

EVALUATION OF TAKĀFUL OPERATORS' EFFORTS IN REALISING MAQASID AL-SHARĪ'AH

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Abstract

Takāful has emerged as a *Shari'ah-compliant* alternative to conventional insurance, which is embedded in realising its underlying *maqasid* (goals or objectives) of *Shari'ah*. Contrary to previous studies that attempted to provide evidence that *takāful* products are compliant with the *Shari'ah* in practice of *takāful* operators (TOs), this paper seeks to take a different approach to investigate their compliance with the fulfilment of the three broad categories of *maqasid al-Shari'ah*. In light of the theoretical perspectives of *maqasid*, each objective was operationally defined for statistical analysis. Six TOs from Malaysia were selected, and five-years' data (2011-2015) have been collected from World Bank's websites and annual reports. Secondary data were analysed through balanced panel data approach. Hausman test results indicate that fixed effect model is more appropriate in explaining the explored phenomena. Taxes paid by TOs were found to have a significant positive impact on economic growth and poverty alleviation while payment of *zakah* found to have a negative impact. The prohibition of *riba* (interest) should not be the only decisive difference between Islamic finance and its conventional counterpart. Islamic banks (IBs) and TOs are accountable toward Allah, and thus their activities should be directed toward the fulfilment of *maqasid al-Shari'ah*. While earlier published literature has explored efficiency and profitability of TOs, the current paper has attempted to focus on the ability of TOs in serving the *maslaha* (public interest/common good of the community).

Keywords: Takāful, Maqasid al-*Shari'ah*, Maslaha, Tax, Zakah

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I. INTRODUCTION

It has been 30 years since Islamic finance industry in Malaysia came to its existence. Islamic Banking Act, 1983 has allowed liberalisation of the Islamic Financial System in Malaysia which led toward an increase in the establishment of Islamic Financial Institutions (IFIs). Takāful is a concept whereby a group of participants mutually agrees to guarantee each participant's loss/damage through contributing a certain amount of tabarru (donation) into a fund, which is managed by the TOs. In the event of loss or damage, TOs will segregate the funds accordingly. On the contrary, any surplus is paid only after all obligations to assist participants have been fulfilled.

Aside to complement the operation of IBs that was established in 1983, the development of takāful industry in Malaysia was inspired by the increased needs of Muslim investors in Malaysia for a Shari'ah-compliant alternative to conventional insurance. The National Council for Malaysian Islamic Affairs and the National Fatwa Committee ruled that conventional insurance is a void contract due to the fact that it contains the elements of gharar (uncertainty/excessive risk), riba and maysir (gambling/games of chance).

If we are to focus on takāful as a tranche of Islamic finance, it is a growing industry mainly in the Middle East, parts of Asia, Africa and Europe. According to an article on the growing importance of takāful by Ajmal Bhatti, takāful grew at a compound annual growth rate of 39% from 2005-2008 regarding global takāful premiums, 45% in the Gulf Cooperation Council (GCC) countries and 28% in South East Asia. Also, the global takāful premium was around USD5.3 billion in 2008 and rose to USD8.9 billion in 2010. It is still very small compared to global insurance premium which stood at \$4.2 trillion in 2008, but the takāful industry is growing fast. Therefore, it has become essential for TOs to fulfil the three basic objectives of maqasid namely, daruriyyat, hajiyat and tahsiniyyat.

II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

The *Takāful* Operators (TO) should operate within the scope of the tenets of *Shari'ah*, where the subject matter and intended objectives should not be unlawful under the *Shari'ah*, contract must be free from *riba* (interest), *gharar* (uncertainty or excessive risk) and *maysir* (gambling or games of chance), contract must not be aimed at deriving personal gain to one

participant and loss to others, participants must agree to co-operate and participants must agree to pay a contribution to help those in need (Fauzi et al., 2016), and so on. In essence, *takāful* is an agreement between a set of participants or investors to guarantee the protection of loss or damage if it occurred to any participants in the scheme.

Previous studies on *takāful* mentioned on the significance of *maqasidai-Sharī'ah* in risk management realm focusing on *takāful*. Management of risk in *takāful* has to fulfil the objectives of the *Sharī'ah*, commonly the protection of life (*hifz al-nafs*), protection of wealth (*hifz al-mal*) and protection of human intellect or *hifz al-'aql* (Matsawali et al., 2012). The statistics on violence in Malaysia provided by Royal Malaysia Police and Ministry of Women, Family and Community Development clearly shows that rape, incest, child abuse and molestation cases have been increased over the ten years during 2000-2010. Therefore, upon incorporating the protection of dignity, *takāful* will have its path to not only flourish as an Islamic financial institution but with a high degree of noble values and *Sharī'ah* influence (Abdullah, 2012). As for our study, we are looking for filling in the gap of TO's responsibility in fulfilling three basic objectives of *maqasidai-Sharī'ah*, namely, *darurriyyat*, *hajjiyyat* and *tahsiniyyat*.

In another study, *takāful* achieves *maqasidai-Sharī'ah* by focusing on several factors such as self and family protection, asset protection, mutual protection, investment, retirement and education, charity and transparent contract (Abdul Aziz & Mohamad, 2013). This study highlights on how TOs should contribute to charity or donate to a good cause and has been successfully implemented by re-*takāful* operators (RTOs) in South Africa, Pakistan and Switzerland (Aziz, Faizal, & Mohamad, 2013). During 2003-2011, Malaysian general *takāful* surplus amounts were up to RM525.7 million, and RM339 million has been paid to participants according to figures from Bank Negara Malaysia (Aziz et al., 2013).

Such huge amount should be channelled to parties which are in need of monetary assistance or even build mosques, religious schools and other noble acts that can alleviate poverty and economic state of the needy. Hence, it is crucial to observe to what extent TOs in Malaysia fulfill their obligation and responsibility in helping the poor of which directly in line with what is said in the Qur'an that mankind is required to give charity (Al-Qur'an 57:7, 9:71, 21:73, 63:10, 31:4, 4:38).

Other studies suggest implementing Islamic microfinance as an alternative to alleviate poverty level (Ratnawati & Sutopo, 2014). Microfinance is a provision of financial services to the poor. This service is not just granting small loans; it rather includes savings and micro-insurance. Thus, the poor receive both credit assistance and also savings as a medium to assist them to develop (Armendáriz & Morduch, 2010; Ledgerwood, 1999). Microfinance has reached its success after initially initiated by Grameen Bank in Bangladesh. However, it has also been criticised due to the fact that it brings more costs to customers (Armendáriz & Morduch, 2010).

Maqasid al-Sharī'ah comprises all the benefits primarily to humanity of any Islamic rules which indirectly wards off bad things and other forms of evil from the *ummah* (the Muslim community). Furthermore, *maqasid al-Sharī'ah* allow a higher degree of appreciation towards Islam and Allah's rules and regulations (Matsawali et al., 2012). The essential interests in the objectives of *Sharī'ah* are by definition, "essential to normal order in society as well as to the survival and spiritual well being of individuals, so much so that their destruction and collapse will precipitate chaos and collapse of normal order in society. The *Sharī'ah* seeks to protect and promote these values and validates measures for their preservation and advancement" (Kamali, 2015). The complementary interests are defined as "benefits, which seek to remove severity and hardship that do not pose a threat to the very survival of normal order." While, the third category of *maqasid al-Sharī'ah*, known as *tahsīniyyât*, are in the nature of desirabilities as they seek to attain refinement and perfection in the customs and conduct of people at all levels of achievement (Kamali, 2015). These objectives are generally divided into four dimensions: levels of necessity, the scope of the rulings, and scope of people included in purposes, and level of universality of the purposes. Modern scholars, however, classify these *maqasid* into three different levels: general objectives, specific objectives and partial objectives (Auda, 2008).

Previous studies focused on *maqasid al-Sharī'ah from the perspectives of Islamic economics, finance and business*. For instance, Laldin and Furqani (2013) highlight on the goals and objectives in the enactment of financial laws and principles which consist of wealth circulation, fair and transparent financial practices, as well as justice in the macro-and micro-dimensions. The element of wealth must and should be circulated throughout every segment of society levels and not only circulated among the rich in the society only (59:7). It is of paramount importance that financial institutions

primarily IFIs ensure fair and equitable mobilisation and distribution of wealth. In this study, we have attempted to carry out a further test on an Islamic financial institution on the elements of wealth circulation in regards to reduce poverty. Therefore, the study focuses mainly on TOs and the mechanics of fulfilling *maqasidai-Shari'ah*.

Laldin and Furqani (2013) also mentioned fair and transparent financial practices vis-à-vis *maqasidai-Shari'ah*. Fairness here is referred to equity and honesty between parties as well as efficiency in transactions. This is in line with the Qur'anic principle where Allah says all agreements and contracts should be transparent and as clear as possible (2:282, 11:84, 17:35, 26:181-182, 55:9, 83:1-3). The last objective is to ensure justice in the macro and micro-dimensions. Macro dimension is much related to the wealth circulation whereas micro-dimension refers to fair and transparent financial practices.

A study undertaken by Cebeci (2016) has found that the concept of social responsibility and corporate social responsibility (CSR) is not enough to describe the roles and responsibilities of IBs. Cebeci (2016) critically examines the social objectives of IBs such as helping to reduce economic inequalities, alleviate poverty despite the existence of welfare institutions such as *mudaraba* (entrepreneurship) and *waqf* (trusteeship). Furthermore, it is mentioned that IFIs should adhere to the concept of social *maslahah*, a concept that requires a financial institution to go beyond CSR.

Al Rajhi Bank, one of the older IBs in the world that says "our responsibility to our community has always been at the forefront of our obligations and is one of the main objectives of the Bank (Al Rajhi Bank, 2016)". To this end, the purpose of this study is to determine whether TOs are able to fulfil their obligations to alleviate poverty and improving social welfare. This is also supported by a study undertaken by Dusuki & Abdullah (2006) on the implications of the *maqasid* on CSR where a corporation should be responsible to Allah in the manner of handling and managing their resources. Regardless of financial conditions, every individual let alone corporation; is liable to assist the less fortunate and the poor. It does not mean that Islam discourages profit making. It is necessary to make profits, but profit maximisation should not be the sole objective of business.

Zakah has the in built mechanism, which can eliminate poverty if implemented in an efficient manner. Studies conducted by Raimi et al. (2010), Shirazi (2006), Ali and Hatta (2014) in Nigeria, Malaysia and Indonesia respectively have found *zakah* to have the inherent capability to

reduce the rates of poverty. It was found that the State with a high collection of *zakah* appears to have a low incidence of poverty and vice versa (Shariff and Jusoff, 2011). However, to make a real impact on the economy, *zakah* payers need to comply with the basic principles of *zakah*, which is laid down by the Qur'an.

The key objective of *zakah* as argued by Sadeq (1997) is alleviation of poverty. Faiz (1990) explored the possibilities of poverty eradication through the existing *zakah* system in Pakistan and suggested for the improvement of the existing system to meet the goal of poverty eradication. Shirazi (2006) also concluded that the system of *zakah* practised in Pakistan is not capable of bridging the poverty gap.

Raimi et al. (2010) explored the ability of *zakah* in alleviating poverty through a faith-based model and concluded that the amount of *zakah* collected during the years 2009-2015 could significantly contribute toward poverty alleviation and actualisation of *Millennium Development Goals* (MDGs) in Nigeria. Such differences in results exploring the ability of *zakah* in alleviating poverty and contributing toward economic development have led this study to formulate the following hypotheses:

H_{1a}: *Zakah* paid by TOs have a positive impact on poverty alleviation.

H_{1b}: *Zakah* paid by TOs have a positive impact on economic development.

H_{1c}: *Zakah* paid by TOs have a positive impact on human capital development.

Effects of income tax on economic growth have been widely studied in the past literature. Gale and Samwick (2014) examined how changes to the individual income tax affect long-term economic growth and found that reform that improves incentives will have more auspicious effects on the long-term size of the economy. Stoilova and Patonov (2013) concluded that tax structure based on direct taxes is more efficient regarding supporting the economic growth in the *European Union* (EU) member countries.⁴ In the context of developing countries, tax revenue mobilisation as a source of financial development has been difficult due to the influence of evasion and avoidance practices.

Musgrave and Musgrave (2004) stated that the economic effects of tax include micro effects on the distribution of income and efficiency of

⁴These are: Austria, Belgium, Bulgaria, Croatia, Republic of Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the UK.

resources' use as well as the macro effect on the level of capacity output, employment, prices and growth. Ogbonna and Ebimobowei (2012) conclude that tax reform is positively and significantly related to economic growth and that tax reforms Granger cause economic growth. However, Lee and Gordon (2004) revealed that statutory corporate tax rates have significant negative correlation with the cross-sectional difference in average economic growth.

While most of the prior studies have examined the relationship between total tax revenue (both individual and corporate) and economic growth (Gale & Samwick, 2014; Lee & Gordon, 2004; Ogbonna & Ebimobowei, 2012), the current study focuses on the amount of tax paid by TOs in Malaysia and links its significance to three different sets of economic development indicators namely, poverty alleviation, economic growth and human capital development. Hence, the following hypotheses are formulated:

H_{2a}: Tax paid by TOs have a positive impact on poverty alleviation.

H_{2b}: Tax paid by TOs have a positive impact on economic development.

H_{2c}: Tax paid by TOs have a positive impact on human capital development.

2.1. THEORETICAL PERSPECTIVE

The very objective of *Shari'ah* is to promote the welfare of the people including the faith, life, intellect, posterity and wealth. Anything that protects or promotes these is considered as serving the *maslaha* and hence desirable (Chapra, 1992). *Maqasid al-Shari'ah* are classified into three distinct broad categories: *daruriyyat*, *hajiyyat* and *tahsiniyyat*.

The IFIs are failing to promote these *maqasid* through their CSR schemes (Cebeci, 2012) and this creates a need to explore alternatives. *Daruriyyat* is objectives which are must and the foundation for the establishment of people's welfare in this world and the hereafter. These fall under the necessities for every Muslim and relates to five crucial matters such as faith, life, posterity, property and reason. Deficiency in *daruriyyat* brings deficiency in *hajiyyat* and *tahsiniyyat*, but not the other way around (Khan & Ghifari, 1992).

Muslim economists have focused on the utilisation of human capital generated by mosques and searched for the validity in investing this fund in financing various Islamic projects. Focusing on the issues of *zakah*, the

Shari'ah permits the investment of *zakah* in *maslaha* purposes. However, controversies relating to investing *zakah* funds have shifted the discussion toward the possibilities of investing those funds in ways that are grounded in *waqf* perspectives.

III. METHODOLOGY

Malaysia was not immune to the global economic downturn, and as such Malaysian economy has also suffered from a global financial crisis of 2007-2008, and the economic indicators have turned around starting from 2012. As a result, we have chosen a post-crisis period in the current study. The data for the empirical analysis are extracted from annual reports of *Takāful* Operators operating in Malaysia for the year 2011 to 2015.

According to the data provided in Bank Negara Malaysia website, eleven TOs were operating in Malaysia during this period. The firms with missing data are excluded from the sample, and we are left with the final sample size of six TOs with a total number of 30 observations.

In our study, amount of *Zakah* and Tax is considered as independent variables. The estimated model is controlled by company size and leverage. Table 1 provides a brief description of these variables constructed for empirical analysis in the study. To test the effects of tax and *zakah* payment of TOs in the economic development of Malaysia, we chose the following baseline model:

$$Y_{it} = \alpha_0 + \beta_1 X_{it} + \beta_2 C_{it} + \varepsilon_{it} \quad (1)$$

Where Y_{it} represents economic development indicators, X_{it} is a vector of independent variables, and C_{it} is the vector of control variables for firm i at time t . α and β are intercept and parameters to be estimated, respectively and ε_{it} is the error term. The full model is presented in equation 2 below:

$$LGINI_{it} = \alpha_0 + \beta_1 T_{it} + \beta_2 Z_{it} + \beta_3 ROA_{it} + \beta_4 SIZE_{it} + \beta_5 LEV_{it} + \varepsilon_{it} \quad (2)$$

$$LGDP_{it} = \alpha_0 + \beta_1 T_{it} + \beta_2 Z_{it} + \beta_3 ROA_{it} + \beta_4 SIZE_{it} + \beta_5 LEV_{it} + \varepsilon_{it} \quad (3)$$

$$HCD_{it} = \alpha_0 + \beta_1 T_{it} + \beta_2 Z_{it} + \beta_3 ROA_{it} + \beta_4 SIZE_{it} + \beta_5 LEV_{it} + \varepsilon_{it} \quad (4)$$

Table 1
Variable Definitions

SI	Variable	Full Form	Definition
Independent Variables			
1.	T	Tax payment	The log converted tax paid by TOs.
2.	Z	Zakah payment	The log converted zakah paid by TOs.
Panel C: Control Variables			
1.	ROA	Return on asset	Net profit after tax/ total asset
2.	Size	Natural log of assets	Natural logis taken for the total asset of the firm
3.	Lev	Leverage	The ratio of total debt divided by capital at the end of the financial year
Dependent Variables			
1.	HCD	Human capital development	A composite index in measuring average achievement in three basic dimensions of human development—a long and healthy life, knowledge and a decent standard of living
SI	Variable	Full Form	Definition
2.	LDGP	Economic development	The log converted gross domestic product (GDP) measures of national income and output for a Malaysia.
3.	LGINI	Poverty alleviation	Gini index measures the extent to which the distribution of income among individuals or households within an economy deviates from a perfectly equal distribution.

Source: Authors' own

IV. RESULT AND FINDING

4.1.Descriptive Statistics

Table 2 represents descriptive statistics for independent and control variables for the entire sample during 2011-2015. The performance of TOs is measured using ROA. Mean performance for insurance firms is 0.968. The table also indicates that the average *Zakah* payment is RM1336.880 and average tax payment is RM25150.770. The standard deviation of performance variable indicates a high degree of variances among TOs in Malaysia. The minimum value of 0 in tax and *zakah* represents a time of loss for the TO.

Table 2
Descriptive Statistics

	Mean	Maximum	Minimum	Std. Dev.
T	25150.770	119029.000	0.000	34242.050
Z	1336.880	10089.000	0.000	2706.795
ROA	0.968	34.584	-5.995	6.443
S	14.160	16.388	11.703	1.368
L	1.792	16.645	1.059	2.830

	Mean	Maximum	Minimum	Std. Dev.
LGINI	9.119	9.292	8.939	0.132
LGDP	5.611	5.779	5.310	0.176
HCD	0.763	0.777	0.723	0.021

Source: Authors' own

4.2. Correlation Analysis

The results of the Pearson correlation coefficients are presented in Table 3 for all variables included in the study. It is expected that ROA will have a negative correlation with the *zakah* and tax payment. But, ROA is found to have a negative correlation will all economic development indicators. *Zakah* and tax payment, on the other hand, have positive correlations with all three economic development indicators.

Table 3
Pearson Correlation Analysis

	HCD	LGDP	LGINI	T	Z	ROA	S2	L
HCD	1.000							
LGDP	0.923	1.000						
LGINI	0.781	0.937	1.000					
T	0.242	0.277	0.256	1.000				
Z	0.194	0.187	0.131	0.938	1.000			
ROA	-0.381	-0.347	-0.296	-0.083	-0.050	1.000		

	HCD	LGDP	LGINI	T	Z	ROA	S2	L
S	0.162	0.229	0.247	0.796	0.648	-0.125	1.000	
L	0.008	-0.136	-0.184	-0.043	-0.050	-0.024	-0.212	1.000

Source: Authors' own

4.3. Regression Analysis

This section provides a detailed analysis of the impact of performance, tax and *zakah* payment on economic development in Malaysia. The following Table 4, 5 and 6 provide fixed effect panel regression results indicating the impact of each independent variable on economic development. Table 4 provides adjusted R² of the full sample is 73.2 percent (p -value<0.001) where LGini is used as a measure to determine the extent of poverty alleviation in Malaysia. The tax has a significant positive impact ($\beta = 0.007$) on poverty alleviation, while *zakah* has failed to make a significant impact ($\beta = -0.004$) on poverty alleviation. Both size and leverage have significant positive impacts on poverty alleviation. Hence, H_{2a} is accepted.

Table 4
Panel Data Regression Results (DV: Gini)

Variables	Pooled	Fixed Effect	Random Effect
Adjusted R2	0.152	0.732	0.152
Durbin-Watson	0.781	1.39	0.781
P-Value	0.111	0.000	0.109
Variables	Pooled	Fixed Effect	Random Effect
Independent variables			
ROA	-0.006	0.003	-0.006*
<i>Zakah</i>	-0.001	-0.007*	-0.001*
Tax	0.0005*	0.006*	0.0005*
Control variables			
Size	-0.036	0.292*	-0.036*
Lev	-0.012	0.047*	-0.012
C	9.575	4.793*	9.575*
Hausman Ttest	Cross Section Random (P < 0.001)		
Notes: * Significant at 0.01 level; ** Significant at 0.05 level, the table represents panel regression results with logged Gini index as the dependent variable			

Source: Authors' own

Table 5 indicates that tax paid by TOs have a positive impact on the economic development in Malaysia, while *zakah* has failed to make a significant impact on economic development confirming the findings of Shirazi (2006). This finding confirms H_{2b} and is consistent with empirical findings of Gale and Samwick (2014).

Table 5
Panel Data Regression Results (DV: GDP)

Variables	Pooled	Fixed Effect	Random Effect
Adjusted R ²	0.116	0.637	0.116
Durbin-Watson	0.868	1.318	0.868
P-Value	0.158	0.001	0.158
Independent variables			
ROA	-0.009	0.002	-0.009
Zakah	0.005	-0.004	-0.005
Variables	Pooled	Fixed Effect	Random Effect
Tax	0.006	0.007**	0.006
Control variables			
Size	-0.045	0.365*	-0.046
Lev	-0.013	0.059*	-0.013
C	6.206*	0.209	6.206
Hausman Test	Cross Section Random (P < 0.001)		
Notes: * Significant at 0.01 level; ** Significant at 0.05 level, the table represents panel regression results with logged GDP as the dependent variable			

Source: Authors' own

Table 6
Panel Data Regression Results (DV: HCD)

Variables	Pooled	Fixed Effect	Random Effect
Adjusted R ²	0.051	0.383	0.051
Durbin-Watson	1.340	1.856	1.340
P-Value	0.292	0.026	0.292
Independent variables			
ROA	-0.001**	-0.0002	-0.001**
Zakah	-0.001	-0.008	-0.001
Tax	0.005	0.0004*	-0.005
Control variables			
Size	-0.004	0.036**	-0.004
Lev	-0.0003	0.007*	-0.0003
C	0.817	0.233	0.817
Hausman test	Cross Section Random (P < 0.001)		
Notes: * Significant at 0.01 level; ** Significant at 0.05 level, the table represents panel regression results with HCD as the dependent variable			

Source: Authors' own

Finally, tax paid by TOs is found to have a significant positive association with human capital development. This finding confirms H_{2c} and is consistent with empirical findings of Ogbonna and Ebimobowei (2012). Among the two control variables, both size and leverage are found to have a negative association with human capital development.

V. CONCLUSION

Islamic finance industry has the inherent objective to contribute toward the socio-economic developments of the Muslim *ummah*. Prior studies have explored the ability of IBs in making such contribution which leads to mixed findings. While most of the previous studies have incorporated IBs in understanding the contribution of Islamic finance industry toward economic development, to authors' knowledge, this is the first study that introduced *Takāful* Operators into the picture.

The study hypothesised that TOs are making a significant contribution toward economic development, human capital development and poverty alleviation in Malaysia, thus making a significant contribution toward the social *maslahah* and fulfilling the *maqasid al-Sharī'ah*. Results obtained from the fixed panel model indicate that *zakah* payments make a negative impact, while tax paid by TOs make a significant positive impact on the economic indicators operationalised to capture three broad areas of *maqasid al-Sharī'ah*: *darurriyyat*, *hajiyyat* and *tahsiniyyat*.

The negative impact can be justified from the mismanagement of *zakah* fund identified in previous studies. Results provided by the study make a significant contribution to the Islamic finance literature, and it is expected that it would help regulators and TOs to develop framework toward making *zakah* fund management in a more efficient manner in Malaysia. The significant positive impact of tax might play a positive role in tax compliance, i.e., making tax payments and submitting information to the tax authorities on time following the required format.

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