

Zakah from Salary and EPF: Issues and Challenges

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Abstract

The beginning of the 1980's witness a new approach of collecting zakah on monthly bases in some of the Muslim countries such as Sudan, Pakistan and Malaysia. At first, this creates an ambiguous situation amongst Muslim scholars as to its legitimacy, since the payment of zakah is known to be given on annual bases and once it reaches the nisab (the minimum assigned). Recently, a consensus has been given amongst contemporary Muslim scholars that it is lawful to pay the zakah on monthly basis. Malaysia is one of the countries that start implementing zakah deduction on monthly basis through participating in a scheme called the Salary Deduction Scheme. This raises the question on some of the conventional created funds, such as the Employees Provident Fund (EPF), and whether zakah is applicable on them or not. The main objective of this paper is to study the Shariah aspect not only on the validity of the payment of zakah on monthly salaries in Malaysia but the validity of the payment of zakah on other funds such as the EP.

Fields of Research: Shariah, Zakah, EPF, Islamic Investment.

1. Introduction

From the time when colonization took place in the nineteenth up to the first half of the twentieth century, it has been realized that Muslim countries were forced to follow the penal codes that are not Islamic. One of these is the system of taxation which has been followed by many Muslim countries until today replacing one of the most important Islamic Institution, the institution of zakah, which is the third pillar of Islam. This ambiguous situation creates two types of Muslims. The first type of Muslims mixed between zakah and taxes and so believes that paying their taxes will cover paying their zakah. The second type are the sincere Muslims who found themselves paying more than others as they are required to pay their compulsory taxes in addition to their obligatory zakah. The aim of this study is to clarify this ambiguous situation and to highlight the importance of reviving the institution of zakah in the Islamic world by adopting the current practice of Salary Deduction Scheme which has been practice successfully in Malaysia. To achieve this, the study is divided into five sections including the introduction. Section two will provide an overview on zakah. Section three will highlight the practice of the employee provident fund EPF in Malaysia, section four will provide the current practice of zakah on salaries and on EPF in Malaysia and this will be followed by the conclusion and recommendation for future research.

2. Overview on Zakah

2.1 What is Zakah?

Literally zakah means 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 *al-nisab* (the minimum assigned) on annual basis or once harvested to the eight categories of people as specified in al-Quran. It is also important to note that zakah has to be paid from lawful wealth and assets, e.g. zakah cannot be calculated on prohibited or unlawful wealth, such as income from interest, stolen property, or wealth acquired or earned through unlawful means.

2.2 Economic Objective of Zakah

Zakah has many objectives which have been highlighted in both the Quran and the Hadith. For example from the Quran, its main objective is to purify and to bless Muslim's wealth and soul. And from the hadith its objective is to take a portion of money from the rich to be given to the poor.

From these two objectives it is clear that its economic objective is to improve the condition of the receivers of zakah this year to be givers of zakah the following years. Hence, only then in this case zakah can play its role in purifying and blessing not only the rich's wealth and soul from selfishness and greediness but the souls of the eight recipients of zakah, as highlighted below, from hatred, jealousy and laziness resulting in faster economic growth and a cooperative Muslim societies that can alleviate poverty easily from their societies.

2.3 Administration of Zakah

For the institution of zakah to achieve the above mentioned economic objective, zakah must be collected and distributed by the state as has been mentioned in many Quranic verses and in the Sunnah:

خُذْ مِنْ أَمْوَالِهِمْ صَدَقَةً تُطَهِّرُهُمْ وَتُزَكِّيهِمْ بِهَا وَصَلِّ عَلَيْهِمْ إِنَّ صَلَاتَكَ سَكَنٌ لَهُمْ وَاللَّهُ سَمِيعٌ عَلِيمٌ

Of their goods (wealth), take alms, that so thou mightest purify and sanctify them; and pray on their behalf. Verily thy prayers are a source of security for them: And Allah is One Who heareth and knoweth. (Surah Al-Taubah, 9: 103)

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 highlighted that he will fight against those who differentiate between prayers and given their zakah.¹ The same was practice by all the other caliphas placing it in *Baitulmaal* which is directly managed by the state.

Moreover, it is also the responsibility of the state to distribute zakah to the eight categories of people as mentioned in the following Quranic verse.

إِنَّمَا الصَّدَقَاتُ لِلْفُقَرَاءِ وَالْمَسْكِينِ وَالْعَامِلِينَ عَلَيْهَا وَالْمُؤَلَّفَةِ قُلُوبُهُمْ وَفِي الرِّقَابِ وَالْغَارِمِينَ وَفِي سَبِيلِ اللَّهِ وَآلِ السَّبِيلِ فَرِيضَةً مِّنَ اللَّهِ وَاللَّهُ عَلِيمٌ حَكِيمٌ

"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)

In this case zakah is totally different from the conventional tax which had been imposed in almost all Muslim countries during colonization and which continued up to the present time.

2.4 Reasons for the State to Administer Zakah:

Since zakah is a compulsory due and not a charity it has to be administered by the state as came in the Quran and the Sunnah. The main reasons for the state to administer zakah can be summarized as follows²; some Muslim may have no concern in paying their obligation if it left to them so in this case the right of the eight recipients of zakah will be lost resulting in an unjust society. Moreover, receiving zakah directly from the state and not from the rich will preserve the dignity of the recipients from direct humiliation. In addition, collection and distribution of zakah by the state gives the state the responsibility to collect zakah from all affordable people and distributes it in a just and even way to the eight categories of recipients mentioned above.

¹ Abu Hurairah's narration that, "When the Messenger of Allah (pbuh) deceased and Abu Bakr was appointed as the Caliph for the Muslim during that time, some Arab tribes became apostates and refused to pay the zakah. In this case abu Bakr (ra 'a) said, 'By Allah, I would definitely fight against those who make a difference between Prayer and Zakah, for it is the obligation upon the rich. By Allah, I would fight against them even if they withheld a cord (used for hobbling the feet of a camel) which they used to give to Allah's Messenger (pbuh) (as Zakah).'

² Yusuf al Qardawi "*Fiqh al Zakah: A comparative study of zakah, regulations and philosophy in the light of Qur'an and Sunnah*", trans by Monzer Kahf. Scientific publishing centre King Abdulaziz University Jeddah, Saudi Arabia, Vol. II, p 113.

2.5 Conditions of Paying Zakat from Income:

It is well understood in shariah (Islamic law) 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.³ However, nowadays, income in terms of salaries, wages, profit and professional incomes become the most important source of living for the majority of Muslim population. This raises three questions; is the current salary, which is the most important source of income in Muslim countries subject to zakah? Can zakah be given on monthly basis? Is EPF subject to Zakah? To answer those questions let us first highlight the important conditions that must be observed while imposing zakat on income in general and zakah on salaries in particular:

2.5.1 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.

2.5.2 Fulfilling One's Basic Needs:

Fulfilling the basic needs is very important requirement before imposing zakat on income. The person who reaches the *nisab* but still does not fulfill his basic need is not subject to pay zakat.

2.5.3 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.

2.5.4 Completion of *Haul*/ Lapse of a Full Year:

Although the completion of *haul* (one year) is one of the conditions for the payment of zakah,⁴ 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.⁵ Moreover, Dr. Yusuf al-Qaradawi in his book *Fiqh al-Zakah*⁶ provided ample evidences which supported the practice of given zakah from salaries during the early days of Islam. Moreover, 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.⁷

2.5.5 Zakat Calculation on Income:

For the calculation of zakah on income Muslim scholars agreed that zakah from labor and professions can be calculated at the rate of 2.5%.⁸

As such three different approaches were given to validate zakat payment on income as follows:

1. 2.5% from the total annual gross income which exceed *nisab*.
Example: RM 34,800 x 2.5% = RM 870.00
2. 2.5% from the total annual net income (after the allowable basic needs expenses deduction) which exceed *nisab*.
3. 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.

³ Ibid, Vol. I, p 52.

⁴ Zakah is only payable on assets that have been held for at least one year i.e. 1 year Hijri = 354.5 days, 1 year Solar = 365.25 days) <http://www.islamic-world.net/economics/zakah.htm> (access on July 2010).

⁵ For more detail see Yusuf al Qardawi *Fiqh al Zakah* Vol I, pp 250-270

⁶ Ibid, p 252-258

⁷ Ibid, p 259.

⁸ For more detail see Yusuf al Qardawi *Fiqh al Zakah* Vol II, p269.

4. Overview on the Employees Provident Fund EPF

The Employees Provident Fund (EPF) is a social security institution formed according to the Laws of Malaysia, Employees Provident Fund Act 1991 (Act 452) which provides retirement benefits for members through management of their savings in an efficient and reliable manner.⁹ It 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.¹⁰ For the purpose of this study we would concentrate only on people who continued with EPF until their retirements or pre-retirement,¹¹ excluding those who joined the government service and chosen the Government Pension Scheme.

3.1 Mandatory Contribution

The EPF members are the Private and the Non-Pensionable Public Sector employees.¹² 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.¹³

Table 1: Contribution Rates

Year	Employee (%)	Employer (%)	Total (%)
1952-Jun1975	5	5	10
Jul 1975-Nov1980	6	7	13
Dec1980-Dec1992	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-Dec2020	8	12	20

Sources:http://www.kwsp.gov.my/index.php?ch=p2reports&pg=en_p2reports_statistic&ac=1015

As realized from the table above the rate of contribution varies from year to year according to the economic situation and according to the government decision.

3.2 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; Malaysian Government Securities, Money Market Instruments, Loans & Bonds, Equity and Property as highlighted in the table below. The investment returns together with the principal are then paid to members on his/her retirement. These Fund's investments are guided by acts, policies, guidelines and processes in carrying out its investment function.¹⁴

⁹ EPF official website, Available at: http://www.kwsp.gov.my/index.php?ch=p2corporateinfo&pg=en_p2corporateinfo_geninfo&ac=1856, (Accessed on 13 January 2010).

¹⁰ Guide to Employees Provident Fund (Compulsory Savings Scheme) (Malaysia), Available at: <http://www.lawyerment.com.my/library/doc/empl/epf/>, (Accessed on 19 January 2010).

¹¹ Guide to Employees Provident Fund (Compulsory Savings Scheme) (Malaysia), Available at: <http://www.lawyerment.com.my/library/doc/empl/epf/>, (Accessed on 19 January 2010).

¹² EPF official website, Op cit.

¹³ Ibid.

¹⁴ Ghaffar, Roslan A. op cit.

Table 3: EPF Investment Portfolio

	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

Source: Ghaffar, Roslan A. (2005). Implementation of investment guidelines: the experience of the Employees Provident Fund.

Recently, and with the growing demand for Islamic finance Muslims are calling for Islamic investment for their EPF based on Maqasid al-Shariah.¹⁵ This in turn will secure the Muslim's doubt on paying their zakah from their EPF since it is invested lawfully.

3.3 Proposal for Islamic Investment for EPF

With the growing need of Islamic finance it is also important to Islamize the EPF investment portfolio and make it shariah compliant. This can be done by creating an Islamic investment division within the EPF investment structure that looks after the Islamic investment.

3.3.1 Revising the Structure of the Investment Portfolio:

The investment portfolio of EPF can be structured according to a new strategic asset allocation by creating a dual investment portfolio, whereby the fund collected by EPF is segregated into two different pool of fund conventional and Islamic, and invested in the market accordingly. The management of the pool can be done at the early stage during the opening of the account, whereby EPF grant the choice to the member to select the type of their investment they want (i.e whether conventional investment or Islamic investment). The mentioned choice provided will enable the members to make their choice and participate respectively to the establishment of the fund from an Islamic investment.

The dual investment will be according to the following strategic asset allocation:

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	-	-

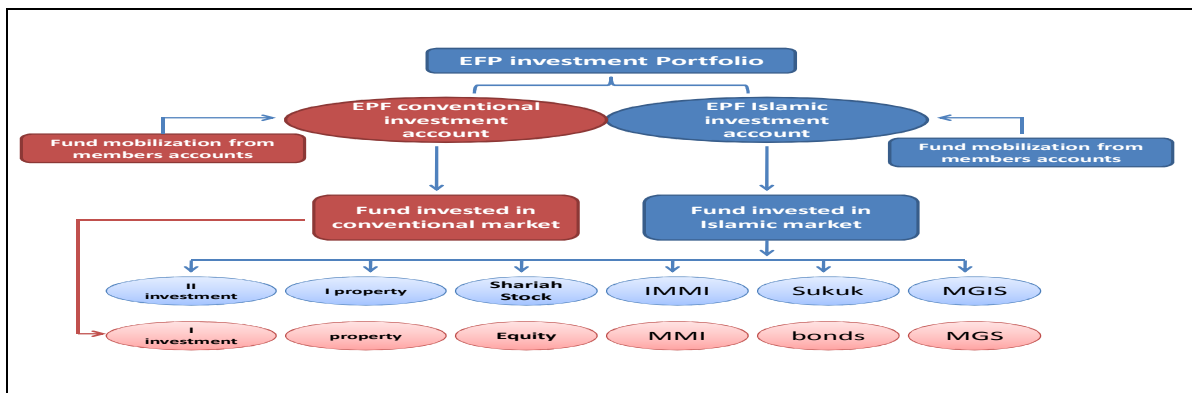
3.3.2 Proposed Investment Structure: With the investment structure highlighted in Figure 1, the members of EPF will have the chance to invest their fund through Islamic investment instruments, whereby the EPF establish two different pool of fund through two separated accounts, a conventional account and Islamic account.

¹⁵ Jaafar Rihan, *Application of Maqasid Shariah in EPF's investment*, paper present in INCEIF 11 MARCH 2010

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 products and instruments, which make the return and profit generated permissible and acceptable from Shariah perspective. The list of Shariah compliant instruments that can be used for investment is as follows:

- Malaysian Government Islamic Securities
- Islamic Bonds / Sukuk
- Islamic Money Market Instruments
- Shariah Stock
- Islamic Property
- International Islamic Investments

Figure 1: EPF Investment Portfolio

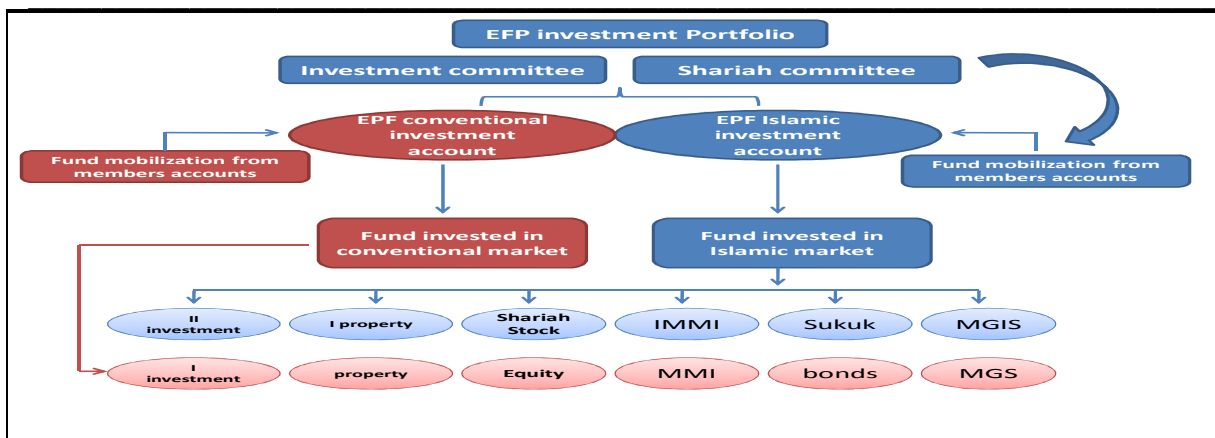


In addition to the above list of products, EPF may select other types of Islamic products offer in the market such as Islamic structured products in order to diversify the investment portfolio when it is needed. Shariah governance can be addressed as well when it comes of the Islamic investment, whereby EPF is advised to have a Shariah advisory committee on the matter related to the Investment to ensure Shariah compliance procedure in the investment, and bring confident to the members of EPF and credibility to the investment structure.

3.3.3. Islamic Investment under Shariah Governance Framework:

The Shariah committees will only advice on the Islamic investment portfolio and monitor the performance of the investment as shown in figure 2; in addition to that they provide advice and guideline to the matter related to the investment of the fund when it is needed the incorporation of Shariah governance structure into the investment structure will ensure the Shariah compliance in the investment.

Figure 2: EPF Investment Portfolio & Shariah Governance Framework



Current Practice of Zakah on Salaries and on EPF

As mentioned earlier some Muslim scholars agreed that income, which includes wages, salaries, rents, profits and dividend, is subject to zakah. Recently some Muslim countries enacted laws for the collection of zakah from salaries on compulsory and on voluntary basis, among those countries Sudan and Malaysia. For example in Sudan, the Sudanese Zakah Law of 1986 gives the right to the government to collect zakah on compulsory basis from all wealth including wages, salaries, professional income and other forms of earnings. This law gives also the right to the government to deduct zakah from all salaries on monthly basis from all Muslims working inside Sudan and all Sudanese working outside Sudan. In Malaysia, the Malaysia Tax Law encourages Muslims to pay their zakah on voluntary basis from their salaries and on monthly basis through Tax Rebate as highlighted in the following table.¹⁶

Table3: Payment of Zakah Through Tax Rebate

Monthly salary	Income tax payment	Zakah Payment	Tax-Rebate
	Considered 1 wife and 1 child	Considered 1 wife and 1 child	
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
21,000	5460	455.92	5004.08
22,000	5720	478.92	5241.08
23,000	5790	501.92	5288.08
24,000	5980	524.92	5455.08
25,000	6500	547.92	5952.08

Source: Calculated from the Schedule of Monthly Tax Deductions of Malaysia, and zakah Calculator provided by the zakah dept. in the website.

¹⁶ The Malaysia Tax Law state that "The equivalent of amount paid in respect of any zakat, fitrah or other Islamic religious dues which are obligatory".

In Malaysia the Schedule of Monthly Tax Deductions has been specified according to the number of wives and the number of children. In this study one wife and one child has been selected just to facilitate explanation. For example, from the table above, taking 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 monthly taxation without changing the net salary pay. This scheme, i.e. Salary Deduction Scheme, encourages the majority of the 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.

Payment Roll for Mr. Y Without Zakah

INCEP				2ND HALF PAYROLL - MARCH 2010		MONTHLY / BANK	
NAME	:	MR Y					31/03/2010
IC NO.	:	5678					
UD NO.	:	SAMP02					
				POSITION :			
EARNINGS		DEDUCTION		EMPLOYER			
BASIC PAY	12000.00	EPF	1320.00	EPF	1440.00		
		SOCSSO		SOCSSO			
		PCB	1486.50				
OVERTIME							
RM 10MIN	0.0000						
RM 10H	0.0100						
RM 20MIN	0.0100						
RM 20H	0.0100						
REST DAY	0.0800						
PUB HOL	0.1200						
ALLOWANCE							

- 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 lends it to the government to invest it on his behalf.

Taking the third group of Muslim scholars we strongly believe that the whole amount of EPF, i.e. the amount contributed by the employee and the amount contributed by employer, is subject to zakah. As such, to ensure the right practice of paying zakah on the whole amount of EPF we recommend the following; since individuals in Malaysia have the right to increase or decrease their amount of zakah when filling the Zakah Form, it is much recommended that they can increase the amount of their zakah by including the amount contributed by the employer to their monthly income. For example in the above case the individual can add the amount contributed by the employer which is RM1440 to his total monthly salary and then he can increase the amount of his zakah from RM248.92 to RM271.92 realizing that no change will result in his net pay. In this case the employee will be encouraged to pay his zakah on his EPF on yearly basis through this Salary Deduction Scheme and hence once reach retirement he doesn't have to pay his zakah again.

4. Conclusion and Recommendation for Future Research

From the above we realized that although zakah is the third pillar of Islam and its level of importance is the same as offering prayer, yet this institution had been neglected in almost all Muslim countries not only in terms of its distribution but in terms of its collection since it had been left to the individual whims to pay. This created an ambiguous situation as realized in this study as the majority of Muslim question the validity of whether zakah is payable on income especially on salaries and other funds such as the EPF. In this study evidences were provided not only to support the validity of the payment of zakah on salaries but also the payment of zakah on other funds such as the EPF (subject to be invested according to shairah). A good example of this was provided as in the case of Salary Deduction Scheme practiced recently in Malaysia. We hope that this Salary Deduction Scheme can be adopted in all Muslim countries that follow the conventional taxation system to replace it with the compulsory zakah. This in turn will create awareness to the majority of Muslims to pay first their obligatory zakah and then their taxation if imposed by their government.

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