

**TOWARDS IMPLEMENTING ZAKAH ON
SALARY & EPF
ISSUES & CHALLENGES**
{Case Study Malaysia}

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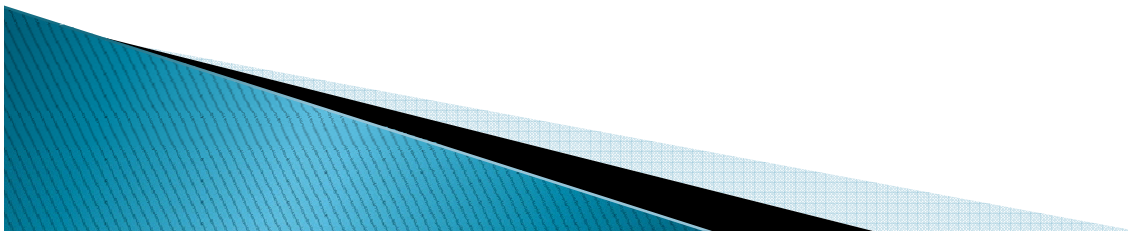
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INTRODUCTION

- A new approach of collecting zakah on monthly basis (practice in Sudan, Pakistan and Malaysia).
- Views of Muslim scholars on the legitimacy of paying zakah on monthly basis.
- Current practice of zakah on monthly salary {Case Study Malaysia}.
- Ambiguous situation amongst Muslim scholars on the legitimacy of paying zakah on EPF on monthly basis.

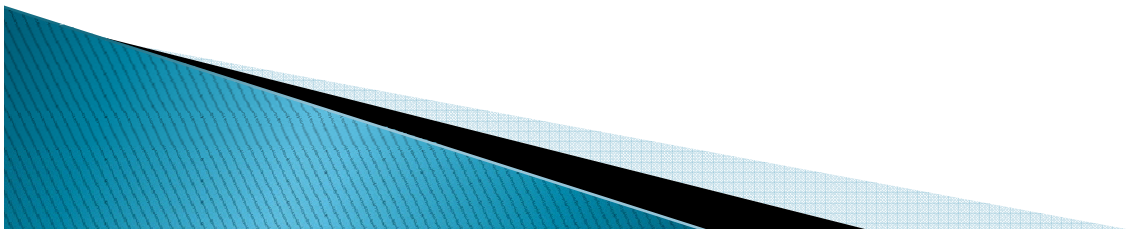
OBJECTIVE OF THE STUDY

The main objective of this paper is not only to study the *Shariah* aspect on the validity of the payment of zakah on monthly salaries in but also to study the payment of zakah on the Employees Provident Fund (EPF).



PROBLEM STATEMENTS

- Whether it is possible to create a venue for Islamic investment for EPF to fulfill the need of the Muslim employees.
- The need for the creation of a system or a scheme to accommodate the payment of zakah on EPF on monthly basis.



WHAT IS ZAKAH?

- Literally -Blessing, purification, increase and goodness.
- Zakah is the third pillars of Islam, it is obligatory upon all Muslims to give part of their wealth and assets once it reaches the minimum assigned proportion/*nisab* on yearly basis or once the crops has been harvested to eight categories of people as mentioned in the following Quranic verse:

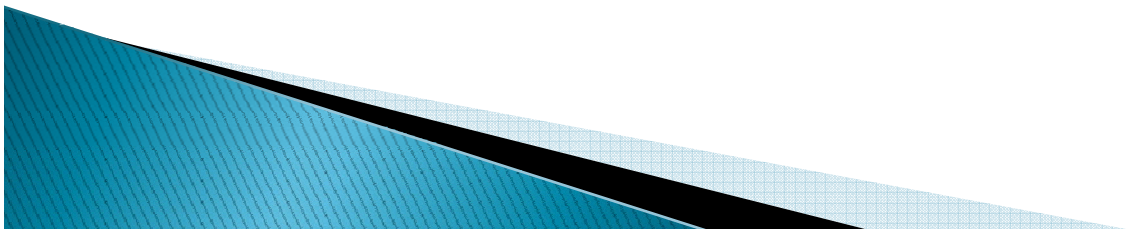
"Zakat is for the poor, and the needy and those who are employed to administer and collect it, and the new converts, and for those who are in bondage, and in debt and service of the cause of Allah, and for the wayfarers, a duty ordained by Allah, and Allah is the All-Knowing, the Wise". (Sura Al-Tauba, 9:60)



OBJECTIVE OF ZAKAH

Zakah has many objectives which have been highlighted in both al-Quran and al-Hadith.

- In al-Quran, its main objective is to purify and to bless Muslim's wealth and soul.
- In al- Hadith its objective is to take a portion of money from the rich to be given to the poor.



ECONOMIC OBJECTIVE OF ZAKAH

- From the above objectives (Quran & Sunnah) it is clear that its economic objective is to improve the condition of the receivers of zakah to be givers of zakah.
- Hence, in this case zakah can play its role in purifying and blessing not only the individual's wealth and soul but the whole society from greediness, selfishness, jealousy, hatred, poverty and starvation.
- As a result of additional members are added in the process of production through zakah mechanism economic welfare will be realized in Muslim societies.



ADMINISTRATION OF ZAKAH

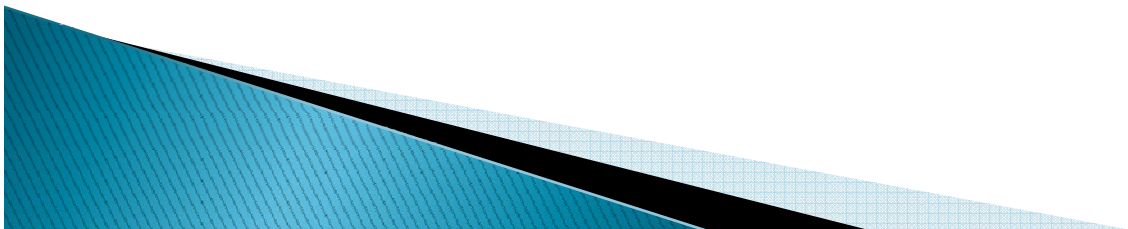
- During the time of the Prophet (pbuh) the collection and the distribution of zakah was directly under the state.
- This was followed by the first caliph Abu Bakr al-Siddiq (ra 'a) who mentioned that he will fight against those who differentiate between prayers and given their zakah during his regime.
- The same was practice by all other Caliphs and they placed its management in *Baitulmaal* which is directly managed and controled by the state.

CONDITIONS ON ZAKATABLE WEALTH

- It is well understood in shariah that zakatable wealth includes livestock, gold, silver currency and jewelry, commercial assets, agriculture, honey and animal products, mining and fishing, rented buildings, plants, and fixed capital.
- Nowadays, income become the main source of living for the majority of Muslim population in terms of salaries, wages, profit and professional, etc. So is it subject to zakah?

MAIN FOCUS ZAKAH ON SALARY

- Is salary, which is the most important source of income for Muslims' today, subject to zakah?
- Can zakah be given on monthly basis?
- Is the Employees Provident Fund EPF subject to Zakah?

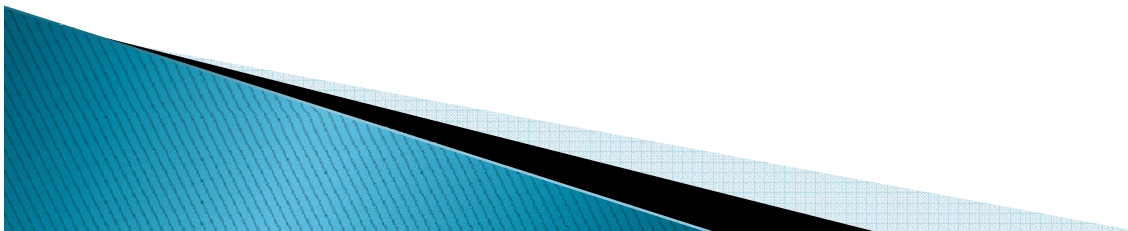


VIEWS OF MUSLIM SCHOLARS

To answer those questions let us first highlight the important conditions that must be observed while imposing zakat on wealth in general and highlight the views of Muslims scholars on zakah on salaries in particular.

FULL POSSESSION

Every Muslim who is of a certain age and has full and legal ownership of an enough assets is required to pay zakah.

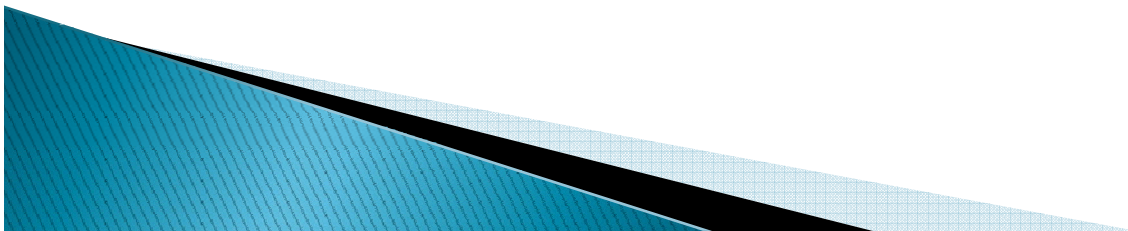


FULFILLING THE NISAB

(MINIMUM AMOUNT LIABLE TO ZAKAH)

There is a consensus among Muslim scholars that zakah on income can be calculated as follows;

- 2.5% from the total annual net income (after the actual basic needs expenses are deducted) which exceed *nisab*.
- The actual BASIC NEEDS expenses comprises: food, clothing, accommodation, education, transportation and medical expenses, and the financial obligation such as outstanding debt within the same year only.



THE LAPSE OF A FULL YEAR

- Although the completion of *haul* (one year) is one of the conditions for the payment of zakah, some Muslim scholars agreed on the permissibility to advance zakat payment, because the prophet accepted the advance payment of zakat of his uncle al ‘Abbas.
- **Note:** Muslim scholars agreed that it is not permissible to advance the payment of zakat if there is no possession of the minimum of the required wealth. But after the possession of *nisab* zakat can be given
- in advance.



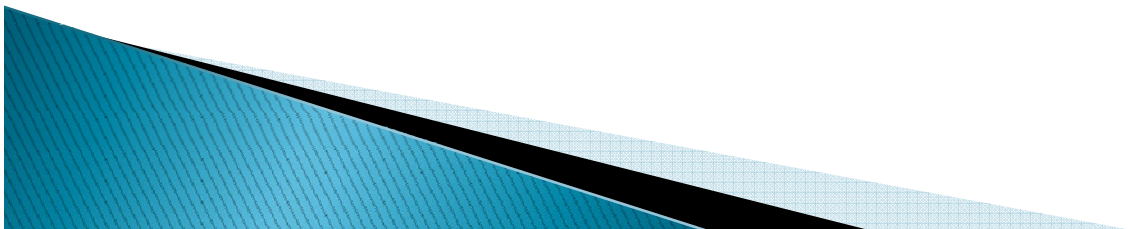
CONT. THE LAPSE OF A FULL YEAR

- ▶ Dr. Yusuf al-Qaradawi in his book Fiqh al-Zakah provided ample evidences which supported the practice of given zakah from salaries during the early days of Islam.
- ▶ al-Qaradawi view on the payment of zakah on income whether salaries, wages, professional income, or return on capital invested in other than trade, such as shipping, planes, and hotels, **is *zakatable* once received, without the requirement of the lapse of one year.**

ZAKAT CALCULATION-INCOME

2.5% from the total annual net income (after the actual basic needs expenses deduction) which exceed *nisab*. The actual basic needs expenses comprises:

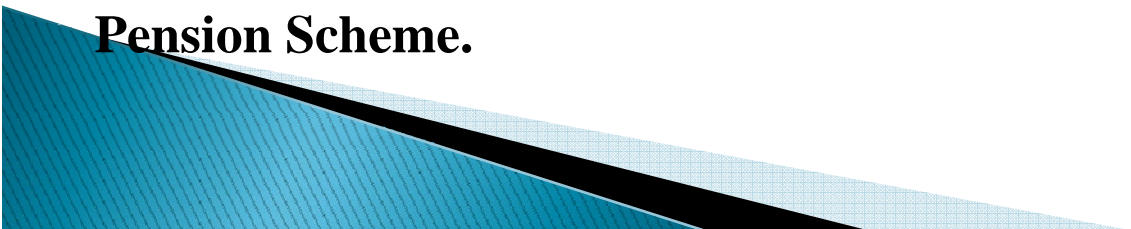
food, clothing, accommodation, education, transportation and medical expenses.



ABOUT EMPLOYEES PROVIDENT FUND EPF

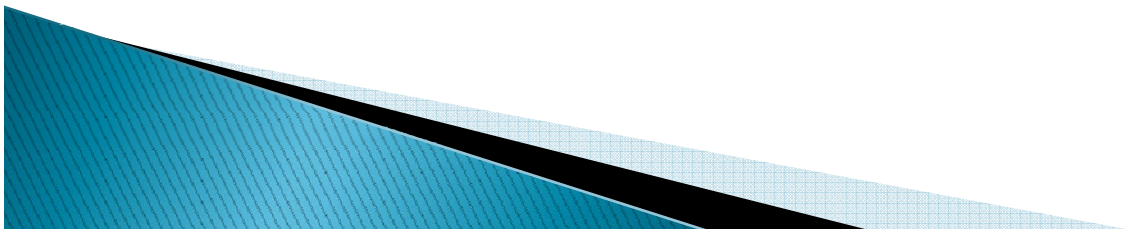
- The Employees Provident Fund EPF is a social security institution established on 1st October 1951 and governed by EPF Act 1991.
- It provides retirement benefits for the private sector and non-pensionable public sector employees.
- The employees and their employers pay monthly contributions to the Fund and the contributions are then credited into the individual member's account to which interest or dividend is added annually.

Note: For the purpose of this study we will concentrate only on people who continued with EPF until their retirements or pre-retirement, excluding those who joined the government service and had chosen the Government Pension Scheme.



MANDATORY CONTRIBUTION

- All employees in Malaysia who have reached the age of 16 and employed under a contract of service must contribute to the EPF.
- Usually the employer will contribute a proportion of the employee's wages and the employee contributes another proportion of his/her monthly wages towards the employee's account.

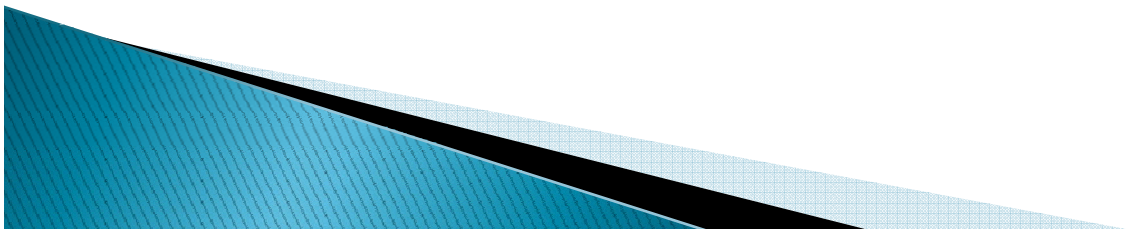


CONTRIBUTION RATES

Year	Employee (%)	Employer (%)	Total (%)
1952 - Jun 1975	5	5	10
Jul 1975 - Nov 1980	6	7	13
Dec 1980 - Dec 1992	9	11	20
Jan 1993 - Dec 1995	10	12	22
Jan 1996 - Mar 2001	11	12	23
Apr 2001 - Mar 2002	9	12	21
Apr 2002 - May 2003	11	12	23
Jun 2003 - May 2004	9	12	21
Jun 2004 - Dec 2008	11	12	23
Jan 2009 - Dec 2010	8	12	20

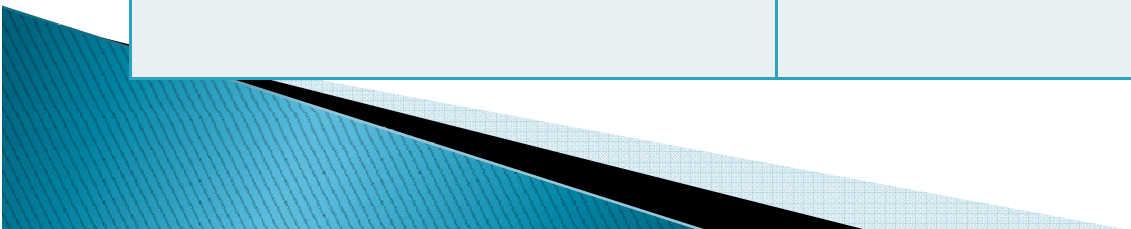
CURRENT INVESTMENT OF EPF

Currently all collected funds from the contributors of EPF are invested in a number of approved financial instruments in order to generate income. These financial instruments are;



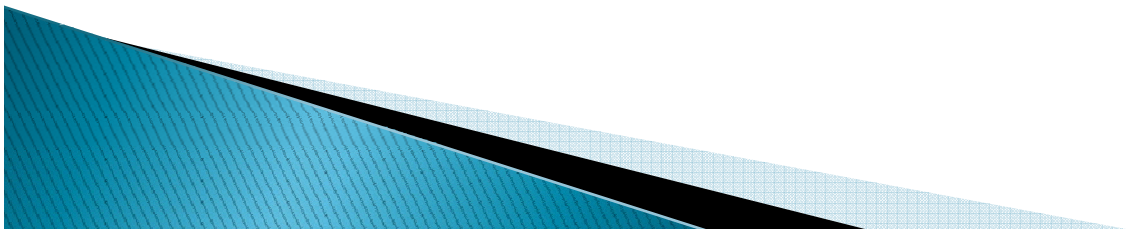
CURRENT INVESTMENT OF EPF

	Strategic asset allocation (%)	Variation (%)
Malaysian Government Securities	25	15 to 35
Loans and Bonds	25	15 to 35
Money Market Instruments	15	5 to 25
Equities	20	10 to 30
Property	5	0 to 10
International Investments	10	0 to 20



CONT. CURRENT INVESTMENT OF EPF

- The investment returns together with the principal are then paid to the members on their retirement.
- These Fund's investments are guided by acts, policies, guidelines and processes in carrying out its investment function



SUPPLEMENTARY BENEFITS

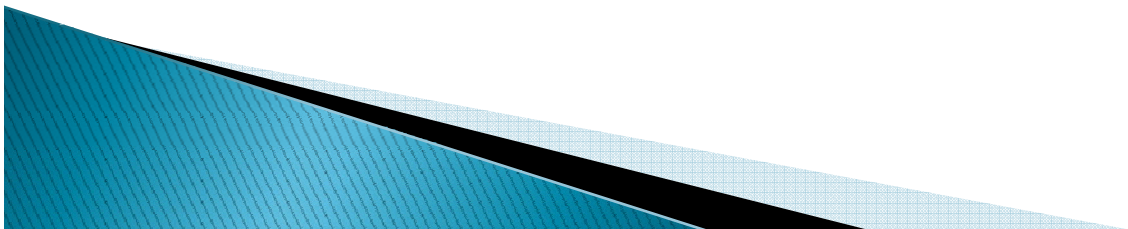
The EPF also provides other supplementary benefits such as pre-retirement at the age of 50 years to utilize 30% of their savings for:

- house ownership,
- medical expenses,
- education for children and;
- investment option schemes

leaving the other 70% to be given once they reach the age of 55 years.

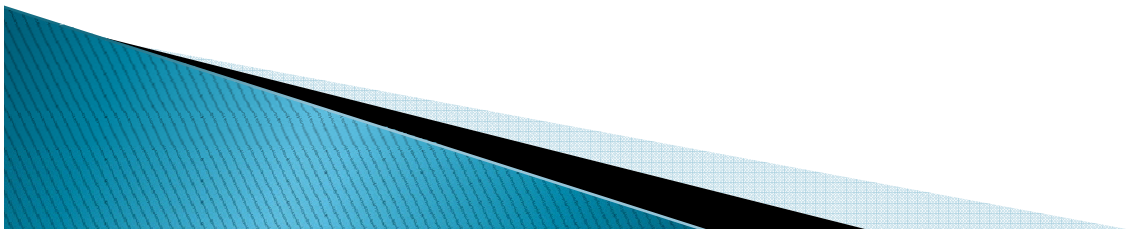
RECOMMENDED ISLAMIC INVESTMENT FOR EPF

- With the growing need of Islamic Finance at the present time it is also recommended to invest the EPF according to Shariah and to meet Muslim's obligation.
- This can be done by creating an Islamic investment division within the EPF investment structure that looks after the Islamic Investment.



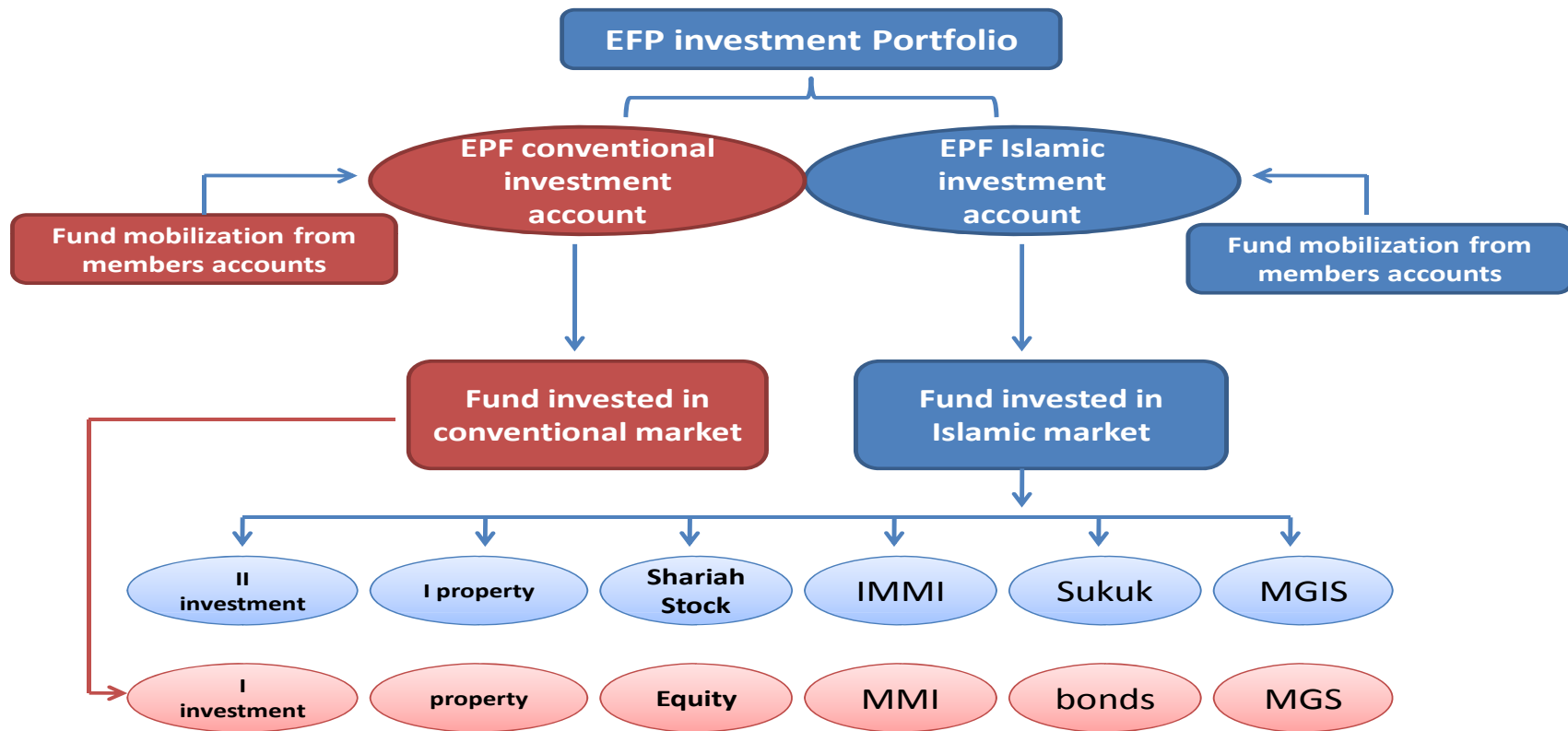
CONT. RECOMMENDED ISLAMIC INVESTMENT FOR EPF

- ▶ By establishing two different pools of fund through two separated accounts, a Conventional Account and Islamic Account.
- ▶ Each account will be channel to different pool of fund that will be investment according to the nature of the account.
- ▶ Therefore fund mobilized under the Islamic account will be invested in Shariah compliant instruments, hence will generate permissible profit.
- ▶ The list of Shariah compliant instruments are as follows:



Type Investment	Market Space	Strategic asset allocation (%)	Variation (%)
Conventional	Malaysian Government Securities	-	-
Islamic	Malaysian Government Islamic Securities	-	-
Conventional	Loans and Bonds	-	-
Islamic	Islamic Bonds / Sukuk	-	-
Conventional	Money Market Instruments	-	-
Islamic	Islamic Money Market Instruments	-	-
Conventional	Equities	-	-
Islamic	Shariah Stock	-	-
Conventional	Property	-	-
Islamic	Islamic Property	-	-
Conventional	International Investments	-	-
Islamic	International Islamic Investments	-	-

PROPOSED INVESTMENT STRUCTURE

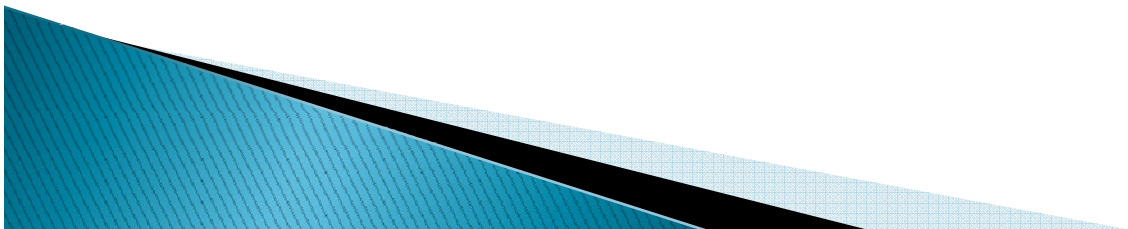


Islamic Investment

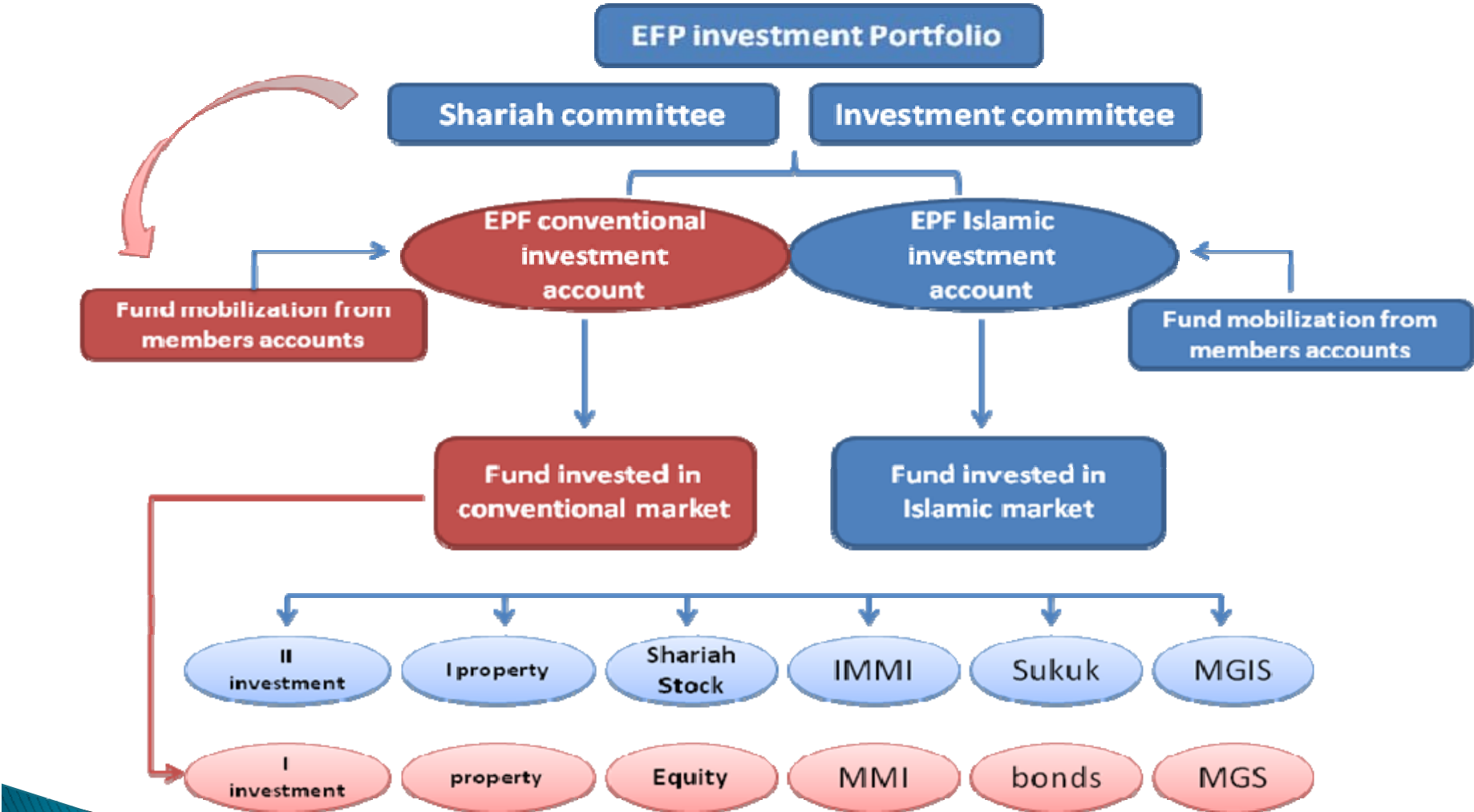
- ▶ In addition to the above list of Islamic financial instruments, EPF may select other types of Islamic products offer in the market such as Islamic structured products in order to diversify the investment portfolio when it is needed.
- ▶ Moreover, Shariah Advisory Committee is much needed in this case in order to ensure shariah compliance in the procedure of investment, and to bring confident to the members of EPF and credibility to the investment structure.

ROLE OF SHARIAH COMMITTEE

- ▶ The Shariah committee will only advice on the Islamic investment portfolio and monitor the performance of the investment;
- ▶ To provide advice and guideline to the matter related to the investment of the fund when it is needed.
- ▶ To incorporate Shariah Governance Structure within the investment structure to ensure shariah compliance of the investment.

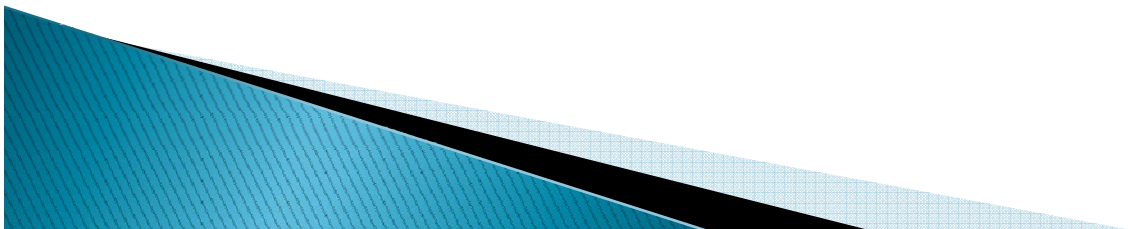


ISLAMIC INVESTMENT UNDER SHARIAH GOVERNANCE FRAMEWORK



THE CURRENT PRACTICE OF ZAKAH ON MONTHLY SALARIES

- Recently some of the Muslim countries enacted laws for the collection of zakah on income on obligatory and on voluntary basis, such as Sudan and Malaysia.
- **Sudan**, the Sudanese Zakah Law of 1986 gives the right to the government to collect and to distribute zakah from all wealth including wages, salaries, professional income and other forms of earnings.
- **Malaysia**, the Malaysia Tax Law encourages Muslims to pay their zakah on monthly basis through tax rebate as highlighted in Table;



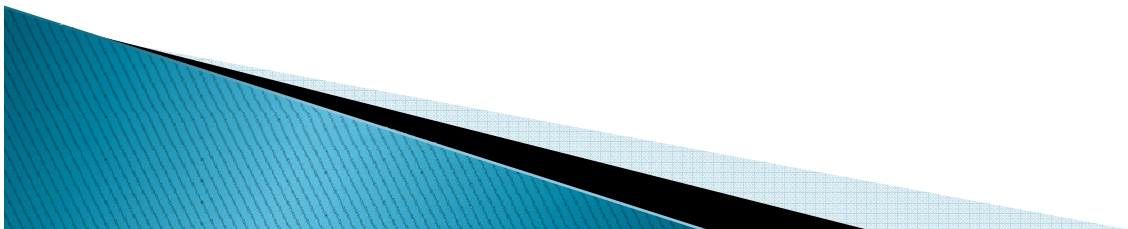
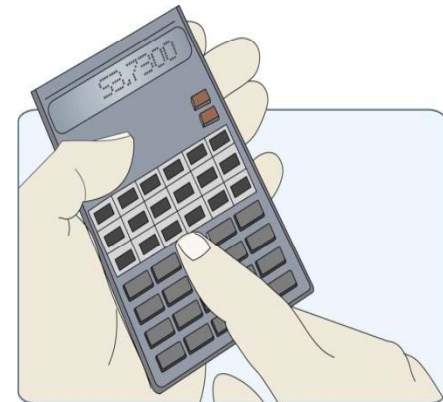
Monthly income	Income tax payment	Zakat Payment	Tax-Rebate
	<u>Considered 1 wife and 1 child</u>	<u>Considered 1 wife and 1 child</u>	
2,500	Nil	30.42	--
3,000	Nil	41.92	--
4,000	130	64.92	65.08
5,000	250	87.92	162.08
6,000	424	110.92	322.08
7,000	620	133.92	486.08
8,000	860	156.92	703.08
9,000	1100	179.92	920.08
10,000	1352	202.92	1149.08
11,000	1612	225.92	1386.08
12,000	1872	248.92	1623.08
13,000	2132	271.92	1860.08
14,000	2392	294.92	2097.08
15,000	2652	317.92	2334.08
16,000	2899	340.92	2558.08
17,000	3172	363.92	2808.08
18,000	3432	386.92	3045.08
19,000	3692	409.92	3282.08
20,000	3952	432.92	3519.08

Zakah Calculators

http://www.muamalat.com.my/v2/tools_zakat_earnings.html

http://www.ramadhanzone.com/zakat_calculator.asp

<http://www.soundvision.com/Info/life/zakatcalc.asp>

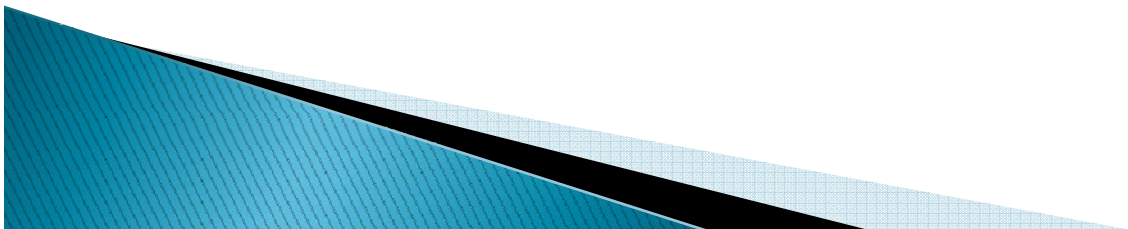


EXAMPLE FROM THE ABOVE TABLE

- Taking e.g. the monthly salary of a husband with one wife and one son. If his income is RM 4,000 he has to pay RM130 for his taxes on monthly basis. However, if he chooses to pay his zakah, then he will only pay RM 65.08 for his tax and RM 64.92 for his zakah.
- Similarly, if his salary is RM10,000 then he has to pay RM1352 for his tax. But if he chooses to pay his zakah then he will pay RM202,92 for his zakah which is almost 6 times less than his tax without changing the net pay.

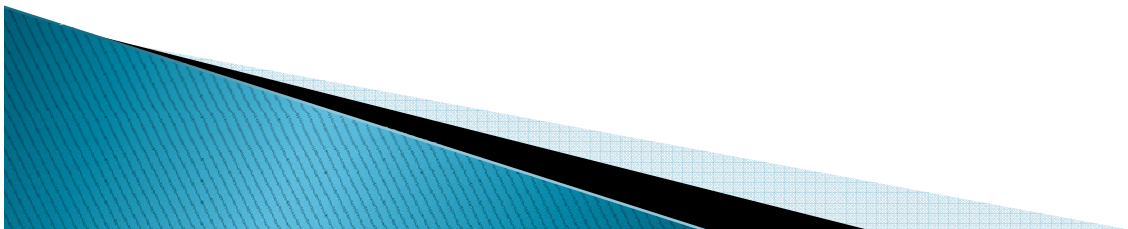
SALARY DEDUCTION SCHEME

The above mentioned Salary Deduction Scheme, encourages the majority of Muslims in Malaysia to pay their zakah on monthly basis through tax rebate leaving their **Net Pay** unchanged as highlighted in the following payment rolls.



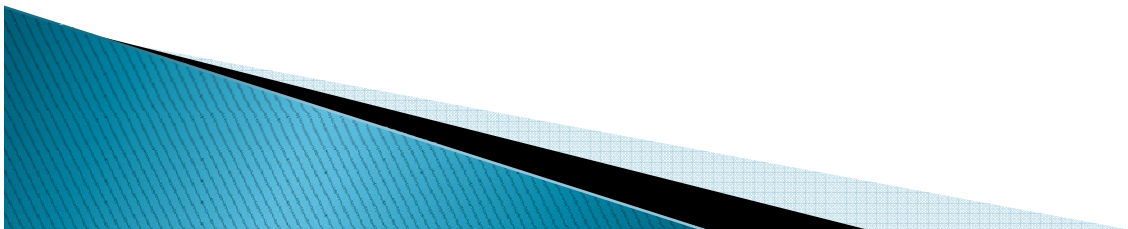
ZAKAH ON SALARIES

- ▶ From the payment rolls above we realized that Mr. Y's salary is RM 12,000. In this case his compulsory contribution to the EPF is RM 1320, his income tax is 1486.50 and his net pay is RM 9193.50.
- ▶ If Mr. Y decided to contribute to zakah, his contribution to the EPF will be unchanged but his income tax will be reduced to RM 1237.60 by an amount paid to the zakah of RM248.92 leaving his net income unchanged, i.e. RM 9193.48



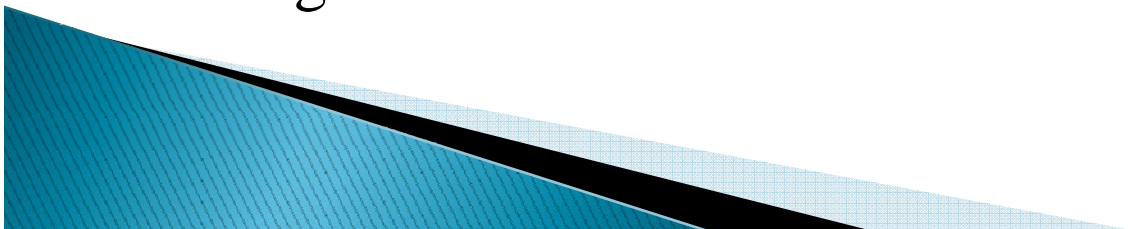
ZAKAH ON EPF

- ▶ Although, from the above example it has been realized that part of the EPF which has been contributed by the employee, zakah has been paid on it (if individual choose so); Muslim scholars are of different views on the validity of the payment of zakah on EPF subject to the condition of its full ownership.
- ▶ There are three views on this issue which can be summaries as follows:



SHARIAH VIEW ON THE VALIDITY OF ZAKAH ON THE EPF

- The first group of Muslim scholars held the view that the EPF is not fully owned by the account holder until a certain age, hence they nullify the payment of its zakah by its account holder.
- The second group mentioned that the money is considered to be a loan to the government so no zakah to be paid on loan money.
- The third group of Muslim scholars stated that the EPF is actually owned by the account holder since the money is held in his account. Besides, the account holder lend it to the government to invest it on his behalf.



SHARIAH RULING ON ZAKAH ON EPF

- ▶ Since there is no full ownership on the EPF fund (incomplete ownership) because the owner has no direct access to it, zakah can be paid immediately upon receiving the fund or withdrawing any amount from the EPF accounts.
- ▶ This Shariah position is inline with Maliki School of thought ruling who gave the fund with incomplete ownership the similar treatment of the receivable debt. However zakah will be imposed on the whole amount of savings withdrawn from the EPF at the rate of 2.5%.
- ▶ For example, if the EPF savings is RM200,000, thus zakah will be $RM200,000 \times 2.5\% = \underline{RM\ 5,000}$ **when received.**

ZAKAH ON EPF ON MONTHLY BASIS

- ▶ Taking the third group of Muslim scholars who supported paying zakah on EPF before receiving it, this can be easily done through Salary Deduction Scheme.
- ▶ Since individuals in Malaysia have the right to increase or decrease their amount of zakah when filling up the Zakah Deduction Form from their monthly salary, it is much recommended that they can increase the amount of their zakah by including the amount of their zakah on their total EPF of the last year divided by 12 mths.

ZAKAH ON EPF ON MONTHLY BASIS

- For example if the total EPF of Mr. Y in year 2009 is RM 50,000

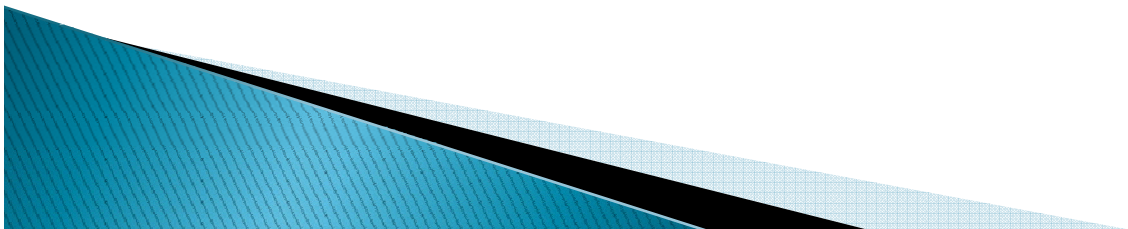
($RM50,000 \times 2.5\% = RM1250/12mth$)

-Then he can start paying his monthly zakah by adding RM104.16 to his monthly payment of zakah on his salary, which is RM248.92.

- In this case the total zakah will be RM353.08 including the EPF and which automatically will be deducted from his tax leaving his net pay unchanged.

CONCLUSION & RECOMMENDATIONS

- Muslims at the present time had been forced to pay their tax from their monthly salaries which exceed the amount of zakah. This means that Muslim can pay their obligatory due, which is the third pillar of Islam, first from their salary before paying their tax, which is a conventional due.
- To facilitate the payment of zakah for the Muslim it can be paid on small amount and on monthly basis (i.e. calculated from the Total Annual Gross Income as recommended in shariah and divided it by 12 mths.)



CONCLUSION & RECOMMENDATIONS

- ▶ For the payment of zakah on EPF it is much recommended to invest the EPF on Islamic portfolio.
- ▶ For Muslims who are contributing to the EPF they can either pay their zakah once they receive their EPF in lump sum or they can pay their zakah on monthly basis through Salary Deduction Scheme.
- ❖ **We hope this Salary Deduction Scheme can be easily adopted in Muslim countries that follow the conventional tax system as it creates an awareness for the Muslim to pay their compulsory zahah first before paying the tax from their salaries.**

THANK YOU

