

Compliance Behavior of Business Zakat Payment in Malaysia: A Theoretical Economic Exposition

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The issue on compliance behavior of business zakat payment has been the subject of much discussion among both academicians and practitioners in Malaysia especially using the economic approach. Lack of review of the literature in the zakat scenario explained the compliance issue based on economic approach. Most of the previous studies on this issue only focused on the behavior approach. In contrast, to the study on the subject of tax compliance are numerous and used various approaches. Hence, firstly this paper is to identify the factors influence compliance behavior of zakat based on previous discussion and secondly to expose the economic approach as an alternative explanation in the issue of zakat compliance. The exposition is based on Expected Utility Theory and Utility Function Model as framework. The unit of study is among the small and medium industry in Malaysia.

Keywords: Zakat, compliance, Utility Function Model, Expected Utility Theory.

INTRODUCTION

Zakat is one of the pillars in Islam and a part of the ibadah for Muslims. It has been identified as an important source of financial seed to jumpstart the economy of the Muslim community and give an impact on socio-economic development of nation (Anita et al., 2011). Basically, there are many types of zakat on wealth and one of them is zakat on business. In the current situation, issue regarding zakat on business often debated and discussed among zakat expertise in Malaysia (Ram, 2010) especially related on how to increase the total payer of zakat on business and at the same time to attract more Muslim business community to pay the zakat on business. This is because zakat institution in Malaysia is still facing some resistance to raise the collection for business zakat (Halizah et al., 2011). Nowadays, total collection of business zakat still at a small number compared with total collection of zakat on income (Halizah et al., 2011). This situation could not be occurred because zakat on business has a potential as the main contributors into total zakat collection in the future (Abd Rahim, 2004). However, it needs a support with the comprehensive effort in order to attract more Muslim business communities to pay zakat on business. The small number of zakat on business payer can be proved as indicated in the table 1.

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Table 1: Number of Business Registered with SSM in Peninsular Malaysia

State	Number of Business	No of Muslim Business (19 %)	No of Zakat on business payers 2005	% of zakat payers	No of Zakat on business Payers 2009	% zakat payers
Johor	461,141	87,617	1,033	1.18	3,309	3.78
Kedah	219,287	41,665	738	1.77	1,508	3.62
Kelantan	192,911	36,653	212	0.58	1,257	3.43
Melaka	151,409	28,768	867	3.01	1,225	4.26
N. Sembilan	134,425	25,541	313	1.23	1,085	4.25
Pahang	172,814	32,835	1306	3.98	2,180	6.64
Perak	313,027	59,475	n.a	n.a	n.a	n.a
Perlis	32,266	6,131	102	1.66	229	3.74
Pulau Pinang	277,571	52,738	521	0.99	767	1.45
Selangor	553,864	105,234	1816	1.73	3,685	3.50
Terengganu	114,104	21,680	1602	7.39	n.a	n.a
W.Persekutuan	435,709	82,785	747	0.90	1,302	1.57

Note: 1. 19 percent assumption is based on the percentage of Malay ownership equity in business environment (Abdullah, 2009; Utusan Malaysia, 28 October 2010)

2. Assume no substantial change in number of business registered in 2009

Source: 1. Statistic data from Companies Commission of Malaysia

2. Annual Report Pusat Pungutan Zakat, Kuala Lumpur

From the table 1, it showed that the percentage of zakat payer among Muslim business community is still at a small rate if compared with the total number of business registered with Companies Commission of Malaysia. For instance, in Selangor which has a high total collection of zakat in Malaysia, the percentage of zakat payer among Muslim business community is approximately 19 percent from the 553,864 business registered. Unfortunately, there have only 3.5 percent (3,685) among of them pay zakat on business. This situation showed only at a small percentage if compared with the total Muslim business community in Selangor.

In addition, previous studies also reported the same scenario. It can be seen through studied by Hasan and Sahnaz (2005) reported in Terengganu from the year of 2000 until 2004, the total Zakat collection has increased but the increment for the small and medium entrepreneur community is still in small number. Apart from that, in Wilayah Persekutuan, there are about 3,000 companies from 3,964 companies and co-operatives that have a high potential to contribute to the zakat on business but fail to do so (Utusan Malaysia, 1 April 2009). Pusat Pungutan Zakat Wilayah Persekutuan also found that there are more than 200,000 active Muslim business owners in Malaysia and less than 20,000 of them who are eligible to pay the zakat. However, from their record, only 500 business owner had paid out the zakat (PPZ, 2001). The same issue seems to be happened in Selangor although this state showed the highest total Zakat collection compared to the other states in Malaysia. However, through a report by Companies Commission of Malaysia, there are more than 14,000 active Muslim entrepreneurs in Selangor and from that the total only account for 817 (5.83%) who had paid their zakat on business (Normala, 2008).

The main issue regarding on this situation is why most of Muslim business community disregard pay zakat on business? Although a variety of efforts by zakat authority and government have been implemented but this scenario is still happened. According to

Muhammad Muda et al. (2005), the reasons of why this situation was happened could be possibly due to the lack of motivation among Muslim business community to pay the zakat on business and among of them are not bothered to fulfil their duty to pay the zakat on business (Mohamad Alayuddin, 2008). As a result, the scenario is closely related with the compliance behaviour of zakat on business.

Second issue need to be highlighted is how the economic theory helps the concept of compliance behaviour of zakat? This is because in Malaysia scenario most of the studies exposed the discussion on compliance behaviour of zakat based on behaviour approach (Kamil, 2002; Zainol, 2008; Ram, 2010; Halizah et al., 2011). If see in the number of review on compliance, there have another alternative in described the compliance such through economic approach and not just can be described through one aspect of study (Butterfield, 2002). For instance, studied by Allingham and Sandmo (1972) using economic theory and utility function model in explained the tax evasion and the model become the famous model in explaining the tax evasion and compliance among economist (Alm et al., 1995; Alm and McKee, 1998; Korobow et al., 2007; Kuperan and Sutinen, 1998; Antonides and Robben; 1995; Clotfelter, 1983; Diabi, 1993; Zulkifli and Sanep, 2010). Therefore, there is an alternative approach can be used in explain regarding compliance issue in zakat on business.

From the two issues that have been mentioned, the purpose of this paper is to identify possible important factors that may leads to the issue of compliance behaviour of zakat on business among Muslim business community and to explore the economic approach become an alternative interpretation on the factors determining of zakat compliance issue as proven in the tax industry. This study focuses only on small and medium entrepreneurs (SMEs) in Selangor due to certain circumstances.

In addition, the remaining of this paper is structured as follows. The next section of this paper will discuss on the concept of zakat compliance. Section 3 and 4 discusses on overview of factors determining the compliance of zakat and economic theoretical assumption respectively. Section 5 looks into exposition of economic compliance model. Section 6 interprets the theoretical framework and in the last section concludes the paper.

COMPLIANCE BEHAVIOR OF ZAKAT

In discuss the compliance of zakat according to Islamic doctrine; it is different with the tax compliance because zakat is one of the Islamic obligations compulsory who satisfy necessary conditions to achieve purity and goodness of soul (Diabi, 1993). This is clearly described in the Holy Qur'an, Surah 87 and Verse 14 mentioned as "*He indeed is successful who purifies himself*". Another occurrence in the Holy Qur'an was mentioned in Surah 9, Verse 9-10 noted that "*He indeed is successful who causes it to grow and he indeed fails who buries it*". It is clear that the concept of zakat compliance is a concept where the action (compliance) in order to meet instruction and order from Almighty for getting the willingness.

Kamil (2002) give an explanation on zakat compliance adapted discussion in tax compliance. As explained by Kamil (2002), zakat compliance is refer to the payment of zakat according to the fatwa and regulation gazetted by zakat authority. Another explanation is by Ram (2010) which mentioned zakat compliance is depend on the reason why Muslim individual taking a decision to comply or to avoid with command of Allah, Islamic obligation and the rules issued by zakat authority.

Nevertheless, Zulkifli and Sanep (2011) discussed on zakat compliance which is more to pay the zakat through official channels. The concept of zakat compliance is about the human behavior (Muslim community) making a decision (comply or non-comply) to pay the zakat (official or unofficial channels) according to enactment and law implemented to achieve satisfaction in the present life and hereafter (al-falah). This clarified by NurBarizah and Abd Rahim (2007) mentioned that zakat payers are expected to get return not just in the lifeafter but in the hereafter as well when they comply with Islamic obligation. Decision to comply or to avoid pay the zakat is a test to measure the degree of a believer's worship to Allah and it is an indication of thankfulness to Allah (Ahmad Bello, 2008). This situation is clearly showed that compliance on zakat more on the fulfilling obligation towards satisfaction in the two life of dimensions compared to compliance on tax where comply more on human regulation in order to avoid punishment and penalties.

OVERVIEW OF FACTORS DETERMINING COMPLIANCE BEHAVIOR OF ZAKAT

In case of zakat compliance in Malaysia, there are various studies showed that increase in total zakat collection does not explain the increasing in total of zakat payer. It is influenced by various factors as found by a number of studies. According to Hasan and Sahnaz (2005) who studied on the entrepreneur group in Terengganu found several factors was proven to influence paying the zakat on business through feedback from 158 entrepreneurs selected through stratified random sampling. The factors included such as organization factor, attitudes and awareness and level of knowledge. In their study, attitudes and awareness are the significant factors influencing paying the zakat on business. Other studies also found that attitude become one of the important factor influence Muslim individual to pay zakat (Kamil, 2002; Kamil and Ahmad Mahdzan, 2001; Kamil and Ahmad Mahdzan, 2002; Zainol et al., 2009; Raedah et al., 2011).

Apart from that, Muhammad Muda et al. (2005) studied on internal and external factors influencing individual's participate in zakat have identified there have five factors; altruism, level of faith, self satisfaction, utilitarian and organization influencing individual's participate in zakat. Altruism become the main factors influence individual to pay zakat and followed by religious, self satisfaction and organization factor. The principle factor analysis has been incorporated in their study.

Mohd Ali et al. (2003) studied the awareness of paying zakat on income among professional staff of National University of Malaysia. They revealed that level of religiosity, gender, level of education, number of dependants and level of knowledge regarding zakat on income become factors influencing professional staff of National University of Malaysia to participate in zakat on income. Among these factors, level of religiosity and religious education become most important factors compared to the other factors. The result based on analysis using a logit binomial model. While zakat institution factor is insignificant which influence the professional staff to pay zakat on income. The result was confirmed by Nurbarizah and Hafiz (2010) who examine on the factors influencing paying Zakat on income in Malaysia. Through a survey from Academicians at three faculties in International Islamic University Malaysia, they found that the level of religiosity becomes the main factor influencing paying Zakat on income in Malaysia. With the high level of religiosity, it becomes an easy way for the Muslim individual to understand the true concept of Zakat which is as a social obligation towards Muslim development and the true concept of wealth in Islam where every wealth and property that are owned and achieved must be shared along with those who need them. Zulkifli and Sanep (2010) stated that level religiosity become one

of the factors influences the compliance of zakat on income payment through formal institution in Aceh which explained based on utility function model.

Law enforcement is also necessary and become a factor determining the compliance of zakat on income and has a direct relationship with the probability to pay zakat on income (Kamil, 2002). With the existence of law enforcement such as religious guide's issuances, acts and others, it clearly shows that zakat is an obligation that compulsory to be fulfilled. Mohamad Alayuddin (2008) stated that without law enforcement especially specific lawlessness on zakat, it may affect the total zakat collection which already stays at a satisfactory level. However, Zulkifli and Sanep (2010) found that law enforcement is insignificant which influence Muslim individual comply pay zakat through formal institution. This is because Muslim individual already know about the obligation to pay zakat. They might be pay zakat through informal channel compared to zakat institution. From their study, it showed that the level of knowledge and environment have significant influence towards Muslim individual who comply pay zakat on income.

Ram (2010) try to identify the factors determining compliance behaviour of zakat on business in Kedah in the case of Malaysia scenario, both factors (internal and external) are important factors influence compliance behaviour of zakat on business. The internal factor consist of level of knowledge and self efficacy while external factor consist of interaction with amil and service quality. Through the primary data collected among 227 entrepreneurs in Kedah, the study revealed that the internal factor (level of knowledge and self efficacy) have significant influence compliance behaviour of zakat on business while interaction with amil (external factor) becomes a factor influence compliance of zakat on business.

Mohamed Alayuddin (2008) mentioned the length of business operation become one of the factors influencing Muslim business community to pay the zakat on business. This factor is refers to the length of time in managing the business activity. In his study, he explained the first three years is the most critical time for all entrepreneurs to manage their business activities. In this situation, business owners may attempt not only to avoid pay zakat on business but also corporate tax because they assume the zakat payment as one of the financial burden. However, lack of empirical study to proved this factor is one of the factors which influence compliance behavior of zakat.

Government incentive as well becomes one of factor influence compliance of zakat. According to Barjoyai (2001) most of the Muslim business community is willing to pay zakat on business and comply pay zakat if they get any incentives such as rebate or deduction from payment of zakat on business. In the other studies by Ram (2010) also mentioned government incentive such rebate tax has relationship influence compliance of zakat on business. The study explained government incentive as second order construct of perceived behavior control has significant positive relationship with intention to comply pay zakat on business.

In general, most of the previous studies found that there were various factors influencing Muslim individual comply to pay zakat on income with rational reason and justification through data analysis. As such, based on the previous studies, this study will try to identify the factors that might influence Muslim business entrepreneurs comply to pay zakat on business and try to identify the possible reason that might influence them who do not comply to pay zakat on business.

ECONOMIC THEORETICAL ASSUMPTION

Most of the previous studies discussed on the subject of compliance based on psychology and sociology theories as a basis discussion (e.g. Fischer et al., 1992; Chan et al., 2000) and lack of discussion give a focused on economic approach. In explain the compliance through the economic approach, the rational choice theory always have been used as a basis in explained regarding compliance.

In microeconomic perspective, rationality related with household behavior. Individual as household positioning a set of commodities that household may consume to maximize satisfaction (utility) (Wetzstein, 2005). This scenario shows that, household has the alternatives to choose the goods and services delivered at specific time and at specific place and decision have been made to choose among the alternatives is to maximize their satisfaction (utility).

In management perspective, the concept of rational is usually discussed when individual have the alternatives and need to choose among the alternatives in maximizing the probability of achieving goal. As a rational decision maker, individual will define the issue carefully among the alternatives that they have and at the same time make a specific goal that they want to achieve (Robbins and DeCenzo, 2005). Due to Robbins and Decenzo (2005), rationality in decision making often involved with the three elements namely certainty, risk and uncertainty in every decision that have been made by each individual. Certainty elements refer to the outcome of every possible alternative that are already known by decision maker, uncertainty elements can be explained as a probability outcome of the alternatives that do not know by decision maker, whereas risk elements were probability outcome from the decision that have been made.

In Islamic perspective, the principle of rational is depends on the religious or faith. As a Muslim, every decision is essential to achieve the two life dimensions; present life and lifeafter (*al-falah*) respectively. In Islam, the principle of rational is not just based on the physical utility (present life) but also include the utility in the lifeafter (*al-falah*) (Zulkifli and Sanep, 2010). For instance, when they take a decision to comply of the zakat payment, they are willing to share their wealth with the community and Islam and at the same time they need to release as a part of their personal consumption. Decision that has been made is still considered as a rational action because the decision is to reach the highest level of satisfaction; physical utility (present life) and lifeafter (*al-falah*) satisfaction. For example, the degree of satisfaction level by every Muslim individual is needed to reach in two life of dimensions. All their actions and decision making will influence their wealth, kindness and happiness in the two life dimensions. As an evidence that every Muslim individual seeks for satisfaction in the present life and life after has been articulated through the Holy Al-Quran, Surah Al-Baqarah verse 201 noted that *“and they pray: Our Almighty God, give us kindness in the present life and the lifeafter and protect us from hell”*.

As a basic theory explained on satisfaction, it becomes an effective theory to explain the compliance, which is closely related to a person's action and making a decision to achieve their satisfaction. This is because the compliance in fulfilling the Islamic obligation such as pay the zakat is one of the satisfactions which are not only in the present life but also in the lifeafter (*al-falah*) as well. As a Muslim, they not just to raise their wealth but also try to find the blessing from Allah (Mohamed Alayuddin, 2008).

EXPOSITION OF ECONOMIC COMPLIANCE MODEL

In the economic perspective, the first and formal model of compliance was formulated by Becker (1968) who explained on criminal activity (Veerinderjeet, 2003). The discussion and explanation is based on the rational choice theory which explain the factors influenced the individual evade from commit the offence. As a rational individual, the taxpayer will maximize utility from their decision making either commit a crime or act according to the law. In maximizing utility, individual will commit a crime if the expected utility to be expanded from committing the crime more than expected utility that can be acquired from a legal action. The specification model formulated by Becker (1968) can be illustrated as follows:

$$EU = pU (Y- f) + U (Y) \quad (1)$$

Where;

EU	an individual expected utility
p	probability of being caught and convicted
f	the monetary equivalent of the punishment if convicted on the offence
Y	gain from undetected from offence
U	individual's von Neumann-Morgenstren utility index

Based on the equation (1), individual will commit a crime when expected utility (EU) that they achieved become positive and vice versa if an expected utility (EU) that they achieve become negative. Positive and negative on an expected utility of each individual depends on the monetary equivalent of punishment if convicted on the offence (f), gain from undetected from offence (Y) and the probability of being caught and convicted (p). For instance, if $f > Y$ and P is sufficiently high, EU will become a negative result.

From the discussion by Becker (1968), Allingham and Sandmo (1972) discussed on tax evasion. Their study stated that decision making either comply or evade the tax is decision under uncertainty. This is because failure to report the full income to tax authority does not automatically impose with penalty or punishment. Taxpayers have a choice between declare actual income or less than actual income or not report at all. Their decision will depend on whether they become detected or undetected by tax authority. The model gives two possible outcomes in maximize expected utility: first outcome is the probability to be detected and punishment from tax evasion (p) by tax authorities. From this situation, a taxpayer will have to pay tax on the undeclared income (W-X) at penalty rate (μ) which higher compared to tax rate (Θ). The second outcome is the probability undetected from tax evasion (1-p). For example, taxpayers will choose whether they pay the tax or avoid pay tax by using the maximum satisfaction estimation as follows:

$$E (U) = (1 - p) U (W - \Theta X) + U (W - \Theta X - \mu [W - X]) \quad (2)$$

Where;

U	Standard utility function
W	Actual income
Θ	Tax rate
X	Declared income
p	Probability investigation by tax authority
W- X	Amount of tax on declared amount / income
μ	Penalty rate

In equation (2), $U (W - \Theta X)$ is utility gain from the revenue income on tax evasion with an assumption the probability undetected by tax authority while $U (W - \Theta X - \mu [W - X])$ is utility gained by a tax payer if the tax evasion has been detected and will be punished by tax authority. For example, in order to maximize utility, a taxpayer is subject to probability if they are being caught or non- caught by tax agency/authorities which become the obstruction, and it can be write as follows:

$$Y_{nc} = W - \Theta X \quad (3)$$

$$Y_c = W - \Theta X - \mu (W - X) \quad (4)$$

Based on equation (3) and (4), it shows the obstruction in maximizing taxpayer satisfaction, the *First Order Condition* (FOC) from the equation (2) can be written as follows:

$$\frac{\partial E(U)}{\partial (X)} = - \Theta (1 - p) U' (Y_{nc}) - (\Theta - \mu) p U' (Y_c) = 0 \quad (5)$$

In order to fulfill the requirement of maximum function, the second order condition (SOC) from the equation (5) can be written as follows:

$$\frac{\partial^2 E(U)}{\partial (X)^2} = - \Theta^2 (1 - p) U'' (Y_{nc}) + (\Theta - \mu)^2 p U'' (Y_c) < 0 \quad (6)$$

From the equation (2) until (6), in order to maximize expected utility, a taxpayer will declare income (X) lower than from actual income (W) or $(Y_{nc} = W - \Theta X)$ which depend on the penalty or punishment they will be faced $(\mu [W - X])$ and how much cost they need to provide for tax evasion. Taxpayer becomes compliance on tax if they assume the cost of penalty and punishments that will be faced if being detected are high until it can affect to the level of their satisfaction. The degree of compliance becomes lower if the cost of penalty and punishment become lower and they become tax evasion. From the formulated model, other researchers were done on some modification regarding on compliance such as Yitzhaki (1974), Diabi (1993), Borck (2004), Chorvat (2007) and Zulkifli and Sanep (2010) and it become a large number of contributions to the compliance literature (Sandmo, 2003).

The first piece of work developed a theoretical model of zakat compliance was Diabi (1993). He explained the concept of zakat evasion based on the economic interpretation which has never been concentrated in economic literature and evasion and it is relatively less conversed in Islamic Economics compared to the issue of tax compliance and evasion (Diabi, 1993). The interpretation based on the consumer behavior theory and economic model but some changes have been done to suitability with the zakat environment. Diabi (1993) assumed Muslim individual declaring their true income (Y_n) depends on the individual faith, attitude towards risk of being detected and the enforcement of a penalty for zakat evasion. As such, they may declare their actual income ($d=1$) or portion of actual income ($0 < d < 1$) or not reported at all ($d=0$). From the zakat evasion, it comes out with two different scenarios which evasion is detected (S_1) and undetected (S_2) Probability the evasion is detected (S_1) to occur is (p) and the probability undetected (S_2) to occur is (1-p). If (S_1) occurs, Muslim individual will consume (X_2) and when (S_2) occurs, they will consume (X_1). From that, there have three possible cases where the penalty rate (k) is equal to $\frac{1}{2}$, the scenario no penalty involved ($k=0$) and lastly, where penalty rate is surrounded by the range ($0 < k < \frac{1}{2}$). From the explanation,

Diabi (1993) formulated one model to explained zakat evasion by adopting the expected utility maximization model as follows:

$$E(U) = pU(X_2) + (1-p)U(X_1) \quad (7)$$

Subject to;

$$X_1 = Y_n (1 - dZ) \quad (8)$$

$$X_2 = Y_n (1 - Z - k - kZ + kdZ) \quad (9)$$

Where;

Y_n	Actual income
d	declare income
Z	Zakat rate
k	Penalty rate

The first order condition (FOC) for maximize is therefore:

$$\frac{\partial E(U)}{\partial(d)} = kZp U'(X_2) - Z(1-p) U'(X_1) = 0 \quad (10)$$

$$\frac{\partial E(U)}{\partial(d)} = kpU'(X_2) - (1-p) U'(X_1) = 0 \quad (11)$$

$$\frac{(1-p)}{kp} = \frac{U'(X_2)}{U'(X_1)} \quad (12)$$

From the equation (7) to (12), if Muslim individual complies with zakat payment, they will declare their true income (Y_n) where their consumption of X_1 ($Y_n (1 - dZ)$). If they dishonest, avoid pay the zakat, it depends in two different state either undetected or being caught from evading ($X_2 = Y_n (1 - Z - k - kZ + kdZ)$). The situation of evader is depends on their preferences which determined by their attitude, zakat rule and the risk of being detected.

Apart from that, Zulkifli and Sanep (2010) also adapted the economic model in the study to identify factors determining the compliance of the zakat on income through the formal institution in Aceh. Zulkifli and Sanep (2010) give details on the modification into the economic model by the Allingham and Sandmo (1972) which need to be done to describe regarding compliance on zakat. It is because zakat not just depends on the weight of physical such as penalty and fine but it is a comprehensive to fulfill the religious obligation. The modification model as follows:

$$E(U) = [1 - p(\alpha - z(\alpha)) U(Z_{tb})] + [p(\alpha - z(\alpha)) U(Z_b)] \quad (13)$$

Where;

U	Standard utility function
α	Total income to pay the zakat
z	Zakat rate
$z(\alpha)$	Total zakat pay to formal institution
p	Probability pay through formal institution
Z_{tb}	Avoid pay through formal institution
Z_b	Comply pay through formal institution

$U(Z_{tb})$ is satisfaction that achieved by zakat payer from avoid paying the zakat through the formal institution. Meanwhile, $U(Z_b)$ refers to the total satisfaction zakat payer received if they comply to pay the zakat through the formal institution. $p(\alpha - z(\alpha))$ is the probability of zakat payer pay their zakat on income through the formal institution. As such, when $p(\alpha - z(\alpha)) = 0$, this mean that zakat payer avoid paying the zakat through the formal institution and become noncompliance paying the zakat on income through the formal institution.

According to Zulkifli and Sanep (2010), in order to determine the factors of zakat on income compliance behavior through the formal institution, there are several limitation factors, which include various aspects such as Islamic aspect and not just based on economic aspects who mentioned by Allingham and Sandmo (1972) through their model. Islamic aspect must be seen as an important factor which influence Muslim individual in complying with every religious obligation such as zakat. The factors include such as law enforcement (*Le*), level of religiosity (*Lr*), level of knowledge (*Lk*), multiple payment mechanism (*Mpm*), trust on zakat institution (*Tzi*), perception on tax system (*Pts*) and environment (*Env*). Therefore, the limitation in maximizing satisfaction of zakat payer through the formal institution is subject to following equation:

$$Z_b = \alpha - z(\alpha) \quad (14)$$

$$Z_{tb} = (1 - z) \alpha - (Le + Lr + Lk + Mpm + Tzi + Pts + Env) (\alpha - z(\alpha)) \quad (15)$$

As such the equation (13) can be written as follows:

$$E(U) = [1 - p(\alpha - z(\alpha)) U((1 - z) \alpha - (Le + Lr + Lk + Mpm + Tzi + Pts + Env) (\alpha - z(\alpha)))] + [p(\alpha - z(\alpha)) U(\alpha - z(\alpha))] \quad (16)$$

From the equation (16), $(Le + Lr + Lk + Mpm + Tzi + Pts + Env)$ are the factors influence Muslim individual avoid to paying the zakat on income through the formal institution. As such, the equation (16), first order condition (FOC) can be shown as follows:

$$= [- (1 - p) U'(\alpha - z(\alpha)) - [(Le + Lr + Lk + Mpm + Tzi + Pts + Env)(\alpha - z(\alpha))].(Le + Lr + Lk + Mpm + Tzi + Pts + Env)] z'(\alpha) + [p U'(1 - z) \alpha - z'(\alpha)] = 0 \quad (17)$$

$$[p U'(1 - z) \alpha. z'(\alpha)] = [(1 - p) U'[(\alpha - z(\alpha)) - (Le + Lr + Lk + Mpm + Tzi + Pts + Env)(\alpha - z(\alpha))]] (Le + Lr + Lk + Mpm + Tzi + Pts + Env) z'(\alpha) \quad (18)$$

$$[p U'(Z_b) z'(\alpha)] = [(1 - p) U'(Z_{tb}) (Le + Lr + Lk + Mpm + Tzi + Pts + Env) z'(\alpha)] \quad (19)$$

In other words, the equation (19) may write as follow:

$$\frac{p U' (Z^b)}{1 - p U' (Z^{ib})} = (Le + Lr + Lk + Mpm + Tzi + Pts + Env) \quad (20)$$

From the equation (20), $(\frac{\rho U'(Z^b)}{1 - \rho U'(Z^{ib})})$ is the Muslim individual probability comply in paying the zakat on income through the formal institution in order to maximize expected utility which depend on the law enforcement (*Le*), level of religiosity (*Lr*), level of knowledge (*Lk*), multiple payment mechanism (*Mpm*), trust on zakat institution (*Tzi*), perception on tax system (*Pts*) and environment (*Env*).

The modification model showed that seven factors significantly influence the compliance of Muslim individual paying zakat through formal institution such as gender, age, level of education, monthly expenses, level of understanding regarding zakat, tax system and environment while the level of religiosity, law enforcement, trust and payment services which become the factors determine the compliance but insignificant influence. This situation proved that, the model by Allingham and Sandmo (1972) can be adapted in explaining regarding compliance on zakat but it needs some extension and modification. The modification on the first model of economic compliance concerned with the factors that change invariably throughout the years, but the model of compliance may be improved by the inclusion of these variables (Ali et al., 2001).

Therefore, two important subjects need to be concentrated. First, compliance not just depends on the one aspect as showed and discussed by Allingham and Sandmo (1972) through tax evasion model and Diabi (2003) through zakat evasion model, but it should depend on the various aspects. This is because when touch on zakat, religious aspect needs to be discussed. Second, even though lack of discussion and modification on economic model towards compliance of zakat, but some of the study has been revealed that there has an alternative approach can be used to discuss on the subject of compliance behavior of zakat on business. Hence, this paper try to expose the economic model in explaining the compliance behavior of zakat on business based on economic theory.

THEORETICAL FRAMEWORK

Based on the previous discussion and explanation in the economic aspect of zakat compliance, there must be several factors such as psychology, sociology and economic (Zulkifli and Sanep, 2010). The development of theoretical framework of this paper is based on the previous studies and a number of literatures in zakat compliance such as law enforcement, level of religiosity, government incentive, level of knowledge, length of business operation and level of trust. Through the literature of study, there are some factors influencing Muslim individual pay zakat. The following factors have also become the basis for the development of the theoretical framework for this study.

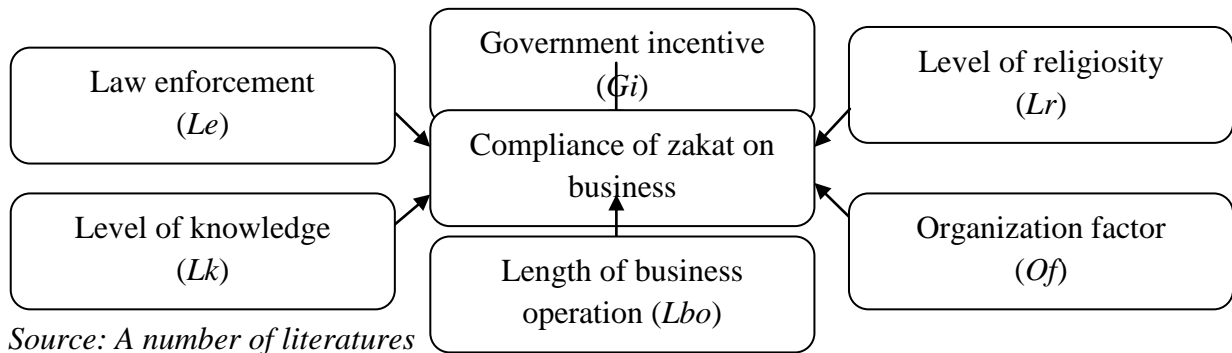
1. Level of religiosity (Ram, 2010; Zulkifli and Sanep, 2010; Kamil, 2002; Zainol, 2008; Muhammad Muda et al., 2005)
2. Level of knowledge (Safri, 2006; Hasan and Sahnaz, 2005; Muhammad Alayuddin, 2008; Kamil and Ahmad Mahdzan, 2001)
3. Length of business operation (Mohamad Alayuddin, 2008)
4. Organization factor (Zulkefli et al., 2006; Muhammad Muda et al., 2005; Zulkifli and Sanep, 2010; Hasan and Sahnaz, 2005) which incurred the trustworthiness from

Muslim business entrepreneur to the zakat institution beside the accountability, transparency, fairness and responsibility in managing zakat funds

5. Government incentive (Ram, 2010; Barjoyai, 2001) where the incentive is referring to the zakat deduction given by government to Muslim business entrepreneur. This incentive is a different approach that has been given by government to zakat on income.
6. Law enforcement (Kamil, 2002; Zainol, 2008; Ram, 2010; Zulkifli and Sanep, 2010)

Based on the above factors, the following theoretical model is proposed to study on how the factors positively or negatively affect the compliance behavior of zakat on business among SMEs entrepreneur in Selangor. The theoretical framework consists of six factors represented in various aspects which can be divided into internal factors and external factors as mentioned by Muhammad Mud et al. (2005) and Nurbazirah and Hafiz (2011). The factors comprise of level of religiosity (Lr), level of knowledge (Lk), length of business operation (Lbo), organization factor (Of), government incentive (Gi) and Law enforcement (Le). The theoretical framework of this study is shown in figure 1.

Figure 1: Theoretical Framework



Source: A number of literatures

From the theoretical model in figure 1, the main assumption in the economic analysis of zakat compliance, individual is a rational decision maker who considers the satisfaction in the two life dimensions (Zulkifli and Sanep, 2010). As such, Muslim business community decision whether to comply or not to pay the business zakat to maximize utility is depends on the factors determining in the figure 1. Hence, if the zakat compliance model formulated by Zulkifli and Sanep (2010) in (13) is adapted to discuss the compliance of the business zakat payment in Malaysia, it can be written as follows:

$$E(U) = [1 - \rho (\delta - z(\delta)) U(Z^{nc})] + [\rho (\delta - z(\delta)) U(Z^c)] \quad (21)$$

Where;

- U Standard utility function
- δ Total income has to pay the zakat
- z Zakat rate
- $z(\delta)$ Total zakat pay
- ρ Probability pay the zakat
- Z^{nc} Avoid pay the zakat
- Z^c Comply pay the zakat

$U(Z^c)$ is satisfaction gained by Muslim business community comply with business zakat payment while $U(Z^{nc})$ refer to the total of satisfaction gained by Muslim business community avoid to pay the business zakat. $\rho (\delta - z (\delta))$ is the probability Muslim business community comply with business zakat payment. As such, if $\rho (\delta - z (\delta)) = 0$, it means Muslim business community does not pay the business zakat. If the factors determining in the conceptual model as figure 1 added into the utility function model, therefore, the obstruction of Muslim business community to maximize utility is subject to following equation:

$$Z^c = \delta - z (\delta) \quad (22)$$

$$Z^{nc} = (1 - \rho) \delta - (Lr+Lk+Lbo+Of+Gi+Le) (\delta - z (\delta)) \quad (23)$$

As such, the equation (21) can be written as follows:

$$E(U) = \frac{[1 - \rho (\delta - z (\delta))U(1-z)\delta - (Lr+Lk+Lbo+Of+Gi+Le) (\delta - z (\delta))] + [\rho (\delta - z (\delta))U(\delta - z (\delta))]}{U(\delta - z (\delta))} \quad (24)$$

Where, $(Lr+Lk+Lbo+Of+Gi+Le)$ are the factors influencing the compliance of the business zakat payment in Malaysia. From the equation (24), the *first order condition* (FOC) is shown as follows:

$$\frac{\partial E(U)}{\partial (\delta)} = [- (1 - \rho)U'(\delta - z (\delta)) - [(Lr+Lk+Lbo+Of+Gi+Le) (\delta - z (\delta))].(Lr+Lk+Lbo+Of+Gi+Le) z'(\delta)] + [\rho U' (1 - z) \delta - (z' (\delta))] = 0 \quad (25)$$

$$[\rho U' (1 - z) \delta . z' (\delta)] = [(1 - \rho)U'(\delta - z (\delta)) - [(Lr+Lk+Lbo+Of+Gi+Le)(\delta - z (\delta))](Lr+Lk+Lbo+Of+Gi+Le) z' (\delta)] \quad (26)$$

$$[\rho U' (Z^c) z' (\delta)] = [(1 - \rho) U' (Z^{nc}) (Lr+Lk+Lbo+Of+Gi+Le) z' (\delta)] \quad (27)$$

In other words, the equation (27) can be written as follows:

$$\frac{\rho U' (Z^c)}{1 - \rho U' (Z^{nc})} = (Lr+Lk+Lbo+Of+Gi+Le) \quad (28)$$

From the equation (28), $(\frac{U' \rho (Z^c)}{1 - U' \rho (Z^{nc})})$ is the Muslim business community probability comply in paying the business zakat in order to maximize utility, while $(Lr+Lk+Lbo+Of+Gi+Le)$ become the factors determining the compliance of the business zakat payment in Malaysia. The equation showed that there has an alternative discussion in explain regarding zakat compliance. But, to reveal either the factors determining in the equation (28) really influence compliance of zakat on business further discussion with analysis need to be done which not covered in this paper.

CONCLUSION

Based on the explanation and exploration, the compliance behavior of zakat on business can be explained through an economic model, framing compliance in terms of behavioral theories

and models. This paper presents a review of the previous studies to identify the factors that influence the compliance of zakat on business and discuss the factors based on the economic approach. Some recent studies in the context of zakat compliance especially in Malaysia explore and discuss the zakat compliance on psychology and sociology approach and there is still a lack of study focus on economic approach. This paper proposes a comprehensive framework for studying the zakat compliance in Malaysia using the economic approach pertaining on business zakat. The development conceptual model and future empirical findings using this model hopefully will contribute and prove the compliance of zakat which can be discussed in many ways.

LIST OF ABBREVIATIONS

CCM	Companies Commission of Malaysia
Env	Environment
Gi	Government Incentive
Le	Law Enforcement
Lk	Level of Knowledge
Lob	Length of Business Operation
Lr	Level of Religiosity
LZS	Lembaga Zakat Selangor
Mpm	Multiple Payment Mechanism
Of	Organization Factor
PPZ	Pusat Pungutan Zakat
Pts	Perception on Tax System
TPB	Theory of Planned Behavior
TRA	Theory of Reasoned Action
Tzi	Trust on Zakat Institution

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