

The Nexus of Corporate Tax Expense and Zakat Distribution Level among of Public Listed Companies in Malaysia

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Abstract: The aspect of transparency and clarity in Islamic muamalah contract are vital for any form of business activities in order to comply with the Shariah principle. The element of “gharar” or unknown and uncertainty are totally not permissible by Shariah, as it will contribute to injustice to social economics. The Al-Quran has clearly forbidden all business transaction which causes injustice for any people as towards the society. Zakat on business which is calculated based on growth level or net working capital level is compulsory obligation for Muslims which the objectives to purify and growth the wealth. Hence, this paper discussed the issue of Zakat reporting and the need for Zakat accounting standard for the emerging Islamic capital market. An investigation on the Zakat reporting was carried out on 830 Shariah-compliant companies listed on Bursa Malaysia. The samples comprised of Shariah-compliant companies from nine sectors: financial institutions, construction, consumer products, trading and services, industrial products, hotels, infrastructure, technology and mining industries. The study found that only 15 (1.8%) Shariah-compliant companies have disclosed Zakat in their financial statements prepared for the year 2009 and 2010. This indicates that Shariah-compliant companies have not disclose their Zakat transaction in their financial report. In term of relationship between effective tax rate and Zakat disclosure, the study also provided some findings which is there is significant difference between the groups.

Key words: Shariah Compliant companies • Zakat • Tax Compliance and ETRs

INTRODUCTION

This paper examines the reporting of *Zakat* by companies which have been listed as Shariah-compliant prior to the announcement of Shariah-compliant securities by Securities Commission of Malaysia on 20 May 2011. There were about 89% of Shariah-compliant companies listed on Bursa Malaysia which has been categorized as Shariah-compliant (Securities Commission Malaysia, 2011). This paper further provides empirical evidence on the inefficiency of the conventional tax system whereby corporate taxpayers utilized aggressiveness tax planning which caused a gap between financial reporting income and tax reporting income and its relationship with *Zakat* disclosure level among Shariah-compliant companies

which were listed in Bursa Malaysia for year 2009 and 2010 respectively. The higher income reported to the capital markets and lower income reported to the tax authorities indicates the loopholes in the financial reporting standards and conventional tax system and loss of revenue which distorts the economic goals of a country.

In addition, the development of Shariah equities and Islamic banking and finance (The Edge: 20.6.2011) requires stringent policy and guidelines in *Zakat* reporting. Hence, it is about time that the *Zakat* system contributes its vital role by effectively integrating itself into the fiscal system at a macro level. The concept of growth and purifying embedded in the *Zakat* principles are believed to increase the revenue, enhance confidence among the stakeholders

and regulates the economy for a better growth. The year 2012 would be the transformation year of financial reporting regime for Malaysian companies.

This study is conducted because there is little prior research on this area or any other similar areas. Most prior studies looked into the *Zakat* aspect itself without blending it together with conventional policies in our financial reporting standard. In other words, prior studies only look into one side of this study area and not many studies have been made to discuss Shariah aspect together with the conventional aspects.

Moreover, this research is conducted to discuss together the elements of Shariah especially for *Zakat* disclosure with two suggested levels in deriving *Zakat* by MASB and also with tax reporting standards as suggested by MASB.

As mentioned above, this study covers all Shariah-compliant companies that are listed in Bursa Malaysia because of several reasons, which are:

- To enhance confidence level of Muslims shareholders in Islamic Capital Market

By making full disclosure especially in terms of *Zakat*, the listed Shariah-compliant companies will increase the confidence level of Muslim 9 shareholders and other potential investors towards Shariah-compliant companies in Malaysia Islamic Capital Market.

This is because, the Shariah-compliant companies who fully disclosed their *Zakat* transactions will exemplify a greater transparency level compared to the Shariah-compliant companies without *Zakat* disclosure.

- To Proposed a Transparency Level in Shariah-Compliant Companies

By having high disclosure especially on the Shariah matters such as disclosure of *Zakat*, some business organization will have a competitive advantage as compared those companies who have not made such disclosure in their financial statements. This will be significantly important to attract more potential investor especially foreign investor to make investments in this country.

- To prevent possibility of scam :

The disclosure of *Zakat* payments in the financial statements for business organizations is believed to provide a control mechanism to prevent possibilities of scam activities by companies.

The main objective of this study is to investigate the level of ETR and *Zakat* disclosure among Shariah-compliant companies in Malaysia and to examine the relationship between the levels of ETR among all Shariah-compliant companies that are listed in Bursa Malaysia. Even though there are different issues before this, such as issues between *Zakat* reporting disclosure and tax reporting disclosure, there is only one ultimate target, which is for the sake of proper national income as well as to improve economic level among Muslims shareholders.

Literature Review: An effective tax rate can be defined as the actual amount of tax paid by the companies, [1]. This mean, even tough business organization is imposed with tax provision under Income Tax Act 1967, not all of them have made payment in accordance with the statutory tax rate (STR). This is because, most companies will utilize tax planning for their business income in order to pay as low as they can for tax purposes. At the same time, tax planning is the legitimate ways for business organization to make tax planning for their business. They can make tax planning by utilizing tax incentive that has been given under Income Tax Act 1967.

Meanwhile, the strategy of Corporate Tax planning has been discussed for a long time ago. This theory was extensively discussed on various researches. Some of them are in terms of developing new tax policy for some country. However this theory was also widely discussed in term of investigation on tax assessment system especially for public listed companies in Malaysia (Rohaya, 2008). Meanwhile, the earliest literature regarding the tax planning theory is by Hoffman, 1961 where he indicates that the tax planning is the capacity of tax payer in terms of managing their income either in business activities or for personal income in order to minimize their tax burden with legitimate ways.

According to Halizah, Kasumalinda and Agoos [2] they analyzed factors that influence *Zakat* payments among several Shariah-compliant companies in Malaysia. They were found one significant factor that will influence *Zakat* payments among Shariah-compliant companies in Malaysia which is percentage of Muslims directors in the Shariah-compliant companies.

On the other hand, Adnan and Abu Bakar, [3] reviewed the accounting treatment for corporate *Zakat* among Shariah-compliant companies in Malaysia. They disclosed that the Shariah-compliant companies lack of presentation of *Zakat* transaction in their financial reports. At the same time, there is an inappropriate account classification for *Zakat* treatment among Shariah-compliant companies in Malaysia.

In relation to the above findings, the purpose of this study is to propose integration of Zakat reporting standard and tax reporting standard among Shariah-compliant companies in Malaysia. The result of this study will provide empirical evidence of inconsistencies in Zakat disclosure among Shariah-compliant companies in Malaysia. At the end of this study, the findings are expected to fill the gap between tax disclosure standards among Shariah-compliant companies in Malaysia and its effect.

Based on the previous study done by NurBarizah [3], she proposed a Zakat accounting standard that needs to be developed then applied by Shariah-compliant companies in Malaysia. She also highlights current practice of Zakat on Shariah-compliant companies in Malaysia together with suggestions on collaborations of various parties to work together with the initiative of developing Zakat accounting standard especially for Shariah-compliant companies in Malaysia.

Zakat disclosure in financial report among of listed companies especially for Shariah-compliant companies is still under MASB TR-i, this issue seem to have close relationship between General Acceptable Accounting Practices (GAAP) in Malaysia. On the other hand, based on MASB TR-i, companies which refuse to voluntarily disclose regarding their *Zakat* transaction in their financial statements will not violate the financial reporting standard. However, based on information gathered from Securities Commission Malaysia (2011), those companies who want to be listed as Shariah-compliant companies in Bursa Malaysia, they must be making application to the Securities Commission Malaysia together with their details of proposal in order to be listed as Shariah-compliant companies in stock market. Further process due with their application will be followed with approval by Shariah Advisory Council (SAC).

Consequent from this approval by Shariah Advisory Council (SAC), these Shariah-compliant companies have agreed with all of the conditions to be listed as Shariah-compliant companies. This means, all of Shariah-compliant companies must be complying with all of Shariah matters regarding their business transaction. In other words, those companies who have agreed with all of the parameters that have been set up by Shariah Advisory Council (SAC), they automatically must be followed all of Shariah rules including paying *Zakat* from their business activity.

However, according to Al Qardawi [4] if the ultimate owner is not a Muslim shareholder, they are not required to pay *Zakat* from any income generated from that business for them even this company is Shariah-compliant

companies. This is because *Zakat* is only compulsory to Muslim people, therefore it does not apply with the non-Muslim trader even their business is considered by Shariah-compliant companies in Malaysia. On the other hand, those companies who have been owned by Muslim shareholders, they must disclose their *Zakat* transaction from their business income in their financial reports. It is important to make full disclosure about *Zakat* transaction in annual report among of Shariah-compliant companies because of the concept of social accountability in Islam [5].

Listed companies which have a higher level of disclosure especially among Shariah-compliant companies tend to get confidence from depositors in the capital market [6]. Most potential and existing investors always make first priority on safeguarding their money from any possibility of losses in any business they invested. The first thing that they always aware with their money is risk of losses especially in terms of transparency that has been portrayed by companies that they have invested [7]. If the companies do not have good transparency levels which meet their expectations, they will be more cautious about making decisions in that company.

However, those companies that have been listed as Shariah-compliant companies in Bursa Malaysia, they must apply full disclosure with their business activity including the *Zakat* transaction. According to Boots and Scheimt [7], they claim that transparency matters in business organization positively influence the investor in monitoring and screening efforts in making investment decisions for some companies. This is because, if the potential or existing investors have lack of confidence regarding their transparency especially among of Shariah-compliant companies, they will stop dealing with that company.

Methodology: As the main objective of this study is to examine the compliance level of tax and *Zakat* disclosures, hence the selection of the sample must be among of the Shariah-compliant companies. Therefore, the sample of 846 companies are selected based on the Shariah-compliant companies which have been identified by Securities Commission Malaysia on 27 May 2011. However, only available data of 830 Shariah-compliant companies are selected as final sample. The final samples comprised of 830 Shariah-compliant companies from nine sectors include: 1) Industrial products; 2) Trading and services; 3) Consumer products; 4) Constructions; 5) Financial institutions; 6) Properties; 7) Plantation; 8) Infrastructure; and 9) Technology. The investigation period covers in this study involve two years, which is year 2009 and 2010.

DISCUSSION AND CONCLUSION

After performing several analyses, the findings answered following research questions which have been developed during early stage of this study. The first research question is, "To what extent the MASB TR i-1 especially in terms of Zakat disclosure has followed all 830 Shariah-compliant companies in Malaysia?". Based on the analysis in chapter four sub section one, it was found that Initial results indicate there is only 1.8% from 830 Shariah-compliant companies disclosing their Zakat report. This figure instantly become a big concern and could lead to the future research regarding this matter. The development of the Islamic financial and capital market requires a clear framework, standards and guidelines to assist Shariah-compliant companies in computing and reporting Zakat. Additionally, the figure 1.8% represent by 15 Shariah-compliant companies which have disclosed their Zakat level.

Surprisingly all of the selected companies made full disclosure for their taxation purposes. Thus these findings do not reflect the value of the company recognised as Shariah-compliant companies. As the Shariah compliance company listed in Bursa Malaysia, they should fully comply with the Zakat disclosure requirements and should be awarded with rules stated in Al Quran and Sunnah. Interestingly, this result supports previous study done by Akhyar Adnan and Barizah Abu Bakar [3].

Furthermore, these results were used to meet the first research objective which is "To examine the disclosure of Tax and Zakat in financial statements among the listed Shariah-compliant companies in Malaysia". As only 1.8% of Shariah-compliant companies made Zakat disclosure, it means 98.2% of others Shariah-compliant companies listed in Bursa Malaysia do not make Zakat disclosure in their annual report.

The scenario indicates that there is low compliance of Zakat disclosures by the Shariah companies listed on Bursa Malaysia. This issue should receive serious attention from the respective bodies as Malaysia is targeting to be the hub for Islamic finance and capital market. Furthermore, the Zakat framework and standards should not only considered issues on measurements and disclosures, but issues such as governance, transparencies, integrity and ethic need to be critically addressed as well.

This result indicates that there is significant difference regarding the effective tax rate level and Zakat disclosure level especially for those companies that paid Zakat on their business income. The gap found between

Shariah-compliant companies with Zakat disclosure and those Shariah-compliant companies that present their effective tax rate is huge. Meanwhile, from all of 830 selected companies, all of them involved in aggressive tax planning which is measured in term of effective tax rate level. However, there is minimum disclosure in their annual report as to comply with the MASB TR i-1.

The second research objective for this study is "To examine the relationship between level of effective tax rate, working capital level and asset growth level with Zakat disclosure among Shariah-compliant companies". Findings relevant to this objective are described which shows the relationship between Zakat disclosure levels among Shariah-compliant companies listed in Bursa Malaysia in year 2009 and 2010 working capital level and asset growth level. These results proved that there are significant relationships on Zakat disclosure level among Shariah-compliant companies listed in Bursa Malaysia for year 2009 and 2010 with working capital level. However based on the Table 13 below, it shows there is no significant relationship exist between asset growth level and effective tax rate level either in year 2009 and year 2010 towards Zakat disclosure level among of Shariah-compliant companies which listed in Bursa Malaysia.

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