Total Reliefs (P1 + P2 + P3 + P4)	24,000
B10	TAXABLE INCOME (B6 – B9) or (B8 – B9) (Fill "0" if negative value)	88,200
B11	COMPUTATION OF INCOME TAX	
B11a	Tax on the first Tax on the first RM70,000 = RM5,600	5,600
B11b	Tax on balance Tax on the balance of RM18,200 @ 21%	3,822
B12	TOTAL INCOME TAX (B11a + B11b)	9,422
B13	Less: Total rebate a) self b) husband / wife c) zakat rebate: i) Zakat <i>al-mal</i> (wealth) and ii) Zakat <i>fitr</i> a) Self : RM0 b) Wife : RM0 c) Zakat Rebate i) Zakat <i>al-mal</i> (wealth): Zakat on income ($RM550 \times 12$) = RM6,600 Zakat on gold: RM100 ii) Zakat <i>fitr</i>: RM35 Total zakat rebate: ($RM6,600 + RM100 + RM35$) = RM6,735	6,735

B14	TOTAL TAX CHARGED (B12 – B13)	2,687
B15	Less: a) section 110 (others) b) Sections 132 and 133	-
B16	TAX PAYABLE (B14 – B15)	2,687
B17	OR: TAX REPAYABLE (B15 – B14)	-
B18	Monthly Instalment / Tax deduction (PCB) paid for the annual income of 2017 (RM250 × 12)	3,000
B19	Overpaid tax (B18 – B16)	313

Table 2.3 shows the illustration of the BE form for Mr Nazri, who has no business income. In reporting the amount of his income, Mr Nazri needs to calculate his aggregate income (B4), obtained by totaling all the items in rows B1, B2, and B3. His main sources of income are from his monthly salary ($\text{RM}8,600 \times 12 = \text{RM}103,200$) and house rental ($\text{RM}750 \times 12 = \text{RM}9,000$). Mr Nazri's aggregate income for the year of 2017 is RM112,200.

The taxable income (B10) is calculated by deducting the amount of total income with all the reliefs. The income tax computation (B11) is different according to the individual's taxable income. The tax rates on the first and on the balance, which are the percentages applied, are different based on the taxable income of each individual. The IRBM has provided examples of the table and calculation for these two items.

The calculation of income tax for Mr Nazri is as follows. For an individual with a chargeable income ranging from RM70,001 to RM100,000, the tax on the first RM70,000 is RM5,600 (B11a). The balance of RM5,600 (RM75,600 minus RM70,000) is subject to tax at the rate of 21%, which is RM3,822 (B11b). Subsequently, the amount

of income tax in row B12 is obtained by adding items in rows B11a and B11b, giving a total of RM9,422. A sample for calculating the income tax is attached in Appendix A.

Row B13c (zakat *al-mal* and zakat *fitr*) shows the zakat rebate, which is the main focus of this study. Mr Nazri can claim a zakat rebate for the total zakat payment he made to zakat institutions including zakat on income, zakat of gold, and zakat *fitr*. The total amount of zakat rebate that Mr Nazri can claim is RM6,735. Zakat paid directly by Mr Nazri to a poor person amounting to RM350 cannot be claimed as a zakat rebate, as it does not meet the first requirement to claim zakat payment as a tax rebate, which is the Muslim resident taxpayer must pay zakat directly to a state zakat institution.

After deducting the zakat rebate from the income tax amount, the amount of tax payable by Mr Nazri is RM2,687 (B16). Since Mr Nazri made monthly tax deductions (PCB) of RM250 a month totalling RM3,000 for the year, it means he does not have to pay an additional income tax. Instead, he has an overpaid tax payment of RM313, which should be refunded to him by the IRBM.

2.6 Summary

This chapter provided an overview of the Malaysian tax and zakat administration. In Malaysia, tax comes under the jurisdiction of the Federal Government, while the zakat institutions are under the jurisdiction of the thirteen states and Federal Territories.

Apart from that, this chapter also reviewed tax and zakat from the perspective of *fiqh*. Al-Qardawi (1973) discussed the differences between zakat and tax according to several bases. The differences can be categorised based on religion, moral, and social categories.

Next, this chapter discussed the integration of tax and zakat in Malaysia. The Malaysian government has introduced a zakat rebate system to Muslim resident taxpayers, which is stated in Section 6A (3) of the ITA 1967. The rebate is granted for the year of assessment to Muslim resident taxpayers on the payment of zakat, zakat *fitr*, or any Islamic religious payments. The rebate system is implemented by the government to relieve Muslim resident taxpayers' obligation in complying with both responsibilities to pay zakat and tax.

The zakat rebate is granted only when the individual meets certain conditions. This chapter explained the conditions that must be fulfilled by Muslim resident taxpayers if they want to claim zakat payment as a tax rebate. This chapter also presented and explained the scenario on how to calculate the zakat rebate on an individual's income tax according to the format of the BE form for 2017.