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3.3. HARMONIZATION OF BUSINESS ZAKAT AND TAXATION IN MALAYSIA

Summary

This paper aims to examine the relationship between business zakat and taxation in Malaysia according to the Income Tax Act 1967. In Malaysia, there are two methods of business zakat accounting, namely, the adjusted working capital method and the adjusted growth capital method. Both methods of business zakat accounting use data from the balance sheet, whilst business taxation gains information from the income statement. However, the question often raised is that, if the business zakat accounting depends on those methods, how entrepreneurs are able to harmonize business zakat and income tax imposed on them? The findings of the research revealed that entrepreneurs are allowed to use any methods that deemed fit and appropriate with their types of businesses. In addition, they also have the option to use business zakat accounting method that based on income in accessing the business zakat.

Keywords: harmonization, business zakat, taxation, working capital, growth capital

Introduction

Obligation of zakat on business is derived from the Qur'an and Sunnah of the Prophet Muhammad. Allah says, "O you who believe! Spend of the good things which you have earned..." (al-Baqarah, 2: 267). Imam al Tabari comments, "Pay *zakah* out of the good things you earn in your economic activity, such as business, industry, or gold and silver, "He also reports through several chains, from Mujahid, that the words "good things you have earned" means by making trade. Imam al Jassas, in his *Ahkam al Qur'an*, says "It is reported that a group of our predecessors explain God's words "good things you have earned" as through trade. These include al Hasan and Mujahid. Imam Abu Bakr Ibn al 'Arabi says that "Our scholars interpret the words of God 'that you have earned' as things earned by means of trade (Yusof al-Qaradawi, 1999). Abu Dawud reported from Samurah Ibn Jundub, "The Prophet used to order us to pay the *sadaqah* (zakat) on what we have prepared for the trade"². There is also a report from Abu 'Amr Ibn Hammas, from his father, who said "Umar passed by me and said,

² Reported by al Daraquani, p.214, and Abu Dawud via Ja'far bin Sa'd from Khubaib Ibn Sulaiman bin Samurah from Samurah, Abu Dawud made no comment, nor did Al Mundhiri. See *Mukhtasar Al Sunan*, Vol. 2, p.175. Ibn al Humam says this means they approve the saying, as in *Al Mirqat*, Vol. 4, p.158, Multan Print. Ibn 'Abd al Barr grades it good. See *Nasb al Rayah*, Vol. 2, p. 376. Al Hafiz says in *Bulugh Al Maram*, p.124 that "its chain is soft." Ibn Hazm claims that Ja'far, Khubaib and Sulaiman are unknown. Ahmad Shakir writes in his footnote on p. 234, Vol. 5 of *al Muhalla* that "They are known, they are mentioned by Ibn Habbab as among the trustworthy". Al Dhahabi quotes Ibn Al Qattan, the trustworthiness of either of them is not determined, in spite of efforts made by critics of hadith. This chain has a few other similarities in its vagueness. Abd al Haqq al Azdi says Khubaib is weak and Ja'far is not dependable. Anyhow this chain is dark and does not stand. See *Al Mizan*, Vol. 1, p.150 (see Yusof al-Qaradawi 1999).

‘Oh Hammas, pay of your possession (wealth)’. I said, “I have nothing except hides and bags. He said, “Determine the price of these things and the pay their zakat” (Abu ‘Ubayd, 1991).

In Malaysia, there are two methods of business zakat accounting, namely, the adjusted working capital method and the adjusted growth capital method. Both methods of business zakat accounting use data from the balance sheet, whilst business taxation gains information from the income statement. However, one might debate that if the business zakat accounting depends on those methods, how entrepreneurs able to harmonize business zakat and income tax imposed on them?

The main objective of this paper is to explore the practices of business zakat accounting in Malaysia particularly after the Department of Islamic Development Malaysia (JAKIM) published *Panduan Zakat di Malaysia* (Malaysia Zakat Guide) in the year 2001. Department of Islamic Development Malaysia (JAKIM) is a Malaysia Government institution which has a vision to assist in the creation of a progressive and morally upright ummah based on Islamic principles in line with the Malaysian vision through an efficient and effective Islamic Affairs Management organization. This paper also aims to harmonize the implementation of the current practices of business zakat accounting for tax deduction from the aggregate income of the business. To accomplish the above objectives, the structure of this paper is divided as follows. Part 1 deals with the development of business accounting in Malaysia. Part 2 discusses the tax deduction for zakat on business income paid by companies. This paper concludes with Part 3, which examines the alternative business zakat accounting method that can be harmonized by the companies in the assessment of their business zakat.

Business Zakat Accounting in Malaysia

The original text on business zakat accounting has been identified to rely more on inventors or goods for trade. However, this premise is no longer undisputable since the scope of business zakat fundamental has been redefined by Muslim jurists. They have broadened the scope of goods for trade (*urud tijarah*) to working capital used in business operation.

Abu Ubayd reported from Maimun Ibn Mihran as saying, “At the time of your payment of zakat, estimate your cash and commercial good, determine the price of your commercial goods in cash, the remaining is your debts from your customers (with the opinion that it will be collected) and minus your own debt, and then pay zakat on the balance” (Abu Ubayd, 1991).

According to Mohamed Abdul Wahab et al. (1995), in Malaysia there are three methods of business zakat accounting which are being practiced in various states and institutions in Malaysia. The first method comprises only the current assets, i.e. cash in hand, cash in banks, accounts receivable, and stocks or inventory. Through this method, the value of stock is stated at cost as being practiced by the Bait-al-Mal of Perak, Kedah, Wilayah Persekutuan and other States. Nonetheless, successful efforts have been made by the authorities to streamline these methods. There are two methods

that can be used, first is the growth capital method, and second is the working capital method.

The second method consists of current asset and profit from investments. Two institutions, i.e Bait-al-Mal of Perlis and the Pilgrim Management Fund Board have been identified to practice this method which considers the stock value at the current market prices. The third method is the difference between current assets and current liabilities which called networking capital, and added to the profits for the year. This method is only adopted by Bank Islam Malaysia Berhad.

To be more specific, The Department of Islamic Development Malaysia (JAKIM) has published a book in the year 2001 entitled *Panduan Zakat di Malaysia*. According to this book, there are two recommended methods of business zakat accounting to be applied. The first method is *urfyyah*. This method is also known as the adjusted growth capital which considers the equity of ownership in a particular company and other financial sources.

The equation is as follows:

$$\text{Equity} + \text{Long Term Equity} - \text{Fixed Asset} - \text{Non Current Asset} +/- \text{Adjustments}$$

Second is the *syariyyah* method. This method is also called the adjusted working capital. It considers current assets and deducts current liabilities and the necessary adjustments by adding or deducting clarified items as given by this equation:

$$\text{Current Asset} - \text{Liabilities} +/- \text{Adjustments}$$

Differentiation of both methods can be demonstrated by the equation below:

$$\text{Equity} + \text{Long Term Liabilities} - \text{Fixed Assets} - \text{Non Current Assets} = \text{Current Assets} - \text{Current Liabilities}$$

Both methods have the same resulting answers which are derived from the same balance sheet. However, most of the states in Malaysia use adjusted working capital method. Being aware of this, three categories adjustment are needed. First is the deduction from current assets. In this case, non-permissible item, limited ownership and non-productive current assets are example of useful item to be considered. Detail items is, firstly, items that not zakat obligated - these items have to be withdrawn from zakat calculation such as items and non-permissible products i.e riba', gambling and liquor. Secondly, limited ownership – water, telephone, electrical and its similar kinds of deposit shall be deducted as it does not comply to the requirements of full rights. Thirdly, financial debtors - any loans will be imposed zakat on the debtor based on the criteria that full ownership of the asset is transferred to the debtor. The debtor has the authority and freedom to manage the money for any purpose to gain benefits from the loan. Fourthly, no item that will be imposed zakat twice – the dividend value that has been paid zakat by the investment company will be excluded. Fifthly, the current asset must be productive - bad debts, dormant stock, obvious downtrend and permanent must be deducted. Sixthly, charity-based funds - funds for the purpose of charity such as education that is located in the current assets will be exempted from zakat. Lastly,

stock inventories – only finished products will be zakatable but raw materials and work in progress work will be exempted.

Second is the addition to current assets. All donations for charitable purposes and purchases on fixed assets are done at the last quarter using internal and these items need to be added to current assets. Third is the addition to current liabilities. Current liabilities which can be deducted are only from operation in nature including trade creditors, operation payables such as salary, electricity, telephone and tax. Therefore, items such as non-operation procedure payable, dividend payable and overdraft are not allowed to be deducted and principally need to be added to current liabilities.

Business Zakat and Tax Deduction

Zakat on business income paid by the Labuan offshore companies has been given as an income tax rebate. This rebate is equivalent to the amount of business zakat paid to the religious authority. It is subject to a maximum of 3% of net profit or RM20,000 which effective from the assessment year of 2004. This practice is however not applicable to zakat on business income paid by other companies until assessment year of 2005. Thereof, zakat paid by companies is allowed as a deduction subject to a maximum of 2.5% of the aggregate income excluded zakat paid by cooperatives and trust bodies. In order to accord equal tax treatment between companies and trust bodies, zakat settled by cooperatives and trust bodies is also allowed as a tax deduction. It is effective from year of assessment 2007, via section 44 (11A) of the Income Tax Act 1967.

Table 1: Calculation of tax for the Year of Assessment 2015

Explanation	Example A	Example B
Aggregate Income	RM40,000	RM40,000
Deduction: Business Zakat (maximum 40,000 @ 2.5%)	1,000	1,500
Taxable Income	39,000	39,000
Total Business Tax (39,000 @ 28%)	10,920	10,920
Tax Payable	RM10,920	RM10,920

Source: own research

The calculation of zakat deduction showed in Table 1. In Table 1, the example A showed that the payment of zakat, RM1,000 is deductible from taxable income as allowable expenses. However, the amount of the deduction allowed is up to a maximum of 2.5 per cent from the aggregate income. Thus, when the zakat payment made is RM1,500 as an example B, the deduction allowed is restricted to RM1,000 only.

Nevertheless, apparently, business zakat accounting uses data from the balance sheet, while business tax deduction gained information from the income statement. In other word, those methods demonstrate no relationship between business zakat accounting

method and tax on business income due to the different sources of information usage. If the companies suffered loss, deduction of zakat payment is not allowed.

Therefore, if the business zakat accounting depends on those methods, do entrepreneurs get benefits from the tax deduction allowable to them? Principally, zakat is payable on the business irrespective of whether profit has been earned or unearned, provided the business has positive working capital. The entrepreneurs would not utilize their benefits in two situations. The first situation is when their business suffer losses but still has a positive working capital. The second situation is when tax deduction is smaller than the amount of business zakat paid.

In this case, what modification or adjustment should be done? It actually requires the harmonization between *fiqh* and law that was currently practiced in Malaysia. According to the Mufti of Selangor State Government, Islamic scholars should be more open to new interpretations and changes of the *hukum* made which were formulated by earlier scholars especially in matters related to zakat. In fact, any changes to the section 44 (11A) of the Income Tax Act 1967 requires a lot of deliberations.

Zakat Accounting, Taxation and Malaysian Scholars

One of the options that could be done to harmonize business tax deduction and business zakat accounting method is to change the latter's method (Zahri Hamat, 2013). To accomplish this task, twelve zakat scholars in Malaysia were selected as respondents (expert) representing the three categories for survey purpose. The first category is the jurist, the second category is the economist, and the third category is the practitioner. This survey is to seek experts' opinions on whether business zakat can be charged on business income or otherwise. If the business zakat can be charged on business income, therefore, tax deduction can be utilized.

The findings revealed that all zakat scholars in Malaysia agreed that adjusted working capital was established based on the report by Maimun Ibn Mahran (Abu Ubayd, 1991). They also agreed that this method should be used, however, other methods cannot be denied. In addition, they expressed the same opinion that business zakat accounting method should not be rigid, therefore, it could be changed according to the requirement of the current situation.

Furthermore, business zakat itself is quoted as general term in the Quran and Sunnah as argued by all Malaysian scholars. To them, since *business zakat* term in both Quran and Sunnah is considered non-specific explicitness, business zakat accounting is not rigid, thus it can be changed. This view is supported by the economist. He drew a specific comment as below:

“Although we agree that adjusted business zakat accounting method should be used, but the scope of interpretation of goods for trade also is very broad. It is reasonably high time now to revisit the interpretation of the definition of good for trade.”

Business zakat accounting is established on the basis of *ijtihad* as agreed by all scholars. They are in the same opinion that one of the alternatives is business zakat

which can be charged on business income. In this case, according to the scholars, zakat on business income can be derived (*qiyas*) from zakat on agriculture yield. This opinion is in line with the affinity that business zakat accounting method can be changed according to the requirement of the current situation such as the conditions of economy and local law. For them, this is the one of highly recommended options in order to harmonize business zakat accounting method and business tax deduction currently practiced in Malaysia. Therefore, if the business zakat accounting relies on the income base, the entrepreneurs can fully get benefits from tax deduction allowable to them under the section 44(11A) of the Income Tax Act 1967.

Conclusions

Business zakat accounting is still far to arrive at consensus or agreement from the scholars and stakeholders (Abdul Ghafar Ismail, Achmad Tohirin - Muhammad Ali Jinnah Ahmad, 2013). Nevertheless, it happened because business zakat accounting is established based on *ijtihad*. In Malaysia, the finding seems to demonstrate no relationship between business zakat accounting method and tax deduction allowable, due to the different sources of data used. On the top of that, entrepreneurs need to pay zakat on the business irrespective of whether a profit has been earned or not, provided the business possess positive working capital. To harmonized business zakat accounting method and tax deduction allowable, the entrepreneurs are allowable to use any methods, either adjusted working capital or business income based. In the case of business operation running at a loss, entrepreneurs are recommended to use business income for their business zakat accounting as being practiced in Aceh Darussalam, Indonesia.

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