World Applied Sciences Journal 35 (9): 1844-1848, 2017
ISSN 1818-4952

DOI: 10.5829/idosi.wasj.2017.1844.1848

The Discussions ofIslamic and Conventional Tax Incentive Towards The Corporate Tax Planning Level In Malaysia

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Abstract: In Malaysia, there is lacking of Islamic tax incentive towards Islamic financial products in order to promote tax compliance among of corporate tax payers. Thus, this study is to investigate the selected Islamic financial products in order to estimate the most relevant influence towards the changes of corporate tax planning level. This is to increase the compliance level because when the corporate tax payer does not fully utilise the tax incentive given, they will involve in the tax fraud which is not illegal. The selected Islamic financial products are Bai BithamanAjil, Ijarah, Mudharabah and Al-Qardhul Hasan. This study also compared with the tax incentives given to the conventional financial products which are housing loan, leasing agreement, short term loan and conventional loan. In this study, the secondary of data is use and the sample of this study consist of Islamic and conventional financial institution listed on Bursa Malaysia from the year 2006 to 2016. This study will employ the following methods: 1) Pooled Ordinary Least Square method (Pooled OLS); 2) fixed effect method; and 3) random effect method. The findings of this study contribute to the literature on the Islamic tax incentives that could influence the corporate tax burden. Besides that, this study also contributes to the broad literature on the differences between Islamic tax incentives and conventional tax incentives towards corporate tax burden.

Key words: Islamic Tax Incentive · Pooled OLS · Random Effect and Fixed Effect

INTRODUCTION

Corporate tax planning is the company's efforts to reduce their tax burdens in their business transaction activities to the tax authorities. These efforts are initiated by the corporate tax payers to minimize tax expenditure from their business income. Tax planning was applied by the corporate tax payers due to various tax incentives given by the tax regulators. Tax incentives are exemption given to an individual or company for the tax charges that was supposed to be imposed [1]. Murphy [2] defines tax incentives as exemption allowed to the enterprise to stimulate investment in certain projects, sectors or geographic areas other than reducing their tax burden. These tax incentives intent to reduce tax rates on profit, decrease tariff of imported goods, raw materials and components and also to protect the domestic market by increasing the tariffs for imported investment projects.

Tax incentive is clearly an important aspect in developing and promoting the Islamic financial market. In order to promote the role of Islamic finance in the economy, Malaysian lawmakers have passed several pieces of legislation providing incentives for the users of Islamic financial instrument as it is in line with the Malaysian Government's efforts to promote Malaysia as an Islamic Financial Centre.

Islamic financing in Malaysia is a real alternative to conventional financing, with eleven locally owned fully-fledged Islamic banks in the country as well as six foreign owned Islamic banks. Malaysia has spearheaded itself as an Islamic Financial hub in the region with the establishment of the Malaysia International Islamic Financial Centre (MIFC) initiative. The MIFC is an initiative aimed at promoting Malaysia as a key global player in Islamic finance. To this end, Malaysia has introduced a sound regulatory framework for Islamic

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financing as well as tax laws which not only seek to ensure that Islamic financial transactions are taxed on an equal footing with conventional financing transactions, but go further to provide tax incentives to the Islamic financial sector to promote the growth of this sector.

Problem Statement: This study investigates the most relevance Islamic financial product that might influence changes in corporate tax planning level. This is because, there is lacking of Islamic tax incentive towards Islamic financial products in order to promote tax compliance among of corporate tax payers. In this study, we are going to investigate the selected Islamic financial product in order to estimate the most relevant influence towards the changes of corporate tax planning level. This is to increase the compliance level because when the corporate tax payer does not fully utilise the tax incentive given, they will involve in the tax fraud which is not illegal. This study is to promote clear Islamic tax framework which should be given to the corporate tax payers in order to help them to reduce their corporate tax burden.

Basically, tax incentives are clearly an important aspect in developing and promoting the Islamic financial sector. Under tax planning system, it was also being developed based on the targets to reduce the leakage of government revenue recognition activities. Tax planning were offered by the government towards the corporate tax payers in the capital market the cost of revenue recognition level could also be increased. Tax planning was applied by the corporate tax payer due to various tax incentives given by the tax regulators. One of the morale behind this provision is to encourage the corporate tax payers to continuously contribute to the government revenue reserve [3].

Literature Review

Corporate Tax Planning: Most companies are involved in tax planning extensively with the purpose of reducing their income taxes since the income tax expenses will reduce their profits. In fact, companies likely choose to hire a tax agent with the intention of minimising the taxes they are required to pay [2]. Tax planning is allowed within the tax laws as it is considered as a legal tax avoidance scheme. Corporate tax planning activities also influences the opportunity for the companies to be involved in tax planning. Thus, companies within different sectors may be involved differently in tax planning.

Sale Based Product and Corporate Tax Planning: Under sale-based product, baibithamanajil is the most popular type of financing.Baibithamanajil is one of the Islamic tax incentives that introduced by government as a complimentary to the property financing that offered by conventional financial institutions.

Bai bithamanajil is known as cost plus profit margin financing contract. Under BBA, the bank purchased the goods for customers. Defer payment were made by customers as the settlement of payment for the goods over a specified period as agreed by both parties. It presents a mode of payment that is to be performed in the future by instalment or in full [4].

Consistent with the government's initiative in encouraging Shariah-compliant financing, it is proposed that the 20% stamp duty exemption for Shariah financing instruments for home financing products that approved by the Shariah Advisory Council of the Bank Negara Malaysia or the Shariah Advisory Council of the Securities Commission Malaysia which is due to expire on 31 December 2015 and extended for another 2 years until 31 December 2017.This can decrease the corporate tax burden by the corporate tax payers. Furthermore, corporate tax payersalso can claim for income tax deduction for expenditure on issuance of Islamic securities pursuant to principles of murabahah and baibithamanajil under rules 2011 PU (A) 355 on 6 October 2011 to decrease the tax burden. These Rules have effect for the year of assessment 2011 until the year of assessment 2015. But, as stated in the Budget 2016, it said that the tax deduction has been extended for another three years from the year of assessment 2016 to 2018 based on Tawarruq approved by the Securities Commission Malaysia from years of assessment 2003 until this year.

Conventional house financing is an alternative to the baibithamanajil house financing that offered by the most conventional financial institutions. In the conventional system, housing loan is simply giving a loan to the customer. The product is interest-driven, with the interest charged to the customer over the period of payment.Interest paid is based on the loan remaining. The rate used is based on a margin above the bank's base lending rate.

In year 2009 and 2010, Malaysia government implemented tax deduction on housing loan made by individuals, provided the sale and purchase agreement of the residential property was completed or signed on or after 10 March 2009 to 31 December 2010. To qualify for the tax incentive, the residential property purchased such as house, condominium and apartment or flat must be a residential property per individual. Those properties under construction were also qualified for the deduction and all individuals who had fulfilled the stipulated conditions were entitled to an annual tax deduction of

RM 10, 000 for three consecutive years of assessment as provided under S46B of the Income Tax Act 1967. For jointly purchase property by more than one person, all of them are entitled for the relief but restricted to the maximum of RM 10, 000. However, the tax deduction of housing loan in Malaysia is only applicable to those who bought a house during the stated period and any transaction after 31 December 2010, the tax payer is not eligible for this special relief.

In Budget 2017, there is an extension of stamp duty exemption for the purchase of first residential property for sale and purchase agreements executed from 1 Jan 2017 to 31 Dec 2018. For property price RM 300, 000 and below, there is 100% stamp duty exemption given to the corporate tax payer for instrument of transfer and agreement of loan. Whilst, for property price ranging from RM 300, 001 to RM 500, 000, there is 100% stamp duty exemption on instrument of transfer and loan agreement for value of the property up to RM 300, 000. The remaining value of the property is subject to the prevailing rate of stamp duty.

Lease Based Product and Corporate Tax Planning: Ijarah is the lease-based product that offered by Islamic financial institutions. Ijarah is refers to a lease contract which the bank or financial institution leases certain goods, equipment or building to its customer against an agreed fixed charge or rental. It is based on a contract between the lessor and lessee for the use of a specific asset. The ownership of the asset is maintained by the lessor which is bank while its possession and use is conferred to the lessee-customer on payment of specified rentals or charges over a specified period of time.

Corporate tax payers can reduce the tax burden by claiming the stamp duty exemptions to all instruments of Al-Ijarah Head Lease Agreement of immovable property executed between a customer and a financier which is a bank, financial institution or leasing company, pursuant to a scheme of Al-Ijarah Term Financing Facility.

Whilst, a conventional lease agreement is a contract between a landlord and a tenant for hire of a specific asset. The lessor retains ownership of the asset, but the right to use the asset to the lessee is given for a period of time in exchange for a series of payments made by the lessee to the lessor [5]. The lessee is the owner of the lease property and the rental falls due from the date when the lessee accepted the goods.

Under conventional lease agreement, the corporate tax payers can claim for stamp duty exemption on instruments of transfer of real property or lease of land or building used for the purpose of carrying on a qualifying activity. Thus, companies can reduce their tax expenses with the certain tax exemption provided from the tax incentives scheme.

Equity Based Product and Corporate Tax Planning: Mudharabah is one of the types of equity-based product. A Mudharabah arrangement is a form of partnership, where profits are shared and losses are borne exclusively by the capital provider.InMudharabah, the owner of capital entrusts his capital with the Mudarib who acts as an entrepreneur to run the business. At the end of the agreed upon period, the Mudarib will return the principal and share of agreed profit to the investor. Any losses from the venture are exclusively borne by the capital owner. The Islamic bank may act as a financier or a Mudarib. As a financier, the Islamic bank provides capital to the entrepreneur while as a Mudarib, the Islamic bank manages the funds deposited by its clients. The profit is distributed based on agreed ratios [6].

Based on the Budget 2017, from year of assessment 2016 to 2018, the resident company can claim for tax incentives which are the double deduction on additional expenses for issuance of Sukuk under the principles of Mudharabah and other Islamic transactions that is based on the Tawarruq. Thus, the corporate tax payer can minimize their corporate tax burden and increase their business income level through claiming the tax incentives provision provided by the tax authorities.

Whilst, conventional banks offer short term and medium term loans to customer to meet working capital requirements of firm. Working capital is required by firms to invest in inventories and accounts receivables and to meet the expenses. The tax incentive given is 50% stamp duty on the value of the loan. Thus the corporate tax payer can claim for tax exemption and contribute to decrease their corporate tax burden.

Other Based Product and Corporate Tax Planning: Al-qardulhasan is benevolent loan given to a needy person for a fixed period of time. Shariah prohibits taking interest or any other benefit from loan given and it encourages people to give qard al-hasan to a needy person with an intention to help them. Qard al-hasan is a type of benevolent loan designed to improve overall welfare for society [7]. At the end of the period predetermined for the loan, the borrower must return the loan amount to the lender. The lender cannot ask for any extra money which is known as interest for the loan. He can claim back only the principal amount lent and nothing else. However, if the borrower gives a reward to the lender being happy with him for the help, probably the lender can receive it.

Islamic bank offers qard al-hasan to needy people in the society without any benefit. However, Islamic bank is allowed to take a service fee for record maintaining and collection of the benevolent loan.Based on Malaysian Institute of Accounting [7], there is a further extension of stamp duty exemption of 20% on instruments of Islamic financing products approved by the ShariahAdvisory Council of BNM or Securities Commission up to 31 December 2015. Therefore, it encourages all the bankers to offer Islamic financing product such as qard al-hasan. Apart of to decrease the tax expenses of the bankers, it give benefit to the borrower to enjoy the interest free loan.

Conventional banks offers loan to their customer for a fixed return. Whilst Islamic financial institutions are restricted by Shari'ah from offering loan for an interest although Islamic financial institution can charge profit on investments but not interest on loans. Conventional system issued three types of loans to their clients which include short term loans, overdrafts and long-term loans while Islamic banks can only issue loans that are free of interest (Qard Hasan). On the other hand, they can do business through the provision of required asset to the client [8].

Research Method: The sample of this study consisted of Islamic and conventional financial institution that listed on Bursa Malaysia. The secondary data were used. The comprised of samples taken from a balance panel data of Islamic and conventional financial institutions listed on Bursa Malaysia from the year 2006 to 2016.

This study will employ the following methods: 1) Pooled Ordinary Least Square method (Pooled OLS); 2) fixed effect method; and 3) random effect method. Thus, data in this study were separately analysed according to these three methods. In order to estimate the best selection model between the Pooled OLS and Random effect methods, this study will employ the Bruesch- Pagan test. Whilst, the Hausman test will also employ for the best selection model between the fixed effect and the random effect regression methods.

The Measurement of Tax Planning: In the current study, corporate tax planning was measured on the basis of the values of accrual tax planning level in the companies. The accrual tax planning level could be understood as the actual level of income tax expenses paid by the companies from the generated business income [9]. Thus, in order to be consistent with a recent study conducted [5] the values of accrual tax planning for the financial institutions were estimated based on two components namely, the information of the corporate income tax expenses and pre-tax income level from the business transaction activities coded as Effective Tax Rate (ETR).

The values of ETR in the current study were also compared with the level of statutory tax rate imposed on the selected financial institutions. Any gaps that may exist between the accrual tax planning and statutory tax rate would be considered as tax planning in the companies. In this study, accrual tax planning has been calculated by dividing the income tax expenses with the pre-income tax values in the business transaction strategies. The measurement approach used to estimate the values of ETR is as follow:

ETR= Income tax expenses / pre income tax.

CONCLUSION

Islamic finance is based on principles from Shariah laws which are fundamental to the Islamic religion. The key factors that differentiate Islamic financing from conventional financing transactions are the earning or charging of interest is prohibited in Islam and Islamic financing works on the principle of sharing of profits and losses and the underlying risks.To this end, Malaysia has introduced a sound regulatory framework for Islamic financing as well as tax laws which not only seek to ensure that Islamic financial transactions are taxed on an equal footing with conventional financing transactions, but go further to provide tax incentives to the Islamic financial sector to promote the growth of this sector.The findings of this study are potentially of interest for several reasons. First, this study contributes to the literature on the Islamic tax incentives that could influence the corporate tax burden. Second, this study also contributes to the broad literature on the differences between Islamic tax incentives and conventional tax incentives towards corporate tax burden.

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