

## ZAKAT AND TAX

Previously, we discussed Islamic Investment and the key principles of accumulating wealth according to Shariah, namely, the prohibition of Riba, Maisir, Gharar and from doing business in activities related to brewery, pig breeding, night clubs, pornography, cigarettes and others that are harmful to society.

In this article, we shall discuss Zakat and Tax being the third component of Islamic financial planning. The major theme in this component is the wealth purification aspects of Zakat that is obligatory upon the Muslims, and the favorable treatment of zakat paid to the State Zakat Authorities by the Inland Revenue Board of Malaysia. We start first with the charitable aspects of Zakat.

### **Zakat is obligatory charity enjoined and structured by Allah.**

In Malaysia, there are many societies or non-governmental organisations (NGO) established for charitable purposes. Yayasan Lim and Yayasan Al-Bukhari are two of the prominent ones. The one thing similar between all these charitable bodies is that they do not have any framework of rules. The amount of funds set aside for charity, the actual amount given out, its frequency and the recipients are largely based on the wish of the founder.

Now, let us look at the Islamic paradigm of charity. In contrast to the *laissez faire* nature of charitable NGOs, Islam does not leave acts of charity wholly to one's wishes and whims. Islam has a complete code of charity. A full discussion here is not appropriate but there are different ranks of charitable act, specified groups of recipient, types of wealth that are liable for charity and the kind of wealth that cannot be given as charity.

Foremost for the Muslim to understand is that Zakat is the obligatory spending on charity. It is the third of the pillars of Islam. It is utmost importance for the Muslims to fulfill their duties of zakat before spending on other types of recommended charity.

Zakat is not arbitrary charity but has its own rules and mathematics. Zakat is based on specific types of wealth, specific rates of payment, specific terms and for the benefits of specific groups of recipients. Therefore, Muslims need to adhere to the rules of Zakat and should not pay their zakat obligations randomly.

### **Protecting wealth via charity: a peek into the metaphysics of Zakat**

Mankind, irrespective of faith, is subject to the laws of the Creator. In this regard, their future is never certain and none can be sure of what will happen tomorrow, no matter how comprehensive the plans. Basically, we are all subject to Pure risk and Pure risk is of Allah, as discussed previously. And, we know that Islam encourages risk management and the use of takaful contracts in mitigating possible losses.

Interestingly, some 14 centuries ago, the Prophet, peace be upon him, had told of a promise of a metaphysical nature, regarding risk management. He said "*Protect your wealth through Zakat, treat your sick patients through Sadaqah & face the turmoil of difficulties through supplications & heartfelt pleas to Allah*" (reported by Abu Dawud) and "*Wealth is not diminished by giving in charity*" (reported by Muslim).

What does “*Protect your wealth through Zakat*” means and what are the requirements when giving in charity?

Firstly, Muslims are enjoined to seek lawful income and wealth. Unlawfully gained wealth will never receive Allah’s blessing. In fact, it will be the cause of severe punishment in the Hereafter. The Muslim’s means of living must be lawful at all times.

Secondly, to give in charity must be from income and wealth that have been gained lawfully. Allah says in the Quran: “*O Believers, spend from the good things that you have earned, and from what We have brought forth from the earth. And do not choose the rotten out of it to give, while you would not take it yourselves unless you close your eyes regarding it. And know that God is Rich, Praiseworthy (2:267)*”, “*Take sadaqah from their wealth in order to purify them and sanctify them with it (9:103)*” and “*And whatsoever you spend of anything (in Allah's Cause), He will replace it (34:39)*”.

Charity, whether large or small, will be rewarded by Allah and will never be lost. The Prophet said “*Protect yourself from Hell-fire even by giving a piece of date as charity*” (reported by Muslim). This is the essence of charity in Islam: to purify one’s wealth and to rescue one’s self from Hell.

Seeking lawful income and wealth is only the starting point. Subsequently, one must give in charity to cleanse the wealth. Perhaps an analogy is appropriate. In the health industry, detoxification or internal cleansing supplementary are sold to cleanse the body from harmful toxin and waste in the body that have been accumulated over time. And, these cleansing measures actually improve one’s general health have been clinically proven.

In similar fashion, not only our bodies need to be cleansed from harmful elements, our wealth also needs to be cleansed because the possibilities of earning from doubtful sources unintentionally or through compromised circumstances are always there.

The act of paying zakat being obligatory charity is the cleansing or purification highlighted in the Quranic verse 9:103 above. It is interesting to note that this notion of wealth cleansing and purification in the Quran has now included the process of eliminating unlawful income acquired unintentionally in portfolio investment.

### **Types of Zakat and wealth subjected to Zakat**

There are two types of Zakat: (1) Zakat Fitrah and (2) Zakat on wealth. Zakat Fitrah is also known as zakat on self; and the time to pay is during the whole Ramadhan (Fasting) month or by the morning of Hari Raya Puasa before the Eid prayers. In Malaysia, the rate of Zakat Fitrah is 2.7 kg of rice and the actual Ringgit equivalent depends on the quality of rice determined by the State Islamic Religious Councils respectively.

Zakat on wealth is divided into two types of assets: monetary and non-monetary. Monetary assets include gold, silver, financial assets such as savings, stocks, unit trusts, etc and working capital assets of a business. And, non-monetary assets are grouped into agricultural, livestock and mining produce.

### **Zakat on monetary assets simplified**

Most Muslims in Malaysia have monetary assets and we shall discuss this first. The important thing to remember when computing zakat on monetary assets is that the zakat payable is based on a flat rate of 2.5% multiplied by the total value of your monetary assets when the ownership of the assets completes a year (i.e. the *hawl*) and the total value exceeds the threshold level (i.e. the *nisab*) of 85 gram of gold. (Current price for Kijang Emas gold coin is about RM100 per gram).

However, the computations on non-monetary assets are on different basis but due to space constraints we are unable to go into it, regretfully.

### **Tax treatment of Zakat**

Zakat paid to the State Zakat Authorities are treated favorably by the Inland Revenue Board (IRB). The net effect is that, the total tax payable is reduced when there is zakat paid during the year of assessment.

When zakat is paid by individuals and sole proprietors, the amount paid is treated as tax rebate; and when paid by companies, the amount paid as zakat is treated as tax deduction, subject to a maximum of 2.5% of aggregate income.

For the individuals, if zakat paid is more than tax payable then the difference cannot be claimed from IRB. And, if zakat paid is less than tax payable then the balance must be paid to IRB.

### **Zakat and Tax are obligations**

Zakat is obligatory on the Muslims while Tax is a civil obligation as a Malaysian citizen. Zakat is obligation to Allah while Tax is obligation to the Federal government. When planning for Zakat and Tax, Muslims must know their zakat liabilities and pay their zakat obligations when they become due and should take steps to minimize their taxes through tax avoidance ways. Failure of zakat compliant will be held as debt to Allah, and this debt is due forever until fully paid. And, failure to comply with tax laws will cause difficulties to the defaulter, of which the deterrent factors include monetary penalty and jail term.