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Article

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The goods and services tax (GST) on *takāful* products: a critical Sharī'ah appraisal

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Goods and services tax on *takāful* products

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Abstract

Purpose – This paper aims to ascertain the Sharī'ah (Islamic law) stance on the imposition of goods and services tax (GST) on *tabarru'*-based *takāful* (donation-based Islamic insurance) products in Malaysia. The paper aims to do so by analysing the philosophy, purposes and structure of GST on *takāful* products and comparing the imposition of GST on *tabarru'*-based *takāful* with its imposition on conventional insurance while probing into the Sharī'ah texts and opinions of classical and contemporary scholars about taxation in Islam.

Design/methodology/approach – The paper uses a qualitative research methodology. In addition to the literature and text on websites, the information on how GST is applied in practice is also obtained through interviews, discussions and documents from *takāful* operators. To determine the Sharī'ah position on GST, reference has been made to classical and contemporary Sharī'ah literature, including local and international Sharī'ah advisory bodies' resolutions and standards.

Findings – This study finds that a strict interpretation of Sharī'ah does not allow for the imposition of GST; however, there is still room for the government to justify it using a broader interpretation of *maṣlahah* (public interest). *Takāful* has become a need for the society and is subscribed to by all income groups, and not only by the rich. Hence, the government should consider exempting *takāful* products from GST. The basis of *tabarru'* in *takāful* does not provide conclusive Sharī'ah evidence for *takāful* to be exempted from GST.

Originality/value – This research paves the way for the industry to propose further measures on GST for *takāful* products such as the exemption of GST on the *tabarru'* amount or imposition of a zero rate of GST on the relevant *takāful* fees and charges that are currently burdensome to consumers.

Keywords GST, *tabarru'*, *takāful*, Sharī'ah, insurance

Paper type Research paper

Introduction

The Goods and Services Tax Act of 2014 (GST Act), which has been effective since 1 April 2015, led to the imposition of a tax on *takāful* (Islamic insurance) products in Malaysia. In line with the tax neutrality approach, *takāful* is treated equally to



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conventional insurance on matters relating to taxation. This has brought about a debate among stakeholders due to the difference in nature between *takāful* and conventional insurance. *Takāful* represents a *tabarru'*-based service with mutual risk being shared among the participants and the *takāful* operator acting as a manager of the funds. Conventional insurance, on the other hand, consists of an insurance premium being paid in exchange for coverage by the insurance company. This research aims to investigate the Sharī'ah stance on imposing GST on *tabarru'*-based *takāful* products.

Research objectives

The specific objectives of this research are as follows:

- to study the philosophy and purposes of GST;
- to analyze the structure of GST that is applied on *takāful* products in Malaysia;
- to make a comparison between conventional insurance and *takāful* in terms of GST as well as the tax neutrality concept; and
- to probe into the Sharī'ah texts and the opinions of classical and contemporary Sharī'ah scholars on the issues of taxation in Islam, the concept of charity in Islam, and the taxation of charitable work and *takāful* practice.

The general basis of *takāful*

Takāful provides an alternative to conventional insurance through the application of certain Islamic principles. These principles, to name a few, include *tabarru'* (donation), *ta'awun* (mutual cooperation) and *wakālah* (agency).

The general concept of *takāful* is based on the principle of mutuality. Rather than the risk being transferred to one party, a group of *takāful* participants collectively agree to share the risk. The participants share the risk by providing *tabarru'* to a common pool, with the *takāful* operator acting as a fund manager. The collective donation of the *takāful* participants in *tabarru'*-based *takāful* is thus used to help one another in the case of loss suffered by one of the participants.

The application of goods and services tax in the *takāful* industry

The main feature of this newly introduced GST is that all goods and services provided in the country shall be subject to 6 per cent tax, unless otherwise stated by the law.

For *takāful*, family *takāful* products that provide death or total permanent disability coverage are exempt from GST. This means that other types of general and family *takāful* coverage such as medical, vehicle, personal accident, critical illnesses and financial liabilities are considered taxable. Besides that, any fees and charges incurred on the supply of services are also subject to GST.

The GST guidelines do not specify what is taxable, whether it is the whole contribution (premium) paid by a participant or only the amount that is paid to the risk fund (*tabarru'* amount). For investment-linked *takāful* products, the practice is to charge GST only on the *tabarru'* amount as the investment and savings are exempt from GST. However, the *takāful* industry seems to differ in its practice regarding the traditional products that are not linked to any investment funds. The reasons cited by those who charge GST at the contribution level are:

- to be more prudent and be on the safe side in terms of abidance by the law;
- to be equal with the practice of conventional insurance; and
- to cut cost by sharing the system with their conventional parents.

Muslim scholars' views on taxation

Besides *zakāh* (almsgiving) as a financial obligation on Muslims, Muslim scholars also unanimously allow three types of taxes to be imposed on non-Muslims, namely, *jizyah*, *kharāj* and *'ushr*, based on the tradition of the Rightly Guided Caliphs and *ijma'* (consensus). *Jizyah* is a per capita yearly tax historically levied by Islamic states on every non-Muslim residing in Muslim lands. *Kharāj* is a tax on agricultural land and its produce. *'Ushr* is a tax on merchandise imported from foreign states that tax the Muslims on their products (Al-Rais, Diya'uddin, 1985, p. 127; *Al-Mawsū'ah al-Fiqhiyyah al-Kuwaitiyyah*, 2007, vol. 15, pp. 95-97). Many scholars, especially from the Ḥanafī School, also agree that one-fifth of any minerals, metals, precious stones and jewelleries extracted from the earth is to be paid to the government (*Al-Mawsū'ah al-Fiqhiyyah al-Kuwaitiyyah*, 2007, vol. 23, p. 100).

Some scholars mention consensus that no tax can be levied on any local goods sold domestically unless it is taken and treated as *zakāh*, which is limited to the rate of 2.5 per cent annually (Ibn Ḥazm, n.d., p. 121; Al-Mawardī, n.d., p. 309; Al-Dardir, n.d. vol. 2, p. 322; Al-Rais, Diya'uddin, 1985, p. 128).

There is also consensus among classical Muslim scholars to allow the government to collect some of the extra wealth of the rich on a temporary basis in urgent and exceptional cases, such as during war, famine, catastrophe, on the strict condition that the government's coffers are empty and the available resources are not sufficient to meet the needs of the poor and the needy or the expenditures of the army (al-Juwaynī, 1401H, p. 259; Ibn al-'Arabī, 2003, vol. 1, p. 88; Al-Qurtubī, 1964, vol. 2, p. 242; Al-Nawawī, 1991, vol. 2, p. 321; Al-Qaradāghī, n.d.).

The allowance has been broadened by some contemporary scholars, for example, the former grand imam of Azhar University, Maḥmūd (2004, p. 109), who allowed the government to levy tax on the people for the purpose of general public interest such as building hospitals, institutions of learning, roads and others. He also allowed taxes to be deducted from people's money before payment of *zakāh*. Al-Qaradāwī (2000, vol. 2, pp. 297-310) also agrees on the matter of taxation for the public interest with certain conditions. The Malaysian National Fatwa Committee, in its resolution, allowed implementation of GST.

Research findings

The research finds that by applying a strict interpretation of the Sharī'ah, as supported by the consensus reported by Ibn Ḥazm, al-Mawardī and others, GST as a tax on local supplies of goods and services should not be permissible. Moreover, the structure of GST levies the tax on all consumers without differentiating between the rich and the poor. However, there is still room for the government to justify the implementation of GST using a broader interpretation of *maṣlahah* (public interest).

Takāful, as a new financial product, has become a need of the society and it is subscribed to not only by the rich but also by all income groups. Hence, the government should consider exempting *takāful* products from GST.

Taxation can be benchmarked to *zakāh*, as they share many similarities in terms of their purpose and objective. Moreover, taxation is allowed by the scholars only when *zakāh* is not sufficient to support the needs of the people. In *takāful* practice, as *takāful* is a form of charity (*tabarru'*), the *tabarru'* fund (risk fund) may be deemed as not being liable to *zakāh* (AAOIFI, Standard No. 35, 3/1/5 and 5/3/5). Hence, on this ground, the GST should not be levied on the risk fund. However, on the other hand, the charitable (*tabarru'*) nature of *takāful* – especially in the Malaysian practice – is not absolute, as the contribution paid by the participants is still considered to be owned by them and the surplus of the fund is also shared among them. On this basis, the fund may be deemed to be liable to *zakāh* and, hence, GST is justifiable. This is analogous to the case of family *waqf* (*waqf ahli*) where the *waqf* (endowment) beneficiaries are still liable to pay *zakāh* (AAOIFI Standard No. 35, 3/1/6). In summation, having the element of *tabarru'* does not necessarily eliminate the duty of *zakāh* or tax.

Conclusion and recommendations

The research concludes that Shari'ah evidence does not support GST and that those who allow it apply a broad interpretation of *maṣlahah* to justify it. However, the research also concludes that having *tabarru'* as the basis for *takāful* is not a strong argument for objections to the imposition of GST on *takāful* products. However, this research recommends that the government review the imposition of GST on the ground that *takāful* has become a need of the people, whether rich or poor. The paper also recommends a thorough study be conducted on the contemporary interpretation and application of *zakāh* on trade merchandise (*zakāt 'uruḍ al-tijarah*) as a more Shari'ah-compliant alternative to GST.

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