

Waqf Agencies and Tax Incentives in Malaysia

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Abstract

Currently, waqf agencies are faced with financial challenges in sustaining their operations and therefore, have the imminent need for some tax incentives to alleviate operation costs as the lack of incentives. Therefore, this paper highlights the role of tax incentives in promoting the sustainability of waqf agencies in Malaysia. The case study was conducted using review of documentation, including annual waqf report and digital information on waqf practices, and interviews with respondents from two waqf agencies, i.e. Yayasan Wakaf Malaysia (YWM) and Perbadanan Wakaf Selangor (PWS) in Malaysia. This study found that in the Malaysian tax law, waqf is not entitled to receive tax incentive due to the waqf characteristics, i.e. waqf for donation which is needed to maintain the dividend or benefit can be distributed to the beneficiaries. PWS as waqf agency is not exempted from paying the tax because it is treated a profit-oriented company. YWM is exempted from paying income tax and tax relief for the donors, while for PWS, it still earns advantages in terms of tax relief for the donors, assessment tax, and quit rent. Incentives such as tax relief may serve a vital contribution in promoting the sustainability of the waqf agencies.

Keywords: Financial Sustainability, Tax Incentives, Tax Relief, Waqf Agency, Waqf Properties

Introduction

In Malaysia, the waqf properties, including cash waqf, are under the administration of an appointed trustee—the State Islamic Religious Council (Syadiyah et al., 2016). A waqf agency refers to a corporate organization which is established under the waqf authorities or the State Islamic Religious Council that have a legal capacity to implement the waqf practices. In Malaysia, all waqf agencies are responsible for collecting cash waqf as indicated by the *fatwa*, administration of the funds, and also responsible for the development and management of waqf properties. Generally, the waqf agencies heavily depend on the voluntary contribution of the people or corporate organizations in the forms of cash or in-kind benefits., and the

donors are entitled to tax incentives (i.e. tax relief) provided by the government for the waqf contribution. The waqf fund is subsequently allocated for various charitable purposes such as helping the needy and the development of waqf properties (e.g. shop-lots for rental, religious institutions, and schools). The returns gained from the development are partially circulated back into the agency to fund operation cost. The rest of the income is reciprocated to the beneficiaries in various forms as entrusted in the waqf deeds. This is in line with maqasid shariah, which in general, the aim of the Shari'ah is to secure the benefit of people and protect them from evil and harm (Hamidah, 2017). As Allah mentioned in Quran, He says: "And We sent thee not, but as a mercy for all creatures" (Surah Al-Anbiya:107).

Tax incentives can be defined as all measures that provide for a more favorable tax treatment of certain activities or sectors compared to what is granted to the general industry (Klemm, 2009). Tax incentives are very important for the voluntary sector, especially in supporting their financial needs to provide services for a long period of time. In some Western countries, some non-profit organizations can sustain for a long time by fully utilizing the tax incentives provided by the government (Bowman, 2011).

In the absence of tax incentives, the waqf agencies are confronted with several financial problems. First, income tax imposed on the returns gained by the agencies shrinks their residual income on top of other taxes (e.g. assessment tax and quit rent), thereby reducing their budget allocation for the development and management of the waqf properties. Second, donors who contribute to certain waqf agencies are not entitled to the same tax privileges (e.g. tax relief), thereby discouraging them from contributing to the waqf funds in the future. The situation potentially undermines the financial capacity and deteriorates the financial sustainability of the waqf agencies. Consequently, it depreciates the relevance of the waqf agency as an economic and social wellbeing agent.

Previous studies focused on the role of tax incentives for the waqf donors (Affandi and Nufus, 2010; Ismail et al., 2015; Khairi et al., 2015; Zakaria et al., 2012) and examined the legal implications of taxation policy in the waqf institution (Tunku, 2011). Nevertheless, the role of tax incentives in promoting the financial sustainability of the waqf agencies remains unaddressed in studies related to waqf. As waqf agencies are responsible for yielding returns from the development of waqf properties, the positive impacts of tax incentives on the financial sustainability of the agencies should not be underestimated. Therefore, this study addresses an important gap by examining the need for tax incentives for the waqf agencies in promoting their financial sustainability. This paper discusses the tax incentives in the waqf sector, the government policy, and importance of tax incentives for the waqf agencies.

Waqf Agencies in Malaysia

In Malaysia, the waqf administrative jurisdiction is located under the jurisdiction of states as stipulated in the Federal Constitution under Schedule 9, List II: State List (Government of Malaysia, 2010). States, through the Islamic Religious Enactment/Ordinance, have determined that the State Islamic Religious Council (SIRC) is the sole trustee of their respective waqf properties (Mohd and Asmah, 2010). Prior to the establishment of waqf agencies, the waqf fund was managed by the SIRC. Starting in 2001, some SIRCs had established their own waqf agencies to manage the waqf properties by maintaining SIRC as the sole trustee of the waqf agencies (e.g. Perbadanan Wakaf Selangor [PWS]). Unlike PWS,

Yayasan Wakaf Malaysia (YWM) is a unique case compared to other waqf agencies. It is established in 2008 under the Malaysian Department of Awqaf, Zakat, and Hajj (JAWHAR) to assist the SIRC in developing and managing the waqf properties in Malaysia. The agency has also been granted approval from several states to collect cash waqf on their behalf (Malaysia, 2018).

Currently, several SIRCs in Malaysia are privatizing their waqf management by establishing waqf agencies, as illustrated in Figure 1. This is to ensure that the waqf management can run as professionally as a corporate entity and the development of waqf can be achieved more effectively and efficiently. However, these waqf agencies are also facing difficulties in receiving the same benefits as what SIRCs received from the tax law. Unlike waqf agencies, the SIRCs are tax exempted because it constitutes as part of the government. However, the waqf agencies serve the same function as a corporate entity, which requires them to pay taxes. SIRCs are government agencies that receive state funding; therefore, there are no tax incentives provided for waqf. However, the waqf agencies need to find their own sources of income and generate the income for sustainability in the future.

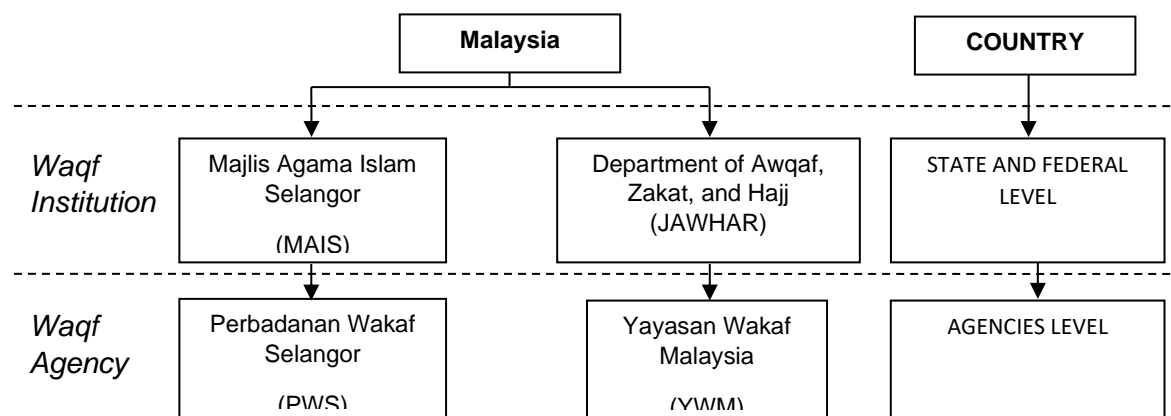


Figure 1: Waqf Institutions and Agencies in Malaysia

Taxation Policies and Practices

Tax policies serve as a fiscal tool to help the government to achieve its development agenda. Tunku Alina (2011) emphasised that taxation policies are one of the methods by which Malaysia can incentivize the formation of future waqf and modernize its governance and management. This will enable the waqf agencies to realize their significant roles as economic agents. Mohamad and Kader (2017) stated that the current budget policy does not provide budget allocation to the SIRC to develop its own waqf properties in the absence of waqf agencies. As such, any kind of taxes or financial liabilities is burdensome to SIRC. The current taxation policy involving the waqf properties is not consistent with the *fatwa* issued by the *Muzakarah Jawatankuasa Fatwa Kebangsaan* (Fatwa Committee Meeting) in 2007, which held that waqf contributions are qualified for tax exemption. The taxation policy with respect to the function of the waqf agencies is important to promote the waqf sectoral development in Malaysia and Singapore. Therefore, this study raises an important concern over the need for tax incentives in promoting financial sustainability of the waqf agencies.

The previous Islamic philosophy supports the importance of tax policy for the waqf development. Chapra (2008) highlighted that, in light of the development theory by Ibnu Khaldun, taxation plays an important role in promoting the waqf development. (Muhammad,

2010) also emphasised Ibnu Khaldun's idea that as more income is received by a waqf agency, the more funds can be redistributed to many charitable programs. According to Shaham (1991), the Ottoman government, during the great Islamic civilization, did not collect tax from the Christian and Jewish waqf or donation. This situation clearly implies support by the Islamic government towards the waqf institution for Muslim context. The government did not impose taxes upon the income generated by the non-Muslim waqf agencies. Based on these deliberations, taxation should serve as an effective fiscal instrument to assist the waqf agencies in promoting their financial sustainability.

Other countries including non-Muslim countries, also provide tax exemption for the income earned by a non-profit organization (NPO). According to (Tunku, 2011) non-profit organizations in the United States of America are eligible for tax exemption on the sale of property and organization income. In addition, Kahf (2003) pointed out that family trusts under different variants in the West, especially in the United States, are granted several tax privileges. Bowman (2012) found several NPOs in the United States are able to sustain their financial performance in the long-term since 1950 just by capitalizing on the tax incentives given by the government. Furthermore, Bowman (2011) suggested for other various organizations (society, cooperation, foundation, and public organization), to explore the tax incentives opportunity because different organization has different incentives eligibility. (Mohammad, 2015) also suggested that waqf agencies learn from effective management of trusts while maximizing their revenues in a tax-effective manner and ensuring the protection of given assets. Some best practices from other countries may serve as a guide in examining the need for tax incentives for the waqf agencies in Malaysia and Singapore.

(Khairi et al., 2015) suggested that the government should provide several incentive packages, including tax reliefs to companies that are directly involved in the practice of corporate waqf as is done to *zakat*. Thus, it is believed that larger companies will be more inclined to allocate a portion of their annual expenses towards corporate waqf. The present corporate waqf funds potentially contribute to the development and economic prosperity while promoting fair wealth distribution in the society.

Impact of Taxes on the Financial Capacity of Waqf Agencies

The waqf agencies assist the government by providing some infrastructures for the benefit of society and reducing the government's burden to incur the development costs (Mohamad & Kader, 2017). Without necessary support from the government, the waqf agencies may encounter various challenges to perform its function with a limited budget. Ismail, Salim, and Hanafiah (2015) argued that the lack of capital and limited financial resources hindered the development of the waqf land. This is because the revenue gained from the waqf land will be redistributed to cover a broad range of expenses (e.g. maintenance, repair, management, and administration of waqf properties) which sometimes exceed its revenue. On top of the expenses, the waqf agencies are also required to pay various taxes. Therefore, by providing tax incentives to the agencies, it will reduce their financial liabilities.

Zakaria et al (2012); Ismail et al (2015) suggested that the individuals or entities who contribute to the establishment of the waqf business should also be provided with tax reliefs, exemptions, or deductions. The government should provide attractive tax incentives to encourage venture philanthropists to engage in the waqf business. Contributions such as a

large capital and resources such as time and expertise are opportunity cost to the venture philanthropists

Similarly, Mahmud and Shah (2010) also supported the notion that tax incentives are needed to ensure the long term sustainability of the waqf agencies. They further recommended a new addendum to the law to be created to provide tax reliefs for the individuals who contribute to the waqf funds through salary deduction so as to facilitate the society to contribute to the waqf funds more conveniently.

In general, waqf agencies do not function like other profit-maximizing companies; they are entrusted to redistribute the returns from the waqf contributions for charitable purposes. Reasonably, the waqf agencies equally deserve the same tax privileges, i.e. tax incentives and a special section in the taxation law. These tax incentives pave more possible ways for waqf agencies to promote socio-economic development. In short, various tax incentives can be provided by the government to support the waqf agencies.

Research Methodology

This is a qualitative research based on interview and review on the documents related to waqf dan tax policy in Malaysia. The respondents were selected from two waqf agencies which have successfully performed their roles as a commendable waqf agency in Malaysia. Data collection was conducted through face-to-face interviews in the middle of the year 2017 to deepen our understanding of how tax incentives and tax relief can support the financial sustainability of selected waqf agencies.

An interview was conducted with the top management staffs from YWM in Putrajaya and PWS. The interviewees included four management staffs from YWM, the CEO of YWM, and three managers from PWS. Documents referred/reviewed were waqf reports, brochures, and websites information on waqf practices. The interview data were transcribed and their responses were analysed based on the thematic analysis, such as the tax treatment, tax system, tax incentives, and implication of incentives towards waqf asset management.

Results and Discussion

Tax Practices in PWS and YWM

The summary of the findings related to tax treatment and tax incentives for both PWS and YWM are presented in the following sections:

a) Tax treatment for PWS

Currently, PWS is not entitled to any tax incentive from the government to support its operation. PWS is still obligated to pay various taxes (e.g. assessment tax, quit rent, and income tax). The only tax incentive received by the PWS is the tax relief which is entitled to the waqf donors. In fact, PWS uses the official receipt issued by Majlis Agama Islam Selangor (MAIS) which enables the donors to enjoy the tax privilege. Nevertheless, the tax relief provided to the donors remains an ongoing controversial matter to the tax authorities. In terms of assessment tax and quit rent, the PWS still enjoys the tax privileges which require them to pay only at a nominal price subjected to certain regulation. For the income tax exemption, negotiation is still underway between the PWS and tax authorities (Informer 1).

The financial source of income for PWS is limited. At present, they only receive financial assistance from MAIS to pay the salary for their staffs. Thus, PWS has to generate income to cover all necessary expenses, including the large-cost development expenditure. With tax exemption, it will reduce the financial liability incurred by the PWS, and the surplus can be allocated for the development and maintenance of waqf properties. Currently, there are 1,328 lots of waqf land estimated at 1,351 acres widely distributed across the state of Selangor. PWS continues to negotiate with the government regarding the tax incentives, especially income tax exemption and tax relief for the donors (Informer 2).

b) Tax Treatment for YWM

Yayasan Waqf Malaysia is a new waqf institution under JAWHAR, which is entitled to various tax incentives from the government. The tax incentives include: (1) income tax exemption for the YWM; (2) tax relief for the waqf donors (e.g. people, organizations); and (3) special tax relief for the organizations that support the Waqf corporate social responsibility (CSR) programs. However, the income tax exemption is not applicable to other incomes than waqf, such as income generated from fixed deposits (Informer 3).

Currently, YWM receives an operating budget allocation from JAWHAR, except for the development budget. However, YWM received a special one-off allowance in 2015 from Unit Peneraju Agenda Bumiputera (TERAJU), amounting to RM50 million, under the Bumiputera development programs. Several projects to improve the Bumiputera's economy have been implemented by YWM. One of the projects includes the procurement of several shop-lots to help entrepreneurs, especially the Muslim entrepreneurs, to rent the shot lots for their businesses by offering competitive rental rates. YWM indirectly generates income via the rental payment collection (Abdul Halim, personal interview, 18 April 2017). Based on the interviews with the YWM officers, tax incentives potentially help YWM in many areas. First, the tax exemption increases residual income generated by YWM in which the surplus from the tax expenses can be allocated for other expenses such as development and operating expenses. Second, the tax relief entitled to the YWM donors encourages more people or organizations to contribute to the waqf. Finally, the special tax relief entitled to companies that work together with YWM in organizing some CSR programs. By having such incentives, many large companies are motivated to collaborate with YWM in many CSR programs (Informer 4).

c) Tax Incentives

Based on the information from the interviews, Table 1 shows the summary of tax incentives in these waqf agencies in Malaysia.

Table 1:

Tax Incentives for Waqf Agencies in Malaysia

Type of Tax Incentive	Malaysia	
	<u>YWM</u>	<u>PWS</u>
Income Tax Exemption	√	X
Donor Tax Relief	√	√
Assessment Tax	X	√
Quit Rent	X	√
Property Tax	NA	NA
Goods and Service Tax (GST)	NA	NA

Note:

√ (Yes - receive tax incentive);

X (No tax incentive);

NA (Not Applicable- tax is not imposed on the agency)

Tax incentive structures are generally different across the waqf agencies in Malaysia. Although YWM is exempted from paying income tax and tax relief for the donors, it still has to pay the assessment tax and quit rent. For PWS, it still earns advantages in terms of tax relief for the donors, assessment tax, and quit rent despite the pending approval for the income tax exemption request and the need to pay goods and service tax (GST). However, GST was no longer imposed in Malaysia since June 2018.

Benefits of Tax Incentives

These are some of the benefits of tax incentives in promoting the financial sustainability of the waqf agencies.

a) Tax Incentives Promote Financial Capacity of the Waqf Agencies

The findings suggest that tax incentives may potentially improve the financial capacity of the waqf agencies. First, tax incentives (e.g. tax exemption and tax relief) can help reduce tax expenses, hence increasing their financial strengths, i.e. residual income. Lower tax expenses enable them to increase their budget allocation for other waqf-related expenses. High allocation of development and maintenance expenditure in managing the waqf assets is imperative in the presence of increased costs in the property market. In addition, waqf agencies are required by law to pay the assessment tax and quit rent imposed on the waqf properties to the tax authorities. Failure to comply with the tax regulations may result in a legal action, i.e. the property will be confiscated and the land will be seized. As the waqf agencies manage thousands of acres of waqf land, a growing amount of quit rent and assessment tax would surely add more pressure to the financially-challenged waqf agencies. In short, tax incentives prove to be an important instrument to help the agencies improve their financial capacity.

b) Tax Incentives Support Waqf Asset Management

One of the main factors contributing to the financial capacity of the waqf agencies is the development and maintenance of waqf properties. According to Ellsworth (1998), the sustainability of capital assets is represented by the on-going maintenance and reinvestment, so that they are not 'used up' either by use, abuse, or inflation and remain available for future generations. Therefore, there is a need to manage, maintain, and develop the waqf properties. With a large number of underdeveloped waqf properties, the agencies are unable

to generate their income while continuously incurring expenses in managing the waqf properties. The potential consequences of underdeveloped waqf properties clearly suggest inefficient waqf asset management.

To develop and maintain the waqf properties, waqf agencies necessitate a sufficiently huge financial capacity. The support by the government in providing tax incentives helps to increase the financial capacity of the waqf institution, which can be further allocated for the development and maintenance of the waqf properties. It is critical because an efficient waqf asset management increases not only the return gained by the waqf agencies but also the benefits to the beneficiaries

For example, PWS in Selangor focuses on the potential land for development. With the huge acreage of waqf land, PWS has planned and implemented several competitive projects to gain higher returns to the agency and society. Among the development plans are housing projects and building of petrol pump kiosks in profitable areas such as Shah Alam. In short, tax incentives would potentially increase the residual income of the waqf agencies, thereby enhancing their financial capacity. Improved financial capacity indirectly promotes more efficient management of waqf properties.

c) Tax Incentives Support Social Agenda

By providing tax incentives to the waqf agencies and the donors, numerous benefits can be extended to the society to support the social agenda, for example:

i) Encourage more people to contribute to the waqf funds – Tax incentives would motivate more people to contribute to the waqf funds. Consequently, people would most likely benefit from the returns gained by the waqf agencies based on their contributions, hence improving social welfare. For instance, waqf schools, waqf healthcare facilities, orphanages, and facilities for elderly people.

ii) Encourage the corporate entities to organize corporate welfare activities – Corporate entities who contribute to the waqf funds are entitled to special tax relief. Apart from promoting the corporate reputation, this platform also serves as a bridge that connects between the entities and the society at large via CSR collaboration with the waqf agencies. For example, the endowment of houses to the YWM for the autistic society such as The National Autism Society of Malaysia.

iii) Narrowing societal wellbeing gap between the rich and the poor – Tax incentives open doors to the rich to channel their wealth to the needy by nominating the waqf agency as a trustee. The trustee accordingly transform the wealth into various benefits to be distributed to the beneficiaries as listed in the waqf deed.

Conclusions

This paper presents the role of tax incentives in promoting the sustainability of waqf agencies. Based on documentation reviews and in-depth interviews with prominent waqf agencies in Malaysia, it is recommended that tax incentives and tax relief should be implemented as these will have some impact to the waqf agencies. Any surplus from the income generated from waqf activities can be redistributed for the development and maintenance while promoting

the waqf culture in the society. In view of the growing operating costs of the waqf agencies, it is recommended that the government evaluate the feasibility of providing tax incentives to the waqf agencies and the donors. Reasonably, the tax incentives encourage the waqf agencies to perform their functions more efficiently while continuously deliver more benefits to the society at large. Further study can explore the potential impact of other taxes on the financial capacity of the waqf agencies and to ensure the sustainability of waqf practices in the future.

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